Decisions, decisions

Leon Greenfield, James Lowe and Daniel Matheson of WilmerHale discuss how the US Supreme Court clarified joint venture law and struck down the patent-equals-market-power presumption formerly applicable to tying cases, all within a week earlier this year

Within a week, the supreme court issued two unanimous opinions in antitrust cases. These are the second and third antitrust opinions of this court term, the other being a price discrimination case. In recent years the court has taken a maximum of two antitrust cases per term, so at the moment there is more antitrust activity than usual at the court.

The court's unanimity implies that the decisions were not unexpected or even controversial, but nonetheless they give greater certainty about the legality of – or at least the level of risk presented by – certain business conduct.

The first case, *Texaco Inc v Dagher* of 28 February, addressed how a joint venture that competitors create can lawfully price the output of the venture. On 1 March, *Illinois Tool Works Inc v Independent Ink*, addressed whether, in a tying case, a court should presume that a patent holder has market power as a result of its patented product.

Texaco Inc v Dagher

Shell and Texaco formed a joint venture, which incorporated all their gasoline refining and distribution assets in the western United States. The venture, Equilon, owned all the contributed assets and took over their management and operation. Shell and Texaco did not retain any assets in this business except for their respective trademarks, which they licensed to Equilon, for purposes of gasoline distribution. Equilon sold its gasoline under the Shell and Texaco brand names.

A committee comprised of Shell and Texaco personnel manage Equilon and decided to sell gasoline to Texaco- and Shell-branded retailers at the same price. This was a change: before the formation of the venture, Shell and Texaco sold their respective branded gasoline at different price points. It was this change that led to the lawsuit.

The plaintiffs, a class of Texaco and Shell service station owners, alleged that setting a common price for Texaco- and Shell-branded gasoline was a per se illegal price-fixing agreement between Shell and Texaco. The district court granted summary judgment for Shell and Texaco, holding that the decision to set prices within the joint venture – rather than have each partner to the venture set a price for its brand of gasoline separately – could not be a per se violation.

A divided panel of the US Court of Appeals for the ninth circuit reversed. The court viewed the setting of prices as the act of two competing entities, Shell and Texaco. The court acknowledged that as a result of the formation of Equilon, Shell and Texaco no longer competed with each other in the refining and distribution of gasoline. Even so, it held that Shell and Texaco were price-fixing: they both participated in Equilon's decision to price Texaco- and Shell-branded gas the same, while in other respects continuing as independent competitors. The court also pointed to evidence that the decision to price the two brands of gas the same may have been made before Equilon was officially formed, implying that the price setting occurred outside the venture.

The court of appeals' decision is impossible to square with existing case law or business realities. It would mean that pricing and output decisions of a fully-integrated joint venture, owned by otherwise competitive firms, could be subject to per se condemnation. If that were the case, how are such joint ventures supposed to make pricing and output decisions for products that the joint venture produces?

It is not surprising that the supreme court reversed unanimously. Although the court was confronted with several arguments urging reversal, the court took the most straightforward approach. It found that the joint venture was a fully-integrated single entity, whose formation stopped all pre-existing competition between the partners concerned in the product and venture markets. It also found that the venture's decision about how to price and sell its output was the act of a single entity. As the action of a single entity, the conduct was not subject to section 1, which requires an agreement between independent economic actors. That the two entities compete in other products and formerly competed in the joint venture products is irrelevant. Texaco and Shell participated in the pricing decision as the owners and managers of Equilon, not as competitors.

The court rejected two approaches that would have allowed them to reach the same decision. First, it essentially ignored arguments that the case fell within the Copperweld doctrine, which holds that separate members of the same corporate family may not be held to conspire in violation of section 1, implicitly holding that the Copperweld doctrine simply does not address such joint-venture arrangements.

Second, the court rejected arguments that the ancillary restraints doctrine applied. This doctrine holds that otherwise illegal agreements between parties to a joint venture affecting conduct outside the core activities of the venture may be lawful, if such agreements can be shown to be ancillary – usually understood to mean 'reasonably necessary' – to the successful operation of the venture itself. The court clearly stated that, as the conduct at issue was central to the operation of the venture, the ancillary restraints doctrine is not applicable. This holding is consistent with long-held understanding about the ancillary restraints doctrine and does not signal any change in the prevailing law.

It is important to note that Dagher's holding is quite narrow. In a lawful, fully-integrated joint venture that eliminates competition between the partners in the venture, the decision about how to price the venture's output to direct customers is the act of a single entity and thus not subject to section 1. Because Equilon was a presumptively lawful venture consisting of all of the refining and distribution assets of its members, its pricing decisions were not subject to section 1.

But assume that Equilon consisted of only the refining assets of Shell and Texaco and that those two firms continued to compete in the downstream distribution and sale of gasoline with gas sourced from Equilon. In these circumstances, Dagher would not change the fact that an agreement between Shell and Texaco, concerning the price each would charge in the downstream market, could be subject to per se condemnation unless truly ancillary to the purposes of the joint venture. Even if ancillary, such an agreement could be subject to a section 1 rule of reason analysis because it is not the act of the venture, but rather an act of the two firms to influence their price competition as separate actors in the downstream markets.

Illinois Tool Works

In *Illinois Tool Works v Independent Ink*, the supreme court finally resolved an important issue in tying jurisprudence. It abandoned a legal presumption that a patent in the tying market creates a presumption of market power, which had been supported by supreme court dicta but repeatedly criticised by lower courts and academic commentators. Plaintiffs challenging tying arrangements concerning patented products must now prove market power in the tying product through normal methods of proof.

A tying arrangement is "an agreement by a party to sell one product, but only on the condition that the buyer also purchases a different product, or at least agrees that he will not purchase that product from any other supplier." Courts evaluate tying arrangements under a hybrid of per se and rule of reason analyses: tying arrangements are generally illegal without proof of anticompetitive effect when the seller has market power in the tying product.

Courts have often subjected tying arrangements concerning patented products to a presumption about market power in the tying market: when the sale of a product was 'tied' to the buyer's purchase of a patented product, the patent was presumed to confer market power on the seller. If the defendant was unable to present evidence rebutting this 'patent equals market power' presumption, the arrangement was automatically deemed illegal without affirmative proof of market power in the tying product.

Illinois Tool Works sells, to original equipment manufacturers, printing systems made up of three components: a patented printhead, a patented ink container and unpatented ink. The manufacturers are licensed to put the printing systems into printers only on the condition that they purchase ink exclusively from Illinois Tool Works. Independent Ink developed ink chemically identical to the ink that Illinois sold. In connection with a related patent dispute, Independent claimed that Illinois's licensing agreement constituted illegal tying and monopolisation in violation of the Sherman Act. The district court granted Illinois Tool Works's motion for summary judgment because Independent had failed to submit evidence establishing Illinois's market power.

The federal circuit reversed. It found the district court was wrong in rejecting Independent's contention that Illinois had "market power in the market for the tying product as a matter of law, solely by virtue of the patent on their printhead system." In doing so, the federal circuit was quite explicit in criticising the reasoning of the patent equals market power presumption that it read supreme court precedent to require. But as the court put it: "even where a Supreme Court precedent contains many 'infirmities' and rests upon 'wobbly, moth-eaten foundations,' it remains the 'Court's prerogative alone to overrule one of its precedents.'" The federal circuit felt bound by "the duty of a court of appeals to follow the precedents of the Supreme Court until the Court itself chooses to expressly overrule them."

The federal circuit's predicament was not unique: owing to the small number of antitrust cases heard by the supreme court, lower courts have more than once struggled with the disconnect between binding but arguably outdated supreme court decisions and more sophisticated, economics-influenced analysis of antitrust issues.

The supreme court accepted this invitation to re-examine the presumption that a patent confers market power in a tying product, a presumption that "migrated from patent law to antitrust law in *International Salt Co v United States*." It observed that congress's decision in 1988 to remove the patent equals market power presumption from patent misuse law, "certainly invites a reappraisal of the per se rule announced in *International Salt*." The court noted the widespread academic criticism of the presumption, and, in a sharp divergence from earlier supreme court precedent describing tying arrangements as almost always anticompetitive, observed that "[m]any tying arrangement[s], even those involving patents and requirements ties, are fully consistent with a free, competitive market."

The court concluded that the treatment of tying arrangements concerning patented products should be consistent with the treatment of other types of tying. So although tying arrangements concerning patented products remain unlawful when they are the product "of a true monopoly or a marketwide conspiracy [...] that conclusion must be supported by proof of power in the relevant market rather than by a mere presumption thereof." The supreme court remanded to the district court, making clear that Independent should be given an opportunity to offer proof of market power in the tying market.

Notably, nothing in *Illinois Tool Works* directly calls in to question another bright line rule in the law of tying: the long-standing doctrine that a tying arrangement will be illegal when the supplier is found to have market power in the tying market, without examination of the actual competitive effects. The issue was not presented to, or decided by, the supreme court. It will be interesting to see whether the court's recognition that tying is not always anti-competitive will lead it to revisit the traditional treatment of all tying arrangements.