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MEMORANDUM

To: Donald S. Clark
Office of the Secretary
Federal Trade Commission
Sixth Street and Pennsylvania Avenue, N.W.
Washington, D.C. 20580

From: Clark C. Havighurst
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Re: Comment on Issues Related to Joint Venture Project

Exorcising *Topco*'s Ghost: The Antitrust Agencies and the Overregulation of Competitor-sponsored Joint Ventures

Introduction

The FTC's Joint Venture Project is a timely effort to clarify the antitrust treatment of competitor-sponsored joint ventures, and I appreciate the opportunity to provide this comment.

I recommend that the Commission and the Department of Justice (DOJ) be advised to state unequivocally their intention never to apply a per se rule to any joint venture that has a plausible raison d'etre compatible with the maintenance of competition as a dynamic process for allocating resources efficiently and enhancing consumer welfare -- unless, under factual scrutiny, the venture appears to be a naked cartel agreement. To signify their renunciation of per se rules as shortcuts to prosecutorial success (as opposed to bright-line rules that facilitate prosecution of hardcore violations and thereby discourage cartel behavior), the agencies should disavow the Supreme Court's holding in *Topco Associates, Inc. v. United States*, 405 U.S. 596 (1972). That decision, more than any other, threw the law of joint ventures into confusion, necessitating corrective congressional action on two occasions and almost on a third. The willingness of prosecutors to exploit the opening created by *Topco* and to threaten the use of per se rules to punish concerted

action without regard to its procompetitive character and probable innocuousness discouraged many joint ventures that might have strengthened competition and benefitted consumers. Although the antitrust agencies have rarely confessed having done a poor job in carrying out the nation's antitrust policy, they should do so on this occasion in order that procompetitive joint ventures will not be deterred by fear that antitrust enforcers will choose to make an issue of their inevitable restrictive features or forced into inefficient modes of operation simply to preserve appearances and minimize the risk of agency disapproval.

My views on the subject of competitor collaboration, shaped over many years of teaching antitrust law and evaluating concerted action in the health care industry, were recently crystallized by an in-depth evaluation of the 1994 Statement of DOJ/FTC Enforcement Policy on Physician Network Joint Ventures. In a widely circulated critique of that Statement,[1] I argued that the agencies were taking an overly regulatory approach in appraising the legality of physician networks. This and other criticisms of the agencies' administration of the law with respect to physician joint ventures prompted congressional inquiries, legislative proposals, and finally, in August 1996, a revision of the stated enforcement policy. Unfortunately, although the revised guidelines introduced new flexibility and were reassuring to proponents of new networks, they still feature an essentially regulatory approach to antitrust administration. It is time for the agencies to disavow the role of regulators charged with specifying the characteristics of joint ventures that will be admitted to the market and to rededicate themselves to serving as prosecutors whose sole task is to recognize and head off real threats to competition.

The Joint Venture Project, if it undertakes an honest reappraisal of joint venture law, should produce a fundamental restatement of the appropriate function of per se rules in antitrust administration and of the appropriate stance of the enforcement agencies in making prosecutorial decisions and giving antitrust advice. What is required is not more enlightened regulation of competitor joint ventures but enlightened antitrust enforcement. Instead of scrutinizing all competitor joint ventures with restrictive features to see if they promise enough "efficiencies" to be admitted to the market, the agencies must let markets be markets, determining which joint ventures are efficient enough to survive. The agencies should confine themselves to ensuring, as prosecutors, that markets are not prevented by private agreements from effectively performing that task.

In this comment, I will briefly review the recent antitrust experience with physician network joint ventures to demonstrate how the agencies have departed from their appropriate prosecutorial role. I will then argue that the *Topco* case both symbolizes and provides virtually the only legal warrant for the agencies' tendency to misuse per se rules as regulatory sanctions against joint ventures that do not satisfy their predilections about what ventures are potentially valuable enough to consumers or the economy to be deemed "procompetitive." I hope to show why disavowal of the *Topco* approach to joint venture analysis would be in accord with both time-honored antitrust principles and the public interest.

The Unfortunate Experience with Physician Network Joint Ventures

The thesis of my article on Statement 8 in the 1994 health care guidelines was that the DOJ

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[1]Havighurst, *Are the Antitrust Agencies Overregulating Physician Networks?*, 8 LOYOLA CONSUMER L. REP. 78 (1995-96).

and FTC were too quick to presume anticompetitive harm in evaluating networks formed by physicians to market themselves to large employers and to competing managed care plans -- if those networks in any way curtailed price competition among the doctors in the network. Statement 8 specified two conditions one or the other of which a physician network had to meet in order to avoid having its price-fixing features treated as a per se violation -- that is, to avoid being condemned without proof that its actual or probable effect was anticompetitive. Either (1) the doctors would have to "share substantial financial risk" by accepting capitation payments or by agreeing to have a substantial portion of their fees withheld to cover possible shortfalls, or (2) they would have to integrate their practices to such an extent that they could offer what the agencies would recognize as a "new product."

These requirements were not laid down merely as conditions that had to be met to qualify for a regulatory "safe harbor." Instead, Statement 8 was written so that illegality (per se treatment) could be avoided only by complying with its prescriptions -- even if the joint venture was very small or would face a market that was highly competitive and likely to remain so. Read literally (and there was no reason for lawyers counseling clients not to read them literally), even three solo doctors in a large market could not appoint an agent with authority to sell their services at a fixed price. Unless they met one of the agencies' prescriptions, they would be treated as having committed the potentially criminal offense of price fixing. Yet it is difficult for individual doctors to sell their services in today's complex market.[2] Their efforts to compete by appointing a marketing agent therefore cannot, by any stretch, be automatically equated with cartel behavior such as the Sherman Act was enacted to suppress. Nor is there any basis in antitrust theory, when no threat to competition itself has been demonstrated, for compelling the collaborators to do business in ways or within limits prescribed by the antitrust agencies.

The position of the antitrust agencies on physician networks in 1994 was fundamentally -- not just marginally -- unsound, both as antitrust doctrine and as competition policy for the health care sector. As a matter of doctrine, all physician networks, because they have a plausible raison d'etre besides price fixing, are entitled to rule of reason treatment -- that is, to a reasonable evaluation of their probable effects on competition, not just among the joint venturers themselves, but in the market as a whole. To be sure, many networks would fail the rule of reason test -- often after only a so-called "quick look" -- that is, an application of the rule of reason so rapid that it might seem that a per se rule was in fact applied.[3] But there can be no justification whatsoever for a conclusive

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[2]In Broadcast Music, Inc. v. CBS, 441 U.S. 1 (1979), the Supreme Court upheld, against a Sherman Act challenge, an arrangement whereby composers of music pooled their compositions for marketing purposes. The efficiencies to which physician networks can point to justify their joint selling efforts (reductions of the high transaction costs that both physicians and bulk purchasers would face in creating relationships by individual negotiation and in administering those relationships) closely resemble both in kind and magnitude the efficiencies achieved by the performing-rights societies in *BMI*. In many markets, physician networks could make a case for joint selling at least as persuasive as the *BMI* defendants.

[3]Professor Areeda once helpfully observed how the rule of reason can often be applied "in the twinkling of an eye." See NCAA v. Board of Regents of the University of Oklahoma, 468 U.S. 85, 109 n.39 (1981). For a classic instance of a "quick-look" application of the rule of reason, see

presumption that a network is illegal just because it has a price-fixing feature.

Thus, in the 1994 guidelines, the antitrust agencies adopted arbitrary rules of thumb when they should have applied the rule of reason. My article questioning those guidelines raised, not just a quibble, but a fundamental question concerning the expedient prosecutorial strategy of using per se rules as regulatory sanctions against conduct that the agencies disapprove -- or, conversely, using rule of reason treatment as a reward for approved conduct rather than simply as a way to discover a practice's actual or probable effects on competition.

The health policy (as opposed to the doctrinal) objection to the 1994 guidelines was that they forced innovation in the packaging and marketing of physician services into narrow channels, with adverse consequences for the range of consumer choice and possibly also for the quality of care. In addition, the guidelines failed to reflect an adequate appreciation that the market for physician services had changed dramatically since the early 1980s. To be sure, there was once good reason to believe that, whenever doctors got together, they were trying to stop change and to prevent competition from getting a foothold in a local market, and the agencies still need to be alert to that possibility. But, in most local health care markets today, it is no longer easy to stop or roll back market developments. Indeed, there is at least an equal chance that doctors are getting together, not to stop competition, but to compete more effectively with other groups on price, cost, and quality. Moreover, purchasers of doctors' services are much more sophisticated and aggressive today than in the past and are quite capable of protecting themselves against doctors attempting to exercise market power. Finally, there are other integrated systems competing in most markets, so that physician networks that do not satisfy purchasers will not attract any. Precisely because today's markets are usually capable of rejecting networks that set noncompetitive prices or offer no efficiency in the delivery of care, there is no need for the antitrust agencies to screen such networks. Indeed, the great virtue of markets is that they obviate the need for regulators. The 1994 guidelines on physician networks evidenced a disturbing regulatory mentality in the agencies -- a willingness to prescribe how physicians can market themselves without regard to whether they present any hazard to competition and consumer welfare.

As for the new guidelines issued in 1996, they are a distinct improvement from a policy point of view and are unlikely, as a practical matter, to block physician-sponsored arrangements that are needed to enhance the competitiveness of the market and to ensure consumers a full range of choice. The revised enforcement policy, however, still leaves the agencies operating in a regulatory mode. While the agencies are now less prescriptive than they were in the 1994 guidelines, they still require, before they will waive the per se rule against price fixing, some form of risk sharing or "integration." Thus, they still act essentially as regulators deciding what kinds of joint ventures will be permitted to compete, rather than as prosecutors charged with enforcing the law when competition is specifically endangered. Even though the agencies may finally be acting reasonably in regulating physician networks, they are still using rule of reason treatment as a reward for conduct they approve and the threat of per se rules to enforce their vision of how physician joint ventures should look.

Thus, while the new guidelines may have allayed industry and congressional criticism, they

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the *Maricopa County Medical Society* case discussed in note 4 *infra*.

have not corrected the doctrinal problem in joint venture law of which the 1994 guidelines were a symptom -- namely, the open-ended regulatory mandate that the agencies have enjoyed, to the consternation of would-be joint venturers and their legal counsel, at least since the *Topco* case. This remnant of the overly regulatory antitrust regime spawned by the Supreme Court in the 1960s needs to be overturned if antitrust law is not to continue to discourage many desirable joint ventures. Since the Supreme Court is unlikely to have an opportunity to clarify the use of per se rules anytime soon,[4] the agencies themselves should renounce reliance on that case in the interest of returning antitrust law to its original and true purpose of preserving competition as a vital instrument of social control and guarantor of efficiency and consumer welfare.

How Antitrust Enforcers Became De Facto Regulators of Competitor-sponsored Joint Ventures

In order to convey more fully my concern with the regulatory way in which the antitrust agencies are currently handling physician networks and, presumably, all other joint ventures under the Sherman Act (or FTC Act), it is necessary to compare current practice with the basic principles of antitrust law applicable to competitor collaboration.

For many years now, the agencies have been ready and willing to apply per se rules to any conduct that falls in particular no-no categories without regard to the conduct's probable effect in the actual marketplace. Despite the brilliant guidance provided by Judge William Howard Taft nearly 100 years ago,[5] the agencies do not sharply distinguish between naked restraints and those that may be ancillary to achieving the collaborators' legitimate, procompetitive purposes. Indeed, as the case of physician networks has plainly shown, if a particular per se label fits, the agencies then have to be affirmatively persuaded, not just that there is no threat to competition,[6] but that the public interest and consumer welfare will somehow be advanced by the collaboration in question. It is not enough that the parties' purpose is not to harm competition but to compete more effectively (they may find, of course, that purchasers have no interest in what they are selling) or that they lack the

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[4] Unfortunately, additional confusion about the nature and uses of per rules resulted from Justice Stevens' opinion for the plurality in *Arizona v. Maricopa County Medical Society*, 457 U.S. 332 (1982). That case, however, should be read for what the plurality did rather than what it said. Despite its rhetoric defending per se rules in antitrust jurisprudence, the Court did not in fact apply such a rule to the challenged conduct until after it had carefully examined, in a "quick-look" application of the rule of reason, the defendants' claims that their conduct was procompetitive, not anticompetitive. Significantly, a vital observation in Justice Stevens' opinion was the statement that "the limited record in this case is not inconsistent with the presumption that the respondents' agreement will not significantly enhance competition." *Id*. at 333. By consulting the record to see whether a presumption of illegality raised by the transaction's price-fixing feature might be successfully rebutted, Justice Stevens demonstrated that the presumption he was employing was not a conclusive one, as a per se rule would be.

[5]United States v. Addyston Pipe & Steel Co., 87 Fed. 271 (6th Cir. 1898), affirmed, 175 U.S. 211 (1899).

[6] The effect on competition among the parties themselves apparently satisfies this now largely technical requirement.

power necessary to harm competition in the market as a whole or even that the market is highly competitive and likely to remain so. The agencies essentially sit in judgment of the parties' business purposes and of the products the collaborators are seeking to market. I submit that the problem with joint venture law for the last thirty years -- since the heyday of the cavalier and regulation-minded Warren Court -- has been this tendency to make regulatory judgments rather than judgments exclusively about probable effects on the competitive process.

There is no question that the antitrust treatment of competitor-sponsored joint ventures has long been in an unsatisfactory state. The best evidence that joint venture law has been seriously out of touch with commercial reality is the fact that Congress has had to revisit the treatment of joint ventures under the antitrust laws on three separate occasions, each time to consider lightening the heavy hand of antitrust enforcement that was inhibiting desirable joint conduct. These three occasions are, of course, the National Cooperative Research Act of 1984, the Production Joint Venture Act of 1993, and the Hyde bill (H.R. 2925, "The Antitrust Health Care Advancement Act of 1996"), which Congress considered last year as a way of correcting the problem of agency overregulation of physician networks. This need for congressional intervention, not to assist special interests but to remove the threat of unpredictable antitrust action against benign, highly proconsumer joint ventures, speaks volumes about the failure of antitrust enforcers to send a clear signal that only anticompetitive joint ventures will be opposed.

Almost certainly, congressional attention to antitrust joint venture law would not have been necessary if the Supreme Court in 1972 had not accepted the Department of Justice's argument for applying a per se rule in the *Topco* case. In that case, several independent grocery chains with very modest market shares formed a joint venture to develop a private brand of products as a way of competing effectively with national grocery chains. In aid of that effort, they undertook that they would not sell Topco products in each other's territories; they could compete in all other respects but could not free-ride on consumer loyalty to the Topco brand developed by another partner. At the government's behest, the Court found that the restrictive agreement violated the per se rule against horizontal market division, even though the agreement was clearly and reasonably ancillary to what was in all respects a procompetitive purpose. Simply because the market-division label fit, the government was not required to prove any actual or likely harm to competition in the grocery market or to consumer welfare.

The only plausible explanation for the perverse outcome in the *Topco* case is that neither the government nor the Supreme Court believed that the Topco brand was a worthwhile contribution to consumer welfare. Instead, they probably saw it as merely a promotional gimmick -- a new label on the same old peas. Failing to see the Topco brand as a new or useful product, they saw no reason why a time-honored antitrust rule should (as they saw it) be bent. Instead of asking whether the joint venturers were trying to harm competition or were instead just trying to compete in ways not incompatible with dynamic competition in the market for groceries, the government and the Court made a value judgment that the Topco brand was not worth very much and therefore consumers did not stand to lose very much if the joint venture and others like it were forced to play under hazardous rules. It should (but cannot) go without saying that such regulatory value judgments have no place in antitrust law, which should be concerned solely with maintaining competitive conditions.

The Supreme Court's decision in *Topco* gave the antitrust agencies the power to condemn as per se violations not only naked restraints (for which per se rules were exclusively designed) but also

any ancillary restraints the object of which the agencies find objectionable -- not because of their effects on the competitive process but as a matter of general public policy. In this way, the antitrust agencies became de facto regulators of competitor-sponsored joint ventures, deciding which products such ventures can offer to consumers. In the case of physician networks, the agencies assumed -- and still presume to exercise -- the power to say which joint ventures promise enough efficiencies of an acceptable kind to be permitted to compete in the marketplace. Rather than let consumers and their purchasing agents decide which products they prefer, the agencies have assumed a regulatory stance, substituting their own judgments for those of the very marketplace and market forces they are supposed to foster. A strong sign of this regulatory posture is how little the new guidelines on physician networks make prevailing market conditions (as opposed to characteristics of the joint venture itself) a factor in the agencies' evaluations. Until some steps are taken to exorcise it, antitrust counselors must assume that the ghost of *Topco* still walks the halls of the FTC and the Justice Department.

It is conventional wisdom, of course, that Congress, in legislating in 1984 and 1993 to foster R&D and production joint ventures, intended only to provide reassurance to potential joint venturers, not to change substantive antitrust law. Yet the need for legislation arose directly from the legal climate created by the *Topco* decision and from the agencies' assumption of the regulatory power to decide which kinds of joint ventures are potentially valuable enough to warrant waiving a per se rule. The agencies' insistence that a technically applicable per se rule gives them the authority to evaluate the purposes underlying competitor collaboration, the magnitude of the efficiencies to be achieved, and the desirability of the products to be produced left would-be joint venturers and their counsel at sea. Thus, it was necessary for Congress to give its own imprimatur to limited classes of joint ventures (by requiring that such ventures be accorded rule of reason treatment) in order that their formation would not be deterred. Other joint ventures, however (such as physician-sponsored networks), were still subject to regulatory assessments and value judgments before they could gain access to the market. Only rarely will classes of would-be joint venturers be able to muster the political clout necessary to obtain categorical relief of the kind accorded R&D and production joint ventures and nearly enacted for physician networks. The time has come to clarify joint venture law across the board, so that joint venturers of all kinds can count on having their projects evaluated for effects on competition, not under some vague public interest test.

Conclusion and Recommendation

Judging from their experience with guidelines for physician networks, the antitrust agencies still focus their analyses of competitor joint ventures -- just as command-and-control regulators would do -- principally on the form of the venture and its desirability in some public policy sense rather than attempting to assess its probable effects on overall competitive conditions and its compatibility with the maintenance of healthy competition in the market as a whole. The Joint Venture Project provides a welcome opportunity for the antitrust agencies to correct these problems in joint venture law once and for all. It is obviously not enough to deal with these issues piecemeal each time a new class of desirable joint ventures, such as R&D and production joint ventures and physician networks, is found to be inhibited by the uncertainties of prospective venturers about the regulators' attitude toward their undertaking.

The easiest and best way to address the problem of agency overregulation of competitor-sponsored joint ventures would be for the agencies simply to announce (1) that they no longer regard *Topco* as sound precedent and (2) that, accordingly, they intend to revert to appraising all joint

ventures (indeed, all competitor collaboration other than naked restraints) under the rule of reason. They should also declare that, in applying the rule of reason, the general health and vigor of the larger marketplace is the only issue on the table and that potential efficiencies or the potential value of a joint venture's products to consumers matter only insofar as they may provide a clue to the parties' true purposes and thus to the joint venture's probable effects on competition. Although the agencies have long (and properly) resisted "worthy purpose" defenses for naked restraints of trade, they have implicitly required joint ventures to pass a "worthy product" test before they will give rule of reason treatment to a restraint that is clearly ancillary to the accomplishment of a procompetitive purpose. Per se rules have been used, in effect, to enforce the predilections of agency staffs, not to facilitate enforcement against truly naked restraints.

The Joint Venture Project provides the perfect occasion for the antitrust agencies finally to renounce the regulatory powers they have assumed with respect to joint ventures and to return to their proper roles as protectors of the competitive process. Even if the problems facing physician networks were eventually resolved to most people's satisfaction, there are other potential venturers out there -- in many industries -- who still have reason to fear that an agency will come after them if its bureaucrats do not in some normative way approve their endeavors, however procompetitive those endeavors may be in fact. It is high time, it seems to me, to straighten out these very basic issues of antitrust analysis.