TESTIMONY OF ERNEST GELLHORN[*]
BEFORE THE FEDERAL TRADE COMMISSION
HEARINGS ON JOINT VENTURES

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Mr. Chairman, members of the Commission, I appreciate your indulgence and endurance in listening to me for a third time about critical issues of competition policy and, in particular, on the development of standards for testing competitor collaboration. Previously I outlined, with others, my views on some inadequacies of the current antitrust framework applied to joint ventures and standard-setting organizations and presented some preliminary thoughts about analytical approaches and institutional processes for implementing competition policy.[1] Along with others, I urged that Commission to adopt guidelines on competitor collaboration; the Staff Report on Competition Policy and these hearings are a responsive challenge to do so.

My testimony today identifies the principles which should serve as the framework for such guidelines as well as a set of rules for building on that foundation. It accepts the Staff Report's counsel "that the development of such rules and processes depends on a cautious approach, reliance on specific facts, a willingness to learn from the past, transparent decision making, and the articulation of competition values whenever antitrust policy is made." Indeed, if the proposed guidelines are to be accepted by prosecutors, courts, and private parties, they must not stray too far from an understanding of what the law either does or should permit.

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[1]See Ernest Gellhorn & W. Todd Miller, Joint Ventures and Standard-Setting: Problems in the Current Framework, Statement (mimeo) in FTC Hearings on Global and Innovation-Based Competition (Oct. 12, 1994); Ernest Gellhorn & William E. Kovacic, Analytical Approaches and Institutional Processes for Implementing Competition Policy Reforms by the FTC, id. (December 12, 1995).

<u>Need for "Competitor Collaboration" Guidelines</u>. The dominant theme throughout the initial FTC hearings was that markets and competition are changing rapidly. Their increasingly global scope is being driven by vast technological innovations which can improve efficiencies and create new products and services. First mover advantages are often less significant than they once were. Product life cycles have been shortened and continuing innovation is critical to survival and expansion. To compete in these markets, companies find themselves compelled to assemble complementary assets, share know-how, attain wide market coverage and collaborate on costly research and development.

But the legal rules and policies applied to competitor collaborations have not kept pace. Consider, for example, the different approaches taken in evaluating mergers and joint ventures. Where competitor combinations result in mergers, they are assessed under well-established rule of reason standards outlined in the Merger Guidelines (as modestly modified by the Intellectual Property Guidelines for mergers of innovation efforts). These merger standards represent a systematic effort to provide reliable guidance for measuring the competitive effects of proposed mergers and for deciding when they should be challenged under Section 7 of the Clayton Act. The strengths of the Merger Guidelines lie in their rationalization of previously irreconcilable caselaw, their coherent incorporation of current economic theory, and their practical applicability. Populist concepts applying discredited tests for measuring the likely effects of the merger -- such as warped markets and minuscule market shares and historical concentration trends, the parties' intent, the structure of the transaction, and the availability of less restrictive alternatives -- no longer play a significant role in merger analysis, while possible efficiencies (still rejected in much of the out-dated case law) resulting from the merger receive increasing attention. With the recent adoption of a revised framework for efficiency analysis in the Merger Guidelines, those guidelines generally reflect actual practice.

Where combinations result in joint ventures, however, both the process and legal standards are radically different even though the underlying transactions often have similar designs, justifications and likely effects. Mergers are subject to systematic pre-implementation review once they pass minimum size thresholds, while joint ventures are subject only to sporadic and inconsistent review, usually years later because of complaints by those not included in the now successful venture.[2] While less formal or permanent, and thus probably more common and competitively less dangerous than outright mergers or acquisitions, joint ventures receive a more hostile reception in the agencies and courts.

As the Staff Report recognized, the legal framework for analyzing joint venture is neither consistent nor rational. Early cases, still cited by the agencies, applied narrow and rigid tests. Recent moves to a variegated rule of reason analysis are only sometimes followed by the courts and the agencies. Particularly troubling is the application of a general rule of per se illegality to joint ventures which do not involve financial or operational integration or do not include risk sharing[3] because there is no evidence supporting the conclusion that such integration or risk sharing is a proper measure of likely purpose. (That the presence of risk sharing, for example, may relate to possible efficiencies is no response because the absence of risk sharing does not

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[2]However, joint ventures which merge significant assets are subject to advance notice and substantive merger law requirements. See 16 C.F.R. § 801.40 (premerger notification requirements for joint ventures); United States v. Penn Olin Chem. Co., 378 U.S. 158 (1964).

[3]ABA, 1 Antitrust Law Developments (Fourth) 395 (1997 ("Ordinarily, the threshold issue with respect to a joint venture involving actual or potential competitors is whether it involves a sufficient integration of the economic resources of the parties to escape condemnation as a per se unlawful cartel arrangement under Section 1 of the Sherman Act.")

demonstrate the contrary.) Indeed, the structure of the joint venture does not necessarily provide any insights into the parties' purpose, the likelihood of other entry or the benefits or harms which can be expected to result. As developed in the economics of the firm, the structure and the degree of integration or risk sharing of joint ventures often are best explained as a search for efficiencies, a response to legal requirements or a result of similar exogenous effects (e.g., tax consequences).[4]

Or, to turn the analysis around, it is sometimes asserted that financial and operational integration and risk sharing by the joint venturers demonstrate that the venture is not a cover for a price-fixing cartel. Why this is so, however, is unexplained, and there seems to be no basis for such assertions. If an illicit market division is the parties' object, there is nothing to prevent their integration to achieve that end. More significantly, there is no legal or economic theory -- or case examples -- demonstrating that integration changes this possibility. Nor is there any logic supporting the argument that price-fixers are unlikely to integrate finances or operations but competitors working together to intensify competition by offering a new product, expanding services, etc., usually integrate. The degree of integration, if any, is a function of firm design generally dependent on such factors as what form is best structured to achieve their objectives.[5] Further, without consideration of the venture's possible benefits and market power, automatic condemnation of the unintegrated joint venture is unsound.

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[4] See Ronald H. Coase, The Nature of the Firm, 4 Economica (n.s.) 386 (1937).

[5] See Oliver E. Williamson, Transaction Cost Economics in 1 Handbook of Industrial Organization 135, 150-59 (Richard Schmalensee & Robert D. Willig eds. 1989); Paul L. Joskow, The Role of Transaction Cost Economics in Antitrust and Public Utility Regulatory Policies, 7 J. L. Econ. & Org. 53, 55-66 (1991).

A different but equally harmful disconnect exists in regard to the application of antitrust law to standards-settings organizations. Here, however, the problem is one of underenforcement because of inadequate attention to the possible misuse of the standards process by competitors to exclude new products or innovations. One reason is the extraordinary deference given immunity arguments for otherwise illegal conduct when the standards are subsequently "adopted" by legislative incorporation in official codes. Because most standards which have significant market effects also are subsequently adopted by some government body, the result has been that standard-setting organizations are almost wholly insulated from antitrust enforcement. Contrary to the usual rule that exemptions for antitrust are disfavored and read narrowly, privately prepared standards have been wrapped in the cloak of petitions for state action even though generally prepared for private and public use and even though the public adoption is only achieved after independent presentations to public bodies. This is, I believe, a misreading of *Noerr-Pennington* and *Allied Tube* because of one misguided but influential Ninth Circuit opinion.[6]

Confusion in Current Case Law/Enforcement. This contrast and confusion in joint venture/standard-setting enforcement practice is also reflected in the case law.[7] Almost any interpretation or rule can be found in some case or ruling. That law applied to joint ventures and standards organizations is an odd mixture of simplistic per se prohibitions, formulaic rule of reason applications based on structure rather than competitive effect, and sensitive evaluations of

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[6]See discussion note 14-18 infra and accompanying text.

[7]For a concise and accessible summary, see Donald I. Baker & Roland E. Brandel, The Law of Electronic Funds Transfer Systems ¶ 21.02 (2d ed. 1988) ("Joint ventures constitute one of the most confused areas of antitrust. . . . There is little case law and that which does exist is often poorly reasoned or vague.")

market realities and effects. There is, for example, an ancient line of authority -- still cited by the Supreme Court despite unremitting criticism[8] -- which condemns joint ventures on per se grounds without regard to their purpose or effect because they "wrongly excluded" others from their venture or market. Others apply financial integration/risk sharing criteria to test whether the parties' purpose and the agreement's likely effect is anticompetitive -- sometimes under a rule of reason "quick look" and other times as part of a per se characterization test.[9] And still others apply a more economically-oriented architecture, similar to the Merger Guidelines, in evaluating the impact of the joint venture on output, entry, price and costs.[10] Thus, as in the merger arena before the 1982 Guidelines were adopted, the agencies have a wide array of conflicting analytical approaches available in reviewing joint ventures and in deciding which should be challenged.

Torn by these choices and, perhaps, driven by the concern that a more permissive approach would impose too great a burden of proof that the joint venture was a cover for a cartel, the agencies have not given clear or reasonable guidance on the rules applicable to the formation

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[8]Compare Timken Roller Bearing Co. v. United States, 341 U.S. 593 (1951); United States v. Sealy, Inc., 388 U.S. 350 (1967); United States v. Topco Assocs., Inc., 405 U.S. 596 (1972) with Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210 (D.C. Cir. 1986), cert. denied, 479 U.S. 1033 (1987). See also Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752 (1984) (joint ventures have "the promise of increasing a firm's efficiency and enabling it to compete more effectively").

[9]See Arizona v. Maricopa County Medical Soc'y, 457 U.S. 332 (1982); FTC v. Indian Fed'n of Dentists, 476 U.S. 447 (1986); FTC v. Superior Court Trial Lawyers Ass'n, 493 US. 411 (1990).

[10]Broadcast Music, Inc. v. CBS, 441 U.S. 1 (1979); NCAA v. Board of Regents of Univ. of Okla., 468 US. 85 (1984); Rothery, supra note 8.

and operation of joint ventures.[11] Even the basic question of whether a joint venture's operating rules are subject to per se or rule of reason inquiry is uncertain, and the once-heralded continuum alternative to the rigid dichotomy between per se and rule of reason tests is in jeopardy.[12] Factors of importance in joint venture prosecutions and cases have varied from the serious to the spurious.[13] The former include whether the joint venturers' purpose or effect was to increase output, whether the parties were offering a product or service that was otherwise unavailable, and whether the venture would provide significant efficiency gains. The spurious include the integration/risk sharing test already discussed, whether less restrictive alternatives were available, and, incredibly, a disregard of whether a market had been defined and market power demonstrated. As a result, the tests applied to challenge or measure the legality of a joint venture have not always looked at whether they were likely to cause substantial adverse competitive effects.

A somewhat different set of antitrust rules -- those involving concerted refusals to deal -- have been applied to measure the legality of joint actions by members of a standards-setting

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[11]The various Health Care Policy Statements are the most sustained effort to do so, but even as recently revised, they illustrate a wrong-footed approach. The Statements take the view that physician networks are illegal unless they fit into one of the proscribed forms (i.e., financial or clinical integration and risk sharing). See Clark Havighurst, Antitrust Issues in the Joint Purchasing of Health Care, 1995 Utah L. Rev. 409.

[12]See California Dental Ass'n, 5 Trade Reg. Rep. (CCH) ¶ 24,007, at 23,796 n.26 (FTC. March 25, 1996); but see Joel I. Klein, A Stepwise Approach to Antitrust Review of Horizontal Agreements, Before ABA Section Semi-Annual Fall Policy Program (Nov.7, 1996). Compare Ernest Gellhorn & William Kovacic, Antitrust Law and Economics, 212-22 (4th ed. 1994) with id. at 252-64.

[13]While this analysis concentrates on antitrust rules applicable to the operation of a joint venture, similar criticisms can be made of the legal tests applied to access issues where competitors or others seek to force their way into a network or alliance. See generally Donald I. Baker, note 7 supra.

organization. Here, antitrust doctrine has stabilized in a sensible way after wavering between per se and rule of reason tests. The leading (and most recent case) focused on likely competitive effects under the rule of reason where the organization's market power and efficiency justifications are examined.[14] Evidence of whether exclusionary effects can be reasonably justified also has been critical.[15] Thus, standards pass antitrust scrutiny if "based on the merits of objective expert judgments and through procedures that prevent the standard-setting process from being biased by members with economic interests in stifling product competition."[16]

My concern with antitrust case law applicable to joint standard-setting relates to the measure of antitrust injury and causation. In Allied Tube, the Supreme Court upheld a damage award because the defendants' joint action barring plaintiff's product from a privately developed standard effectively caused independent market place harm by stigmatizing the product as unsafe and unacceptable. But in a similar circumstance, in Sessions Tank Liners, Inc. v. Joor,[17] the Ninth Circuit held that where the injury is traceable in any fashion to subsequent government adoption, even though that government action was not the focus of the private action, the Noerr-

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[14]See Allied Tube & Conduit Corp. v. Indian Head, Inc., 486 U.S. 492, 500-01 & n.6 (1988) (distinguishing between adoption and enforcement of standards).

[15]Compare Radiant Burners, Inc. v. Peoples Gas Light & Coke Co., 364 U.S. 656, 659-60 (1961)(per curiam) with Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co., 472 U.S. 284 (1985); Massachusetts Bd. of Registration in Optometry, 110 F.T.C. 549 (1988).

[16]Allied Tube, supra note 14, at 501.

[17]Sessions Tank Liners, Inc. v. Joor Mfg., Inc., 17 F.3d 295, 299-300 (9th Cir.), cert. denied, 115 S.Ct. 66 (1994); see also Massachusetts School of Law v. ABA, 937 F. Supp. 435 (E.D. Pa. 1996), aff'd, ___ F.3d ___ (3d Cir. 1997).

Pennington[18] immunity for petitions to government applies. This expansion of antitrust immunity for direct petitioning -- contrary to the usual rule that such exemptions are read narrowly -- effectively wipes out antitrust liability for the actions of most standards organizations. More importantly, it is inconsistent with the rationale of Noerr-Pennington and unnecessary to protect First Amendment interests.

Principles for Unified Standards for Competitor Collaboration. Competitor collaboration is desirable because it may add a new entrant into the market, improve efficiencies, increase output, support innovation and provide other market benefits. The concern, as with all trade restraints, is that the activity also may be a cover for a cartel or unduly expand the participants' market power. In either case, the focus should be on whether the joint venture will reduce market output, raise price, constrain entry, fail to produce efficiencies, or otherwise adversely affect the way in which the participating firms or others compete. The central issue for antitrust is to establish rules for accurately determining which set of circumstances is likely to dominate and to ascertain whether there is sufficient certainty in this judgment to justify intervention in the market place.

There are, I believe, several principles (invariably borrowed from other areas of antitrust enforcement) that should serve as the bases for these competitor collaboration guidelines. First, joint ventures generally serve socially valuable ends supporting innovation, improving efficiency and otherwise intensifying competition.[19] Thus, they should be treated hospitably and viewed (like mergers) as presumptively lawful. Second, joint ventures without market power are

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[18]Eastern R.R. Pres. Conf. v. Noerr Motor Freight, Inc., 365 U.S. 127 (1961); United Mine Workers of America v. Pennington, 381 U.S. 657 (1965).

[19]See Copperweld, note 8, supra.

unlikely to pose serious threats to competition. Thus, those with modest market shares generally should be left alone. As in the case of mergers and other horizontal agreements with legitimate purposes, market power should be a necessary predicate for antitrust concern. Nor is a joint venture without market power likely to significantly increase the likelihood of competitor collaboration. Third, the potential benefits from competitor collaboration can only be assured by antitrust enforcement that concentrates on actual and likely effects and seriously examines both efficiencies and misuses of market power to constrain entry or retard innovation. Fourth, structural measures such as financial integration or risk sharing (which may be easy to apply) have no demonstrated relationship to market place competition and thus do not provide useful operational criteria for evaluating joint ventures.

With this background, an analytical framework for applying these principles and related criteria can be identified. However, like all such policy statements, the proposed Competitor Collaboration Guidelines can only identify the steps and criteria which the agencies should apply, not how they should assess the facts of a particular case. And, of course, it is the facts that are ultimately decisive. But before discussing this taxonomy, some special issues separately applicable to joint ventures and standard-setting need to be considered.

Special Issues of Joint Ventures. First, all joint ventures deserve to be reviewed on the same basis as mergers. Except where readily identified as disguised efforts at cartelization, they should be examined under a rule of reason structure because of likely beneficial effects. Similarly, the process whereby a merger is generally reviewed in advance should be extended to joint ventures which are typically challenged only after they have been in operation for several years. Early review of joint ventures is needed both by the parties and antitrust enforcement agencies. It would provide certainty and encourage beneficial alliances and serve the same public policies which justified the National Cooperative Research and Production Act. Automatic notice and review of joint ventures passing substantial threshold size criteria are warranted, as with mergers, both because of their potential harm and because such review would give enforcement agencies advance notice of joint ventures which could have substantial adverse market effects. The agencies should rationalize this process by rule (or statutory modification) to provide a filing procedure similar to that mandated under the Hart-Scott-Rodino Act.[20]

Second, the agencies have applied a rule of reason analysis to joint ventures only where it is shown that the participants have integrated their operations to a substantial degree and shared financial risks. As noted, that limiting premise is erroneous. In fact, it seems more likely that the lower the degree of integration and risk sharing among the participants, the more likely that the venture will be limited in scope and duration and thus have only short term and narrow market effects. Nor is there any economic theory or study showing that risk sharing and integration have a necessary relationship to lower costs, more efficient or effective use of resources or assets, or similar economies. The critical issue, instead, is whether the venture is likely to result in serious anticompetitive consequences and, if so, whether that possibility is overcome by likely efficiencies or other benefits.[21]

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[20]15 U.S.C. §18a. See also ABA Antitrust Section, Premerger Notification Practice Manual 71 (1991) (transfer of interest in unincorporated joint venture not reportable). Substantial definitional issues -- e.g., when does a licensing agreement become a joint venture -- would have to be addressed in implementing this recommendation.

[21]Nor can it be argued that the integration/risk sharing criteria ensure that the joint venture is more like a "beneficial merger." Indeed, joint venture may be preferable to a merger (continued...)

The application of a least restrictive alternative approach, occasionally identified by agencies and the cases as a limiting requirement,[22] should be discarded. To require that a joint venture demonstrate that the benefits it seeks are not readily available in other (less threatening) ways turns antitrust analysis on its head. The issue is not whether the venture is the best or better way to achieve the asserted economies, but rather whether the dangers it poses to competition, if any, are too great. Further, a "best approach" requirement assumes greater knowledge of operational alternatives than agencies or courts possess. However, to the extent that the least restrictive alternative approach is based on the idea that the venture and its restrictions should not be overbroad and its restraints should be reasonably tailored to specific needs -- similar to the ancillary restraint doctrine applied to covenants not to compete -- it is valid. But to force the venturers to guess which alternative an antitrust agency or court would find least restrictive several years later is counterproductive.[23]

The most sensible course would be to apply the analytical framework of the Merger Guidelines in evaluating whether to accept or object to a proposed joint venture. The question in both instances is identical: is the change in the market affected by the

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[21](...continued)
because the combination is not permanent and the firm's combined efforts often provide a product or service not offered by any venturer.

[22]See, e.g., Board of Regents of U. of Okla. v. NCAA, 707 F.2d 1147, 1154 (10th Cir. 1983), aff'd, 468 U.S. 85 (1984).

[23]This seems particularly true for operating requirements such as "routing rules" for network joint ventures which are designed to address "free-rider" concerns and do not have any direct effect on price, output or quality. See National Bancard Corp. v. VISA U.S.A., Inc., 779 F.2d 601-02 (11th Cir. 1986)(upholding joint venture); General Leaseways v. Nat'l Truck Leasing Ass'n, 744 F.2d 588, 591-95 (7th Cir. 1984)(rejecting venture's claims).

new entity/arrangement likely to create or enhance market power substantially or facilitate its exercise. In both the critical questions are likely to be (i) whether the joint venture significantly increases market concentration with the result that the market would become dangerously concentrated; (ii) whether such concentration and related market factors raise substantial concerns about potential adverse competitive effects; (iii) whether entry is likely to be timely and sufficient either to deter or to counter any such competitive effects; and (iv) whether the probable efficiency gains outweigh remaining anticompetitive effects.

Special Issues of Standards-Setting. The rule of reason standard generally applied to measure the operation of standards-setting organizations is neither exceptional nor controversial. Rather the problem in the standard-setting arena is one of serious underenforcement where agencies have been slow to understand how the organizations are readily manipulated by competitors with the result that standards often preclude entry and product innovation. Such constraints can be particularly critical in markets characterized by rapid change. Where innovation is important and the duration of product life cycles brief, delay in the approval of a standard critical for entry into a market can be as effective a direct exclusion. In particular, the agencies' uncritical acceptance of consensus standards, after Allied Tube, too often ignores obvious risks. While the "consensus" procedures used by standards organizations usually require "balanced" committees and thus specifically deny competitors a majority of those voting on the standard, they also generally impose supra-majority requirements when adopting a standard, allow committees to be controlled by competing industry representatives, and permit individual negative votes by any member to block a standard at any stage of the process (thereby sending the proposed standard back to the initiating committee to consider the objection). In theory, each internal check on the process seems a reasonable quality control to ensure meritorious standards. In practice, these provisions are notorious for giving competitors de facto control of the process.

Thus, effective competitor collaborator guidelines must be sensitive to possible misuse of standards organization's procedures and should put the burden on organizations representing competitors with substantial market power to demonstrate that their procedures are not subject to abuse. It is no answer to assert that only industry competitors have the expertise to examine proposed standards and to determine which proposals satisfy rigorous standards requirements. Industry representatives can reasonably be given full information and allowed to present their views. The antitrust objection arises when they control the agenda or the decision-making process. In the latter situation, the dangers of self-interest are, as the Court recognized in Allied Tube, too great.

Finally, as previously noted, the agencies should not be paralyzed by the Noerr-Pennington exception and should not allow private boycotts to be insulated from antitrust liability simply because a legislative body subsequently incorporates a standard into a code, or a government agency subsequently adopts the standard or adheres to it as a purchaser. The Noerr exception protects petitions for government action by private groups because the Sherman Act governs private not state action and because the antitrust laws should be interpreted to avoid conflict with the First Amendment.[24] Thus,

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[24] See generally, ABA Antitrust Section, The Noerr-Pennington Doctrine, Monograph 19,
(continued...)

direct petitioning by a standards group to a government body is immune. But the Court in Allied Tube refused to extend Noerr immunity to abuses of the process by which standards are adopted. As a result, the Noerr exception should not be applied to underlying conduct which results in the biased standard unless that standard is adopted for no other purpose and is directly part of the petitioning process. The failure to recognize this distinction in the proper limits of Noerr-Pennington in the Ninth Circuit's decision in Sessions should be challenged.

With these special issues in mind, I would propose **first**, that the HSR notice requirements and Merger Guidelines be applied to all joint ventures meeting HSR size criteria before they become operational. In applying the Guidelines, proper discount should be given to factors likely to make the joint venture more or less dangerous than a merger among the participants. Many factors such as short term duration, limited product/service scope, termination rights, etc., are likely to diminish possible anticompetitive effects as compared with a complete merger of the joint venturers. On the other hand, industry-wide coverage raises the question whether the standard is likely to be exclusionary to innovative designs.

But many joint ventures -- and in particular, standard setting organizations -- may develop significant market power and raise antitrust conduct issues after they become operational. Thus, a **second** approach is necessary to evaluate the reasonableness of a joint

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[24](...continued)
at 2-6 (1993).

venture's operation. In this circumstance, the conduct of operational joint ventures should be subjected to antitrust scrutiny under a four-step analysis.[25]

(1) Facial Review for Per Se or Rule of Reason Application. Expressly adopting the BMI framework, the threshold inquiry should be whether the collaboration "facially appears to be one that would always or almost always tend to restrict competition and decrease output" or, alternatively, whether its design is likely to "increase economic efficiency and render markets more, rather than less competitive." This preliminary determination should be a limited assessment of the competitive merit of the venture or restraint.

The initial premise should be that if the collaboration (or any particular aspect of it being scrutinized) could reasonably provide possible gains to competition, then rule of reason review is appropriate. At this preliminary stage, the issue is narrowly limited to whether there is a legitimate basis for concluding that the collaboration is likely to produce market benefits -- not whether its benefits outweigh its costs, whether the collaboration constrains entry or output, or whether it magnifies market concentration and imperils competition. Quick look review at this stage should be just that. Properly applied, most standards organizations and most joint ventures should pass this per se characterization review without difficulty.[26]

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[25] See also, Robert Pitofsky, A Framework for Antitrust Analysis of Joint Ventures, 54 Antitrust L.J. 893 (1985).

[26] Cf. California Dental Ass'n, supra note 12 (proceeding with rule of reason analysis even though practice lacked any legitimate competitive rationale). If it had any possibility of adoption, we would prefer that this step be omitted (as in the Merger Guidelines) because of a recognition that joint ventures generally are competitive. See Jefferson Parish Hospital Dist. No.
(continued...)

(2) **Market Power Screen**. Once it is established that the venture could result in substantial competitive benefits, the enforcement agencies should determine whether the collaboration has sufficient market power to cause competitive harm and is likely do so.[27] As with mergers, the drawing of market boundaries and identifying of market participants and their market shares, can be both difficult and critical; but these problems are not distinctive to joint ventures. The level of market shares found in other antitrust contexts to provide safe harbors varies: some cases find no market power even though the defendants have market shares of up to 43%;[28] guidelines often presume that restraints cannot be harmful where market shares do not exceed 20%;[29] and the Merger

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[26](...continued)
2 v. Hyde, 466 U.S. 2, 15-18 (1984) (per se treatment given to tying arrangements only if market power is present). Just as per se rules should be adopted only after experience determines that the likelihood of harm from the practice warrants general condemnation, so should they be abandoned when new learning demonstrates probable beneficial effects from the arrangement. See Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977). See also State Oil Co. v. Khan, 93 F.3d 1358 (7th Cir. 1996), cert. granted, __ U.S. ___ (1997).

[27]See California Dental Ass'n, supra note 14 (market power generally examined in rule of reason case). See also Polk Brothers, Inc. v. Forest City Enterprises, Inc., 776 F.2d 185, 191 (7th Cir. 1985) (In the absence of market "power to raise price by curtailing output, [the parties'] agreement is unlikely to harm consumers, and it makes sense to understand their cooperation as benign or as beneficial."); Chicago Prof. Sports Ltd. Partnership v. NBA, 1996-2 Trade Cas. (CCH) ¶ 71,554, at 77,993 (7th Cir. 1996) ("[s]ubstantial market power is an indispensable ingredient of every claim under the full Rule of Reason").

[28]See, e.g., Winter Hill Frozen Foods & Servs. v. Haagan-Dazs Co., 691 F. Supp. 539 (D. Mass. 1988).

[29]See, e.g., U.S. Dept. of Justice & FTC, Antitrust Guidelines for the Licensing of Intellectual Property, ¶ 4.3 (1995); U.S. Dept. of Justice & FTC, Statements of Antitrust Enforcement Policy in Health Care, Statement 8.A.1. (1996), reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,153, at 20,815 (exclusive physician network joint ventures).

Guidelines apply more complex HHI evaluations and varying presumptions depending on market concentration as well as market shares.

While there is no magic in any of these numbers, it seems sensible to suggest that the competitor collaboration guidelines not chart new territory and should, instead, model themselves on prior approaches. Thus, a joint venture which passed facial review should not be challenged if the venture controls less than 30% of the relevant market.[30] One arguable exception to this market power screen would be where actual anticompetitive effects can be shown -- although it is doubtful that such effects are possible without significant market power. Otherwise there is no basis for challenging an arrangement which has legitimate objectives, efficiency justifications or public benefits (step one).

(3) **Evaluation of Competitive Effects**. Where the venture's market shares do not pass the filter of step two, the agency should be obliged to evaluate its likely competitive effects in a fashion similar to that set forth in the Merger Guidelines. Critical factors that should be considered include the type of venture (e.g., industry-wide or network); its duration (e.g., time period, termination, access) and scope (e.g., territory, exclusivity, relationship to participants). Also important are: its use to avoid free-riders and the potential for spillovers into other areas of the parties' business; the venture's output and price incentives and its ability to constrain entry; and any other effects on market place competition. Similarly, market concentration and the dangers of

[30]The 30% threshold has the advantage of being the number used by the Supreme Court in Jefferson Parish. I am not aware of any case where a joint venture with lower market shares evaluated under a rule of reason by practice was stricken as unreasonable. An alternative would be to apply the Merger Guidelines' HHI numbers, although they seem lower than necessary for a joint venture guideline. See Rothery, supra note 8, at 219.

coordination or direct cartelization, among other things, should be examined. These adverse effects, if any, should then be weighed against the efficiencies and other benefits identified in step 4 which follows.

(4) **<u>Efficiencies and Other Benefits</u>**. Efficiencies, as now recognized in the Merger Guidelines (1997 Merger Guidelines § 4), should be accepted as legitimate justification for collaboration. Other benefits particularly associated with the collaboration which should be weighed in the balance include the addition of a new product or service, reduction in information costs, increased industry scale (particularly for network industries, even if such scale is not supported by scale economies), network externalities (such as consumer usage), generation of research and development capital, and full utilization of complementary assets. While guidelines cannot identify the quantum of proof necessary to establish these efficiencies, the evidence required should vary depending on the degree, scope, and anticipated duration of adverse effects against which they are being compared. For example, collaboration by firms with higher market shares, or in concentrated markets where the danger of cartelization is ever present, should bear a heavier burden of demonstrating likely benefits (i.e., potential increase in output or other efficiencies). As noted, whether the claimed efficiencies could be obtainable by other means should be irrelevant.

<u>The Process of Adopting Competitor Collaboration Guidelines</u>. Finally, the FTC and Antitrust Division should assure that the process used to approve competitor collaboration guidelines satisfies the transparent decision-making standard urged by the Competition Policy Report. In the past, guidelines have been written by the agencies -- first separately and now together -- in comparative secrecy with no or limited public input.[31] To be sure, select members of the antitrust bar often have been shown drafts and given an opportunity to comment, but it has truly been a game of inside-the-beltway antitrust baseball. While the FTC and DOJ are not formally required to follow notice-and-comment rulemaking procedures because the guidelines would not constitute substantive law,[32] nonetheless, good agency practice should provide a serious opportunity for public review and comment before significant guidelines are issued. This is the process used by most executive departments and agencies in developing published enforcement policies. Just as the Commission's hearings provided diverse and helpful comments on significant competition policy issues, public scrutiny of draft guidelines could ensure that the competitor collaboration rules are workable and reasonable.

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These continuing hearings on Competition Policy and Joint Ventures have documented serious concerns that current antitrust policy applicable to joint ventures and standards organizations is often uncertain and not infrequently counterproductive. The result is that the development and introduction of new products and services probably have been inhibited. Joint ventures have been treated too harshly and their likely benefits valued too narrowly whereas standards organizations generally have been allowed to operate with limited scrutiny even when used by competitors to keep out improved products and services. Striking the right balance is

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[31]The FTC hearings on Competition Policy in 1995 and these hearings on the Joint Venture Product in 1997 are noticeable and welcome exceptions. Even then, however, they do not go so far as to follow notice-and comment procedures where draft guidelines would be subject to public comment before final guidelines are issued.

[32] See 5 U.S.C. § 553(b) (substantive rulemaking procedures not required for interpretative rules or general statements of policy).

never easy and others may challenge the proposals made here. That is as it should be in the development of informed public policy. How these issues are resolved, however, will determine whether this critical area of antitrust law becomes more rational and whether the full benefits of joint ventures and standards organizations will be realized.

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