

Acredula

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Bricker & Eckler LLP's *Acredula* is available to clients and friends of the firm, and highlights information of particular importance to boards and executives. The information contained in this newsletter is not to be construed as legal advice or opinion.

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Acredula is the Latin word for "owl," connoting wisdom. This newsletter is intended as wise counsel for boards and executives.

Alliances Face Antitrust Scrutiny

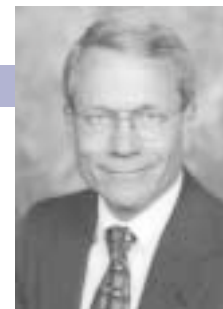
Strategic alliances are popular because they typically do not result in a change in control as do traditional mergers or acquisitions. While different from traditional mergers or acquisitions, strategic alliances remain subject to scrutiny for antitrust implications. As described in our August 2001 issue of *Acredula*, a strategic alliance by definition involves mutuality or "collaboration" rather than a change in control.

Both the Department of Justice and the Federal Trade Commission have increased their focus on strategic alliances. In April 2000, they jointly issued the *Antitrust Guidelines for Collaborations Among Competitors*. These guidelines define a "competitor collaboration" as "a set of one or more agreements, other than merger agreements, between or among competitors to engage in

Editor's Note

economic activity . . . such as research and development . . . production, marketing, distribution, sales or purchasing."

In this month's *Acredula*, antitrust lawyers Edward A. Matto and Elizabeth H. Watts examine the guidelines as well as the practical considerations to determine whether an alliance is a collaboration that enhances or hinders competition. Because the potential penalty of treble damages is so substantial, parties to any alliance should make the "rule of reason" analysis suggested by Ed and Elizabeth.



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Acredula is now bi-monthly and looking to go electronic

As you may have noticed from this issue, *Acredula* is now a bi-monthly publication. Although our publication schedule has changed, we will continue to bring you timely and practical information on board and executive issues.

Due to national concern over tampering

and misuse of mail, we would like to distribute *Acredula* electronically by email. This will allow us to send you immediate bulletins on important or pending issues.

To become part of this movement toward electronic distribution and updates, send your email address to jbeavers@bricker.com.

Antitrust Issues and Risks for Strategic Alliances

Edward A. Matto and Elizabeth H. Watts

Competition in today's fast-paced markets is driving many competing businesses to enter into strategic alliances or collaborations. These newly formed alliances provide flexibility to permit expansion into foreign markets, joint innovation, research and development and cost efficiencies.

The terms "strategic alliance" and "collaboration" can be defined broadly as any collaborative activity, short of a full merger, by which firms combine for specific purposes to provide common products or services. Today's strategic alliances can vary from a loose contractual arrangement to a complete combination of two entities on a par with a full merger. No matter how an alliance is formed or what its ultimate goal might be, it can have significant competitive effects just like any other agreement among otherwise independent competing firms. As a result, alliances are subject to scrutiny under the antitrust laws. Under these laws "competitor" refers to both actual and potential competitors. (Information sharing and various trade association activities also may take place through competitor collaborations and would also be subject to antitrust issues.)

Although strategic alliances are in the news every day, the antitrust implications are very rarely discussed. Antitrust enforcement agencies, however, have increased their focus on the implications of strategic alliances in recent months. Despite the fact that antitrust considerations have gained notoriety on the heels of the Microsoft case, many executives are unaware of the possible antitrust pitfalls inherent in strategic alliances. Each alliance requires an analysis of its potential effects on competition in the markets where the alliance will operate. Restrictions on competition deemed necessary among the alliance participants may raise significant antitrust concerns. Joint price setting, limits on



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competition with the alliance and/or its members, assignment of primary responsibility for markets or customers, exclusive arrangements and restrictions on output are the types of issues that need careful legal review before implementing an alliance agreement.

Antitrust Guidelines

The antitrust laws prohibit joint anticompetitive conduct and certain anticompetitive conduct engaged in by single entities. Under these laws, conspiracies or agreements to engage in anticompetitive conduct and monopolization or attempts to monopolize by a dominant entity are considered illegal. The Department of Justice, the Federal Trade Commission, and the state attorneys general are responsible for enforcing antitrust laws.

Jointly issued by the Federal Trade Commission and the Department of Justice, the *Antitrust Guidelines for Collaborations Among Competitors*, provides analytical principles that constitute a framework for looking at any potential collaboration among competing businesses. Addressing the question of "legitimate" collaborations, the guidelines specifically identify ways to show that an affiliation is valid under the antitrust laws. The affiliation must have a legitimate purpose for its existence and cannot exist merely or primarily to increase prices, allocate markets or services, or for any other anticompetitive purpose. The alliance may also provide substantial economic risk sharing among the participants. Economic risk sharing usually requires not only the sharing of profits and losses but also other risks of financial loss from the alliance's operation. If the alliance can show that it is sufficiently integrated through controlling costs, improving quality, or promoting research and development resulting in significant cost-efficiencies for its participants, then it will likely be deemed

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a valid collaboration. The alliance should be able to demonstrate its legitimate purpose; for example, that it has legitimate efficiency-enhancing, quality improvement purposes.

As noted above, many strategic alliances among competitors do not raise antitrust concerns. Strategic alliances allow businesses to achieve efficiencies that ultimately benefit consumers and most have sufficient safeguards built into their structure to prevent anticompetitive consequences. The antitrust analysis of a strategic alliance will review the structure and purpose of the arrangement, the competitive relationship among the participants, and the likely impact in the market from the alliance. The federal guidelines are helpful in understanding when and under what circumstances the enforcement agencies may investigate and/or challenge a particular alliance.

“Rule of Reason” Analysis

Strategic alliances or collaborations with an agreement to raise prices, restrict output, or allocate customers, suppliers, territories, or lines of commerce are regarded by the enforcement agencies and the courts as *per se* illegal. In other words, agreements of this nature will be challenged without further inquiry into the effects on the marketplace. Such arrangements are regarded as consistently anticompetitive and not requiring further antitrust analysis.

Agreements that are not *per se* illegal are reviewed under the “rule of reason” test to determine their overall competitive effect. A “rule of reason” analysis focuses on an alliance’s impact on the state of competition. If the strategic alliance is likely to harm competition in the marketplace, the enforcement agencies will balance that potential harm against any procompetitive benefits to be gained by allowing the strategic alliance to exist. An analysis of a strategic alliance or collaboration ordinarily involves an examination of the geographic and product markets and the potential for anticompetitive behavior within these parameters. The enforcement agencies will evaluate the collaboration’s competitive effects in each of the relevant markets in which it operates or has substantial impact.

The “relevant” geographic and product markets are those within which the alliance will operate its business or each

participant operates. To determine product markets, the enforcement agencies look to what substitutes, as a practical matter, are reasonably available to consumers for the services in question. The relevant geographic market for each relevant product market will be determined through a fact-specific analysis that focuses on the location of reasonable alternatives.

Strategic alliances may provide advantages to these relevant markets such as economies of scale. For example, purchasing and warehousing inventory that might ensure access to a stock of goods that would otherwise be unavailable is a benefit that the agencies would likely deem acceptable. Forming an alliance to provide a service to a group of competitors under proper circumstances could create procompetitive advantages and provide little antitrust risk.

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Competitive Effects

After determining the relevant geographic and product markets, the agencies will examine the arrangement’s potential effects between competitors and between parties that are not competitors, such as manufacturers or distributors.

The effect of competitor collaborations on the marketplace may differ from those of mergers. Mergers typically end competition between merging parties. By contrast, competitor collaborations preserve competition to some extent or even enhance it. This continuing competition may reduce the agencies’ competitive concerns or it may raise issues as to whether the participants have agreed to “conspire” for anticompetitive purposes.

A strategic alliance’s competitive influences may change over time, due to changes in internal reorganization, additions of new collaboration agreements, additions or departures of participants, or changes in market conditions. During any review, the enforcement agencies will attempt to address any concerns of possible harm to competition, whether such harm would occur at the formation of the collaboration or at a later time.

Finally, it is important to be aware that some strategic alliances may be subject to prior notification to the federal enforcement agencies under the *Hart-Scot-Rodino Antitrust*

Improvements Act of 1976. This law requires certain size entities to report the formation of a joint venture to the federal enforcement agencies. In general, the act requires that the formation of an alliance be reported to the Federal Trade Commission and the Department of Justice when the alliance is in corporate form and the transaction meets the applicable size-of-person and size-of-transaction thresholds.

Conclusion

Despite the potential for enforcement agencies to review strategic alliances, the fact is that the federal and state agencies review but a scant few of the many strategic alliances that are formed each day. The vast majority of alliances do not pose antitrust risks and are formed for purposes that enhance rather than hamper competition. Evidenced by the sheer number

of strategic alliances formed in the past year and the enthusiasm with which they are received in the business world, forming strategic alliances is a practice that is here to stay.

Successful alliances can allow partners to share, evolve and enter new markets, ultimately making their businesses more valuable by broadening the scope of their operations. However, it is important to avoid the *per se* illegal motives for creating alliances and to avoid being charged with antitrust violations. Private parties (usually competitors or customers) can sue for treble the damages they suffered from an antitrust violation. Businesses should enter into alliance transactions with their "eyes wide open" and with appropriate respect for the competitive issues involved, and the role the antitrust laws play.

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