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Using *Dagher* to Refine the Analysis of Mergers and Joint Ventures in Petroleum Industries and Beyond

By Peter C. Carstensen*

I. Introduction

The recent decision in *Texaco v. Dagher* illustrates problems with the contemporary strategy employed by plaintiffs’ attorneys of narrowly framing antitrust claims to assert “per se” illegality without any explanation of what makes the specific conduct anticompetitive. Although this strategy is understandable given the Supreme Court’s hostility towards competition as a public policy goal, the result of this process is harm to the fundamental public interest in having workably competitive markets. This is particularly true in the case of petroleum where there have been a number of consolidations. In addition, the major firms in the industry have a tradition of entering into joint ventures and other cooperative agreements. Others have told and retold the history of anticompetitive activities by the major oil and gas companies starting with the infamous *Standard Oil of New Jersey v. United States*.2

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The goal of this brief comment is to highlight how the plaintiffs' narrow conception of the case concerning market exploitation collided with the Dagher Court's refusal to recognize the implications of the evidence. As an appeal to law reviews, the goal is to explain why the plaintiffs had a plausible case, and how it might have been framed to increase their chances of prevailing. Such after the fact case specific analysis has utility only insofar as it suggests how future cases might avoid the fate of Dagher.

The Dagher case focused on a decision by oil companies, Texaco and Shell, to restrain the pricing discretion of the managers participating in their joint venture to refine and market gasoline in the Western United States, where the joint venture's market share of gasoline exceeded 25 percent. As the owners of this venture, Texaco and Shell commanded the managers to maintain uniform prices between the two brands in every specific market area. Prior to this action, Texaco gas had sold below the prices of other major brands, and so the immediate implication of this restraint was to raise the price of Texaco branded gas by roughly two cents per gallon. In this context, such a restraint would seem to be contrary to the best interests of the joint venture as a profit-maximizing enterprise. If price uniformity was a rational strategy for the firm, presumably the managers would have adopted this pricing strategy independently.

After adopting this price coordination requirement, both brands apparently experienced a substantial price increase despite lower costs of production and declining prices of petroleum. Thus, the elimination of price differences in some way resulted in a general increase in the price of both gasoline brands in circumstances where the price increasingly diverged from the cost of production. While a profit-maximizing firm necessarily seeks to increase the margin between cost and price, in a workably competitive market a firm ought

http://www.gao.gov/highlights/d0496high.pdf [hereinafter The GAO Report] (finding increased concentration resulting from mergers has resulted, inter alia, in higher consumer prices).

3 Dagher v. Saudi Refining, Inc, 369 F.3d 1108, 1111 (9th Cir. 2004).
4 Id. at 1112.
6 Dagher, 369 F.3d. at 1113 (showing in the record a $.40 per gallon increase in Los Angeles, and a $.30 increase in both Seattle and Portland despite declining crude oil prices).
not to be able to increase prices as its costs decline. At best, a firm experiencing uniquely lower costs might hold prices constant in an effort to increase its margins. Thus, the observed events are anomalous in terms of the standard predictions of economics. They suggest that the price coordination between the two brands in some way caused or contributed to the increased ability of the joint venture to exploit buyers by increasing prices without any cost justification.

The plaintiffs focused on the agreement to set a uniform price as the central issue in their case. They developed a strong record that there was no business explanation for the adoption of this price policy relating to the refining and distribution of the two brands of gas. Hence, the plaintiffs' counsel essentially argued that the agreement to eliminate pricing discretion of the venture's managers was "horizontal price fixing" and therefore "per se" illegal. The plaintiffs expressly waived any claim that the restraints were "unreasonable" under the "rule of reason", although their position seemed to allow them to argue that the restraint was illegal under a "quick look" analysis.

Although the plaintiffs developed a strong case that the restraint imposed on the venture lacked any apparent business justification, they did not advance any theory to explain how the elimination of pricing discretion could result in higher prices. Nor did they produce evidence, which they apparently possessed, showing that prices were increased not only by the joint venture's brands, but also by its

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8 Dagher, 369 F.3d at 1113.

9 Id. at 1113-14.

10 Id. Per se illegal restraints are ones without any legitimate competitive or efficiency justification such as cartels.

11 Dagher, 547 U.S. at 3. The definition of the rule of reason remains elusive. See, e.g., Peter Carstensen The Content of the Hollow Core of Antitrust: The Chicago Board of Trade Case and the Meaning of the "Rule of Reason" in Restraint of Trade Analysis," 15 Research in Law and Economics 1 (1992). In general, the rule of reason evaluates restraints based on their effect on competition, the function of the restraint, i.e., does it serve some legitimate business purpose or is its only use to exclude or exploit, and, often times, the market power of the party imposing the restraint.

12 See generally Polygram Holding, Inc. v. Fed. Trade Comm'n, 416 F.3d 29 (D.C. Cir. 2005). In some cases, it is possible to determine that a restraint is unreasonable based on an examination of the conceded facts. The hallmark of such cases is the lack of a rational and legitimate business justification for the restraint.
competitors in the various regional markets.\textsuperscript{13}

The plaintiffs' position was that the owners of the joint venture engaged in an illegal restraint of trade by agreeing to limit the pricing discretion of the managers within the enterprise because the agreement lacked a non-exploitative explanation.\textsuperscript{14} After extensive discovery, the trial court granted summary judgment to the defendants.\textsuperscript{15} The Ninth Circuit reversed based on its belief that the uncontested fact that Shell and Texaco had no explanation for their actions relating to the operation of the joint venture, meant that it was possible the agreement was a naked restraint on competition and therefore "per se" illegal.\textsuperscript{16}

The Supreme Court reversed the circuit court and reinstated the trial court's summary judgment of dismissal.\textsuperscript{17} In a brief opinion from Justice Thomas, the Court concluded that the owners of a joint venture may agree on the prices to be charged and that this cannot be "per se" illegal.\textsuperscript{18} Thus stated, the result seems inescapable. What is mysterious is why the Ninth Circuit had reversed the trial court's summary judgment decision. Indeed, how could such a case have survived a motion to dismiss on the pleadings? Unless the circuit court panel was behaving totally irrationally, there must have been some reasonable basis for concern about this record.

Joint ventures and other collective activity are rife in the oil and gas industry.\textsuperscript{19} Such arrangements, sometimes called "strategic alliances", are also increasingly prevalent in a variety of other industries, especially those with significant levels of concentration. The facts of \textit{Dagher} suggest that such ventures may result in substantially higher prices to consumers. Moreover, those higher prices may be unrelated to any improvement in the quality of the products being sold or to changes in the costs of inputs. Rather, they may simply be the result of changes produced by the parties to the venture made to

\textsuperscript{13} Email communications with Daniel Schulman, counsel for petitioners, October 4, 2005, on file with the author [hereinafter Schulman Email]. See also \textit{Dagher}, 369 F.3d. at 1114-15.

\textsuperscript{14} See \textit{U.S. v. Microsoft Corp.}, 253 F.3d 34 (D.C. Cir. 2001) (a monopolist must justify a restraint that has adverse effects on competition). This is a form of the "quick look" analysis in that it would create a presumption of illegality that the defendants would have to rebut.


\textsuperscript{16} \textit{Dagher}, 369 F.3d. at 1108.

\textsuperscript{17} \textit{Dagher}, 547 U.S. at 2.

\textsuperscript{18} \textit{Id} at 2-3.

\textsuperscript{19} Brock, \textit{supra} note 2.
create market power or to more effectively exploit market power that had been latent.

The following section first describes the Texaco-Shell venture and its review by antitrust enforcement agencies. Second, the case record, actual and potential, is summarized along with the Court’s response. Third, the facts are revisited in terms of potential theories of competitive effects. This will show that the facts raised serious questions about the decision of the Federal Trade Commission (FTC) to allow this combination, as well as the failure of plaintiffs’ counsel to articulate coherent theories focused on the restraint of pricing discretion that would have warranted treating this specific restraint as impermissible. Finally, I critique the narrow decision of the Court and suggest how a policy committed to competition as a process should view this case. This leads to suggestions on both how plaintiffs ought to present cases of this sort, and how those who enforce mergers and other aspects of antitrust law should view joint ventures and other collaborations, especially in the field of petroleum products.

II. The Shell-Texaco Deal

In 1998, Texaco and Shell commenced two joint ventures. One combined their refining and retailing activities west of the Mississippi River, while the other combined the same assets in the eastern half of the United States and included another partner. The two companies continued to compete in the rest of the world—both had major refining and retailing activities in other countries and continued to compete with each other in these markets. They also continued to compete with respect to some aspects of the broadly-defined petroleum business in the United States, including competing for new crude oil supplies.

The venture was well short of being a merger. Each party insisted on retaining rights to its brand names, which were only licensed to the venture. In addition, the parties imposed some limits on the managers of the venture with respect to treatment of the two brands. The basic commitment was for equal treatment of the two brands in terms of promotion and marketing.

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20 The third partner was Saudi Oil. The original complaint charged that the eastern venture also raised prices. However, that claim was dismissed since none of the class members had purchased gasoline from that venture, which the courts held to be discrete and separate from the western venture. Dagher, 369 F.3d at 1114-16. There was evidence in the record, nonetheless, that the two ventures operated in a coordinated way. In particular, they adopted the same pricing strategy as part of a collective action involving both ventures. Id. at 1115-16.

21 One potential business justification for Shell and Texaco’s new pricing re-
The purported rationale for the venture was that it would create important economies and efficiencies. The parties estimated a savings of over $800 million a year.\(^{22}\) Exactly how such substantial gains in operating efficiency would occur and why they would be specific to this venture is not clear. Nothing in the official FTC reports provides any insight to this question.\(^{23}\) Certainly in some litigated cases, the provable claims of efficiency gains turned out to be substantially less than those asserted to the antitrust enforcement agencies.\(^{24}\) Moreover, many efficiencies are not unique to the specific transaction or merger.\(^{25}\) In that case, they do not provide any justification since the gain could be achieved by other means without paying any price in terms of anticompetitive effects. Another unknown is the ratio of purported savings to the total operating expense of the enterprise. While $800 million is a substantial number, it could be only 5 percent of total sales if that total were $16 billion. Savings at such a level would seem to be modest and provide only limited scope for price reductions.

The FTC and several state attorneys general investigated the proposed joint venture.\(^{26}\) After that investigation in which the parties claimed that the joint venture would produce substantial efficiency gains, there was a settlement by consent decree. The FTC complaint identified a number of markets in which there would be adverse competitive effects from the combination.\(^{27}\) The complaint may well have been written in light of the proposed settlement to which Texaco

\(^{22}\) Dagher, 547 U.S. at 3.


\(^{25}\) See U.S. Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines § 4 (1997) (only efficiencies that are “unlikely” to occur “in the absence of the . . . proposed merger” will be considered as potential justifications for an otherwise anticompetitive merger).

\(^{26}\) See Shell Oil Co., supra note 23.

\(^{27}\) Id. at 775-77.
and Shell agreed.\textsuperscript{28} That settlement imposed some divestiture requirements with respect to refinery ownership and terminal facilities. It also imposed some limits on the conduct of the joint venture and its parents for a period of ten years.\textsuperscript{29} In light of subsequent developments, it would be interesting to learn what the internal FTC assessment of the overall transaction was. It is worth noting that one commissioner dissented as to the relief, except as to one market.\textsuperscript{30} However, there is nothing in the subsequent record of the case that suggests that the FTC considered the potential of the joint venture to use pricing strategy involving its two national brands to affect competition.

III. The \textit{Dagher} Evidence and the Supreme Court

The plaintiffs were a class of retailers who had to pay the higher prices resulting from the limitation on price differences. They asserted that the decision to restrain the pricing discretion of the regional managers lacked any business justification. The plaintiffs focused their evidence on this issue and built a substantial record that established this point.\textsuperscript{31} But, of course, any business might be expected to raise prices if it can. Without something more, the plaintiffs only showed that the joint venture in some way had market power and exploited that power.

Two issues central to the dispute are when was the price restraint imposed and why. With respect to timing, one version was that it was an external command from the owners, Texaco and Shell, imposed some time after the venture was created.\textsuperscript{32} As such, it would be an interference with the normal ideas of managerial control. In another version, the price restraint was an element of the venture from the beginning as part of maximizing the economic potential of the venture.\textsuperscript{33} What remains anomalous, under either version, is the rationale for imposing such a limit on the pricing discretion of those who set day-to-day prices in response to changes in both supply and

\textsuperscript{28} \textit{Id.} at 777-93.

\textsuperscript{29} \textit{Id.} at 790-91.

\textsuperscript{30} \textit{Id.} at 812 (Commissioner Azcuenaga, concurring and dissenting).

\textsuperscript{31} \textit{Dagher}, 369 F.3d at 1122 (finding by the court that “the Defendants have thus far failed to offer any explanation of how their unified pricing of the distinct Texaco and Shell brands of gasoline served to further the ventures’ legitimate efforts to produce better products or capitalize on efficiencies”).

\textsuperscript{32} \textit{Id.} at 1112.

\textsuperscript{33} \textit{Id.}
demand, and who would ordinarily have the discretion to set prices for different brands differently if that would maximize the total income of the enterprise. Gasoline prices vary greatly depending on the specific location of the gas station receiving the fuel. Even stations located in the same community may have very different prices. Hence, pricing strategy is very local in character and cannot have an overall uniformity. The reality of the situation is that the only overall limit that owners could impose on those who decided on local prices was to require that the price of the two brands be similar. The plaintiffs did produce evidence of price increases for Shell and Texaco in various markets.

Plaintiffs' counsel had additional evidence showing that, after the elimination of price differences between Texaco and Shell, the price of all gas in concentrated regional markets increased substantially. Moreover, this evidence also showed that prices increased most significantly in the markets where the joint venture had the largest market share. However, this evidence never made it into the record.

The core problem with the plaintiffs' case was that they did not articulate any theory of why the joint venturers had decided to eliminate the kind of pricing discretion that ordinarily would be a key attribute of managers. Without an anticompetitive explanation, it is hard to imagine why the owners of businesses cannot tell managers what to do even if it is economically illogical.

The district court dismissed the case on summary judgment, finding that there could not be a "per se" violation of the antitrust laws. In light of Broadcast Music, Inc. v. Columbia Broadcasting System, Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co., and other similar cases, the prima facie right of owners of a venture to set prices seems indisputable. This would be the case even if the price-setting system were irrational. On appeal, a divided Ninth Circuit panel reversed that decision and remanded the case for trial. The majority decision focused heavily on the lack of rationality for the price restraint as well as evidence that the partners

34 Alexi Barrionuevo, Secret Formulas Set the Price for Gasoline, WALL ST. J., Mar. 20, 2000, at B1. Price differences for the same brand of gas are substantial even within a single community. Id.

35 See Dagher, 369 F.3d. at 1113.

36 Schulman Email, supra note 13.


implemented the restraint only after getting clearance to create the venture.\textsuperscript{39} At the same time, there was also some evidence that they had intended, from the outset, to impose uniform prices on the two brands, but they had concealed this from the FTC. These facts, if proven, would lead the majority to believe that the restraint on price might be a limit without any legitimate business justification. Once again the weakness in the opinion is the lack of a positive theory to explain how or why the elimination of price differences was more than rational profit-maximizing by the owners of two brands.

There was consternation and outrage in the business community over the Court of Appeals’ decision. This was evident by the number of amicus briefs filed in connection with the Supreme Court review.\textsuperscript{40} The obvious and legitimate concern was that whenever the owners of a joint venture agreed upon any command relating to the competitive conduct of the venture, they could be sued under the antitrust laws and were at risk of having a court declare their conduct illegal “per se” or based on a “quick look” regardless of the prima facie legitimacy of such actions. On the other hand, a cynic might wonder why, if usually legitimate business reasons exist for managing aspects of the competitive conduct of joint ventures, the business world was so intent on establishing an absolute right of the owners to control the venture regardless of the economic analysis of the merits of that conduct.

The brief opinion by Justice Thomas recognizes that the owners of a joint venture necessarily must command its actions in the market. This kind of restraint is internal to the venture (at its “core”) and an essential component of any joint ownership of productive assets.\textsuperscript{41} In an interesting aside, Justice Thomas distinguishes “ancillary” restraints as those that affect third parties conduct when they deal with a venture.\textsuperscript{42} This distinction is suggestive that stricter re-

\textsuperscript{39} Dagher, 369 F.3d at 1122-25.


\textsuperscript{41} Dagher, 547 U.S. at 4.

\textsuperscript{42} Id. at 3-4. For example, if the owners agreed on how they would compete in related markets, as Shell and Texaco did, such an agreement would be ancillary in Justice Thomas’s terms. Similarly, if the venture imposed a restraint on the resale of its product such as minimum price, that too could be ancillary. However, historically it would be viewed with great concern. See Dr. Miles v. John D. Park & Sons, 220 U.S. 373 (1911); see also Leegin Creative Leather Prod. v. PSKS, 127 S.Ct. 763 (2006) (granting certiorari to review the per se rule of Dr. Miles, 220 U.S.
view is appropriate when the restraint involves such external controls. Conversely, when the restraint is internal to the transaction or venture, it is subject to a strong presumption of validity.

The Court's opinion, in fact, suggests at one point that such internal restraints are both inherently ancillary and "valid."\(^{43}\) Such an approach would negate any challenge to such a restraint even if it was excessive in terms of the legitimate interest of the parties.\(^{44}\) However, at other points the opinion reflects the general modern rule stemming from *United States v. Addyston Pipe & Steel Co.* that all restraints are subject to a "rule of reason".\(^{45}\) The harder question is what does that "rule" mean in context. The only clue from the *Dagher* opinion is that when the restraint involves a "core" attribute of a venture, the fact that it is an irrational limit in terms of business logic is not sufficient to turn it into a violation.

A prior Supreme Court decision, *Northwest Wholesale Stationers*, provides guidance on this question.\(^{46}\) There too, the restraint (a membership rule) was part of the "core" of the venture. Without such rules, a venture lacks definition. In rejecting a similar kind of mechanical "per se" claim based on exclusion from membership, the Court pointed out two routes by which the plaintiff could establish that the action was unreasonable.

The first option would be for the plaintiff to establish that the defendants had significant market power in the markets affected by the restraint (their exclusion from access to the benefits of the joint venture).\(^{47}\) The implication of such proof is that it would then be relevant to the public interest in competition for a court to review the specific reasonableness of the exclusion. If there were no market power implication, then the premise would be that the market processes would eliminate any unreasonable restraint imbedded in a joint venture. However, if the venture had market power, then it would be important to review those core components to ensure that they did not unnecessarily hamper competition in that, or related, markets. The

\(^{43}\) Id.

\(^{44}\) Such an approach would return antitrust law to the standard set forth in *United States v. Trans-Missouri Freight Ass'n*, 166 U.S. 290 (1897) and *United States v. Joint Traffic Ass'n*, 171 U.S. 505 (1898), where the Court distinguished between "direct" (i.e., naked restraints) and "indirect" ones (i.e., ancillary restraints) and held that only direct restraints could violate antitrust law.

\(^{45}\) *Addyston Pipe & Steel Co. v. United States*, 85 F. 271 (6th Cir. 1898) aff'd 175 U.S. 211 (1899).

\(^{46}\) *Nw Wholesale Stationers*, 472 U.S. at 284.

\(^{47}\) Id. at 296.
recent successful litigation over credit card membership rules provides a clear illustration of the context in which such antitrust review is essential.\(^{48}\)

The second option, from *Northwest Wholesale Stationers*, is for the plaintiff to undertake to prove that the restraint is "pretextual," despite its apparent linkage to the core of the venture.\(^{49}\) The plaintiff would have to undertake to prove that the restraint was, in function only, a naked restraint on competition. This is a return to the *United States v. Trans-Missouri Freight Association* and *United States v. Joint Traffic* approaches of Justice Peckham.\(^{50}\) The obvious rationale for such an approach is that if the only function of the restraint is to eliminate competition or exploit consumers or suppliers, then such conduct is inherently harmful to the competitive process. While this option ends with a "per se" conclusion, it must start with the statement of a theory of how the conduct at issue is only a naked restraint of competition and refute any alternative explanation tendered by the defendants. Thus, the plaintiffs, relying on this approach, must do more than demonstrate that the restraint lacks a positive business justification. The plaintiffs must also show that the conduct is consistent with one or more theories that support the conclusion that the function of the restraint was only to harm competition. In some contexts, this may be an impossible burden to meet. However, it is not irrational to impose such a burden where the restraint is a prima facie core element of the collective enterprise.

**IV. Dagher Facts Revisited**

The question left unexplored in the lower courts and the Supreme Court is why Shell and Texaco would have followed the pricing strategy that they did. It is not a prima facie rational economic strategy. While it is plausible that identical prices might be a profit-maximizing strategy in some markets, there is no reason to think that it would be in all markets. Nor is it logical to constrain the executives charged with setting local prices by requiring in all markets that prices be same.

Professor Steven Ross has suggested that such a price strategy might be a consequence of the inefficiencies inherent in a joint venture.\(^{51}\) The Ross speculation still does not explain what the two com-


\(^{49}\) *Nw. Wholesale Stationers*, 472 U.S. at 296-98.

\(^{50}\) See *Trans-Missouri* 166 U.S. at 290; *Joint Traffic*, 171 U.S. at 505.

\(^{51}\) See Brief of Amicus Curiae American Antitrust Institute in Support of Re-
panies were seeking to achieve by eliminating the pricing difference between the two brands. This is particularly curious because, as independent enterprises, they clearly had decided that different prices were the best marketing strategy. Since neither Texaco nor Shell exited the market, and the joint venture only involved the downstream refining and distribution of the two brands while retaining the unique characteristics of each, there is no obvious reason to believe that there was some significant change in the market context that warranted a new strategy for pricing.

Three anti-competitive hypotheses exist that might explain why the price restraint was imposed. Because the plaintiffs did not attempt to hypothesize why the restraints existed and contented themselves with proving that the needs of the joint venture did not warrant any kind of price control, these hypotheses necessarily remain hypothetical. However, there is some evidence (both within the overall record of the case and external to it) that at least permits some testing of the plausibility of each of these theories.

A. A Unilateral Effects Theory

One possible theory is that Shell and Texaco are closely substitutable brands—more so than other brands. Hence, once the two were jointly marketed, it made sense to eliminate the price differential. The effect of this action was to raise the price of gasoline to Texaco buyers, and to remove the differential from selecting Shell. Those customers who had previously favored Texaco to Shell, only because of the price differences, would now be indifferent between the two brands or even switch brands. If the bulk of Texaco buyers were only willing to consider the two brands, then while there would be some switching from Texaco to Shell there would be little overall attrition. On this assumption about substitution, it would also now be possible to raise both the Shell and Texaco brand prices substantially above their prior levels.52 Those customers who had stayed with

52 See Dagher, 369 F.3d at 1113 (evidencing that prices for both brands were increased despite lower costs).
Texaco would still have no alternative given the assumption they only would switch to Shell. Moreover, the Shell customers who similarly might switch to Texaco would likewise have no incentive to change. Thus, assuming these two brands were unique substitutes, common control would encourage price uniformity and escalation to exploit the willingness of these customers to remain loyal to these two brands. Indeed, because there would be little loss to other brands, the total sales of the two brands in combination would change significantly.

This is a unilateral effects theory and would suggest that the FTC analysis of the joint venture missed a major competitive harm. It would also imply that the two brands in combination had substantial market power. Hence, the coordination of prices between the two brands would allow the joint venture to exploit consumers in ways that neither brand could if standing alone. Such an analysis of the conduct would also arguably satisfy the first option from Northwest Stationers so that further judicial review of the reasonableness of the restraint on pricing discretion would be warranted.

However, this theory has holes in it. First, there is little evidence that there is much brand loyalty in gasoline sales. In general, lost sales would be likely to flow to a number of different brands based on the location and price of the alternative stations. Second, there is no reason to believe that Shell and Texaco were particularly close substitutes. In fact, the record suggests that the two brands appealed to different types of customers. Texaco’s clientele was more blue collar or rural while Shell’s clientele was more upscale and urban. Third, the extra-record evidence suggests that prices of all substantial competitors moved up in relative harmony. This would suggest that the price increases were a result of some kind of coordinated price movement.

B. A Regional Cartel Signaling Theory

The central apparent consequence of the change in pricing

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53 The GAO Report, supra note 2 (reporting that following consolidation refiners sold less gas to generics thus reducing the pressure on branded gasoline to compete on price).

54 Id. The report found that the generic gas was a significant factor in controlling the prices of branded gas. This demonstrates that consumers were and are willing to substitute in ways that are inconsistent with the unilateral effects theory. Id.

55 Dagher, 369 F.3d at 1112.

56 See Schulman Email, supra note 13.
was that Texaco's brand ceased to be the low priced, national brand. Instead, its price came into conformity with that of other brands of gasoline. Moreover, in a number of regional markets this price coordination between Shell and Texaco represented a substantial share of local market sales. Finally, after the change in pricing, prices generally rose rapidly in these markets despite dropping crude oil prices and purported increased efficiency in refining and distribution arising from the joint venture.

The data thus presented is consistent with a signaling to regional competitors of a new willingness on the part of the joint venture partners to engage in tacit collusion. The central premise would be that prior to this signal, other major retailers were concerned that customers would switch to the marginally less costly Texaco brand if prices increased substantially. This held in check the willingness to engage in coordinated price increases. By eliminating that price differential the venturers signaled their interest in engaging in a more active tacit collusion over prices. Given the signal, regional managers could then coordinate prices relatively easily by watching the prices of competitors.

The hypothesis is that the change to price uniformity across the entire region was a clear signal to other gasoline retailers that the Texaco-Shell joint venture would not engage in opportunistic pricing by holding down the Texaco brand when others raised their prices. In effect, the joint venture was giving a guarantee that it would not use its strategic capacity to engage in price differentiation. This, in turn, would encourage competitors to rely on the commitment of the joint venture managers to maintain prices. In addition, any price competition would require that the prices on both brands be cut equally. To the extent that the two brands were sold to somewhat differentiated customers and the stations were concentrated in different parts of the market area, this price uniformity would also tie together larger areas. It would also ensure that price coordination would be more pervasive if successful and that any price war would reach a broader area, thus increasing the cost of price competition.

Viewed from this perspective, the price uniformity would signal both an increased willingness to engage in tacit price collusion and create capacity to retaliate if other retailers sought to use different prices in parts of the regional market. Such a theory would satisfy the "pretextual" option from Northwest Wholesale Stationers

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57 See Dagher, 369 F.3d at 1111 (the combined firm held at least 25 percent of all gasoline sales in the western half of the United States).

58 See id. (the areas and customers served by the two brands were quite different).
since it involves a demonstration that the change in policy is explicable only because it was undertaken to facilitate tacit or express collusion with the other major gas retailers.

The weakness of this theory is the lack of support in the record. To be convincing, one would want data on actual price changes in gasoline in the regional markets in the period after the elimination of the price differential. Was the change in policy clearly communicated to the market? In particular, was the fact that prices would be uniform made evident? This fact is pivotal to the theory advanced here. Unless the joint venture communicated the new constraint on its managers' pricing discretion, competitors would not have had as clear a basis to predict how the venture would respond to price increases or decreases. In his recent study of the oil and gas industry, Brock describes the "clubby" nature of the industry.\textsuperscript{59} The fact that the same companies are involved in a variety of joint enterprises and frequently swap gasoline may suggest that there would have been informal ways to communicate the new policy as well as signal new pricing strategies. Alas, the plaintiffs' counsel did not undertake to put whatever evidence they had on these issues into the record on appeal.

C. Global Cartel Signaling Theory

A second theory of cartelistic conduct focuses on the global markets in which both of the parents continued to participate. In some of those markets, they are dominant firms and impose supra-competitive prices. However, in those same markets, there are outlets for other global competitors who can disrupt such exploitation by discounting prices. The result is a global system of mutual forbearance in which each major competitor has the capacity to disrupt other competitors' dominant markets.\textsuperscript{60} The price of peace is that no one will engage in price cutting in order to obtain market share in the low volume markets.

Against this background and accepting the joint venture's claim that it would achieve substantial economies in the refining and distribution of gasoline, there is a potentially serious risk of disrupting the global compact if the venture used its efficiency to drive down prices in the west and capture greater market share. The decision to eliminate pricing discretion can then be hypothesized to re-

\textsuperscript{59} Brock, supra note 2.

\textsuperscript{60} There is long history to such mutual forbearance. \textit{Anthony Sampson, The Seven Sisters: The Great Oil Companies and the World They Shaped} (Viking Adult 1975); \textit{John Blair, The Control of Oil} (Vintage Books 1978).
flect a signal to the other major competitors that the venture would not engage in any kind of strategic high-low pricing between its two brands in ways that might shift market share to the venture. Instead, the venture would content itself with increasing retail prices thereby increasing its profits within its regional market, but not disrupting the overall understanding that governed global competition.

This theory is not inconsistent with the known facts. Texaco and Shell continued to face the same small group of major competitors in markets around the world. A price war in any region could stimulate responses in other markets where the aggressor would least like to face competition. Once again, the elimination of the price differential between the two brands would be a signal to the other major players that the joint venture was not going to engage in vigorous price competition. Indeed, the fact that the same policy covered the Eastern United States as well further supports the theory that this was a signal to global competitors.\(^{61}\)

This theory, however, does not account for the price increase of gasoline in the markets where the Texaco-Shell venture had a leading market share. As such, it is less plausible as an explanation for that specific set of events. Still, it is a somewhat more plausible explanation for the complete elimination of price differences. That is an easier signal for global competitors to receive. The fundamental problem with this theory, like the regional cartel signaling theory, is that the plaintiffs made no effort to develop the information that would support such an explanation for the conduct of Texaco and Shell. Admittedly, the factual support for this theory is less easily identifiable. However, armed with a testable theory, it becomes possible to look for specific exchanges of information among the major firms, for past similar events, and for any other confirmation that the historical interdependence of the industry continued.

Like the prior conspiracy theory, this theory can satisfy the “pretext” option because it too would rest on the proposition that the only reason for the restraint on pricing freedom was to signal other global competitors that the new venture was not going to disrupt the on-going oligopoly’s tacit collusion.

Finally, the two collusion theories are not inconsistent with each other. One might postulate that the joint venture had two possible strategies that it could pursue. One was to lower prices relative to its competitors (given its enhanced efficiency) and to seek larger market shares for its two brands with a resulting increase in profits based on higher sales volume. The second option was to facilitate local, tacit collusion and gain higher per sale profits despite some re-

\(^{61}\)Dagher, 369 F.3d at 1111-13.
duction in total sales. The second option would also reduce or elimi-
nate the risk of a global or multi-regional price war that might result
from the venture being more aggressive in its pricing in the United
States. Thus, the owners, as rational business decision makers, hav-
ing an eye on the long-term best interests of their overall enterprises,
might well have opted for the tacit collusion strategy even if its short
term profit prospects were somewhat less than aggressive price com-
petition. This would have made sense because, in the long run, that
strategy reduced the overall risk of competition breaking out in any
number of markets.

V. The Flawed FTC Analysis—Unilateral or Collusive
Market Power

Given the apparent pricing patterns engaged in by the venture, it
seems that FTC approval was misguided. Even if there would be
some efficiency gain unique to the venture, a claim that would not be
readily testable at the proposal stage, the increased regional market
power ought to have lead to a rejection of the venture. Basically, the
asserted post-venture price increases in a period of declining cost
mean that either the venture created unilateral market power as postu-
lated in part IV A or it facilitated the creation and use of collusive
market power as postulated in parts IV B or IV C.

The post-creation conduct of the venture calls into question
the motivation of the parties in creating the venture. Retail gasoline
markets are both relatively local and apparently amenable to various
kinds of price manipulation. The approach of the FTC appears
flawed because it sought to remedy what it perceived to be specific
risks in specific markets. This overlooked the overall capacity of
these firms to compete with each other and, equally or more impor-
tant, constitute potential competitive threats to each other in all mar-
kets in which they were not presently marketing gas.

62 This is an application of the "prisoners' dilemma" used in game theory. The
best long-run strategy is cooperation because competition invites retaliation and
that results in reduced income for the parties. Peter Carstensen, While Antitrust
Was Out to Lunch: Lessons from the 1980s for the Next Century of Enforcement,
of Cooperation (Basic Books 1984) that demonstrates that cooperation, tacit collu-
sion in antitrust terms, is the optimal long run solution of the prisoners' dilemma).

63 The GAO Report, supra note 2. The GAO report is critical of the FTC's
merger enforcement record because of the evidence of adverse effects on consum-
ers as a result of the increased concentration that the agency permitted. Id.

64 See Barrionuevo, supra note 34, at B1.
Assuming the accuracy of the post-venture price data showing increased prices for the two brands despite lower input costs and improved efficiency, the FTC’s investigation did not recognize how the parties could exploit their combination to create adverse effects on consumers. Moreover, it seems that the harm to consumers exceeded the efficiency gains to the parties, again assuming there were actual gains that were also specific to this venture.

From the standpoint of merger enforcement, the implication of these facts is that the agencies should not try to “slice and dice” the assets. It is too likely that the result will be that the agency does not get it right. Indeed, in a major post-settlement study, the FTC found that a significant number of its partial divestiture settlements had not been successful.\(^5\)

The basic message is that when the market is concentrated, the answer to proposed combinations, whether as mergers or joint ventures, is to just say no. The agencies are not sophisticated enough or knowledgeable enough to figure out how the merger will harm competition. Moreover, if there are real and significant efficiencies, it is very likely that one or both parties can figure out how to achieve those without the detriment of increased concentration.

VI. The Concealed Point of \textit{Dagher}

The underlying facts of \textit{Dagher} make it abundantly clear that market structure matters and is a central issue in antitrust claims. When concentration increases, the incentives to exploit latent opportunities increase along with the capacity to do so. The result is a “bigger is better” mentality in corporate boardrooms. However, the issue for victims of the combination is what can be done to ameliorate the harms. While it is possible for both private parties and the affected states to challenge consummated mergers, this is an unlikely route.

Damage litigation is the ultimate source of hope both to deter future conduct and to compensate the victims of exploitation. It is also remunerative to the lawyers who represent such plaintiffs, provided they can collect their reasonable attorneys’ fees. The challenge for those who would represent plaintiffs is how to present such cases so that they do not sink into an interminable and probably unwinnable open-ended “rule of reason” argument. In order to avoid unbearable costs and delays, plaintiffs’ lawyers must think along the

lines of the evolution of the law and not just in conventional doctrinal categories.

The strength of the plaintiffs’ case in Dagher was the recognition that the starting point of an attack is to show that the restraint at issue lacks a non-exploitative business justification. The weakness was that having established that analysis, there was no follow up to show that the conduct was logically and empirically consistent with an explicitly anticompetitive hypothesis.

Consumer welfare is a central concern in antitrust rhetoric. Therefore, it is essential for plaintiffs to go beyond a claim that there is no legitimate justification for specific conduct and show how it can affirmatively harm consumers. Such a claim extends the exposure of a plaintiff. There must be support not only for the lack of justification for the conduct, but also for the affirmative theory of how this conduct harms consumers. It is deeply regrettable that the Dagher lawyers did not do more to articulate and demonstrate the creditable claims they had concerning the harm to consumers directly resulting from the Texaco-Shell agreement to eliminate price differentials.

A different critique applies to the Court. It has, in other decisions, expressed a positive enthusiasm for monopoly. The Court believes that monopoly profits are the reward for innovative efforts by firms on the frontier of new technology. Only a very effective presentation of the underlying business facts and their economic analysis can possibly overcome the Court’s prejudice in favor of incumbents, even monopolistic ones.

Thus, the “point” of Dagher is that those who would challenge anticompetitive conduct by dominant firms or joint ventures need to develop an analysis that focuses on harms to consumers and the competitive process that has or will result from the conduct at issue (regardless of the doctrinal category in which they propose to locate their case). In some situations, this is going to be a serious challenge to plaintiffs. However, the plaintiff and its lawyer should address that issue at the outset and not rely on some legal characterization of the conduct.

The Dagher facts highlight the need for better conceptualization of claims. The plaintiff focused on the fact that two former competitors, Shell and Texaco, agreed to eliminate competition between them and then agreed to fix the price at which their products

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67 Id. at 407. Some cynics noted that Justice Scalia’s praise of monopoly was lavished on a case involving the monopolist heir to the AT&T monopoly that had used its inherited monopoly power to exclude innovative competition. See, e.g., United States v. AT&T, 524 F. Supp. 1336 (D.D.C. 1981).
were sold to the public. Price fixing among competitors is "per se illegal,"68 except when it is not.69 It is insufficient to show that a particular piece of conduct lacks apparent economic rationality when that conduct is within the core of what partners and joint venturers may well do, even if it is irrational.70 It is vital to present the positive case showing how this particular conduct fits with an anticompetitive scheme that harms competitors.

The frustration that some have with Dagher, is not in the sensible result of the Court on its statement of the facts. Rather, the problem lies in an awareness of what could have been said to show that the conduct in question only made sense if it had an anticompetitive goal. To be sure, the Court is now generally opposed to antitrust law.71 However, it remains possible that the majority's opposition stems in substantial part from the failure of those supporting more active antitrust enforcement to make the case on the merits of those claims. Stare decisis is a concept that courts all too often honor in theory rather than practice.

VII. Conclusion

The Dagher case may ultimately be a mere footnote in the data set of antitrust decisions of the Supreme Court. Nevertheless, it illustrates a couple of important issues. First, in some industries such as oil and gas, consolidation may impose significant costs on consumers even when, presumably, the standard indicia of likelihood of harm are limited. This suggests that in authorizing mergers and joint ventures both federal and state antitrust agencies should exercise greater veto power than they have in the past. Second, when private parties suffer harm as a direct result of the failure to retain a worka-

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69 Broad. Music, 441 U.S. at 9 ("Literalness is overly simplistic and often overly broad.")

70 To paraphrase Justice Scalia: Conduct can be both economic folly and lawful. CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 96-97 (1987) (Scalia, J concurring).

bly competitive market, their lawyers need to present a theory of how the merger or venture harmed competition. Proving the negative (it had no legitimate justification) is not sufficient. In today's world, the plaintiff has a much better chance to succeed when it shows how the arrangement or combination has or will harm consumers. Unfortunately, this is not always easy. However, it behooves those who would challenge anticompetitive conduct to do their homework before litigation and not leave it to the law journals to suggest what might have been.