Joint Venture Alliances - Competition Issues

Joint venture alliances between rival corporations often make sense commercially. An obvious benefit is that they allow the joint venture partners to share the benefits of enhanced production efficiencies without having to go as far as a full blown merger. However, aspects of such alliances can be unlawful. If they breach the *Trade Practices Act* ("TPA"), the companies involved - and their directors, managers and possibly advisers - can face fines of up to $10 million and $500,000 respectively.

Despite this risk, many major corporations are currently considering joint venture alliances as a means of gaining a competitive edge. Those which are need to ensure that their sophisticated structures and arrangements do not blind them to the underlying legal problems which can arise.

A recent reminder

A reminder of these problems surfaced in late April when the Australian Competition and Consumer Commission ("ACCC") began legal action against two suppliers of industrial compressors for allegedly engaging in market sharing and price fixing. While this case does not involve any apparent complexities in terms of business structures, the laws being invoked by the ACCC are relevant to companies which consider that a joint venture alliance may be commercially appealing.

In this particular case, the ACCC has alleged that the two wholesale suppliers of compressors to engineering and power tool distributors, major retailers, automotive dealers and industrial firms, divided up the market for particular models. Specifically, the ACCC alleges that an agreement between the suppliers that they each would focus on different customer groups and different territories constituted a primary boycott. It is also alleged that each supplier had agreed to follow common guidelines in relation to pricing and discount.

At one point, an employee of one of the suppliers allegedly expressed concern about the legality of these arrangements but was told by one of his directors *not to worry about it.* Stories of this kind were last splashed across the daily newspapers when the ACCC took the transport giants Mayne Nickless and TNT to court in the mid-1990s.

In some ways, market sharing and price fixing are cultural issues for companies that have not woken up to the fact that law enforcement in Australia is much tougher than it used to be and that cozy deals with competitors are no longer tolerated. While such activities may have strong commercial appeal, they can be unlawful and more visible than many assume. Companies which discount their chances of getting caught because they are utilising more sophisticated structures should also think again.

Consider this

The following hypothetical example is instructive. It involves a joint venture alliance between two mythical toy manufacturers which combine their manufacturing operations so that they can reap improved economies of scale and other cost savings. At the wholesale level, the two companies remain independent even though each has an equity interest in the joint venture vehicle. Once things are up and running, the companies achieve their cost savings while retaining their competitive independence within a loose alliance.

Consider next an agreement between these toy wholesale competitors to buy all their supplies from the joint venture manufacturer, and at a price which is the same for each of them depending on volumes purchased. They also agree that it would be more profitable for their joint venture business - and entirely consistent with their alliance arrangements - that neither will sell directly into the other's territory. There is, therefore, an informal understanding that one restricts itself to servicing the markets on the eastern seaboard, while the other focuses on the southern and western States.

Lastly, these two businesses agree that in order to ensure an equitable division of profits based on sales, the wholesale prices they charge to retailers will not go below a certain amount on particular items. Knowing that price fixing is unlawful, they resist the temptation to be any more prescriptive than to establish a *benchmark* price that each is free to follow or, in theory at least, disregard. Where the services of independent toy distributors are used, the two companies will exchange commission information to avoid allegations that they are discriminating against certain distributors. Accordingly, each distributor will now get roughly the same commission for units sold.

Without going into the details of the laws against price fixing and primary boycotts, it should be clear that where competitors stop short of a full merger, which may in itself need ACCC approval at some point, any alliance between them that involves agreements to cooperate in a joint or common endeavour will raise potentially serious trade practices risks.

The legal risk

In the above example, the agreements between the two competitors to use a common supplier exclusively, to not encroach on each other's territories, and to not allow discrimination between themselves as to the price of supplies set by the joint venture vehicle or between prices charged to different retailers or commissions paid to distributors, constitute potentially devastating breaches of the TPA. If the ACCC received a complaint from a competitor who was unhappy with the success of this alliance - or from any other source including its own market intelligence - the maximum penalties mentioned earlier could be imposed for each breach of the law that the alliance partners committed.

Private actions by competitors or other interests are also a possibility, although only compensatory orders (not penalties) can be sought by these groups.

Guiding principles

However, joint venture arrangements can be structured to avoid most of these kinds of pitfalls. The guiding principles for corporations and their legal advisers include carefully checking the likely competitive effect - not just the purpose - of the proposed arrangements (i.e. might they lead inadvertently to cooperative or non-rivalrous behaviour between the parties on pricing, purchasing and selling decisions?); resisting the temptation to just change *the documentation* of the arrangements while ignoring the substance of those agreements or the (nod and a wink) understandings that augment them; considering whether any of the technical exemptions from the law that are found in the TPA may be of benefit; and lastly, considering whether the ACCC should be invited to give the arrangement its informal *blessing* so as to reduce to a minimum the likelihood of subsequent enforcement action.

Difficulties no excuse

It is relatively easy for companies to overlook the competition law issues that can arise in these types of complex alliances. Specialist legal practitioners are often the only ones who can look beyond the written agreements and detect the tell-tale signs that fundamental problems may exist. However, such difficulties are no excuse. If the ACCC is content to take action against small businesses whose relatively simple plans may involve unlawful conduct, it will regard knocking down the more elaborate but equally unlawful conduct of our leading entrepreneurs at the big end of town a prize worth chasing.

- Clayton Utz' Competition Law Issues.