An Economic Perspective on Single Entity Law after American Needle

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- I. Summary of Economics
- II. Copperweld's Description of a "Single Economic Entity"
- III. Applying the Principles of *Copperweld* to Joint Ventures



I. Summary of Economics

- Modern economic analysis of the firm can be said to begin in 1937 with Ronald Coase's landmark article on *The Nature of* the Firm.
 - According to Coase, the economic advantage of organizing production within a firm is the cost savings of not having to transact in the marketplace, which he identifies with the avoidance of negotiation and contracting costs.
 - Transactors deciding whether to move production within a single firm compare these contract cost savings with the increased administration costs of "directing" resources within the firm.



- A large theoretical and empirical literature has subsequently developed that attempts to more systematically answer Coase's fundamental question by focusing on a broader set of transactor performance problems that are avoided when production is moved within a single firm.
- These economic theories of the firm may be categorized in two main ways in which integrating production within a single firm solves transactor performance problems.*

^{*} The economics literature is summarized in Benjamin Klein & Andres V. Lerner *The Firm in Economics and Antitrust Law*, Issues in Competition Law and Policy, Vol. 1, pp. 249-71 (ABA Section of Antitrust Law, 2008).



 One set of theories emphasizes the allocation of residual profit rights to the firm owner.

This provides the owner with an increased economic incentive to more closely monitor performance and to make investments.

 A second set of theories emphasizes the allocation of residual control rights to the firm owner.

This provides the owner with the increased ability to mitigate performance problems by directly controlling performance.



- Transactors should be thought of as choosing among different ways in which to organize production by trading-off the relative economic advantages and disadvantages along these two dimensions – control and incentives.
 - The example of General Motors and Fisher Body: Integrating body production within General Motors provided increased GM control at the cost of decreased Fisher Body incentives.
 - The primary economic advantage associated with organizing production within a single firm that is suggested by economic theory is the degree to which ownership provides increased control, not access to a residual profit stream.



II. Copperweld's Description of "Single Economic Entity"

The economic view of the firm in terms of control is fully consistent with the legal principles formulated in *Copperweld*, where the Supreme Court held that a wholly owned subsidiary was incapable of conspiring with its parent even though the parent and its subsidiaries were separate legal entities.



 In particular, the Supreme Court explained that a parent and its wholly owned subsidiary:

are not unlike a multiple team of horses drawing a vehicle under the control of a single driver. With or without a formal "agreement," the subsidiary acts for the benefit of the parent, its sole shareholder. If a parent and a wholly owned subsidiary do "agree" to a course of action, there is no sudden joining of economic resources that had previously served different interests, and there is no justification for §1 scrutiny.



The *Copperweld* Court also describes this situation as one where the parent and subsidiary have "a complete unity of interests."

A parent and a wholly owned subsidiary have a complete unity of interests. Their objectives are common, not disparate; general corporate actions are guided or determined not by two separate corporate consciousness, but one.

 However, the Court's statement is followed immediately by the analogy to a single driver controlling a team of horses, making clear that what "a complete unity of interests" means is ultimate control.



The Court explains that a parent and a subsidiary

share a common purpose whether or not the parent keeps a tight rein over the subsidiary; [because] the parent may assert full control at any moment if the subsidiary fails to act in the parent's best interests.

 And when the Court considers whether the parent has control over day-to-day operations of the subsidiary, it states that such control

> simply describe[s] the manner in which the parent chooses to structure a subunit of itself. They cannot overcome the basic fact that the ultimate interests of the subsidiary and the parent are identical, so the parent and the subsidiary must be viewed as a single economic unit.



Focusing on a parent's ultimate control of its subsidiary, rather than "a complete unity of interests", makes fundamental economic sense.

 For example, consider the Chevrolet and Buick divisions of General Motors. There is not "a complete unity of interests" between the divisions, but ownership provides General Motors with ultimate control over their decisions.



III. Applying Copperweld Principles to Joint Ventures

- Joint ventures can be thought of as partial mergers.
- In contrast to full mergers that result in wholly-owned subsidiaries controlled by a single parent company, joint ventures are partial integrations, where the owners of independent firms agree to delegate control rights over particular functions to a jointly owned entity.
- Depending on how this integration occurs, the question of whether the joint venture is considered a single entity should be analyzed on a function-by-function basis.



We must distinguish between the competitive analysis of two separate actions:

- 1. Formation of the joint venture
- 2. Ongoing conduct by the joint venture



- The analysis of the first action involves a determination of whether formation of the joint venture is competitive, and also whether a single entity has been established over the delegated functions.
- The answer provided to the single entity question then determines the antitrust standard used in evaluating the ongoing conduct by the joint venture.



• The potential economic advantage of the single entity doctrine is that, rather than leaving all conduct in these cases as concerted actions to be evaluated under Section 1 by rule of reason, transactors have the predictability of knowing that some "routine internal business decisions" will not be second guessed by plaintiffs and the court.



Criteria that are discussed by the Court in *American Needle* in answering the single entity question in connection with joint venture formation

- 1. Is the joint venture an economically efficient way to organize the designated activities?
 - Although relevant for determining whether a joint venture is competitive, *American Needle* notes that the justification for cooperation is not relevant in determining for whether cooperation is concerted or independent action.



- 2. Does the formation of the joint venture "deprive the marketplace of the independent centers of decisionmaking that competition assumes and demands"?
 - However, even full mergers that clearly create single entities eliminate independent decisionmakers.
 - For example, the claimed "agreement" at issue in Copperweld
 was between the parent Copperweld Corp. and its wholly-owned
 division, Regal Tube Co., which Copperweld had earlier
 purchased from Lear Singer.



• The Court in Copperweld when discussing a reduction in independent decisionmakers uses the term "sudden", indicating that the Court is describing the plaintiff's claimed "agreement" between Copperweld and its subsidiary after the merger, at a point in time when independent decisionmakers have already been eliminated.

If a parent and a wholly owned subsidiary do "agree" to a course of action, there is no sudden joining of economic resources that had previously served different interests, and there is no justification for §1 scrutiny.



The elimination of independent decisionmakers is important for judging the potential anticompetitive impact of a joint venture. But given the absence of any likely anticompetitive effects, the elimination of independent decisionmakers implies that it is more likely the joint venture is a single entity.

- The ability of individual copyright holders to opt out in BMI means it is less likely BMI represents a single entity.
- Joint venture exclusivity with respect to relevant functions in Equilon and NFLP means it is more likely they represent single entities.



- 3. Is the specified function covered by the joint venture "fully integrated" into the joint venture?
 - The Equilon joint venture integrated all Texaco and Shell refining and marketing assets in the Western U.S.
 - Problem of limited duration of the joint venture.



- 4. Is there a unity of interests of the joint venture members?
 - Requiring "a complete unity of economic interests" by the individual joint venture partners as a criterion for single entity does not make economic sense.
 - Because the joint venture is a partial merger, it is highly unlikely that the financial interests of the parties will fully coincide. The members remain as separate entities that compete in other dimensions.



- The joint venture members will vote their individual interests, not necessarily the interests of the joint venture. But that is no different from a normal firm that is not controlled by a single large shareholder.
- If the joint venture operates competitively for the sole joint benefit of its members, it may be considered a single entity.



IV. Conclusion

Rather than trying to clarify these economic principles, *American Needle* substantially narrows the *Copperweld* single entity defense.

