General Counsel Corner

By Peter H. Gunst, Esquire

Shell-Texaco Joint Venture Meets the Ninth Circuit

When Shell and Texaco decided to pool their refining and marketing efforts in the western United States by forming their Equilon joint venture, they most likely underestimated the legal challenges that they would face. Now, for the second time, the Ninth Circuit Court of Appeals has agreed with dealers who attacked the union.

First came *Abrahim & Sons Enterprises v. Equilon Enterprises, L.L.C.*, 292 F.3d 958 (9th Cir. 2002), where the federal appellate court reversed the trial court's dismissal of dealer claims that the Equilon defendants had violated a California state statute, Business and Professions Code § 20999.25(a), by transferring the Shell and Texaco service station assets to Equilon without making a *bona fide* offer to transfer the stations instead to its franchise dealers. The argument made by the Equilon defendants that the transfers to Equilon were mere technicalities that somehow fell outside the statute failed to impress the Ninth Circuit Court of Appeals.

On June 1 of this year the Ninth Circuit delivered a second blow to the Equilon defendants in *Dagher v. Saudi Refining, Inc.*, 2004 WL 1191941 (9th Cir. 2004), this time concluding that the joint venture could well constitute an illegal price-fixing conspiracy.

In *Dagher*, plaintiffs representing a class of 23,000 Texaco and Shell dealers advanced a legal theory of breathtaking simplicity. They argued that, because Equilon continued to market under the supposedly independent Texaco and Shell gasoline brands, and because there was no need for Shell and Texaco to abdicate to Equilon the authority to set prices charged for gasoline to the dealers, the Equilon joint venture constituted a *per se* illegal price fixing agreement between what had until then been two independent competitors, Shell and Texaco.

If an agreement constitutes *per se* price fixing among competitors, it is absolutely illegal, no ifs, ands or buts. If its impact were to increase prices to the dealers by, say, three cents per gallon, each dealer would be entitled to triple damages that could amount to nine cents for each gallon purchased.

The *Dagher* case followed the same course as had the *Abrahim* case. The trial court rejected the dealers' theory of liability and entered summary judgment in favor of the Equilon defendants. This was followed by an appeal to the Ninth Circuit.

The issue before the Ninth Circuit was how the joint venture and its pricing function should be viewed. The dealers said that even if Shell and Texaco were justified in forming a joint venture, there was no need -- and thus no legal justification -- for permitting Equilon to set uniform prices at competing Shell-branded and Texaco-branded service stations.

Shell and Texaco argued that because the joint venture totally replaced their previous refining and marketing operations, they had exited the market to be replaced by a single entity -- Equilon. That single entity, they argued, was incapable of conspiring with itself when it determined what prices to charge to the Shell and Texaco branded stations that had previously been supplied by Shell and Texaco.

On June 1, the Ninth Circuit released a 2-to-1 decision in favor of the dealers. Both the majority and dissenting opinions carefully scrutinized the Equilon joint venture, but came to diametrically opposed conclusions.

In ruling against the Equilon defendants, the majority emphasized that even if the joint venture had some pro-competitive aspects and had not been formed "merely to achieve an ulterior purpose," its price-fixing function could still be illegal if it was not "reasonably necessary to further the legitimate aims of the joint venture."

So far, the court noted, the defendants had "failed to offer any explanation of how their unified pricing of the distinct Texaco and Shell brands of gasoline served to further the venture's legitimate efforts to produce better products or capitalize on efficiencies."

Indeed, the majority said, "the record before us reveals that the alliance never considered unified pricing to be relevant to product improvement or to efficiency gains." Therefore, at least to survive summary judgment, the dealers had made "a sufficient showing as to the applicability of the *per se* rule."

Judge Fernandez, in dissent, strongly argued that the joint venture -- as an independent entity that in fact replaced Shell and Texaco in the marketplace -- should have been given an absolute right to price in any way it chose. He could not understand why the joint venture, "when it acts like a true business -- sets prices for its own goods -- subjects its otherwise insulated members to the severe sting of antitrust liability."

In a responsive footnote, the majority stressed that "contrary to our dissenting colleague's understanding, the pricing decision was not made by a single economic entity." The majority emphasized that "there is at least a triable issue of fact as to whether Texaco and Shell agreed in advance to charge the same price for their two distinct gasoline brands as an initial operating requirement of the alliance," so that the unified pricing scheme was in fact made -- not by a separate joint venture entity -- but by the competitors themselves as a precondition to forming the joint venture.

All of this sounds like legalistic hair-splitting, but it could well have very significant real world effects. *If* the plaintiffs are able to convince a jury that the unified pricing scheme was in fact made by Shell and Texaco and had a significant impact on what the dealers were compelled to pay for gasoline, and *if* their legal argument survives further challenge, the many thousands of impacted Shell and Texaco dealers they represent could realize a very significant recovery.

pgunst@agtlawyers.com

astrachan gunst thomas
attorneys at law
a professional corporation