HOW WE CONVINCED THE CALIFORNIA SUPREME COURT THAT THE CARTWRIGHT ACT DID NOT REGULATE MERGERS

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I. Introduction

In 1984, Texaco Inc. agreed to acquire Getty Oil Company and, thereby, become the second largest petroleum company in the United States.[1] The California Attorney General sought to prevent the merger from occurring and sued under the Cartwright Act[2] and the Unfair Competition Act[3] to enjoin Texaco from acquiring the California assets of Getty pursuant to the merger between the two companies.

We defended Texaco in that case. We won a demurrer in the trial court, which held that the Cartwright Act did not reach a corporate merger "such as this one" and dismissed the complaint. The Court of Appeal affirmed on other grounds, which prompted the California Attorney General to seek review in the California Supreme Court. Two weeks after the petition for review was filed, a five-member majority of the California Supreme Court in an unrelated case appeared to decide the Cartwright Act question, which was pertinent to our case:

> The [Cartwright] Act . . . reaches deep in proscribing anticompetitive conduct: it prohibits two or more persons "[to agree] to pool, combine or directly or indirectly unite any interests that they may have connected with the sale or transportation of any . . . article or commodity, that its price *might in any manner* be affected." (*Bus. & Prof. Code, § 16720, subd. (e)(4)*, italics added.) In so doing, the Act reaches beyond the Sherman Act to threats to competition in their incipiency — much like section 7 of the Clayton Act, which prohibits mergers that "*may* . . . substantially . . . lessen competition, or . . . *tend* to create a monopoly" (*15 U.S.C. § 18*, italics added) — and thereby goes beyond "clear-cut menaces to competition" in order to deal with merely "ephemeral possibilities."[4]

Nevertheless, in our case, a majority of the California Supreme Court held that the Cartwright Act did not apply to the Texaco-Getty merger because "the drafters did not intend the Cartwright Act to regulate the bona fide purchase and sale of one firm by another."[5]

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1 *See State ex rel. Van De Kamp v. Texaco Inc.*, 46 Cal. 3d 1147, 1151 (1988).

2 Cal. Bus. & Prof. Code § 16720 *et seq*.

3 Cal. Bus. & Prof. Code § 17000 *et seq*.

4 *Cianci v. Superior Court*, 40 Cal. 3d 903, 918 (1985) (emphasis in original, citations omitted).

5 *Texaco*, 46 Cal. 3d at 1163.

In this article, we share some of the process that led to this remarkable turnaround by the California Supreme Court and allowed us to prevail in that case.

II. Background Of The *Texaco* Case

The *Texaco* case arose out of Texaco Inc.'s acquisition of Getty Oil Company in 1984. The Federal Trade Commission reviewed the potential anticompetitive aspects of the merger under the procedures of the Hart-Scott-Rodino Act[6] and entered into a consent order that permitted Texaco to complete the merger subject to certain conditions.[7]

California's Attorney General John K. Van de Kamp commented on the proposed FTC order, but the final order, issued on July 10, 1984, reflected only some of those comments.[8] Less than one week later, Attorney General Van de Kamp filed a complaint alleging that the merger violated the standards of Clayton Act § 7 and that the Cartwright Act incorporated those standards in its language prohibiting "a combination of capital . . . by two or more persons . . . to pool . . . any interests that they may have connected with the sale or transportation of any article or commodity, that its price might in any manner be affected."[9]

Texaco successfully demurred because "[i]t [was] not apparent to the Court under any test set forth in the cases cited how this otherwise lawful merger which ha[d] been carefully scrutinized and regulated by the FTC, including its California consequences, [was] unfair."[10] The Court of Appeal affirmed on the ground that the FTC's consent order preempted action under state law.[11]

The California Attorney General successfully petitioned for review in the California Supreme Court. As is clear from the *dictum* in *Cianci*, the Attorney General's core argument – that the Cartwright Act on its face regulated mergers under an incipient restraint standard – would be well received by a majority of the California Supreme Court's Justices. However, the Justices who voted for review were not the Justices who decided the case.

The Cartwright Act argument we made in response to the challenge by the California Attorney General was more complicated than merely arguing the incipient restraint standard. We established that the Cartwright Act's language was taken directly from the statutes of other states — notably Texas and Michigan — and that the courts of those states had construed the language of the statute as *not* applying to the outright acquisition of one business by another.[12]

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6 15 U.S.C. § 18(a) (2004).

7 *In re Texaco Inc. v. Getty Oil Company*, 104 F.T.C. 241 (1984).

8 49 Fed. Reg. 8550 (Mar. 7. 1984).

9 *See* Cal. Bus. & Prof. Code §16720(e)(4). When the case was filed in 1984, divestiture was not available as a remedy under federal law as interpreted by the Ninth Circuit. *See IT&T v. Genl. Tel. & Elecs. Co.*, 518 F.2d 913 (9th Cir. 1975).

10 *Van de Kamp v. Texaco Inc.*, No. 321706 (Sup. Ct. Sacramento), slip op. at 9-10.

11 *Van de Kamp v. Texaco Inc.*, 143 Cal. App. 3d 8 (1985).

12 *See Gates v. Hooper*, 39 S.W. 1079 (Tex. 1897); *A. Booth & Co. v. Davis*, 131 F. 31, 37-38 (6th Cir.), *cert. denied*, 195 U.S. 636 (1904).

We then invoked the principle of statutory construction, which presumes that when California adopts a law from another state, the legislature intends the law to be interpreted in the same manner as other state's law is construed.[13] We also pointed out that several states with statutes similar to the Cartwright Act had enacted separate anti-merger statutes. As for the incipient restraint standard, California had adopted a counterpart to certain sections of the Clayton Act with incipient restraint standards (e.g., California Business and Professions Code section 16727 based upon Clayton Act § 3), but no counterpart of the federal anti-merger statute, Clayton Act § 7. In so arguing, we demonstrated that the California statute was not "patterned" on federal antecedents and was most certainly not an incipiency regulation of the kind introduced into competition regulation by the subsequent Clayton Act.

III. Anticipating The End Of The Rose Bird Court

The Court that decided *Cianci* and granted review in *Texaco* was led by Chief Justice Rose Bird. At the time review was granted in *Texaco*, a campaign had begun to unseat Chief Justice Bird and two Associate Justices, Cruz Reynoso and Joseph Grodin, in the upcoming November 1986 election. If these Justices were voted out, their replacements would be appointed by Republican Governor George Deukmejian, who was expected to appoint pro-business judges to the Court. Because both Bird and Reynoso voted with the majority in *Cianci*, we anticipated that their replacement with more pro-business Justices increased the chances for a favorable result for Texaco.

In order to enhance the possibility of having the case heard by new Justices who would not be bound by the *dictum* in *Cianci*, our strategy was to take an extension of our time to prepare an answering brief on the merits. This strategy gave the voters of California and the pro-business Governor the time to reshuffle the Court and thereby increase our chances of winning.

The case was set for oral argument in mid-November 1986, shortly after the elections. When Bird, Grodin and Reynoso were defeated at the polls, oral argument was cancelled. Governor Deukmejian appointed Justice Malcolm Lucas – who wrote the dissent in *Cianci* – to be Chief Justice and appointed John Arguelles, David Eagleson, and Marcus Kaufman as new Justices to the Supreme Court. The *Texaco* case was subsequently set for the first week of oral argument by the Lucas Court.

IV. Avoiding The Constitutional Issues

Once the case was finally set for oral argument in early 1987, the question of argument sequence became a matter of concern. In the Court of Appeal, Texaco had prevailed on the argument that since the Federal Trade Commission had actually reviewed the Texaco/Getty acquisition and cleared it under its statutory powers having required the parties to make some transactional adjustments, its order preempted any effort by California to regulate the interstate merger. This constitutional argument was coupled with a classic – but only marginally persuasive – Dormant Commerce Clause argument.

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13 *See Belridge Farms v. Agricultural Labor Relations Bd.*, 21 Cal. 2d 551 (1978).

But a statutory interpretation argument based on a careful analysis of the history of the Cartwright Act was thought to be at least equally convincing to appellate courts, notwithstanding the *Cianci dictum* from just a few months prior. Moreover, the constitutional arguments were fraught with difficulties once the precedents were examined. If Texaco could prevail on the theory that completed mergers as to which divestiture was sought were not within the domain of Cartwright Act, it would obviate any need to address the knotty constitutional issues.

Following that line of thought, appellate counsel elected to "flip" the order of argument. That is to say, rather than address the preemption theory on which Texaco had won below as the "lead" argument on appeal, we argued "out of the box" that a careful examination of the history of California's antitrust statute demonstrated that completed merger transactions were simply beyond its reach. In so doing we gave pride of place to an argument which said, in substance, that the *Cianci dictum* and the myth that the Cartwright Act was "modeled" on Section 1 of the Sherman Act were without substance. Preemption was a secondary — albeit important argument — since it strongly suggested that beyond all the historical learning there was no "there" there: the public interest had been appropriately invoked by the federal agency and the transaction posed no threat to competition in the relevant markets.

These arguments, and the difference in membership of the Court, appear to have been decisive. Texaco prevailed on a four to three vote, with an opinion by Chief Justice Lucas joined by newly appointed Justices Arguelles and Eagleson. Justice Stanley Mosk, who had written the majority opinion in *Cianci*, was relegated to authoring a dissent. We believe that the analysis of the statute's genealogy was unanswerable and convincingly showed that a literal application of its language to mergers was historically unsound. In a word, the argument was right as Justice Lucas' remarkable and scholarly opinion demonstrated.

V. Aftermath Of The *Texaco* Decision

Texaco's holding that the Cartwright Act excludes mergers remains good law. In 1989, an attempt was made to bring mergers within the scope of the Cartwright Act[14], but that attempt failed in the Legislature.[15] Section 17200 of the California Business and Professions Code, on the other hand, was amended in 1992 to encompass a single "act," as opposed to just a "practice,"[16] but that amendment did not expand the scope of Section 17200 remedies available to the Attorney General to include divestiture. Accordingly, while the Attorney General now may use Section 17200 to challenge a merger, it presumably cannot use that section to obtain a divestiture, the remedy it sought in *Texaco*. Divestiture, though, is now available to the Attorney General under the federal antitrust statutes.[17]

The Supreme Court similarly has not retreated from its holding in *Texaco* that the Cartwright Act was patterned after the 1889 Texas statute, as opposed to the Sherman Act.

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14 Assem. 671 (1989-1990 Cal. Reg. Sess.)

15 Cal. Legis., Assembly Recess History (1989-1990 Reg. Sess.) Oct. 3, 1990, p. 211.

16 Stats. 1992, ch. 430, p. 1707.

17 *See California v. American Stores Co.*, 495 U.S. 271 (1990) (divestiture available to the Attorney General under Section 16 of the Clayton Act).

Despite the clarity of that holding, and the careful historical analysis supporting it, wayward *dicta* creeps into lower court opinions from time to time.[18] But even these courts recognize that Sherman Act precedent, while perhaps "useful" in interpreting the Cartwright Act, is not controlling, which is in accord with the limited use of Sherman Act precedent authorized by the Supreme Court in *Texaco*.[19]

Indeed, because *Texaco* did not fully disavow the use of Sherman Act cases to interpret the Cartwright Act, the relative dearth of Cartwright Act cases virtually guarantees that future courts will continue to rely on the vast body of Sherman Act precedent when interpreting the Cartwright Act, despite the teaching of *Texaco* that the roots of the Cartwright Act lie elsewhere than the Sherman Act.

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18 *See, e.g.*, *Cellular Plus v. Superior Ct.*, 14 Cal. App. 4th 1224, 1240 (1993) (Cartwright Act patterned after Sherman Act).

19 *Texaco*, 46 Cal. 3d at 1164.