FORESHADOWING ANTITRUST LIABILITY FOR COLLUSIVE SUPPLY RESTRICTIONS AMID PANDEMIC-RELATED SUPPLY CHAIN DISRUPTIONS

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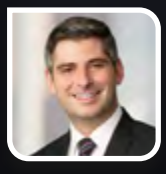

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By Zach Terwilliger, Craig Seebald & Evan Seeder

Continuing price increases associated with ongoing disruptions to the supply chain during the COVID-19 pandemic have unquestionably caught the attention of competition watchdogs around the world. At the moment, there is a great deal of just speculation as to exactly when and under what theory of liability regulators and private parties will seek antitrust remedies for misconduct related to the supply chain crisis. Conspicuously empty shelves and clogged shipping lanes and ports have made shippers, carriers, and retailers the focus of much of this speculation. However, it is worth considering the potential exposure to liability faced by manufacturers, producers, and other actors on the supply-side for perceived anticompetitive conduct arising out of the supply chain crisis. Private antitrust cases alleging conspiracies to restrict supply and thus to increase prices have become increasingly common. While such cases are difficult to prove, the conditions of the supply chain crisis provide a backdrop for more private lawsuits and possible government enforcement actions under this theory.

I. REGULATORS ARE CURRENTLY TARGETING CARTEL-LIKE BEHAVIOR ASSOCIATED WITH SUPPLY CHAIN DISRUPTIONS

On February 17, 2022, the Department of Justice ("DOJ") announced an initiative to "deter, detect and prosecute those who would exploit supply chain disruptions to engage in collusive conduct."[2] In addition to "prioritizing any existing investigations where competitors may be exploiting supply chain disruptions for illicit profit," the DOJ has committed to "proactively investigate collusion in industries particularly affected by supply disruptions."[3] Nor is the DOJ alone in these efforts, as it also announced it had formed a working group to focus on "global supply chain collusion" with antitrust regulators from Australia, Canada, New Zealand, and the United Kingdom by "sharing intelligence [and] utilizing existing international cooperation tools" to detect collusive schemes.

No particular industry or position on the supply chain was identified as a potential target in the DOJ's announcement. Instead, the DOJ manifested only its broad intention to target cartel-like behavior relating to the supply chain crisis without highlighting any industry or position on the supply chain of concern. However, a series of recent private cases highlights a theory of antitrust liability that could well be used against suppliers for conduct occurring during pandemic-era supply chain disruptions: liability for competitors who agree to limit output (i.e. supply) to control prices.

II. A TRENDING ANTITRUST LIABILITY THEORY: RESTRICTION OF PRODUCTION OR SUPPLY

Suppose Company A and Company B both make office chairs and together control 100% of the relevant market. After the COVID-19 pandemic began, demand for office chairs skyrocketed as many people began working from home for the first time. Company A and Company B agree to make a certain amount of office chairs per month, even though each has the capacity to make many more. Each company then raises the price for their respective products. Publicly, the companies blame the price increase on the combination of skyrocketing demand and not being able to get the parts necessary to make enough chairs to meet demand due to the disruption in the global supply chain. Both companies in this scenario could be held liable for antitrust violations.

Under the Sherman Act (and many foreign antitrust laws), it is illegal for competitors to agree to purposefully restrict production and limit supply of a product in order to raise, stabilize, or "fix" prices.[4] Such agreements historically have been treated as *per se* violations of the Sherman Act, thus making it unnecessary to prove antitrust injury via the rule of reason. This is by no means a new theory of antitrust liability;[5] however, it has been employed by private plaintiffs more frequently in the last decade.

For example, in *Miami Products & Chemical Co. v. Olin Corporation*, direct purchasers of caustic soda (also known as lye) sued caustic soda producers, alleging that producers engaged in a conspiracy to fix caustic soda prices in the United States.[6] Defendants were estimated to collectively control 90 percent of the domestic supply of caustic soda.[7] During the alleged conspiracy period, defendants announced price increases while informing customers that the domestic supply of caustic soda was "tight" and that the product was "scarce" or otherwise limited.[8] The purchasers accused the defendants of coordinating cuts in caustic soda production and plant shutdowns to justify artificial price increases.[9] In March of 2020, the United States District Court for the Western District of New York allowed the purchasers' claims to proceed against many of the defendants, finding that the purchasers had met the lenient pleading standards and had plausibly alleged a Sherman Act conspiracy based on allegations that defendants artificially cut supply of caustic soda and made misleading public statements about the availability of caustic soda after years of market stability.[10] Litigation in this matter is ongoing.

2 Press Release, Dep't of Justice, Department of Justice Announces Initiative to Protect Americans from Collusive Schemes Amid Supply Chain Disruptions (Feb. 17, 2022).

3 *Id.*

4 See *In re Nat'l Football League's Sunday Ticket Antitrust Litig.*, 933 F.3d 1136, 1150 (9th Cir. 2019) (citing 15 U.S.C. § 1).

5 See *United States v. Aluminum Co. of Am.*, 148 F.2d 416 (2d Cir. 1945).

6 *Miami Products & Chem. Co. v. Olin Corp.*, 449 F. Supp. 3d 136 (W.D.N.Y. 2020).

7 *Id.* at 151.

8 *Id.* at 158.

9 *Id.* at 162-63.

10 *Id.* at 160-164.

Recent cases alleging coordinated supply restrictions have arisen in other industries with respect to products such as computer components,[11] ethanol,[12] and pork products.[13]

III. HORIZONTAL AGREEMENTS TO RESTRICT SUPPLY ARE DIFFICULT TO PROVE

Despite recent indicia of the viability of such claims, it is nonetheless difficult to actually prove that firms coordinated to fix prices by restricting supply. The Sherman Act prohibits only agreements to restrict supply, not independent decisions to reduce supply or production. It is not unusual for commonly situated companies to have similar responses to common circumstances, and thus the Sherman Act does not prohibit parallel independent conduct. In a recent case, for example, a court dismissed a supply restriction claim where the only evidence of collusion was parallel conduct: lockstep supply reductions by competitors over a period of several years.[14] Without additional evidence of, say, direct communications among competitors related to supply changes followed by conduct not explained by benign reasons, collusion to restrict supply is difficult to establish absent evidence of a formal agreement.

Real world circumstances also make claims of supply restriction hard to prove. Often, manufacturing facilities are large and expensive, so it is neither easy nor often rational to shutter them in the hope of gaining more profit from a supply shortage. Further, competitors usually have different production capacities, which means that the lost sales from an alleged agreement to restrict supply would fall disproportionately on some competitors than others. In those circumstances, courts have said "[i]t makes little sense" that one competitor would sacrifice more sales than others.[15]

On a more basic level, it is not easy to establish what the baseline level of output should be in the absence of anticompetitive conduct. Certain industries with homogenous products (like helium gas) may have fairly predictable output. Output for other industries' products, however, may be affected by variables such as seasonal shifts in production or labor, supply and demand changes, and maintenance or mechanical breakdowns. Likewise, a firm's production capacity may suddenly change for a number of benign reasons. For example, a steel company might decide that it no longer makes sense to keep one of its mills open. By closing one mill, it naturally loses some capacity to produce steel at the same rate it had previously been able to achieve, and supply naturally decreases as a result. Likewise, natural disasters, plant shutdowns, maintenance, and shipping problems are also benign reasons for declines in production capacity.

All told, not only is it difficult to prove that competitors colluded to reduce supply, but reductions in supply can also be disuniform between firms and are often readily explainable.

IV. IMPLICATIONS FOR SUPPLY RESTRICTION CLAIMS RELATED TO PANDEMIC-ERA SUPPLY CHAIN DISRUPTIONS

In some ways, the difficulty of proving supply restriction claims intensifies in the context of the supply chain crisis. After all, restricting supply may well be a logical response to supply chain disruptions. For example, a supplier of a product that is spoilable may not want to risk producing at full capacity when shipping times are long and unpredictable and there is no guarantee that carriers will have sufficient cargo space to accommodate a typical shipment. On the other hand, the supply chain crisis provides regulators and private plaintiffs with a compelling setting in which to locate supply restriction claims. Supply chain disruptions provide bad actors with superficial excuses to limit supply, such as untenable shipping delays or pandemic-related labor shortages. Likewise, failures in other links of the supply chain can be used to justify supply shortages (e.g. failure to receive the raw materials needed to construct microchips). And further, the supply chain crisis has created a general assumption that demand is much higher than available supply in many industries. Under these conditions, price increases may be subject to less scrutiny at first glance.

In light of the increased frequency of private supply restriction cases and heightened attention from regulators, it is not difficult to imagine that this theory will under supply chain-related antitrust claims in the future. Suppliers risk antitrust liability if they discuss supply chain

11 *In re Dynamic Access Memory Indirect Purchaser Litig.*, F. Supp. 3d, 2020 WL 8459279 (N.D. Cal. 2020).

12 Press Release, European Commission, Antitrust: Commission fines former ethanol producer Abengoa € 20 million in cartel settlement (Dec. 10, 2021).

13 E.g. *Aldi Inc. v. Agri Stats, Inc.*, No. 0:22-cv-00367 (D. Minn. filed Jan. 24, 2022) (multi-district litigation).

14 See *In re Dynamic Access*, 2020 WL 8459279, *supra* at note 11.

15 *Washington County Health Care Authority, Inc. v. Baxter Int'l, Inc.*, 328 F. Supp. 3d 824, 837 (N.D. Ill. 2018).

problems with competitors rather than responding unilaterally. Instead, suppliers should consider scrutinizing relationships with competitors and examining how changes in output could be perceived from the perspective of regulators, purchasers, and competitors. Further, those suppliers should endeavor to document their independent, non-collusive reasons for a reduction in output lest they ever be investigated or accused of conspiring to fix prices.

Overall, antitrust investigations and litigation will not quickly resolve current supply shortages or other supply-side problems. Antitrust investigations can carry on for two or more years, whereas antitrust litigation can last for over a decade without resolution. There may even be three or four more supply chain disruptions before enforcement actions or private lawsuits on issues raised today are resolved. Accordingly, any analysis conducted by suppliers now with respect to supply or output changes should be oriented toward developing long-term strategies to address possible liability exposure in anticipation of continuing disruption to the supply chain.

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