Antitrust Chronicle

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Supply Chains

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LETTER FROM THE EDITOR

Dear Readers,

Until recently, global supply chain issues have not typically penetrated the popular consciousness. This has changed in recent years and months. Remarkably, supply chains and logistics have become a hot-button topic in media and political circles.

Prominent examples include the hampered launch of Sony's PlayStation 5; the global chip shortage hindering everything from electronics to automobile production; shipping to and from the UK being frustrated by Brexit-related frictions; labor instability in road, rail and shipping; traffic backlogs at transportation choke points such as the Suez canal; shutdowns due to COVID-19 outbreaks in key outsourced manufacturing facilities in Asia; the fallout from the conflict in Ukraine; and countless interrelated issues. These disruptions to the supply chain are blamed for rampant inflation, reduced economic output, and wealth disparity worldwide.

To state the obvious, supply chains have become a burning political, economic and social question. The relevant problems derive, ultimately, from a combination of evolving global trade patterns, the movement from physical sales to e-commerce, and the shifting tectonic plates of geopolitics and public health. Against this complex backdrop, the enforcement of antitrust rules is but one of many tools that public authorities (and private parties) can leverage to alleviate the perceived economic pain. Yet it is a key part of the puzzle. Indeed, the genesis of antitrust lies in transportation, specifically the enforcement of the Sherman Antitrust Act of 1890 against the railway "trusts" that gave the Act its name. European competition law and rules in various other jurisdictions followed a similar pattern.

In light of this history, the pieces in this Chronicle address the potential for antitrust enforcement to alleviate these pressing issues, while also being cognizant of the inherent limitations of a single policy tool (such as antitrust) to act as a panacea for what is ultimately an infinitely complex problem. The authors tackle it from a variety of perspectives, each of which offers a unique insight.

As Adam L. Hudes points out, competition authorities across the world have publicly expressed concerns that certain businesses are taking advantage of supply chain disruptions to engage in collusion and other forms of anticompetitive behavior. This builds on a relatively rich history of enforcement (in sectors such as freight forwarding, air cargo, ocean shipping, and other related areas). This will continue, perhaps with greater vigor in the current context. Yet the same enforcement dilemma remains: what is the role of antitrust? Specifically, how can authorities distinguish between price increases due to epistemic macroeconomic shocks and those due to collusion and/or abuses of dominance?

Another perceptive piece by Ramsi A. Woodcock acknowledges that supply chains are fundamental to antitrust because no firm should be permitted to exclude competitors by denying them access to inputs. But it does not follow that antitrust can effectively be used to reduce inflation or redistribute wealth between different levels in a supply chain. It is impossible to introduce competitive pricing to every link in a given supply chain: supply chains can be endlessly subdivided, and a firm's decision not to source every component of its final offer separately would shut down markets for separate components. The piece concludes that policymakers would be better off using other instruments such as price controls and taxation to address inflation and wealth inequality.

In antitrust parlance, supply chain-related issues have typically been dealt with under the rubric of "Vertical Restraints" (i.e. agreements between economic actors at different levels of the economy, typically input producers, manufacturers, distributors and retailers). Charlotte Breuvart & Henry de la Barre address recent proposed reforms by the European Commission in its draft revised Vertical Block Exemption Regulation and accompanying Guidelines on Vertical Restraints, issued in July 2021. In light of public feedback, which was largely critical of the proposals, the Commission returned to the drawing board. This timely article compares the existing rules with the European Commission's new proposals, which are expected to enter into force this June.

As noted, the automotive industry is one of the sectors that has been most affected by supply chain friction in recent years. Drawing on his experience, Sheldon Klein elucidates how the automotive supply chain is particularly complex, distinctive and susceptible to allegations of bid-rigging conspiracies. To mitigate risk, U.S, auto manufacturers have added antitrust specific provisions to their purchasing terms and conditions to better protect themselves against such conspiracies. Different companies have adopted distinct approaches, each which may be imperfect, but provide buyers with meaningful advantages vis-à-vis their suppliers.

Then, there is the elephant in the room: Supply chain shocks were in the offing even before the pandemic. But as Zach Terwilliger, Craig Seebald & Evan Seeder note, this looming threat was catalyzed by COVID-19. There is much speculation as to exactly when and under what theory of harm regulators and private parties will seek to use antitrust remedies for alleged misconduct in this new context. As the authors note, antitrust cases alleging conspiracies to restrict supply and increase prices have become increasingly common in this new backdrop. All is to play for.

In sum, revolutionary changes in the functioning of supply chains at the local, regional and global levels are afoot. Antitrust enforcement is one of the key levers (among many) that will be used by both public and private actors to remedy perceived problems as the global economy undergoes several fundamental evolutions simultaneously. This set of articles represents the reflections of key thinkers and practitioners dealing with these issues in real time.

As always, thank you to our great panel of authors.

Sincerely,

CPI Team

SUMMARIES

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ANTITRUST AND COMPETITION LAW IN GLOBAL SUPPLY CHAINS: RECENT DEVELOPMENTS AND BEST PRACTICES

By Adam L. Hudes, Catherine Medvene & Kathryn Lloyd

Significant supply chain disruptions have become prevalent in the context of the COVID-19 pandemic and, more recently, ongoing political conflict. These disruptions involve important and interconnected national and global industries, including logistics, consumer goods, pharmaceuticals, healthcare, retail, and agriculture. Following complaints submitted by businesses and industry groups, five national competition agencies — in the U.S., the UK, Canada, Australia, and New Zealand — announced that they are collaborating to share intelligence regarding rising supply chain prices, which could be caused by breaches of competition law, including cartel behavior. All five agencies are signatories to a cooperation framework. This article outlines the supply chain and competition law considerations that gave rise to this cooperation framework, how competition agencies in the U.S., the UK, and the EU, in particular, have previously tackled supply-chain concerns, as well as their potential next steps for unilateral and collaborative enforcement under the framework agreement. Further, this article proposes recommended best practices for businesses to consider to avoid the scrutiny of enforcement agencies.

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INSIGHTS FROM SUPPLY CHAIN MANAGEMENT: IMPLICATIONS FOR COMPETITION POLICY AND ANTIRUST LAW

By Gregory T. Gundlach & Riley T. Krotz

Many areas of competition policy and law intersect supply chain management. Describing recent developments in supply chains and supply chain management, the authors examine their implications for competition policy and law involving resale price maintenance — a controversial vertical restraint affecting $300 billion in U.S. sales annually. Their findings augment economic understanding of resale price maintenance and thereby offer potential to advance competition policy and antitrust law.

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ANTITRUST AND THE INFINITE, CIRCULAR SUPPLY CHAIN

By Ramsi A. Woodcock

Supply chains are fundamental to antitrust because no firm can exclude competitors without denying them access to inputs. But this does not mean that antitrust policy can reduce inflation caused by supply chain disruption or effectively redistribute wealth between different levels of a supply chain. Competitive markets do not eliminate profits — or price increases — that are due to scarcity rather than monopoly. In any case, it is impossible to introduce competitive pricing into every link in a supply chain, because supply chains are, technically, infinite. Every atom or fraction of an atom can be defined as a separate component. A firm's decision not to source each atom or fraction thereof separately shuts down markets for the separate components, impoverishing those who would otherwise supply them. But requiring firms to source each atom or fraction thereof separately would cause production to grind to a halt. Antimonopolists would instead do well to turn to price controls and taxation to address scarcity-driven inflation and wealth inequality.

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DUAL DISTRIBUTION IN THE DIGITAL AGE: THE EUROPEAN COMMISSION DRAFTS NEW COMPETITION RULES

By Charlotte Breuvart & Henry de la Barre

Dual distribution has flourished with the rise of e-commerce and is a key focus of current reforms to vertical agreement rules by the European Commission, which published a draft revised Vertical Block Exemption Regulation and draft revised Guidelines on Vertical Restraints on July 9, 2021. Public consultation feedback was largely critical of the draft new vertical rules with respect to dual distribution. In particular, as the contemplated regime for information exchange in dual distribution was perceived as unreasonable, impractical and adding legal uncertainty as compared to the current regime, the European Commission recently returned to the drawing board to address these issues. This article compares and discusses the main differences between today's rules and the European Commission's envisaged new rules, which are expected to enter into force on June 1, 2022.

SUMMARIES

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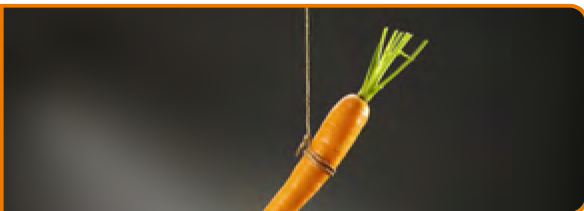

ANTITRUST ENFORCEMENT: LEVERAGING SUPPLY CHAIN INCENTIVES

By Nitish Jain & Serguei Netessine

Antitrust regulations are meant to promote fair competition in the market, but balancing administrative and legal costs with enforcement can be difficult when multi-layered supply chains are involved. The canonical example of this challenge is the landmark *Illinois Brick* ruling, which limits antitrust damages to only the direct purchasers of a product; for instance, consumers can file antitrust claims against colluding retailers but not against colluding manufacturers – only retailers can file claims against manufacturers. This controversial ruling was meant to reduce legal costs, but it can clearly lead to missed enforcement opportunities. In this paper we demonstrate how the Illinois Brick ruling interacts with contracts adopted in the supply chain and we show that otherwise equivalent supply chain arrangements can have markedly different effects. In particular, we find that wholesale price, minimum order quantity, revenue-sharing and quantity discount contracts lead retailers to take legal action against manufacturers in the event of collusive behavior. However, the wholesale price plus fixed fee contract structure (a.k.a. a two-part tariff or slotting fee contract) facilitates collusion among the manufacturers with retailers compensated by the fixed fee and not filing the antitrust litigation. We further demonstrate that collusion is more likely under high demand uncertainty and high competition at the retail level but is less likely under high competition at the manufacturer level. Our paper helps public enforcers identify market conditions conducive to antitrust violations.

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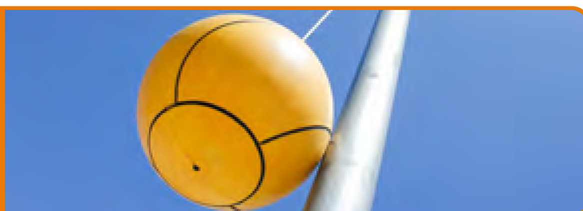

TETHERING VERTICAL MERGER ANALYSIS

By Daniel P. O'Brien

Antitrust practitioners are mis-applying simple vertical merger screening techniques (e.g. vertical foreclosure arithmetic, price pressure analysis) to reach flawed and internally inconsistent conclusions about vertical mergers. Specifically, practitioners have struck on a formula for claiming harm from vertical mergers: They argue that relatively low upstream margins mean that, post-merger, the merged firm has an incentive to disadvantage rivals' access to the upstream product thus driving more sales to the merged firm's relatively more profitable downstream product. This reasoning is backwards in the same way that standard critical loss analysis was backwards when it concluded that large pre-merger margins make harm from horizontal mergers less likely. A low upstream profit share implies that the upstream firm faces significant competition and likely lacks the ability to foreclose competition, whereas a high upstream profit share admits foreclosure as a possibility (though by no means a certainty). This paper discusses the issues and touches on how to fix them, a topic addressed in more detail in a forthcoming companion paper.

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CONTRACTING AROUND THE ANTITRUST LAWS: THE AUTOMOTIVE SUPPLY CHAIN EXAMPLE

By Sheldon Klein

The automotive supply chain is complex, distinctive and, susceptible to antitrust, particularly bid-rigging, conspiracies, as illustrated by the *Auto Parts Antitrust Litigation*, an unprecedently expansive conspiracy to bid rigs for many scores of components by many scores of sellers. In response, two U.S. auto manufacturers, Ford and FCA, have added antitrust specific provisions to their purchasing terms and conditions to better protect themselves against such conspiracies. FCA's provision is narrowly focused on the *Illinois Brick* problem that is inherent in a multi-tiered supply chain. Ford's is more ambitious, designed to provide a quicker and larger recovery when its suppliers are involved in criminal conspiracies. Each of the provisions are imperfect, but each provides the buyer meaningful advantages.

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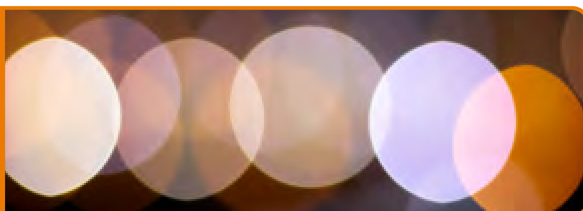

FORESHADOWING ANTITRUST LIABILITY FOR COLLUSIVE SUPPLY RESTRICTIONS AMID PANDEMIC-RELATED SUPPLY CHAIN DISRUPTIONS

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.

WHAT'S NEXT?

For May 2022, we will feature an Antitrust Chronicle focused on issues related to (1) **Healthcare** ; and (2) **No Poach Agreements**.

ANNOUNCEMENTS

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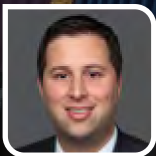
Contributions to the Antitrust Chronicle are about 2,500 – 4,000 words long. They should be lightly cited and not be written as long law-review articles with many in-depth footnotes. As with all CPI publications, articles for the CPI Antitrust Chronicle should be written clearly and with the reader always in mind.

Interested authors should send their contributions to Sam Sadden (ssadden@competitionpolicyinternational.com) with the subject line "Antitrust Chronicle," a short bio and picture(s) of the author(s).

The CPI Editorial Team will evaluate all submissions and will publish the best papers. Authors can submit papers on any topic related to competition and regulation, however, priority will be given to articles addressing the abovementioned topics. Co-authors are always welcome.

ANTITRUST AND COMPETITION LAW IN GLOBAL SUPPLY CHAINS: RECENT DEVELOPMENTS AND BEST PRACTICES

BY ADAM L. HUDES,[1] CATHERINE MEDVENE[2] & KATHRYN LLOYD[3]



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I. INTRODUCTION

On February 17, 2022, five competition authorities announced that they had created a working group to develop and share market intelligence to monitor and investigate suspected anti-competitive behavior impacting global supply chains. These authorities are the UK Competition and Markets Authority ("CMA"),[4] the United States Department of Justice ("DOJ"),[5] the Australian Competition and Consumer Commission,[6] the Canadian Competition Bureau[7] and the New Zealand Commerce Commission ("NZCC")[8] (the so-called "Five Eyes"). The parties signed a Multilateral Mutual Assistance and Cooperation Framework for Competition Authorities (the "Five Eyes Framework") on September 2, 2020.

This development arises in the context of significant supply-chain disruptions in the wake of the COVID-19 pandemic, global inflation concerns, as well as ongoing political conflict. According to recent United States labor data, consumer prices increased by 7.5 percent from January 2021 to January 2022, the fastest rate since February 1982.[9] Similarly, the Office for National Statistics in the United Kingdom reports that the Consumer Price Index rose by 5.5 percent in the 12 months to February 2022, the highest CPI 12-month inflation rate in the National Statistics series beginning in January 1997.[10]

The working group announcement also follows complaints submitted by businesses and industry groups to the CMA, including the manufacturers' organization Make UK and the British Chambers of Commerce, which expressed concerns about whether extreme rises in shipping costs, in particular, were justified.

The five competition authorities have publicly expressed concerns that certain businesses are taking advantage of supply chain disruptions to engage in collusion and other forms of anticompetitive behavior. To that end, the authorities will assess whether supply-chain disruptions, and related cost increases resulting from demand and supply shocks, account for price increases, or whether those price increases are the result of anti-competitive conduct – whether unilateral or coordinated.

This article outlines the supply chain and competition law considerations that gave rise to this cooperation framework, how competition agencies in the US, the UK, and the EU, in particular, have previously tackled supply-chain concerns, as well as potential next steps for unilateral and collaborative enforcement under the framework agreement. Further, this article proposes recommended best practices for businesses to consider to avoid the scrutiny of enforcement agencies.

II. HISTORICAL APPROACH IN THE UNITED STATES

The DOJ has statutory authority to bring civil and criminal actions against individuals and companies that harm American consumers by engaging in offenses that violate the U.S. antitrust laws. [11] Criminal enforcement of the U.S. antitrust laws by the DOJ historically has been reserved for the most serious offenses, such as naked conspiracies among competitors for price fixing, bid rigging, or allocating markets or customers. Such

4 *Competition and Markets Authority Press Release, International Agencies Put Supply Chains on Notice Against Collusion*, Competition and Markets Authority (February 17, 2022) https://www.gov.uk/government/news/international-agencies-put-supply-chains-on-notice-against-collusion (last visited on March 18, 2022).

5 *Department of Justice Press Release, Department of Justice Announces Initiative to Protect Americans from Collusive Schemes Amid Supply Chain Disruptions*, Department of Justice (February 17, 2022), https://www.justice.gov/opa/pr/department-justice-announces-initiative-protect-americans-collusive-schemes-amid-supply-chain (last visited on April 8, 2022) (last visited on April 8, 2022).

6 *Australian Competition and Consumer Commission Press Release, Five Eyes Competition Authorities to Focus on Collusion in International Trade*, Australian Competition and Consumer Commission (February 17, 2022), https://www.accc.gov.au/media-release/five-eyes-competition-authorities-to-focus-on-collusion-in-international-trade (last visited on March 18, 2022).

7 *Canadian Competition Bureau Press Release, International Working Group Targets Potential Collusion by Competitors in Supply and Distribution of Goods*, Canadian Competition Bureau (February 17, 2022), https://www.canada.ca/en/competition-bureau/news/2022/02/international-working-group-targets-potential-collusion-by-competitors-in-supply-and-distribution-of-goods.html (last visited on March 18, 2022).

8 *Competition Agencies Work Together to Identify Potential Cartel Conduct in Global Supply Chains*, New Zealand Commerce Commission (February 17, 2022), https://comcom.govt.nz/news-and-media/media-releases/2022/competition-agencies-working-together-to-identify-potential-cartel-conduct-in-global-supply-chains (last visited on March 18, 2022).

9 See US Bureau of Labor Statistics, https://www.bls.gov/opub/ted/2022/consumer-prices-up-7-5-percent-over-year-ended-january-2022.htm (last visited on April 8, 2022).

10 See Office for National Statistics, https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/february2022 (last visited on April 8, 2022).

11 In the United States, both the DOJ and the Federal Trade Commission ("FTC") investigate and regulate competition. However, the DOJ, rather than the FTC, joined the working group likely because the DOJ prosecutes both civil and criminal actions.

violations have been unanimously condemned in the U.S. as especially harmful to consumer welfare and lacking procompetitive benefits that may justify the conduct.

The DOJ also has substantial experience investigating and prosecuting antitrust activity related to supply chains in a variety of industries, such as air cargo, freight forwarding, ocean shipping, among others. In numerous instances, these investigations have also resulted in lengthy parallel private litigations.

A. Air Cargo

From 2006 until 2011, the DOJ prosecuted global airlines and their executives for a price-fixing scheme that artificially inflated passenger and cargo fuel surcharges between 2000 and 2006 to make up for lost profits. At least 22 airlines and 21 executives were charged, and more than $1.8 billion in criminal fines were assessed against the defendants.[12]

The DOJ, in conjunction with the European Commission ("EC"), began investigating the air cargo industry in 2005 after officials with German-based Lufthansa notified the DOJ that the airline had been conspiring to set cargo surcharges. Following a year-long investigation, FBI agents and their European counterparts raided airline offices in 2006. Investigators eventually found a paper trail laying out agreements stretching back to 2000 to set passenger and cargo fuel surcharges.

The DOJ filed criminal lawsuits beginning in 2006, alleging that airlines conspired to suppress and eliminate competition by fixing particular cargo base rates or fees charged to customers for certain international air shipments, including to and from the United States.[13] The result was an unreasonable restraint of interstate and foreign trade and commerce in violation of Section 1 of the Sherman Act. The conspiracy, according to the DOJ's findings, was conducted through participation in meetings, conversations, and communications related to cargo rates and fees for international air shipments, the levying of cargo rates in accordance with the agreements reached, and the monitoring and enforcement of the agreed-upon cargo rates.[14]

Shortly after the DOJ's criminal prosecution began, consumers of air cargo services brought more than 90 class action lawsuits against dozens of air cargo carriers. These cases were later consolidated in the Eastern District of New York in a multidistrict litigation (or "MDL") titled *In re: Air Cargo Shipping Services Antitrust Litigation*.[15] Mirroring the DOJ indictments, the MDL complaint alleged that air cargo carriers agreed in secret meetings, conversations, and other communications on cargo rates to and from the United States. The court ultimately certified a class of tens of thousands of direct purchasers of air cargo shipping services. However, the Second Circuit dismissed the indirect-purchaser class, finding that federal aviation law pre-empted price-fixing claims brought against foreign carriers under state antitrust statutes. The *Air Cargo* MDL resulted in more than $1.2 billion in settlements and more than $100 million in attorney's fees.[16]

B. Freight Forwarding Industry

Between 2010 and 2011, the DOJ prosecuted 16 companies and executives in the freight forwarding industry, which arrange for and manage the shipment of goods, including receiving, packaging and otherwise preparing cargo destined for international ocean shipment. These prosecutions lead to the imposition of more than $120 million in criminal fines.[17] The DOJ alleged that the companies colluded regarding freight forwarding services to fix, raise, and maintain prices charged to customers. According to the DOJ, the companies met in the United States and elsewhere to discuss and agreed to fix prices in violation of Section 1 of the Sherman Act.

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12 See *EVA Airways Corporation Agrees to Plead Guilty and to Pay $13.2 Million Fine for Price Fixing on Air Cargo Shipments*, DOJ News (May 27, 2011), https://www.justice.gov/opa/pr/eva-airways-corporation-agrees-plead-guilty-and-pay-132-million-fine-price-fixing-air-cargo (last visited on April 8, 2022); See also *Martinair Airline Executive Indicted in Conspiracy to Fix Surcharge Rates on Air Cargo Shipments*, Department of Justice, https://www.justice.gov/opa/pr/martinair-airline-executive-indicted-conspiracy-fix-surcharge-rates-air-cargo-shipments (last visited on April 8, 2022); *Polar Air Cargo LLC Agrees to Plead Guilty to Price Fixing on Air Cargo Shipments*, https://www.justice.gov/opa/pr/polar-air-cargo-llc-agrees-plead-guilty-price-fixing-air-cargo-shipments (last visited on April 8, 2022); *Major International Airlines Agree to Plead Guilty and Pay Criminal Fines Totaling More Than $500 Million for Fixing Prices on Air Cargo Rates*, https://www.justice.gov/archive/opa/pr/2008/June/08-at-570.html (last visited on April 8, 2022).

13 See e.g. *United States v. Eva Airways Corp.*, No. 1:11-cr-00170-JDB (D.D.C. 2011), https://www.justice.gov/atr/case-document/file/495316/download (last visited on April 8, 2022).

14 *Id.*

15 No. 11-5464 (E.D.N.Y.)

16 *$100M in Attn Fees Approved in Air Cargo Antitrust MDL*, Law360 (October 6, 2016), https://www.law360.com/articles/848942 (last visited on April 8, 2022).

17 *Japanese Freight Forwarding Company Agrees to Plead Guilty to Criminal Price-Fixing Charge*, United States Department of Justice, https://www.justice.gov/opa/pr/japanese-freight-forwarding-company-agrees-plead-guilty-criminal-price-fixing-charge (last visited on April 8, 2022).

Again in 2018 and 2019, DOJ prosecuted freight forwarders for a conspiracy to fix prices. Several executives were sentenced to prison for this conduct.[18]

The EC similarly also announced that it had sent statements of objection to several companies in 2010 in connection with its investigation of the industry.[19]

C. Ocean Shippers

Beginning in 2014, DOJ brought charges in Maryland federal court — the most recent filed in 2018 — against five carriers based in Japan, Norway, and Chile, plus 13 individual employees, for price fixing, bid rigging, and allocating customers in the international ocean shipping industry for "roll-on, roll-off" ("RoRo") cargo, a method used to ship vehicles and agricultural equipment.[20] The shippers were ordered to pay more than $255 million in criminal fines, and several executives received prison sentences.[21]

More recently, on July 9, 2021, President Joe Biden took aim at the ocean shipping sector of the maritime industry with the issuance of his Executive Order ("E.O.") on Promoting Competition in the American Economy.[22] The E.O. specifically references consolidation in the maritime shipping industry during the past couple of decades, suggesting that such consolidation may disadvantage U.S. exporters. The E.O. encourages the Federal Maritime Commission ("FMC") "to ensure vigorous enforcement against shippers charging American exporters exorbitant charges" and to "consider further rulemaking to improve detention and demurrage practices and enforcement of related Shipping Act prohibitions."[23] The E.O. further encourages the FMC to cooperate with DOJ on enforcement efforts—focusing on the fees imposed on U.S. exporters by increasingly consolidated foreign shipping conglomerates.

On July 12, 2021, the Antitrust Division and FMC entered into a memorandum of understanding ("MOU") to collaborate and redouble their efforts to enforce antitrust laws and Shipping Act protections applicable to the maritime industry.[24]

On February 28, 2022, the Biden Administration issued a press release and fact sheet stating that the DOJ is expanding its cooperation with the FMC, and will "provide the FMC with the support of attorneys and economists from the Antitrust Division for enforcement of violations of the Shipping Act and related laws." Likewise, the FMC will share shipping industry experience with the DOJ for Sherman Act and Clayton Act enforcement actions.[25]

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18 See *DOJ News, Freight Transportation Company Agrees to Plead Guilty to Antitrust Charge*, United States Department of Justice (September 17, 2019), https://www.justice.gov/opa/pr/freight-transportation-company-agrees-plead-guilty-antitrust-charge (last visited on April 8, 2022); *Third Freight Transportation Executive Pleads Guilty to Antitrust Charge*, United States Department of Justice https://www.justice.gov/opa/pr/third-freight-transportation-executive-pleads-guilty-antitrust-charge (last visited on April 8, 2022).

19 In New Zealand, the NZCC filed proceedings against several shipping logistics companies, including units of the Deutsche Bahn Group, accusing them of agreeing to fix surcharges and other fees for air freight-forwarding services. The NZCC has reached settlements with two of the defendants. In addition, competition authorities in Italy and Brazil are reportedly investigating freight-forwarding companies.

20 *Fourth Ocean Shipping Executive Pleads Guilty to Price Fixing on Ocean Shipping Services for Cars and Trucks*, United States Department of Justice (March 26, 2015), https://www.justice.gov/opa/pr/fourth-ocean-shipping-executive-pleads-guilty-price-fixing-ocean-shipping-services-cars-and (last visited on April 8, 2022).

21 *Japanese Company Agrees to Plead Guilty to Price Fixing on Ocean Shipping Services for Cars and Trucks*, United States Department of Justice (September 26, 2014), https://www.justice.gov/opa/pr/japanese-company-agrees-plead-guilty-price-fixing-ocean-shipping-services-cars-and-trucks; https://www.justice.gov/opa/pr/fourth-ocean-shipping-executive-pleads-guilty-price-fixing-ocean-shipping-services-cars-and (last visited on April 8, 2022); *Two International Shipping Executives Indicted for Participating in Long-Running Antitrust Conspiracy*, United States Department of Justice (June 26, 2019) https://www.justice.gov/opa/pr/two-international-shipping-executives-indicted-participating-long-running-antitrust (last visited on April 8, 2022).

22 *Executive Order on Promoting Competition in the American Economy*, The White House (July 9, 2021) https://www.whitehouse.gov/briefing-room/presidential-actions/2021/07/09/executive-order-on-promoting-competition-in-the-american-economy/ (last visited on April 4, 2022).

23 *Id.*

24 *Memorandum of Understanding between the Federal Maritime Commission and the Antitrust Division, Department of Justice*, United States Department of Justice, https://www.justice.gov/opa/press-release/file/1411101/download (last visited on April 8, 2022).

25 Fact Sheet: Lowering Prices and Leveling the Playing Field in Ocean Shipping, The White House (February 28, 2022), https://www.whitehouse.gov/briefing-room/statements-releases/2022/02/28/fact-sheet-lowering-prices-and-leveling-the-playing-field-in-ocean-shipping/ (last visited on April 8, 2022).

D. Other Industries & Enforcement Efforts

In addition to the above-mentioned enforcement efforts, the DOJ has sought to protect supply chains against anti-competitive conduct in the following settings:

- *Capacity Constraints*: The DOJ has brought antitrust enforcement actions to prevent agreements that artificially restrain the supply of goods, with a particular emphasis on the food supply chain. For example, the DOJ is currently investigating the meat and poultry industries, where it is alleged that a lack of competition and dominant producers control so much of the supply chain that they can increase their own profits at the expense of both farmers and consumers.[26] The DOJ has cited meat and poultry prices as driving food inflation and has identified market concertation in the meatpacking industry as an area of focus.

- *Merger Context*: The DOJ also assesses potential supply chain concerns in the context of its merger review responsibilities. For example, in late November 2021, the DOJ announced it was filing a civil antitrust suit to block the merger of U.S. Sugar Corp. and Imperial Sugar Co.[27] This decision was based in part on the DOJ's concerns regarding the impact of the merger on the supply chain for refined sugar.[28] The DOJ alleges that United Sugars and Imperial Sugar compete head-to-head to supply refined sugar to customers across the South-eastern United States, resulting in lower prices, better-quality products and more reliable service for customers across the region. Because transportation costs make up a significant portion of the total price customers pay for refined sugar, the nearest sugar products are often customer's best competitive options. As such, DOJ alleges that U.S. Sugar's proposed acquisition of Imperial Sugar would further consolidate an already concentrated market for refined sugar.

- *State Price-Gouging*: The DOJ has also worked in conjunction with state enforcement authorities to take action against suspected price gouging efforts. Approximately 38 states and the District of Columbia have statutes or regulations prohibiting price increases for certain essential products. For example, during the beginning of the COVID-19 pandemic, the federal and state enforcement authorities worked together to stop and prevent price gouging of essential medical supplies such as face masks, respirators, and diagnostics.[29]

III. HISTORICAL APPROACH IN THE EUROPEAN UNION AND THE UNITED KINGDOM

Competition authorities in the European Union and the United Kingdom have similarly investigated, and issued substantial administrative penalties, in respect of the sectors that are likely to be scrutinized by the five eyes with renewed interest.

As noted above, in several well-known cases, the logistics and transportation industry has previously been scrutinized by the EC in parallel investigations with their US counterparts.

Like the DOJ, in 2012, the EC found that a number of competitors in the freight forwarding sector had engaged in infringements of Article 101(1) of the Treaty on the Functioning of the European Union ("TFEU") and Article 53(1) of the Agreement creating the European Eco-

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26 *Four Executives and Company Charged with Price Fixing in Ongoing Investigation into Broiler Chicken Industry*, United States Department of Justice (July 29, 2021) https://www.justice.gov/opa/pr/four-executives-and-company-charged-price-fixing-ongoing-investigation-broiler-chicken (last visited on April 8, 2022).

27 *Press Release, Department of Justice, Justice Department Sues to Block U.S. Sugar's Proposed Acquisition of Imperial Sugar*, United States Department of Justice(November 23, 2021), available at: https://www.justice.gov/opa/pr/justice-department-sues-block-us-sugar-s-proposed-acquisition-imperial-sugar(last visited on April 8, 2022); *U.S. v. U.S. Sugar Corporation, et al.*, No. 1:21-cv-01644 (D. Del.).

28 Assistant Attorney General Jonathan Kanter stated that "[t]his deal substantially lessens competition at a time when global supply chain challenges already threaten steady access to important commodities and goods . . . [The lawsuit seeks to] protect the resiliency of the American domestic sugar supply." *Press Release, Fed. Trade Comm'n, FTC Launches Inquiry into Supply Chain Disruptions* (November 29, 2021).
Less than a week after the DOJ filed suit to block the U.S. Sugar merger, the Federal Trade Commission announced its intention to study supply chain disruptions to the extent "these disruptions are causing ongoing hardships for consumers and harming competition in the U.S. economy." Section 6(b) of the FTC Act authorizes the FTC to engage in investigative studies that need not have a law enforcement purpose. See 15 U.S.C. § 46. In its 6(b) study relating to the supply chain, the FTC ordered several large retailers, wholesalers, and goods suppliers to respond to questions and to provide internal documents regarding supply chain disruptions. As such, the issue of supply chains is being attacked from multiple fronts.

29 *Memorandum for All Heads of Department Components and Law Enforcement Agencies*, Office of the Attorney General Washington, DC (March 24, 2020), https://www.justice.gov/file/1262776/download (last visited on April 8, 2022).

nomic Area ("EEA") when they entered into agreements and concerted practices to fix air freight forwarding surcharges. [30] In particular, those surcharges related to new export systems, advanced manifest systems, currency adjustment factors and peak season surcharges. The conduct was found to amount to a single and continuous infringement between at least 2003 and 2007, facilitated by meetings and email exchanges. The conduct related to routes between China/South China and Hong Kong and the EEA; between the EEA and the United States; and between the United Kingdom and third countries outside the EEA. The total amount of the fines imposed on the firms amounted to EUR 169 million. Deutsche Post was granted conditional immunity. In 2018, the Court of Justice of the European Union upheld the amount of the fines imposed by the EC.[31]

Other examples of the EC finding cartel infringements in the logistics sector include:

- *"Blocktrain" cargo services*:[32] On July 15, 2015, the EC announced that it had fined Express Interfracht, part of the Austrian railway incumbent Österreichische Bundesbahnen ("ÖBB"), and Schenker, part of the German railway incumbent Deutsche Bahn ("DB") a total of EUR 49 million for their involvement in a cartel arrangement to fix prices and allocate customers for "blocktrain" cargo services between 2004 and 2012.[33] Kühne+Nagel, a Swiss-based company, was not fined as it was granted immunity.

- Air cargo: In 2017, the EC fined 10 air cargo carriers a total of EUR 776 million for engaging in price fixing between December 1999 and February 2006 in relation to airfreight services covering flights to and within the EEA, in contravention of Article 101 of the TFEU. The EC reissued fines that were originally issued in 2010, but which had been annulled by the European General Court.[34]

- *Ocean Shippers*: On February 21, 2018, the EC found that five maritime car carriers had engaged in a single and continuous infringement on various international trade routes between October 18, 2006 and 6 September 2012 to coordinate prices and allocate customers for the provision RoRo deep sea carriage services for new motor vehicles, cars, trucks, and high and heavy vehicles.[35] The amount of the fines imposed totaled EUR 395 million.

At the national level, in Spain, on March 9, 2018, the Comisión Nacional de los Mercados y la Competencia ("CNMC") announced that it had fined parcel delivery companies, including CEX, FedEx, UPS, DHL, and TNT a total of EUR 68 million for entering into a total of nine customer allocation agreements (executed through WhatsApp conversations, internal email exchanges and verbally) in relation to their commercial clients in Spain.[36] On October 28, 2019, the French Autorité de la Concurrence imposed a fine amounting to EUR 3.98 million on Astre road transport group (an industry association of small and medium-sized road transporters) for its involvement in customer allocation through a bid-rigging arrangement over a period of two decades.[37] On June 20, 2020, the Office for the Protection of Competition ("OPC") in the Czech Republic imposed fines equivalent to approximately EUR 690 million on AWT Čechofracht a.s., Interfracht s.r.o., Argo Logistics, s.r.o. and Spedica, s.r.o. for implementing a cartel arrangement in the sector of international rail freight transport and forwarding through allocating customers and contracts and coordinating prices for their services between 2004 and 2013.[38] Most recently (since November 2021) the CMA has been investigating

30 The EC defined freight forwarding as "the organisation of transportation of items (possibly including activities such as customs clearance, warehousing, ground services etc.)". The EC segmented the freight forwarding business into domestic and international freight forwarding and freight forwarding by air, land, and sea. EC Decision *CASE AT.39462 – Freight forwarding*, European Commission, https://ec.europa.eu/competition/antitrust/cases/dec_docs/39462/39462_6408_3.pdf (March 28, 2012) at para 3.

31 EC Press Release No 09/18: *The Court of Justice Upholds the Fines Imposed by the Commission on a Number of Companies for their Participation in Cartels in the International Air Freight Forwarding Services sector*, European Commission (February 1, 2018), https://curia.europa.eu/jcms/upload/docs/application/pdf/2018-02/cp180009en.pdf (last visited on March 23, 2022).

32 The EC defined blocktrains as cargo trains that deliver goods from one site to another without being stored or split up on the way.

33 See *EC Press Release: Antitrust: Commission Fines Cargo Train Operators EUR 49 million for Cartel*, European Commission (July 15, 2015), https://ec.europa.eu/commission/presscorner/detail/en/IP_15_5376 (last visited on March 23, 2022).

34 See *EC: Antitrust: Commission re-adopts decision and fines air cargo carriers EUR776 million for price-fixing cartel*, European Commission (March 17, 2017), https://ec.europa.eu/commission/presscorner/detail/en/IP_17_661 (last visited on March 18, 2022).

35 EC Decision *CASE AT.40009 – Maritime Car Carrier*, European Commission (February 21, 2018), https://ec.europa.eu/competition/antitrust/cases/dec_docs/40009/40009_2427_7 (last visited on April 8, 2022).

36 See *CNMC Press Release*, CNMC, https://www.cnmc.es/sites/default/files/editor_contenidos/Notas%20de%20prensa/2018/20180308_NP_Sancionador_Paqueteria_eng.pdf (last visited on March 27, 2022).

37 See *Autorité de la Concurrence Press Release* (October 28, 2019), *The Autorité de la concurrence fines the Astre transport group €3.8 million for anticompetitive practices*, https://www.autoritedelaconcurrence.fr/en/press-release/autorite-de-la-concurrence-fines-astre-transport-group-eu38-million-anticompetitive (last visited on March 27, 2022).

38 See *OPC Press Release The Office imposed fine for the third cartel agreement in rail freight transport* (June 22, 2020), https://www.concurrences.com/IMG/pdf/office_for_the_protection_of_competition_news_-_competition_the_office_imposed_fine_for_the_third_cartel_agreement_in_rail_freight_transport.pdf?61170/f4e66fcb111994d7a6b364556da0c47c5d75d9e7 (last visited on March 27, 2022).

whether a capacity-sharing agreement between P&O Ferries and DFDS – two ferry operators on the Dover-Calais route – has the potential to prevent, restrict or distort competition within the United Kingdom.[39]

These findings have the potential to give rise to private follow-on damages actions. For example, in the United Kingdom, in relation to the "ocean shippers"/RoRo cartel, on February 22, 2022, the UK Competition Appeal Tribunal ("CAT") certified follow-on damages claims brought on behalf of consumers who purchased or financed new cars or commercial vehicles from the relevant car manufacturers (amounting to more than 17 million vehicles).[40] Those claimants are automatically part of the relevant class, as collective proceedings were brought on an opt-out basis. Relevant to the claim is the degree of pass-through or pass-on of the price increases, which will require the presentation of robust economic evidence, and which will be determinative of the extent of harm suffered by claimants. As these developments illustrate, follow-on damages actions that are brought in the United Kingdom may rely on EC decisions as prima facie evidence of an infringement where those decisions were issued prior to the United Kingdom exiting the European Union on January 31, 2020.

The above decisions reflect that (i) competition authorities are likely to closely scrutinize pricing in the logistics sector as the authorities have previously identified these sectors as conducive to coordination; and (ii) firms could face considerable penalties where they are found to have engaged in coordinated conduct and unilateral exploitative conduct. A challenge for the Five Eyes will be separating price increases resulting from exogenous shocks, on the one hand, from price increases resulting from conduct undertaken in violation of the competition laws, on the other hand.

However, notably, on March 21, the European Competition Network (comprising the 28 competition authorities within the European Union and the DG Competition of the European Commission) in a statement indicated that it would not actively intervene to address necessary and temporary cooperation to ensure the purchase, supply, and distribution of scarce products in the context of the ongoing political conflict.[41]

While the EC is not a party to the Five Eyes Framework, the EC regularly coordinates with competition authorities worldwide on a bilateral basis, including the individual members of the Five Eyes, in the context of reciprocal waivers issued in the context of specific cases.

IV. POTENTIAL NEXT STEPS

If, following their collaboration, the authorities identify that firms in key sectors have engaged in unilateral or coordinated conduct that has led to the high prices, they could take further steps to gather information or to launch investigations or other enforcement functions.

The EC has the ability to compel the production of information in the context of sector inquiries, which are frequently, but not always, made public. Under Article 20(1) of Regulation 1/2003, the Commission is empowered to conduct "all necessary inspections" for the application of Articles 101 and 102 TFEU. During the pandemic, the EC has begun to apply more intensive remote investigation tools and is now back conducting dawn raids.[42] In the UK, the CMA has broad powers to request documents and information from parties subject to strict penalties for non-compliance. The CMA may call for the production of documents in the context of a market study. For example, in the context of its market study into online platforms and the digital advertising market in the UK, the CMA collected information from online platforms.[43] Additionally, the

39 See *CMA Press Release: Investigation into a capacity sharing agreement between P&O Ferries and DFDS*, Competition and Markets Authority (November 12, 2021): https://www.gov.uk/cma-cases/investigation-into-a-capacity-sharing-agreement-between-p-and-o-ferries-and-dfds (last visited on April 8, 2022).

40 CMA: UK Competition Appeal Tribunal: *Mark McLaren Class Representative Limited v MOL (Europe Africa) Ltd and Others* (1339/7/7/20), 1339/7/7/20 Mark McLaren Class Representative Limited v MOL (Europe Africa) Ltd and Others | Competition Appeal Tribunal (catribunal.org.uk) (last visited on March 20, 2022).

41 See *European Commission Press Release: 'ECN authorities' statement on the application of competition law in the context of the Russian invasion of Ukraine*', European Commission (March 21, 2022), https://ec.europa.eu/neighbourhood-enlargement/news/competition-ecn-authorities-statement-application-competition-law-context-russian-invasion-ukraine-2022-03-21_en (last visited on March 31, 2022).

42 See press releases: *Antitrust: Commission carries out unannounced inspections in the manufacturing and distribution of garments sector; Antitrust: Commission carries out unannounced inspections in the animal health sector in Belgium* Concurrences-Mayer Brown, *Competition Inspections in 21 Jurisdictions: a Practitioner's Guide*, edited by Nathalie Jalabert-Doury.

43 *Online Platforms and Digital Advertising Market Study Final Report*, Competition and Markets Authority (1 July 2020), available at: https://assets.publishing.service.gov.uk/media/5fa557668fa8f5788db46efc/Final_report_Digital_ALT_TEXT.pdf (last visited on April 1, 2022).

CMA may call for the production of documents when performing an enforcement function,[44] as well as in the context of dawn raids.[45] In March 2019, the CMA issued its first administrative penalty (amounting to £25,000) for obstruction of an inspection through failure to produce document.[46]

In addition, the Five Eye's investigation could potentially give rise to some of the authorities' scrutiny of firms' pricing as a unilateral exploitative abuse of dominance (specifically, excessive pricing), if a firm is shown to have "directly or indirectly imposed an unfair purchase or selling price" which has "no reasonable relation to the economic value of the product supplied."[47] While relatively rare, excessive pricing rules have recently been applied in several cases in the pharmaceutical sector in the United Kingdom and under state price gouging laws in the U.S.[48]

For example, in an ongoing case initiated prior to the COVID-19 pandemic, a pharmaceutical company's pricing practices for an epilepsy drug have come under scrutiny by the CMA. Following a remittal by the UK CAT and an appeal by Flynn to the Court of Appeal of England and Wales, the CMA on August 5, 2021 provisionally found (subject to reviewing representations from the parties) that Pfizer and the distributor Flynn had abused their dominant positions by overcharging the National Health Service for vital anti-epilepsy drugs.[49] Further, in two additional excessive pricing cases, in July 2021, the CMA announced that it had fined firms (i) £260 million for excessive pricing in relation to hydrocortisone tablets (a corticosteroid);[50] and (ii) £100 million for excessive pricing in relation to the supply of liothyronine tablets (used to treat hypothyroidism), respectively.[51] Under EU/UK law, the competition authorities do not apply any single test when determining whether a price is excessive, and a company may face a high burden of proof to rebut extensive economic evidence based on comparator prices (where the price at issue is "appreciably higher than those comparators"), cost-price analyses and, possibly, profitability tests.[52]

Exploitative abuses in the pharmaceuticals sector have also been considered in Europe,[53] Italy[54] and Spain[55] in respect of Aspen. Further, firm's prices for essential products during the pandemic were monitored by governments in the context of consumer protection law and, specifically, price gouging prohibitions. Price gouging could potentially be tackled as an exploitative excessive pricing abuse if the authorities were to adopt narrow market definitions and reach findings of temporary or collective dominance.[56] While certain extraordinary measures adopted

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44 Section 174 of the Enterprise Act, 2002 ("EA02").

45 Inspections without a warrant may occur under Section 27 of the Competition Act 1998 ("CA98") and inspections with a warrant may occur under Section 28 CA98. Where the CMA has reasonable grounds for suspecting that there may be an agreement which affects trade within the United Kingdom, and "*has as its object or effect the prevention, restriction or distortion of competition within the United Kingdom*" (Section 25 CA28), the CMA may compel the production of documents relevant to its investigation under Section 26 of CA98.

46 *CMA Press Release: "Penalty Notice: Musical instruments and equipment: suspected anti-competitive agreements*": Case: 50565-3, Competition and Markets Authority (March 6, 2019), https://assets.publishing.service.gov.uk/media/5c9a1b27e5274a3cab0beb97/Fender_Europe_Penalty_Notice__26_March_2019__FINAL__Redacted.pdf (last visited on March 20, 2022).

47 *The United Brands Company and United Brands Continentaal BV v Commission of the European Communities – Case 27/76 (1978),* at para 235; Article 102(a) of the TFEU.

48 For example, as recently as March 2022, New York sought public comment on crafting a law to prevent price gouging at every point in the supply chain. See *New York State Office of the Attorney General, Advance Notice of Proposed Rulemaking,* New York Attorney General (March 3, 2022); https://ag.ny.gov/sites/default/files/information_notice_for_price_gouging_anprm_.pdf (last visited on April 1, 2022).

49 See *CMA Press Release: CMAaccuses pharma firms of illegal pricing*, Competition and Markets Authority (August 5, 2021), https://www.gov.uk/government/news/cma-accuses-pharma-firms-of-illegal-pricing (last visited on March 23, 2022).

50 See *CMA Press Release: "CMA finds drug companies overcharged NHS*, Competition and Markets Authority (July 15, 2021), https://www.gov.uk/government/news/cma-finds-drug-companies-overcharged-nhs (last visited on March 23, 2022).

51 See *CMA Press Release: CMA fines pharma firm over pricing of crucial thyroid drug*, Competition and Markets Authority (July 29, 2021): https://www.gov.uk/government/news/cma-fines-pharma-firm-over-pricing-of-crucial-thyroid-drug (last visited on April 8, 2022).

52 See e.g. CaseC-177/16 AKKA/LAA EU:C:2017:689, para 49; *Deutsche Post AG – Interception of cross-border mail OJ* [2001] L 331/40.

53 *European Commission case file AT.40394 Aspen*, https://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=1_40394 (last visited on March 25, 2022).

54 *Italian Competition Authority case file A480 – Price Increase of Aspen's drugs,* https://en.agcm.it/dotcmsDOC/pressrelease/A480_eng.pdf (last visited on March 25, 2022).

55 *Comisión Nacional de los Mercados y la Competencia Case File S/DC/0601/16: Laboratorios Aspen.*

56 Notably, Commissioner Vestager stated at an online event at the beginning of the pandemic that the EU Commission "*will stay even more vigilant than in normal times if there is a risk of virus-profiteering.*"

at the start of the pandemic, including exemptions for co-ordination, have been relaxed,[57] competition authorities' and governments' scrutiny of firms' pricing may endure. As the CMA noted in a November 2020 report, "*[t]he pandemic has … brought the reliance of the UK economy on international supply chains into focus*".[58]

Regarding next steps in the United States, the DOJ has worked in conjunction with the United States Federal Bureau of Investigation ("FBI") to focus on investigating potentially anticompetitive activity in a variety of industries affected by supply chain disruptions. Often, these cases begin as civil investigations used to challenge conduct for which the competitive effect may be ambiguous. That is, the conduct is not unlawful unless it is on balance more anticompetitive than procompetitive. Such ambiguous business conduct may include competitive joint ventures, mergers, and distribution restraints. However, the DOJ may pursue criminal enforcement if the conduct appears to be inherently anticompetitive and unlawful, such as price fixing and other "*per se* illegal" conduct undertaken with criminal intent.

V. RECOMMENDED BEST PRACTICES

With the above guidelines and patterns of enforcement activity in mind, we would recommend that firms:

- Perform risk assessments to understand the company's legal obligations (including not just competition law compliance, but also obligations under consumer protection, human rights reporting, supply chain due diligence laws, etc.) as well as those of their suppliers in the respective markets in which they operate.
- Document procurement cost increases and make clear how price increases are related and proportionate to those cost increases. Consider whether the firm is in a dominant position and be prepared to objectively justify higher prices against actual or potential competitors' prices.
- Keep thorough records of industry meetings with competitors, and to keep minutes of those meetings.
- Ensure that the company's compliance policies are up-to-date– including in respect of dawn raids conducted at domestic premises – and being monitored and enforced consistent with local best practices and recommendations from enforcement agencies.[59]
- Seek legal guidance before entering into any agreements with competitors to ensure that its actions do not raise antitrust trust concerns.
- Closely review vertical agreements to determine whether these are compliant with the new draft Vertical Block Exemption Regulations in Europe and the UK (which are due to come into force this Spring).

Enforcement agencies are also providing guidance on best practices in order to avoid liability. For instance, the CMA has published supply chains due diligence principles on its website,[60] as well as supply chains guidelines.[61] In general, the CMA recommends that companies perform due diligence to enable them to make an informed judgment on transactions and the integrity of their supply chains. Principles for due diligence include performing risk assessments to understand the company's legal obligations and those of their suppliers in the respective markets in which they operate. Relatedly, on February 23, 2022, the EC issued a proposal on due diligence obligations to protect

57 For example, exclusion orders in the groceries, health services and maritime crossings sectors applied in the United Kingdom during the pandemic were lifted in October 2020. See CMA Guidance on competition law exclusion orders relating to COVID-19, available at: https://www.gov.uk/guidance/competition-law-exclusion-orders-relating-to-coronavirus-covid-19 (last visited on 7 April 2022).

58 See *CMA Report: The State of UK Competition* (November 2020), Competition and Markets Authority, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/939636/State_of_Competition_Report_Nov_2020_Final.pdf (last visited on April 7, 2022).

59 For instance, the DOJ has issued guidance on the evaluation of compliance programs in the context of criminal violations of the Sherman Act. See *DOJ, Evaluation of Corporate Compliance Programs in Criminal Antitrust Investigations*, United States Department of Justice (July 2019), available at: https://www.justice.gov/atr/page/file/1182001/download (last visited on April 8, 2022) (last visited on April 8, 2022).

60 See *CMA: Advice on applying supply chain due diligence principles to assure your labour supply chains*, Competition and Markets Authority, available at: https://www.gov.uk/government/publications/use-of-labour-providers/advice-on-applying-supply-chain-due-diligence-principles-to-assure-your-labour-supply-chains#supply-chain-due-diligence-principles" (last visited on April 7, 2022).

61 *Id.*

human rights and environmental considerations across supply chains in certain “high-risk sectors” and where certain size and revenue thresholds are met.

VI. CONCLUSION

The Five Eyes are expected to scan the environment internationally in relation to all levels of supply chains in various industries, such as air cargo, freight forwarding, ocean shipping, pharmaceuticals, and possibly key raw materials, to consider whether anti-competitive conduct could be the cause of supply chain disruptions. While they have not yet formally launched any investigations, the Five Eyes will coordinate to share information that might support the opening of investigations. Past enforcement by the authorities regarding coordinated conduct and unilateral abuses, for which examples have been provided in the United States, Europe, and the United Kingdom in this article, has been focused and far-reaching. Enforcement decisions have the potential to result in follow-on damages actions across jurisdictions with significant repercussions. We advise that firms remain vigilant regarding engaging in the above-recommended best practices to manage their risk exposure and to remain compliant with the competition and antitrust laws applicable to the regions in which they are active.

INSIGHTS FROM MARKETING AND SUPPLY CHAIN MANAGEMENT: IMPLICATIONS FOR COMPETITION POLICY AND ANTIRUST LAW

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I. INTRODUCTION

Competition policy and antitrust law overlap supply chain management (hereafter "SCM") in many areas. In addition to addressing dealings between organizations occupying the same level of a supply chain (e.g., manufacturer to manufacturer), competition policy and antitrust law also addresses dealings between organizations occupying different levels of the supply chain (e.g., manufacturer to retailer). These dealings may involve arrangements with upstream and downstream organizations in a supply chain. In some circumstances, they involve agreements that restrict the ability of one or both organizations to freely compete. Commonly referred to as "vertical restraints" in competition policy and antitrust law, these restrictions include a variety of supply chain-based business practices. Vertical "price" restraints limit the capacity of another organization, operating at a different level in the supply chain, to compete on price (e.g. minimum and maximum resale price maintenance). Vertical "nonprice" restraints limit the capacity of another organization, operating at a different level in the supply chain, to compete through nonprice ways (e.g. customer restrictions, location clauses, etc.). Hybrid restraints incorporate aspects of both price and nonprice restraints.

From the vantage point of competition policy and antitrust law, vertical restraints can encourage competition and may benefit consumers where they lead to a more efficient and/or effective supply chain. However, by definition, vertical restraints limit competition and can harm consumers where they unreasonably restrain trade. Given these complexities, disputes involving vertical restraints in the U.S. require analysis of whether they unreasonably limit competition. Ultimately, determining the reasonableness of a vertical restraint following antitrust law is multifaceted, requiring an in-depth understanding of the nature and effects of the restraint for competition and consumers.

Minimum resale price maintenance (hereafter "RPM") is a common, albeit controversial, vertical restraint. Agreements to engage in RPM establish the price below which a manufacturer's products may not be resold by downstream resellers (e.g., wholesalers, distributors, retailers). RPM impacts in excess of $300 billion in U.S. sales each year and has been found in the sale of a wide variety of products (e.g. stereo equipment, home improvement supplies, clothing and accessories, kitchen appliances, personal care products, etc.). As a supply chain practice, RPM raises challenging issues for competition policy and antitrust law. In this brief essay we describe four developments in supply chains and SCM and examine their implications for competition policy and antitrust law involving RPM.

II. IMPLICATIONS OF DEVELOPMENTS IN SUPPLY CHAIN MANAGEMENT FOR RESALE PRICE MAINTENANCE

Various developments in supply chains and SCM offer potential to impact understanding of RPM in ways that inform competition policy and antitrust law. These include evolving developments in the way supply chains are organized, how they are managed, advances in the technology of supply chains, and changes in the way that supply chain participants interact.

A. Organization of Supply Chains: Impact of Consolidation and Firm Concentration

To fully explain the effects of RPM for competition and consumers, competition policy and antitrust law adopts opposing perspectives of supply chain organization. Procompetitive perspectives, including the free rider thesis, view that typically supply chains are unconcentrated with few barriers to entry and that relative power in these systems generally favors upstream firms (e.g., manufacturers). Checked by market forces, procompetitive explanations for RPM describe how manufacturers are more likely to use RPM for procompetitive purposes. Thus, the free rider thesis explains that RPM is used by manufacturers to procompetitively resolve externalities that result from free riding in the distribution of their products.

In contrast, anticompetitive perspectives, including the forestalling competition thesis, adopt a less certain view of the role of market forces in the organization of supply chains and the ability of these forces to discipline against the abuse of RPM. Possessing market power obtained through consolidation and other factors, anticompetitive explanations describe that RPM is more likely to be used RPM for anticompetitive purposes. Thus, the forestalling competition thesis explains that RPM is forced upon a manufacturer by a more powerful retailer in an effort to preserve the retailer's profits (or willfully adopted by the manufacturer to preserve their profits). Given the contrary perspectives of RPM that exist in competition policy and law, a key question is whether (and to what extent) the organization of supply chains align with either view.

As reported in SCM research, consolidation and other influences have altered many supply chains, leaving them more concentrated than in the past and shifting the locus of power to downstream members of the supply chain (i.e. retailers). For example, research reports that

in 2005, the ten largest retailers in the U.S. accounted for over 80 percent of the average manufacturer's business. This compares to only approximately 30 percent two decades prior. This trend is continuing today. Related research documents as well that the greater relative power obtained by retailers has increased their bargaining power over manufacturers. Thus, more retailers now hold power and persuasion over their upstream counterparts. In *Leegin* (2007), the Supreme Court identified this trend and its implications for RPM. As Justice Breyer (writing for the dissent) described:

> "[t]hat change [increased retail concentration and bargaining power], other things being equal, may enable (and motivate) more retailers, accounting for a greater percentage of total retail sales volume, to seek resale price maintenance, thereby making it more difficult for price-cutting competitors (perhaps internet retailers) to obtain market share" (*Leegin*, 2007, p. 922).

Considered together with the logic of the forestalling competition thesis, the prospect exists that RPM may be increasingly used for anticompetitive purposes in the future.

B. Strategy of Supply Chains: Impact of Multi-Channel Systems and Cross-Channel Shopping

Competition policy and antitrust law involving RPM also draws conclusions about supply chains strategy. The free rider thesis presumes that cross-channel shopping (i.e., where a consumer shops in one retail channel but then purchases the product in another retail channel) should be discouraged as it encourages free riding. However, due to changes in the way consumers shop brought about by manufacturers' growing use of multiple retail channels to distribute their products, researchers in SCM report that many manufacturers are reexamining their distribution strategy. Some are continuing to apply strategies that discourage cross-channel shopping. However, others are embracing cross-channel shopping and developing strategies that profit from it. These strategies include monitoring and compensating the contribution that each channel member makes to a final purchase. Accordingly, a significant question regards the consequence of these developments for competition policy and antitrust law involving RPM.

In relation to the free rider thesis, for free riding to occur a consumer must shop across channels on their path to purchasing a manufacturer's product. Thus, as channels of distribution have proliferated, and cross-channel shopping by consumers has increased, so have conditions favorable for free riding. Consequently, to the degree manufacturers view these circumstances as promoting free riding, the more likely they will adopt strategies, including RPM, to discourage cross-channel shopping. Alternately, to the degree manufacturers view cross-channel shopping as beneficial and rely on strategies of distribution to maximize these benefits, the less likely they are to adopt strategies like RPM. This prospect has potential to challenge the basic premise of the free-rider thesis, that cross-channel shopping should be discouraged.

C. Technology of Supply Chains: Impact of Internet Commerce and the Role of E-Commerce Platforms

Competition policy and antitrust law involving RPM may also be limited in its understanding of the technology of supply chains. The forestalling competition thesis was developed well before the advent of Internet technology and the development of e-commerce and e-commerce platforms. Thus, in practice, the explanation has been primarily applied to describe how powerful "brick-and-mortar" resellers use RPM to preserve their own profits through anticompetitive means. However, Internet commerce and the technological advances that led to creation of the Internet have also created opportunities for the development and application of novel forms of RPM. This includes the development of creative mechanisms by which powerful resellers can monitor and enforce the use of RPM. These mechanisms and their effects are only beginning to be understood.

A novel way in which powerful resellers are using information technology and the Internet to monitor and enforce RPM is reportedly under investigation by the U.S. Federal Trade Commission (FTC). According to reports, the FTC is gathering evidence of how Amazon has employed its information technology to monitor rival's prices to determine if they are lower than prices charged by third-party sellers on Amazon's e-commerce platform. This information and Amazon's power is then used to make it more difficult to find and buy the products of the third-party seller, in an effort to influence the third-party seller to raise their prices elsewhere in the seller's supply chain. According to Amazon, a core objective of their strategy is to have a reputation for low prices, and Amazon works to maintain that reputation by ensuring they offer competitively priced products in its store. However, their approach has come under scrutiny because it involves influencing third-party sellers to raise their prices elsewhere - versus lowering their prices on Amazon. Given the rapid growth of e-commerce and the power of many e-commerce platforms, novel forms of RPM represent an important future area of focus for competition policy and antitrust law.

D. Interactions in Supply Chains: Impact of Relational Exchange and Interfirm Relationships

Competition policy and antitrust law also draws conclusions from how members of a supply chain interact. The nature of interactions between manufacturers and retailers is a key consideration in the determination of whether an agreement to engage in RPM exists. In the U.S., an RPM "agreement" generates more concern than where a manufacturer unilaterally announces in advance an RPM policy and then refuses to deal with those retailers that do not comply with their policy. Known as "unilateral price policies" such policies are viewed differently from an RPM agreement. However, in practice distinguishing a unilateral price policy from an agreement to engage in RPM is challenging. Thus, understanding the nature of circumstances that are more likely to result in an agreement can be useful for making such determinations.

Today, few researchers in SCM question that distribution arrangements have trended toward exchange relationships. In contrast to past, where exchange was conducted at arm's length, modern exchange relationships involve much greater collaboration and closer ties between manufacturers and retailers. As extensively described in SCM research, this evolution has impacted manufacturer-retailer interactions making it much more difficult for manufacturers to develop and adopt marketing strategies in isolation from the strategy of their retailers. A consequence is that the form of interaction found in these arrangements is less compatible, if not entirely contrary, to the development and implementation of unilateral price polices. Instead, the greater collaboration and closer ties between manufacturers and retailers is more conducive to the type of interactions that underpins agreements. To the degree these impacts are found they are likely to have a consequential effect on whether an agreement to engage in RPM is found.

III. CONCLUSION

Insights and research on supply chains and SCM have potential to inform the development and application of competition policy and antitrust law in significant ways. This brief essay examined four developments in supply chains and SCM and highlighted their implications for competition policy and law involving RPM. Further study and understanding of developments in supply chains and SCM and their implications for competition policy and antitrust law is encouraged.

ANTITRUST AND THE INFINITE, CIRCULAR SUPPLY CHAIN

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I. INTRODUCTION

The concept of the supply chain is central to what antitrust does, but antitrust can neither tame inflation attributable to supply chain disruption, as the Biden Administration wishes antitrust could, nor equalize the wealth of participants at different levels of the supply chain, as antimonopolists wish antitrust could.[2] The concept of abuse of power by a monopolist is coherent only in the context of a supply chain. A monopolist can harm competitors only if the monopolist can deny something to them that they need, otherwise competitors are unaffected by the monopolist's actions. That thing is, by definition, an input into competitors' production processes — otherwise competitors would not need it to remain in the market. It follows that a monopolist can exclude competitors only by participating in two rungs on a supply chain at the same time: an input market that the firm must control, and the downstream market in which the firm harms competition.[3]

The same is true of a monopsonist. The monopsonist's product is effectively a vehicle that upstream suppliers to the monopsonist need in order to put their own products into the hands of downstream consumers. When a monopsonist refuses to purchase an upstream supplier's products, the monopsonist is denies the supplier an input that the supplier needs to remain in the market. Indeed, like a monopolist, a monopsonist can exclude competitors in upstream supply markets only by participating in two rungs of a supply chain at the same time. In the case of monopsony, those rungs are the input market monopsonized by the monopsonist, and the upstream supply market in which the monopsonist harms competition.

Even the archetypical raising of prices by a retail monopolist — which, at first glance, appears to have nothing to do with supply chains — represents exploitation of supply-chain-based power. Supply chains are always circles — or, at least, spirals — because consumers are also workers. Even if they do not work on the particular products that they buy, their labor is an input into the production of other goods and services. A monopoly can raise prices only by denying access to its output to those who are not willing to pay higher prices. In so doing, the monopoly denies an input — food, clothing, or whatever else the monopolist retails — to producers of labor services. The relationship to supply chains of a monopsonist's archetypical lowering of wages to workers or prices to suppliers is easier to discern. A monopsonist is able to reduce the wages it pays to workers or the prices it pays to suppliers only by refusing to buy from those who are not willing to sell at lower prices, denying an input — namely, the monopsonist's product as vehicle by which workers and suppliers reach downstream consumers.

Despite having a fundamental connection with supply chains, antitrust can neither tame inflation attributable to supply chain disruption nor equalize the wealth of participants at different levels of supply chains.[4] For antitrust is a poor method of regulating prices or redistributing wealth.[5] Competitive prices are not necessarily low, at-cost prices. Even in competitive markets, some firms become rich and others do not because some firms have access to scarce resources that enable them to produce at lower cost than others.[6] Moreover, it is impossible to bring competition to every link in a supply chain because the number of links in any supply chain is always infinite, or nearly so.[7] A pencil is, technically, a near-infinite agglomeration of atoms, each of which can be classified as a separate component. A firm that does not open each atom up to separate sourcing destroys competition in the markets to supply those atoms, harming those who would have participated in those markets. But it would be impossible for firms to produce at all if they were to source components on an atom-by-atom basis. As a result, many — indeed, given the infinite divisibility of products (why stop at atoms?), an infinite number of — markets must be monopolized in any given supply chain, enriching the monopolist or monopsonist and impoverishing others. Price controls and taxation are more effective ways of taming inflation and redistributing wealth.

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2 *See* Jim Tankersley & Alan Rappeport, *As Prices Rise, Biden Turns to Antitrust Enforcers*, N.Y. Times (Dec. 25, 2021), https://www.nytimes.com/2021/12/25/business/biden-inflation.html [https://perma.cc/G7LD-YTF9]; Phillip Longman, *The Case for Small-Business Cooperation*, November/December 2018 Wash. Monthly (Oct. 28, 2018), https://washingtonmonthly.com/magazine/november-december-2018/the-case-for-small-business-collusion/ [https://perma.cc/D48Q-C3KS]. This essay draws heavily upon, and indeed borrows from, three working papers: Ramsi A. Woodcock, *Antimonopolism as a Symptom of American Political Dysfunction* (2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3864585 [https://perma.cc/3HPD-G393]; Ramsi A. Woodcock, *The Contrasting Approaches to Power of the Modern State and the Antitrust Laws: Lessons for Platform Regulation* (2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3704450 [https://perma.cc/8NTC-TWBZ]; Ramsi A. Woodcock, *How Antitrust Really Works: A Theory of Input Control and Discriminatory Supply* (2021), https://papers.ssrn.com/abstract=3794816 [https://perma.cc/4UFS-V9R2].

3 It is an unfortunate quirk of American antitrust law that enforcers test for monopoly power in the downstream market in which competition is harmed rather than in the input market. For without control over an input — which is to say, monopoly power in the input market — a firm has no power to harm competition in the downstream market. Moreover, collusion or merger aside, a firm cannot maintain monopoly power in the downstream market for long unless the firm monopolizes an upstream input to a sufficient extent to permit the firm to use it to exclude downstream competitors. See Ramsi A. Woodcock, *How Antitrust Really Works*, supra note 2.

4 See Tankersley & Rappeport, supra note 2; Longman, supra note 2.

5 Ramsi A. Woodcock, Antitrust Can't Tame Inequality, Let Alone Inflation, TheHill (Jan. 28, 2022), https://thehill.com/opinion/finance/591609-antitrust-legislation-cant-tame-inequality-let-alone-inflation [https://perma.cc/Q94L-AJMZ]; Ramsi A. Woodcock, Antimonopolism as a Symptom of American Political Dysfunction, supra note 2.

6 See Ramsi A. Woodcock, Antimonopolism as a Symptom of American Political Dysfunction, supra note 2.

7 See Ramsi A. Woodcock, *How Antitrust Really Works*, supra note 2; Ramsi A. Woodcock, To Produce Is to Self-Preference, What am I missing?, https://zephyranth.pw/2021/11/19/the-buy-or-make-or-market-decision/ [https://perma.cc/8H4N-C99C].

II. ANTITRUST, INFLATION, AND PRICE CONTROLS

The Biden Administration's interest in using the antitrust laws to tame inflation attributable to supply chain disruption reflects a misunderstanding of antitrust's means and ends.[8] It is a common misconception that antitrust's end is to reduce prices — or stop their increase.[9] If that were antitrust's end, then one would expect a monopolist's charging of high prices to violate the antitrust laws. But it does not.[10] Indeed, the price charged by a monopolist — or a cartel — is not an element of any antitrust offense, save predatory pricing, for which it is low prices, not high prices, that can lead to liability.[11]

It is true that lower prices are sometimes a byproduct of antitrust action, for antitrust promotes competition and competition can lead to lower prices. But lower prices are no more than a byproduct. Competition can also lead to higher prices — the entry of smartphones into mobile phone markets drove mobile phone prices up, for example, because consumers were willing to pay more for a more sophisticated product.[12] Moreover, even were lower prices to be antitrust's end, antitrust's means are very poorly suited to achieving it, for even when competition drives prices down, it is anyone's guess how far they will fall, or precisely how much of a reduction in price any particular antitrust remedy, such as breaking up a company, will bring about.[13] But getting prices right is important. Above-cost prices redistribute wealth from poor consumers to rich shareholders.[14] Below-cost prices destroy markets. Too little competition can leave prices too high. But too much competition — ruinous competition — can drive them too love.[15]

Antitrust is concerned not with using competition to get prices down but with using competition to improve products.[16] It is for this reason that antitrust does not condemn the firm that acquires a monopoly by developing a better product, even when that firm raises prices.[17] Apple undoubtedly charges high, above-cost prices for iPhones — surely, some part of the $170 billion in cash and marketable securities that the company carries on its books is not needed by Apple to maintain its operations or reward investors — but no court will break the company up on that ground.[18] Antitrust condemns only the firm that acquires a monopoly by degrading the products sold by competitors instead of improving its own, because that reduces the overall quality of goods delivered by the market to consumers.

Observers sometimes mistake antitrust's consumer welfare standard for a focus on price. After all, higher prices do sometimes harm consumers. But a consumer's welfare is the difference between the value a consumer places on a product — which is a function of product quality — and the price the consumer pays for the product. So consumer welfare is determined by product quality as well as price. Antitrust's consumer welfare standard implies a focus on the former — product quality — rather than the latter, because economists agree that product quality is the more important determinant of the two.[19] There is a floor below which prices cannot fall, limiting consumer gains from lower prices, but no ceiling on the gains to consumers from improvements in product quality — especially when product quality is understood to include the introduction of new and innovative products.[20]

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8 See Tankersley & Rappeport, supra note 2.

9 *See, e.g.* Herbert Hovenkamp, Federal Antitrust Policy: The Law of Competition and Its Practice 387 (6th ed. 2020) (describing antitrust as "a market alternative to price regulation") (emphasis omitted).

10 See *ibid.* at 356–58.

11 See *ibid.* at 444–46.

12 See Matthew Miller, *Ten Reasons to Still Consider a Basic Flip Phone in Today's Smartphone World*, ZDNet, https://www.zdnet.com/article/ten-reasons-to-still-consider-a-basic-flip-phone-in-todays-smartphone-world/ [https://perma.cc/U3QQ-P2MQ].

13 *See* Ramsi A. Woodcock, *Using Price Regulation Instead of Competition to Reduce Prices after Patents Expire* (2021), https://papers.ssrn.com/abstract=3466473 [https://perma.cc/3366-FM2J].

14 See Jonathan B. Baker & Steven C. Salop, Antitrust, Competition Policy, and Inequality, 104 Geo. L.J. Online 1, 11–12 (2015).

15 *See* Alfred E Kahn, The Economics of Regulation: Principles and Institutions II: 173-78 (1971) (MIT Press 1988).

16 See Ramsi A. Woodcock, *How Antitrust Really Works*, supra note 2.

17 *See* Daniel J Gifford & Robert T Kudrle, The Atlantic Divide in Antitrust an Examination of US and EU Competition Policy 28 (2015).

18 Apple, Inc., Annual Report (Form 10-K) 24 (2021), https://s2.q4cdn.com/470004039/files/doc_financials/2021/q4/_10-K-2021-(As-Filed).pdf [https://perma.cc/CL4Q-ZZ3P]; Rule 52 Order after Trial on the Merits at 1, Epics Games v. Apple, No. 4:20-cv-05640-YGR (N.D. Cal. Sept. 10, 2021) ("Success is not illegal.").

19 *See, e.g.* Kenneth J. Arrow, Workshop on the Economy as an Evolving Complex System: Summary, in The Economy as an Evolving Complex System 275, 281 (Philip W. Anderson et al. eds., 1988).

20 This assumes, of course, that innovative monopolists never obtain the power to charge prices so high that consumers cannot share in the gains from product improvement. So far, at least, that has been the case.

Antitrust does not focus on reducing prices charged by monopolists because there is a much more reliable way to reduce prices: price controls. Both a price regulator and an antitrust enforcer faces the challenge of identifying the costs faced by firms, so as to avoid driving prices too low. But the price regulator does not face the additional problem, faced by antitrust enforcers, of determining what effects antitrust remedies, such as breakup, are likely to have on prices.[21] The price regulator simply dictates the regulator's preferred price directly to the market.

Price controls are not only a more reliable method of reducing prices than antitrust, but price regulators can also apply price controls to reduce above-cost prices that are due to scarcity rather than monopoly, which the antitrust laws cannot do.[22] The power of a monopolist to raise prices is due to *artificial* scarcity. The monopolist could choose to increase output and drive prices down, but does not do so. By contrast, much above-cost pricing is due to *natural* scarcity — the fact that some firms are able to produce better-quality products than others, but only in limited quantities.[23] In the case of natural scarcity, the resources or technical capacity to produce more output simply do not exist. Because more cannot be produced, competition cannot drive scarcity-inflated prices down, and so no antitrust remedy — all of which are directed at promoting competition — can reduce scarcity-inflated prices. But price controls can. A firm must obey a price regulator's order to reduce prices, whether the firm's power to charge above-cost prices is due to artificial or natural scarcity.

To the extent that the present inflation is driven by supply chain disruption, the source of firms' power to raise prices is natural scarcity, not the artificial scarcity punished by the antitrust laws.[24] Supply chain disruptions occur when access to inputs — which are what supply chains deliver — is limited. The limited supply of inputs in turn forces firms to restrict output — or fail to grow output as fast as usual — leading to involuntary (i.e., natural) scarcity and the power to increase prices that comes with it. It follows that only price controls can tame the present inflation.[25]

Antitrust enforcers could attempt to offset natural-scarcity-based inflation by condemning firms that charge high prices due to artificial scarcity (i.e., monopoly) rather than supply-chain disruption.[26] These firms might have used their monopoly power to raise prices long before the start of the present inflation. Or they might have held off on exercising their power before the inflation for fear of alienating consumers.[27] Now that there is a general inflation, consumers are no longer able to distinguish natural-scarcity-based from artificial-scarcity-based price increases, and so these firms can raise prices without attracting consumer ire.[28] Antitrust enforcement against these firms would put some downward pressure on prices.[29] But this approach is less potent than price controls, which, as already observed, can reduce prices due to natural scarcity as well as those due to artificial scarcity.

III. ANTITRUST AS SUPPLY CHAIN REGULATION

Antitrust may not be the solution to inflation attributable to supply chain disruption, but supply chains are central to antitrust. Indeed, they are constitutive of antitrust's basic conception of abuse of power: we cannot conceive of abuse of power other than in the context of a supply chain.[30]

21 See Ramsi A. Woodcock, Using Price Regulation Instead of Competition to Reduce Prices after Patents Expire, supra note 13; Ramsi A. Woodcock, Antitrust as Price Regulation by Least Efficient Means, What am I missing?, https://zephyranth.pw/2020/09/21/antitrust-as-price-regulation-by-least-efficient-means/ [https://perma.cc/76Q2-WUFP].

22 See Ramsi A. Woodcock, Antimonopolism as a Symptom of American Political Dysfunction, supra note 2.

23 See *ibid.*

24 See Woodcock, supra note 5.

25 *See* James K. Galbraith, *The Case for Strategic Price Policies*, Project Syndicate (Jan. 21, 2022), https://www.project-syndicate.org/commentary/strategic-price-controls-warranted-to-fight-inflation-by-james-k-galbraith-2022-01 [https://perma.cc/9QKX-VNZL]. For an argument for why the charging of higher prices during shortages is not necessary to stimulate output, see Ramsi A. Woodcock, The Efficient Queue and the Case against Surge Pricing, (2021), https://osf.io/preprints/socarxiv/g8tym/ [https://perma.cc/ZJ8W-JJ5W].

26 *See* Paul Krugman, *Why Are Progressives Hating on Antitrust?*, N.Y. Times (Jan. 18, 2022), https://www.nytimes.com/2022/01/18/opinion/biden-inflation-monopoly-antitrust.html [https://perma.cc/T7F2-NVJ9].

27 See *ibid.*

28 See *ibid.*

29 Cf. *ibid.* I have argued elsewhere that antitrust could also be used to offset price increases brought about by the spread of personalized pricing. *See* Ramsi A. Woodcock, *Big Data, Price Discrimination, and Antitrust*, 68 Hastings L.J. 1371, 1372–80 (2017).

30 See Ramsi A. Woodcock, *How Antitrust Really Works*, supra note 2.

The antitrust laws support two basic kinds of claims, which map roughly onto Sections 1 and 2 of the Sherman act.[31] The first is a claim against the centralization of control over resources, otherwise known as collusion and merger.[32] The most famous example is the per se rule against price-fixing.[33] Firms that fix prices agree collectively to withhold access to a good unless buyers pay the fixed price.[34] Thus, a group of independent firms comes to act as one.[35] A collective mind has centralized control over their output.[36]

The second is a claim against abuse of power, understood to mean the unreasonable denial of access to a good by an entity that has centralized control over the good.[37] The classic example here is the refusal to deal or essential facilities claim.[38] A firm that owns an essential input — some infrastructure, say — and also competes in a market that uses that input, denies access to the input to competitors and the courts condemn the denial of access. The courts have condemned, for example, the refusal of an owner of the only power transmission lines in a particular region to allow a competitor in the power generation market to deliver power to customers through the transmission lines.[39]

Refusal to deal and essential facilities claims are only the most obvious examples of antitrust's input-denial-based conception of abuse of power. All abuse of power claims in fact have the form of an input denial.[40] Another abuse of power claim — exclusive dealing — attacks the use of contractual obligations to prevent an input controller from supplying inputs to a competitor.[41] I have argued that tying, which antitrust also condemns as an abuse of power, is no more than a refusal to supply the tying product to firms competing in the market to sell the (tying-plus-tied-product) bundle.[42]

The connection between antitrust's conception of abuse of power and input denial is unavoidable because the general concept of power — political as well as economic — is itself bound up with input denial.[43] In the archetypical exercise of power, one person uses the threat of violence to force another person to do something. We are not used to seeing this as a denial of access to an essential input, but it is.[44] Security is an essential input into all human activity.[45] Without it, we die violently. A person who uses the threat of violence to compel another to act uses the threat of denial of access to security to exercise power.[46] All political power is then, ultimately derived from monopolization of the security input.[47] Public law — including, notably, constitutional law — regulates denial of the security input by the government.[48] Antitrust law regulates denial of all other inputs by firms. Public law regulates political power; antitrust regulates economic power. But the underlying logic of power as input denial is the same.[49]

The input denial paradigm applies even to the archetypical act of a monopolist of raising prices, something that at first glance does not appear to have anything to do with inputs and supply chains. A monopolist does not simply raise prices. A monopolist delivers a threat to its

31 *See* 15 U.S.C. §§ 1, 2.

32 See Ramsi A. Woodcock, *How Antitrust Really Works*, supra note 2.

33 See Hovenkamp, supra note 9, at 247–48.

34 See Ramsi A. Woodcock, *How Antitrust Really Works*, supra note 2.

35 See *ibid.*

36 See *ibid.*

37 See *ibid.*

38 See *ibid.*

39 *See Otter Tail Power Co. v. United States*, 410 U.S. 366, 368–83 (1973).

40 See Ramsi A. Woodcock, *How Antitrust Really Works*, supra note 2.

41 See *ibid.*

42 See *ibid.*

43 See Ramsi A. Woodcock, The Contrasting Approaches to Power of the Modern State and the Antitrust Laws: Lessons for Platform Regulation, supra note 2.

44 See *ibid.*

45 See *ibid.*

46 See *ibid.*

47 See *ibid.*

48 See *ibid.*

49 See *ibid.*

customers: pay the higher price or I will not deliver my product to you.[50] That is a threat of denial of access to an input — and, typically, some customers cannot afford to pay and are cut off. The input might be a good that we typically classify as a consumption item, such as ice cream, rather than as an input. But all products, even consumption items, are, in fact, inputs, because economists describe economies as circles.[51] Firms produce products that they sell to consumers, who in turn provide labor services to firms. In introductory economics textbooks, an arrow connects firms to households and another arrow connects households back to firms.[52] What consumers buy and consume can be considered inputs into the production of labor, which in turn is an input into the production of goods and services, including consumption items. If you are not rewarded with a BMW, you will not be able to work for a corporate law firm — your mental health will not allow it. But the law firm enables transactions that permit BMWs — or other consumption goods — to be produced. Thus, even when a monopolist retailer raises prices to consumers, the mechanism through which this takes place is denial of access to an input.

The reason we do not typically think of a monopolist's price increase as input denial is that, in addition to failing to see consumers as laborers securing inputs necessary for them to work, antitrust contains a broad exemption from liability for a monopolist's unilateral price increases, as already mentioned in Part II.[53] If this exemption did not exist, however, the monopolist's price increase would violate the antitrust laws, for it could well drive more innovative consumer-workers from labor markets, and innovation — or, rather, the improvement in product quality to which innovation gives rise — is the criterion according to which antitrust distinguishes reasonable from unreasonable abuses of power.[54]

Indeed, the guiding principle in antitrust's regulation of supply chains is product improvement.[55] The question antitrust always asks, albeit often implicitly, is: does the denial of access to the input improve the downstream product that requires the input?[56] More generally, the basic paradigm, applied implicitly in every antitrust case involving the abuse of power, is this. Antitrust identifies a centralization of control over a particular input and then asks whether the manner in which the controlling firm allocates access to the input to downstream firms — the manner in which the controlling firm denies the input to some, provides it to others, and on what terms — reduces the quality of the products offered by the downstream firms.[57] If it does, then antitrust condemns the input controller's behavior.[58] If not, and particularly if the input denial improves the quality of products offered by downstream firms, antitrust does not condemn the controller's behavior.

Firms that control inputs sometimes use input denial to influence the extent and direction of innovation in downstream markets.[59] Innovation increases demand for downstream products, and that in turn increases the size of the profits generated by downstream firms. An input controller can extract those profits through the prices it charges for inputs, so input controllers have an incentive to drive downstream markets in innovative directions.[60] Often, input controllers use input denial to favor innovative firms as part of a plan for the allocation of scarce resources. The inputs are naturally scarce and so the input controller must decide to which downstream firms to allocate them. The input controller chooses the most innovative firms. A railroad line can only run so many trains in a given period of time, so it must decide which train operator to permit to use its tracks. The railroad will choose the company that offers the highest-quality service because that company will have more profits to share with the railroad line. The railroad denies access to other train operators because there is no more room available on the track. This sort of discriminatory allocation of naturally scarce resources does not implicate the antitrust laws.

But sometimes an input controller seeks to promote downstream innovation by refusing to supply inputs to less-innovative downstream firms even when the input controller has the capacity to supply the less-innovative firms. In this case, the input controller creates artificial scarcity and the antitrust laws are implicated. But although the antitrust laws are implicated, they do not prohibit this sort of input denial, so long as the

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50 See Ramsi A. Woodcock, *How Antitrust Really Works*, supra note 2.

51 *See, e.g.* Paul A. Samuelson & William D. Nordhaus, Macroeconomics 26 (15th ed. 1995).

52 *See, e.g. ibid.*

53 See Hovenkamp, supra note 9, at 356–58.

54 See Ramsi A. Woodcock, *How Antitrust Really Works*, supra note 2.

55 See *ibid.*

56 See *ibid.*

57 See *ibid.*

58 See *ibid.*

59 See *ibid.*

60 See *ibid.*

effect is to promote downstream innovation.[61] The only local supplier of restaurant equipment — grills, tables, and the like — might choose not to supply equipment to restaurants that earn low hygiene scores from the municipal health department. The input denial drives unclean restaurants out of business and enables cleaner restaurants to replace them. The supplier stands to benefit because cleaner restaurants attract more diners and earn greater profits, allowing the equipment supplier to raise equipment prices. Under the doctrine of the rule of reason — what I call "innovation primacy" — antitrust does not condemn this sort of product-improving discrimination in input supply.[62]

A firm that controls an input can also use input denial to reduce downstream product quality.[63] If artificial restrictions in supply of the input are involved, then the input denial constitutes an abuse of power in violation of the antitrust laws. An input controller might, for example, starve downstream firms that the controller believes may one day grow to challenge the firm's control over the input.[64] Those downstream firms might be the most innovative in the downstream market, so the input controller's intervention would reduce product quality in the downstream market, violating the rule of reason. Or an input controller might starve downstream firms that make it difficult for the controller to determine how much profit the firms have to share with the controller.[65] This criterion for denying access does not take the innovativeness of the downstream firms into account, and so innovative firms may be destroyed and the overall level of quality in the repair market reduced. That, too, would violate the rule of reason. For example, a maker of photocopy machines might refuse to supply spare parts to independent service organizations that do not share data on their revenues, because without that data the manufacturer cannot tailor the prices it charges for the parts to each independent servicer in order to extract the largest possible share of profits from the independent servicers.[66] But the independent servicers that fail to share data might do a better job of servicing photocopiers than those that do share data. Antitrust would condemn the manufacturer's actions.

The foregoing examples all involve input controllers that do not compete directly in the downstream market in which they influence competition. But the analysis applies, if anything, with greater force to the more archetypical case of input controllers that manipulate competition in downstream markets in which they formally compete.[67] The railroad that directs scarce track to the more innovative trains that the railroad itself operates does not violate the antitrust laws, because, as before, the railroad allocates a naturally scarce resource. The restaurant supplier that supplies only its own, cleaner restaurants does not violate the antitrust laws because it offers a better-quality product. But the manufacturer that cuts off independent service organizations that refuse to share profit data in favor of its own in-house repair shop, with respect to which the manufacturer of course has complete data access, does violate the antitrust laws.[68] Because an input controller can use the prices it charges for its input to extract profits from downstream firms that the controller favors, the input controller is always in a sense integrated with the downstream firms it favors, and so is always engaged in manipulating competition in markets in which it competes, whether it formally owns a downstream firm or not.[69]

The foundation of a firm's ability to abuse power is the possession of power itself. If a firm does not control an input, its threats to deny access ring hollow. Downstream firms can obtain the input from other sources. Thus, the centralization of control over inputs — which, as already noted, antitrust also regulates — is a necessary condition for abuse of power.[70] If antitrust could prohibit all centralizations of control over inputs — that is, if antitrust could prohibit all supply chain bottlenecks — there would be no need to prohibit abuse of power, as there would be no power.[71] But antitrust cannot prohibit all centralizations of control.[72] Many are necessary for production to occur. If John Deere alone has the

61 See *ibid.*

62 See *ibid.*; Ramsi A. Woodcock, The Obsolescence of Advertising in the Information Age, 127 Yale L.J. 2270, 2213–14 (2018). Why might the equipment supplier wish to drive out unclean restaurants when consumers can be expected to do that anyway, by patronizing only restaurants with high health grades? The answer is that consumers might not behave as expected, or act in their own best interests. Consumers might, for example, continue to patronize a dirty restaurant from force of habit, enabling the restaurant to remain in the market, even though consumers would be happier, and dine out more often, were the restaurant to be replaced by a cleaner one.

63 See Ramsi A. Woodcock, *How Antitrust Really Works*, supra note 2.

64 See *ibid.*

65 See *ibid.*

66 *Cf. Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451, 458 (1992).

67 See Ramsi A. Woodcock, *How Antitrust Really Works*, supra note 2. Courts do not always recognize this equivalence, however.

68 *See* Andrew I. Gavil et al., Antitrust Law in Perspective: Cases, Concepts and Problems in Competition Policy 524 (3d ed. 2017) (discussing the price discrimination theory of why Kodak wished to raise aftermarket prices).

69 See Ramsi A. Woodcock, *How Antitrust Really Works*, supra note 2.

70 See *ibid.*

71 See *ibid.*

72 See *ibid.*

technological ability to produce a tractor, then John Deere will necessarily have centralized control over the tractor input into farming. If antitrust were to prohibit such control — and a unitary, indivisible John Deere alone can make tractors — then there would be no tractor, which is not a good result.

The antitrust laws avoid this problem by applying the product improvement criterion here, too, to distinguish reasonable from unreasonable centralizations of control.[73] Centralizations that are conducive to product improvement are legal; all others, including those that degrade products, are illegal.[74] In particular, antitrust never challenges centralizations due to organic growth — creation of the input by a firm.[75] If John Deere controls all the tractors because only John Deere makes them, then there is no antitrust violation. Antitrust assumes that only those centralizations carried out by agreements — including merger agreements — between competing input owners can lack a product improvement rationale.[76] They are condemned when they fail to improve the product.[77] Naked price-fixing, which is defined as an agreement to raise price that is not "ancillary" to some other purpose, is an exception. It is *per se* illegal because it has no end other than to increase profits.[78]

IV. ANTITRUST AND SUPPLY CHAIN FAIRNESS

Antimonopolists argue that antitrust should abandon its consumer welfare standard because the standard prevents antitrust from defending workers and small suppliers against monopsony buyers.[79] In response, the antitrust mainstream has pointed out that the consumer welfare standard is really a "trading partner welfare" standard that protects workers and small suppliers in addition to consumers.[80] They are right. But the distributive framing of the debate by both sides misses the singular unsuitability of the antitrust laws to resolving problems of wealth distribution between different levels of the supply chain.[81]

As already observed, a great deal of inequality is due to natural scarcity, not monopoly (i.e., not to artificial scarcity).[82] Thus, even were prices in all buyside and sellside markets competitive, the trading partners that control naturally scarce resources would become rich and those that do not would not.[83] That is why progressives have long struggled against attempts to tie the distribution of wealth to competitive market outcomes and why progressives' current romance with antimonopolism is perplexing.[84] As we saw in Part II, only price regulation — or taxation — can redistribute profits due to natural scarcity.[85]

Even were competitive markets associated with wealth equality, antitrust would not be able to make all markets competitive, because, as we have already seen, antitrust does not prohibit centralizations of control over inputs or abuses of power that make products better.[86] In particular, the product improvement criterion for distinguishing good from bad abuses of power applies with as much force to the monopsonies that wield power against workers and suppliers as it applies to monopolies. We can think of a monopsony's refusal to buy from a particular supplier or to hire a particular worker as equivalent to a denial of an input to that worker or supplier. The monopsony's product is a vehicle that workers and suppliers need for their labor or supplies to reach downstream consumers. The monopsonist's refusal to buy is, then, equivalent to a denial of access to that vehicle. We can, for example, think of an Apple employee or supplier as selling, ultimately, to iPhone buyers rather than to Apple,

73 See *ibid.*

74 See *ibid.*

75 See *ibid.*

76 See *ibid.*

77 See *ibid.*

78 See Hovenkamp, supra note 9, at 247–48.

79 See Longman, supra note 2.

80 *See* C. Scott Hemphill & Nancy L. Rose, *Mergers That Harm Sellers Collection: Unlocking Antitrust Enforcement*, 127 Yale L.J. 2078, 2080 (2017–2018).

81 See Ramsi A. Woodcock, Antimonopolism as a Symptom of American Political Dysfunction, supra note 2.

82 See *ibid.*

83 See *ibid.*

84 See *ibid.*

85 See *ibid.*

86 We have also seen that antitrust does not prohibit the charging of supracompetitive prices by a monopolist. This exemption also applies to the infracompetitive prices charged by monopsonists.

using the iPhone as a vehicle to bring the employee's labor or the supplier's supplies to consumers. When Apple terminates an employee or supplier, the employee or supplier loses an input that the employee or supplier needs to reach the market. Thus, for purposes of antitrust prohibitions on abuse of power, monopsony and monopoly can be considered under the same input denial rubric. Consistent with the antitrust treatment of monopoly, a monopsony is, then, to be preserved under the antitrust laws if the monopsony makes input denial decisions that improve the products that reach downstream consumers.[87] If a monopsonist terminates suppliers of poor-quality inputs, there is no antitrust violation.

Even were antitrust to jettison its commitment to product quality and work instead to promote competition at every link in the supply chain, antitrust would run up against another problem: making every link in a supply chain truly competitive is impossible.[88] The only way to prevent a monopsonist from favoring some suppliers or workers over others is to require that the monopsonist buy from all workers or suppliers on nondiscriminatory terms.[89] To make John Deere treat its suppliers well, for example, antitrust enforcers must insist that John Deere purchase tractor parts on nondiscriminatory terms from all suppliers willing to offer them. But every purchase of a whole good or service by the monopsonist represents a decision to exclude sellers of parts of the good or service in favor of sellers of the whole good or service, so discrimination in the sourcing of inputs is pervasive.

It is also unavoidable because products cannot be assembled from an infinity of separately sourced parts. If John Deere purchases whole wheels from suppliers, then John Deere discriminates against potential suppliers of half wheels (i.e., of semicircular wheels), denying them access to the John Deere tractor qua means of bringing their products to downstream consumers. Half wheels are, in fact, a link in the supply chain, but one that is submerged because John Deere's discrimination against sellers that specialize only in half wheels is so absolute — John Deere never buys from them. An antitrust interested in promoting competition in *all* links in the supply chain would be compelled to surface this link by requiring John Deere to purchase separate half wheels rather than whole wheels. And what is true for half wheels would be equally true for quarter wheels — in not buying quarter wheels, John Deere suppresses the market for quarter wheels — and eighth-wheels and so on, ad infinitum. What is true of half wheels would also be true for every component of a tractor, not just wheels. To fully liberate every link of the supply chain, John Deere would need to purchase each atom of its tractors separately and in nondiscriminatory fashion. Indeed, the purchasing would need to extend beyond that to the subatomic level.

That would, of course, be impractical. To accommodate semicircular wheels, for example, John Deere would need to require that the semicircular wheels the company purchases be designed to lock together to form whole wheels, otherwise its tractors would not run. But the locking systems would make the wheels more expensive to produce and less reliable. Every new link in the supply chain would further increase design complexity and production costs until tractors would become so expensive that no one would buy them. And each new integrating component of the design — such as the lock mechanism required to attach two semicircular wheels — would add an infinity of additional components to the design, each of which would itself need to be sourced separately and accommodated. The supply chain would be atomized, and production would grind to a halt.[90]

Antitrust, as presently constituted, would not punish firms for avoiding this infinite regress. To the extent that adding links to the supply chain would make the product unworkable — to the extent that the tractor cannot run at all on wheels composed of semicircular components — a firm's refusal to add a link would be due to artificial scarcity in available product designs and so would fall outside of the ambit of the antitrust laws. The monopsonist would simply have too few products available to enable all possible suppliers to use them as vehicles to deliver their supplies to downstream buyers. But to the extent that adding links to the supply chain would not make the product unworkable, just less useful or more expensive, the antitrust laws would apply, because it would be possible for the monopsony to introduce additional, atomized designs.[91] Output could increase, and a monopsony's refusal to increase it, by not sourcing components separately, would represent the creation of artificial scarcity. But, as presently constituted, the antitrust laws would not punish firms for refusing to add the links, because such refusals lead to better products, or at least avoid the creation of less useful or more expensive products. An antitrust that is bent upon promoting competition at all levels of the supply chain, regardless of the effect on product quality, would, however, be compelled to intervene, regardless of whether natural or artificial scarcity were involved. For every decision not to source products separately precludes competition in a supply market and impoverishes the firms excluded from it.

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87 See Ramsi A. Woodcock, *How Antitrust Really Works*, supra note 2.

88 See *ibibid.*

89 See *ibibid.*

90 See *ibid.*

91 In fact, there is no hard distinction between a design that is unworkable and one that merely reduces the quality of the product or makes it more expensive. The non-applicability of the antitrust laws to cases of natural scarcity is merely an extension to extreme cases of product improvement of the rule that conduct that improves products is exempt from antitrust liability.

The anti-self-preferencing legislation currently making its way through Congress suffers from this problem of infinite regress.[92] The legislation prohibits input denial by firms that compete in the downstream market in which competition is harmed, but, unlike current law, it is not limited to cases in which the input denial degrades products.[93] To avoid the problem of infinite regress, proponents of the legislation have been forced to use other means to limit the legislation's scope, such as making it applicable only to very large firms and only to a carefully defined "platform" input.[94]

Rather than stamp out all exercises of power, antitrust enforcers could seek to break the monopsonist's control over the input that is the source of the monopsonist's power. But this provides less of a resolution to the problem than one might expect. For it is likely that, no matter how many firms produce a particular input, they will discriminate between suppliers in ways similar to a monopsonist, particularly where the discrimination improves the product and so increases the firms' profits. Break John Deere into two firms and both will still likely choose to purchase whole wheels. Only once the market has walked far down the path toward hosting an infinitude of producers will it be possible to find in the market a firm that assembles its wheels from half wheels. And even then, that is unlikely. Decentralization of control over inputs does not, in other words, guarantee that the market will engage in nondiscriminatory sourcing at every link of the supply chain. But for every link at which discriminatory sourcing takes place, there are suppliers who are excluded from the market and made poorer as a result.[95] The fact that deconcentrated input markets can still produce the sort of discrimination in which a monopsonist engages shows how fundamental the logic of product improvement — and the need for limits on competition — is. Wealth cannot be redistributed effectively through the promotion of competition.

V. CONCLUSION

Antitrust, as presently constituted, regulates the creation and abuse of power in supply chains. The guiding principle of this regulation is the improvement of products, not lower prices or the equitable distribution of wealth. Antitrust permits firms to centralize control over inputs, use the resulting power to harm downstream competition, and appropriate riches for themselves through higher prices, so long as doing so improves the quality of the products sold to downstream consumers. Antitrust, as presently constituted, therefore will be of limited use in taming inflation or distributing wealth equitably between different levels of supply chains. More suitable policies are price controls and taxation. Antitrust can be made more suitable only if, as I have proposed elsewhere, price controls are grafted onto it.[96]

92 American Innovation and Choice Online Act, S. 2992, 117th Cong. (2022).

93 *See ibid.* §§ 3(a)(1), 3(a)(2).

94 *See ibid.* § 2(a)(5).

95 See *ibid.*

96 *See* Ramsi A. Woodcock, The Antitrust Duty to Charge Low Prices, 39 Cardozo L. Rev. 1741 (2018); Ramsi A. Woodcock, The Efficient Queue and the Case against Surge Pricing, supra note 25; Ramsi A. Woodcock, Personalized Pricing as Monopolization, 51 Conn. L. Rev. 311 (2019); Ramsi A. Woodcock, *Personalizing Prices to Redistribute Wealth in Antitrust and Public Utility Rate Regulation* (2022), https://papers.ssrn.com/abstract=3378864 [https://perma.cc/G8X8-RQB2].

DUAL DISTRIBUTION IN THE DIGITAL AGE: THE EUROPEAN COMMISSION DRAFTS NEW COMPETITION RULES

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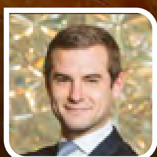

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I. THE CONTEXT

The European Commission ("EC") is currently revising the rules governing vertical agreements under EU competition law, which will expire on May 31, 2022. In this respect, on July 9, 2021, the EC published its long-awaited draft revised Vertical Block Exemption Regulation ("Draft VBER") and draft revised Guidelines on Vertical Restraints ("Draft VGL"). Initial public consultation on the suggested new rules closed on September 17, 2021.

The EC is now finalizing these drafts, and the revision process is nearing completion. If the new rules are adopted according to the planned timetable, they would take effect on June 1, 2022, with a transitional period until May 31, 2023 to adapt vertical agreements already in place at the time of adopting the rules. The new rules are intended to expire on May 31, 2034.

These drafts follow the Commission's extended evaluation process, spanning over two years, which included a 2019 public consultation, a stakeholder workshop, support studies, and a working paper. The EC's specific proposed changes were first unveiled when publishing the Draft VBER and Draft VGL in July 2021, followed by a revision to the Draft VGL in February 2022 to respond to certain stakeholder concerns.

The revamp of the EU competition rules on vertical agreements reflects the expanding digitalized economy, and the EC's main proposed changes focus on novel issues raised by increasingly complex business models that mix elements of traditional and online distribution channels and models.

The rules applicable to dual distribution are a key subject of the reform. In dual distribution, a supplier sells both through independent distributors and directly to customers in competition with its own distributors. A dual distribution relationship thus combines vertical aspects (a supply-distribution relationship) and horizontal aspects (the parties compete at downstream level).

With the ease and limited costs of e-commerce channels, suppliers are increasingly directly selling their products on their own websites, in combination with their traditional sales channels through distributors. This has led to a significant rise in dual distribution agreements, leading the EC to reconsider the currently broad exemption applicable to such agreements.

On dual distribution, public consultation responses to the Draft VBER and the Draft VGL were overall rather critical. The draft new rules on information exchange in a dual distribution context were perceived as unreasonable, impractical, and adding legal uncertainty as compared to the current regime. In response to the criticism, the EC initiated an additional consultation (closed February 18, 2022) on new draft guidance on information exchange in dual distribution, which clarified that information exchange that is "*necessary to improve the production or distribution of the contract goods or services by the parties*" would be covered by the revised VBER's safe harbor (provided that the dual distribution scheme otherwise complies with the revised VBER's conditions).

This article compares and discusses the currently applicable rules and the draft new rules for dual distribution.

II. DUAL DISTRIBUTION – RELATED ANTITRUST ISSUES

In a dual distribution system, a vertical agreement between a supplier and a distributor also involves horizontal aspects since the parties compete at the downstream level. From an antitrust perspective, dual distribution agreements can therefore raise a number of issues.

One of the main questions concerning such dual distribution agreements is the exchange of commercially sensitive information between a supplier and its distributor. Information exchange (e.g. on sales, products, marketing campaigns and market trends) is, however, inherent to any effective vertical relationship.

Current EU rules distinguish between legitimate vertical information exchanges and purely horizontal information exchanges, which are treated much more strictly.

III. DUAL DISTRIBUTION UNDER CURRENT EC RULES

Dual distribution involves vertical agreements between companies that may be prohibited as anticompetitive agreements under Article 101 TFEU. Currently, dual distribution agreements are exempted without any specific limitations other than the general conditions of the Vertical Block

Exemption Regulation ("VBER," Regulation 330/2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices).

The currently applicable framework (the VBER and the EC Guidelines on Vertical Restraints ("VGL")) provides a broad safe harbor for agreements falling under the VBER's scope, which are deemed compliant with the EU prohibition of anticompetitive agreements. The VBER is a critical tool from a business perspective, as it provides significant legal certainty on the validity of certain conduct.

The VBER's safe harbor applies to vertical agreements between parties whose market shares do not exceed 30 percent in any of the relevant markets (i.e. the market on which the supplier sells and the market on which the distributor purchases the contract goods or services). The vertical agreement also must not contain any so-called "hardcore" restrictions, such as minimum and fixed resale-prices or certain types of territorial protection.

Vertical agreements excluded from the safe harbor of the VBER may nevertheless be lawful, but they must be assessed on a case-by-case basis under Article 101 TFEU, which is a significant burden for the concerned parties (under the "self-assessment" principle). Under that analysis (conducted within the framework laid down by Article 101(3) TFEU), a vertical agreement is lawful only if the net effect, i.e. weighing its procompetitive benefits and anticompetitive harms, is positive.

While the VBER generally does not cover vertical agreements entered into between competitors, it provides certain exceptions to this rule. Under the so-called "dual distribution" exemption (Article 2(4) VBER), vertical agreements between competitors benefit from the VBER's safe harbor where:

- *"the supplier is a manufacturer and a distributor of goods, while the buyer is a distributor and not a competing undertaking at the manufacturing level; or*
- *the supplier is a provider of services at several levels of trade, while the buyer provides its goods or services at the retail level and is not a competing undertaking at the level of trade where it purchases the contract services."*

This exemption applies to agreements where the parties act in different economic roles and not at the same level of trade, where the following conditions are met:

1. The agreement must be *non-reciprocal* (i.e. only one party distributes for the other),
2. The *supplier* is either (i) a *manufacturer* of goods who also distributes these goods, or (ii) a *service provider* who operates at several levels of trade,
3. The *buyer* is (i) only a *distributor* (i.e. not competing with the supplier at manufacturing level) or (ii) only operating at the *retail level* (i.e. not competing with the service provider at the level of trade at which it purchases the contract services).

Importantly, the exemption that applies to dual distribution currently only covers vertical agreements entered into by manufacturers or service providers at the upstream level, not wholesalers or importers. In addition, it has generally been understood that the block exemption applying to dual distribution schemes also covers vertical information exchanges between the supplier and the distributor (even if they both compete at the retail level).

The rationale for such exemption is that in dual distribution, the vertical relationship predominates, while horizontal aspects are ancillary. When adopting the VBER, the EC considered that in dual distribution, any potential negative impact on the competitive relationship between the manufacturer and retailer at the retail level was of lesser importance than the potential positive impact of the vertical supply agreement on competition in general at the manufacturing or retail level (see VGL, para. 28).

IV. DUAL DISTRIBUTION EXEMPTION NARROWED UNDER EC'S DRAFT NEW RULES

The Draft VBER and Draft VGL maintain the exemption for dual distribution agreements but significantly reduce its scope and provide for a hybrid regime for information exchange under such agreements. The Commission justified these changes by the growth of direct online sales by suppliers and the fear that "*the current exception for dual distribution is likely to exempt vertical agreements where possible horizontal concerns are no longer negligible*." The draft new rules set out three main principles:

1. Non-reciprocal agreements in dual distribution systems are *fully exempted*, including information exchanges between the parties, provided that the parties' *combined market share* in the retail market *does not exceed 10 percent* and the supplier's and distributor's *individual market shares* on, respectively, the upstream (sale) and downstream (purchase) markets *do not exceed 30 percent* (Article 2(4) and Article 3 Draft VBER).
2. When the parties' *combined market share in the retail market is between 10 and 30 percent*, and the parties' *individual market shares* on, respectively, the upstream and downstream markets *do not exceed 30 percent*, the agreement is exempted, but the exemption does not cover information exchanges (Article 2(5) and Article 3 Draft VBER).
3. Irrespective of the above thresholds, the Draft VBER contains a *blanket limitation* such that it does not apply to vertical agreements which, directly or indirectly, in isolation or in combination with other factors under the parties' control, have the object of restricting competition between the competing supplier and buyer, including by way of information exchange (Article 2(6) Draft VBER).

Under these new rules, as soon as the parties' market shares exceed 10 percent, information exchanges would no longer benefit from the safe harbor of the revised VBER. Such information exchanges would require assessment under the Guidelines on the applicability of Article 101 TFEU to horizontal cooperation agreements ("Horizontal Guidelines"), which could be viewed as inappropriate given the fundamental vertical nature and specificities of dual distribution agreements. In addition, as provided in the Draft VBER (Article 2(6)), information exchanges would be excluded from the block exemption, regardless of the parties' market shares, as soon as they amount to a restriction "by object."

This general limitation on exempting dual distribution agreements, based on the notion of restriction by object, is likely contrary to the main aim of both the current and Draft VBERs to provide business with legal certainty, a key driving principle for any company. By relying on the broad and undefined notion of restriction by object, the draft VBER creates significant uncertainty and triggers the need for at least some kind of self-assessment by undertakings active in dual distribution systems, even when meeting all other conditions of the Draft VBER.

Finally, although the Draft VBER largely reduces the scope of the dual distribution exemption, it also expands the exemption in one notable way: under the Draft VBER, wholesalers, importers, and online intermediaries (e.g. digital platforms) are now also covered by the exemption, subject to the exception discussed below concerning online intermediaries. The inclusion of wholesalers, importers and online intermediaries is a welcome development, since their role largely resembles that of manufacturers as far as dual distribution is concerned.

V. ONLINE INTERMEDIARIES AND SWEEPING EXCLUSION OF "HYBRID" PLATFORMS FROM DUAL DISTRIBUTION EXEMPTION

The Draft VBER's dual distribution exemption now generally covers online intermediation service providers (i.e. digital platforms) acting as intermediaries for retailers to sell their products to end-customers.

A significant exclusion from the Draft VBER, however, applies to so-called "hybrid" platforms, i.e. where a provider of online intermediation services that also sells goods or services in competition with businesses to which it provides online intermediation services enters into a non-reciprocal vertical agreement with such a competing undertaking (Article 2(7) Draft VBER). A hybrid platform operator therefore manages two distinct businesses: (i) an intermediary service (for retailers using the platform to sell their products) and (ii) the operator's own retail business (for selling its own products on the platform).

Thus, to benefit from the Draft VBER, a provider of online intermediation services cannot sell goods or services in competition with the businesses to which it provides the intermediation services. The EC considers that such a hybrid function typically impacts inter-brand competition and may therefore raise non-negligible horizontal concerns (see Draft VBER, Recital 12).

This total exclusion of all hybrid online intermediation service providers, which is probably inspired by equating hybrid platforms with "digital gatekeepers" (a concept stemming from the proposed Digital Market Act ("DMA") and referring to companies deemed with significant market power), results in indistinctly sweeping in the likes of Amazon with a variety of much smaller hybrid companies. On this basis, the EC seemingly considers that horizontal concerns would overshadow the vertical aspects of hybrid platforms. However, the goal of excluding potentially problematic cases from the Draft VBER may have been better served by narrowing the wholesale exclusion of all hybrid platforms by applying, for example, a market share threshold.

VI. UNCERTAINTIES IN INFORMATION EXCHANGE IN DUAL DISTRIBUTION

The contours of legitimate information exchange in dual distribution are also raising uncertainties. As explained above, the draft new rules (as initially published in July 2021) set out a specific regime for information exchanges in a dual distribution context. Currently, the Draft VBER exemption would cover such exchanges only where the combined market share of the parties to the agreement do not exceed 10 percent on the downstream market where they compete. If exceeding the 10 percent combined market share threshold, information exchange aspects would require assessment under the Horizontal Guidelines.

This initial proposed approach to information exchange in dual distribution drew significant criticism, both because of the 10 percent threshold and the reference to the Horizontal Guidelines. Stakeholders pointed out that information exchanges in vertical relationships, including in dual distribution, may generate efficiencies and sought more guidance from the EC on the kind of information that may (and may not) be safely exchanged in a dual distribution context. In challenging the EC's reference to the Horizontal Guidelines, many stakeholders argued that information sharing in a vertical relationship (including in a dual distribution one) is not comparable to information exchange in a purely horizontal relationship between competitors.

Responding to the negative public consultation feedback, in early February 2022, the EC released a new draft section on information exchange in dual distribution for inclusion in the Draft VGL. This new draft, which was briefly open to consultation until February 18, 2022, no longer refers to the 10 percent combined market share threshold, which suggests that the EC intends to remove it. However, this would also require modifying the Draft VBER. While the EC has not released an updated Draft VBER, the new section of the Draft VGL indicates that its proposed guidance is based on the assumption that the revised VBER will include a change reflecting the updated Draft VGL.

In addition, the Draft VGL introduces a new test, providing that the revised VBER will only apply to information exchanges "*necessary to improve the production or distribution of the contract goods or services*." In practice, this means that application of the block exemption to information exchange in a dual distribution context would no longer depend on the parties' combined market share on the retail market and that the only relevant market share threshold would be the 30 percent threshold applicable to the parties' individual positions in the sale and purchase markets (Article 3 VBER). The EC thus recognizes that the horizontal aspect in dual distribution is most often an ancillary concern to a business relationship that is essentially vertical in nature (and involves the sharing of information about sales, products, marketing campaigns, market trends and consumer preferences on a regular basis) and, as such, should be mainly addressed in the revised VGL. The new specification also acknowledges the valuable efficiencies that information exchanges can bring in a vertical context.

Towards addressing a related point of public consultation feedback, the new Draft VGL section also provides detailed guidance on information that can be considered as "*necessary to improve the production or distribution of the contact goods or services*." It sets out a non-exhaustive list of information that can be considered as meeting such condition and thus benefiting from the block exemption, including:

a) Technical information relating to the contract goods or services;
b) Information relating to the supply of the contract goods or services, including information relating to production, inventory, stocks, sales volumes and returns;
c) Aggregated information relating to customer purchases;
d) Information relating to the prices at which the contract goods or services are sold by the supplier to the buyer;
e) Information relating to the supplier's recommended resale prices or maximum resale prices for the contract goods or services and information relating to the prices at which the buyer resells the goods or services, provided that such information exchange is not used to restrict the buyer's ability to determine its sale price or to enforce a fixed or minimum sale price;
f) Information relating to the marketing of the contract goods or services;
g) Performance-related information, including aggregated information communicated by the supplier to the buyer relating to the marketing and sales activities of other buyers of the contract goods or services, provided that this does not enable the buyer to identify the activities of particular competing buyers, as well as information relating to the volume or value of the buyer's sales of the contract goods or services relative to the buyer's sales of competing goods or services.

Conversely, several examples are provided of types of information that "*generally*" do not fall under the exemption of the Draft VBER rules:

a) information relating to actual future prices at which the supplier or distributor will sell the goods or services,
b) customer-specific (non-aggregated) sales data, and
c) information relating to goods sold by a distributor under its own brand name with a manufacturer of competing branded goods.

Those types of information exchanges are not necessarily prohibited under Article 101 TFEU. However, they are subject to an individual assessment, which should take into account the Horizontal Guidelines (also currently under review) and the relevant EU case law relating to exchanges of information between competitors. In addition, such information exchanges are subject to the presumptions established by the EU Court of Justice's case law relating to exchanges of information between competitors (i.e. companies that participate in a concerted practice and that remain active on the market are presumed to take into account information exchanged with their competitors in determining their conduct on the market). Even if the information exchanges do not qualify for the safe harbor, parties to a vertical agreement may nonetheless benefit from the block exemption provided that the agreement otherwise complies with the VBER's conditions.

Precautions can be taken to minimize the risk of engaging in anticompetitive exchanges of commercially sensitive information in relation to the nature of the information exchanged (e.g. should be aggregated and sufficiently old) and the personnel receiving the information (e.g. by implementing technical or administrative measures, such as firewalls and clean teams, to ensure that information provided by the distributor is only accessible to personnel responsible for the supplier's upstream activities and not to personnel responsible for the supplier's downstream retail activities competing with the distributor's).

The new Draft VGL section on information exchange is a welcome improvement, as it reduces the uncertainty and complexity raised by the Draft VBER and initial Draft VGL and facilitates self-assessment. Still, the new Draft VGL section reflects little innovation, and the broad notion of "*necessary to improve production or distribution*" will most likely create uncertainty and trigger discussions as to the information that actually meets this test, which may also depend on the particular distribution model at stake (exclusive distribution, selective distribution, franchise).

While the revised VBER and Vertical Guidelines have yet to be finalized (and are not expected to enter into force before June 1, 2022, with a transitional period until May 31, 2023 to adapt existing vertical agreements), companies would be well-advised to anticipate the upcoming new rules applying to dual distribution and to start implementing possible precautionary measures.

ANTITRUST ENFORCEMENT: LEVERAGING SUPPLY CHAIN INCENTIVES

BY NITISH JAIN & SERGUEI NETESSINE[1]

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I. INTRODUCTION

Supply chain structures are integral to firms' decisions, often enabling or deterring anticompetitive actions, and therefore they often attract attention of antitrust regulators. While many supply chain arrangements came under the scrutiny of lawmakers, perhaps one of most impactful and contentious antitrust regulation concerns the case of *Illinois Brick* (to be detailed shortly). In this short essay we show how policymakers can leverage nuanced understanding of supply chain decision making, which is primarily driven by self-interests of the trading firms, to strengthen enforcement of enacted regulations as it relates to *Illinois Brick*.

Consider the following recent antitrust suit: On February 14, 2020, KPH Healthcare Services, Inc. filed an antitrust case against Pfizer Inc, Mylan Pharmaceuticals and other related parties alleging anticompetitive actions by these parties to monopolize the epinephrine autoinjector market.[2] Specifically, KPH — an indirect buyer as a pharmacy retailer[3] — alleged that direct buyers of Mylan are leveraging a discounted EpiPen program to exclusively stock the autoinjector and, thus, dampening competitors' products. On July 26, 2021 U.S. District Judge Crabtree, in the District Court of Kansas, dismissed the antitrust suit citing a 1977 Supreme Court ruling *(Illinois Brick Co. v. Illinois)* that held that only direct purchasers, and not subsequent indirect purchasers, have antitrust standing to sue and recover damages.[4]

The case involving Pfizer-Mylan and KPH raises several questions. To begin with, is there a flip side of the Supreme Court ruling that debars indirect buyers to file an antitrust suit and recover damages? Put differently, though the ruling was passed with the good intent of reducing administrative and judicial cost, can this ruling in some instances encourage collusive action instead of deterring it? Another natural query is whether we can learn something from the nature of agreements between trading firms that can guide antitrust agencies' investigative efforts in identifying collusion, considering the *Illinois Brick* ruling? Along a similar line, can we identify products and market structures that are more (or less) prone to collusive action under this ruling? With the help of a supply-chain perspective one can start answering the above queries.

II. *ILLINOIS BRICK CO. v. ILLINOIS*: A RECAP

In 1977, the State of Illinois and 700 local governmental entities sued the brick manufacturers of concrete block for alleged antitrust violations.[5] The plaintiffs hired contractors for construction work. These contractors, in turn, engaged with the subcontractors, who purchased the concrete blocks from defendants – the manufacturers. In this transaction, thus, the plaintiffs were not direct purchasers of the defendants' product but were three levels down in the supply chain tiers. The U.S. Supreme Court made a landmark judgment in *Illinois Brick Co. v. Illinois* ("*IB*").[6]

The *IB* decision barred an indirect purchaser from suing and recovering antitrust damages based on a "pass-on" claim (i.e. on claims of supracompetitive prices, charged by the upstream firms, being passed on to them by the intermediary firms). The judgment noted that "whole new dimensions of complexity would be added to treble damages suits, undermining their effectiveness, if the use of pass-on theories were allowed."[7] The indirect purchaser suits could transform "into massive multiparty litigations involving many distribution levels and including large classes of ultimate consumers remote from the defendant,"[8] resulting in an astronomical increase in administrative and legal costs. Hence, the judgment barred purchasers from suing unless they directly suffered the antitrust injury.

2 https://www.govinfo.gov/content/pkg/USCOURTS-ksd-2_20-cv-02065/pdf/USCOURTS-ksd-2_20-cv-02065-0.pdf.

3 KPH operates both brick-and-mortar and online pharmacies.

4 Case No: 20-2065-DDC-TJJ.

5 *Ibid.* at 726-7

6 431 U.S. 720 (1977).

7 *Ibid.* p. 2.

8 *Ibid.*

Since its inception, the *IB* ruling has attracted considerable debate among scholars and practitioners alike. Strong arguments were advanced not only by the ruling's supporters (Litwin et al. 2010,[9] Price 2013[10]), but also by its opponents (Karon 2003[11]) — including a recent call from the Trump administration for its repeal.[12] Over the last 41 years, 28 U.S. states have introduced varying forms of IB repealers (see Figure 1). The other 22 states continue to support the IB ruling, recognizing its importance in limiting administrative burdens. On average, the cost of administering a settlement fund (as a percentage of the settlement amount) associated with indirect purchaser suits is more than 75 percent (2.42 percentage points) higher than the cost for direct purchaser suits (5.63 percent versus 3.21 percent).[13]

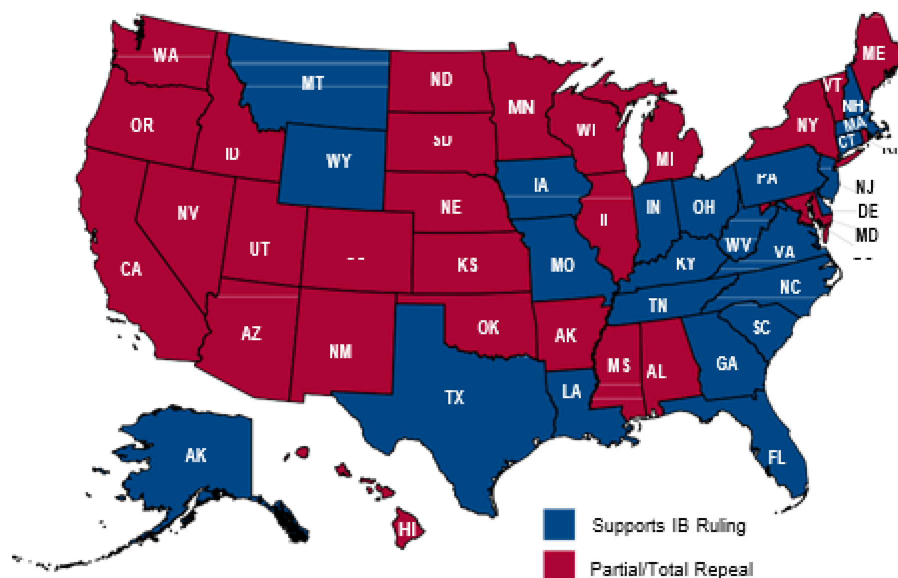

Figure 1. ***Illinois Brick*** **Ruling: States' Repealer Status as in 2020.**

III. THE CHINK IN THE ARMOR: THE THREAT TO THE BALANCE BEWEEN PRIVATE AND PUBLIC ENFORCERS.

Although the *IB* ruling reduces legal costs, at the same time it can enable firms to collude by attenuating incentives of its direct purchasers from filing antitrust suits (Schinkel et al. 2008).[14] In other words, the ruling weakens the role of private enforcers (i.e. firms) in curbing, via lawsuits, the anticompetitive behavior of other firms. As a result, public enforcers (i.e. government entities) must, via monitoring, step up their efforts. This raises a conundrum: how can the IB related benefits of lower legal costs be retained without a significant increase in public enforcement costs?

The challenge in balancing the role of public and private antitrust enforcers is not specific to the *IB* ruling. In the 2001 remarks of Mario Monti, European Commissioner for Competition Policy,[15] creating such a balance is a central tenet for framing antitrust reforms; such reform "should enable us to make the most of the complementary functions of the public and private enforcement of the competition rules." On the one hand, antitrust regulation that favors greater participation by private enforcers burdens the judicial system and thus, increases legal costs. On the

9 Litwin, *Time to Rebuild The Illinois Brick Wall*, Bloomberg Law Reports, Vol. 3, No. 19. Accessed December 18, 2020, https://bit.ly/2KAvcXC.

10 Price, G., *One Short Of a Load: Why an Illinois Brick Repealer Will Increase Private Antitrust Enforcement in Montana*, Montana Law Rev. 74(2).

11 Karon D.R., *Your Honor, Tear Down that Illinois Brick Wall— The National Movement Toward Indirect Purchaser Antitrust Standing and Consumer Justice*, Wm. Mitchell L. Rev. 30:1351 (2003).

12 Strimel & Ilter, *Trump DOJ's Next Target: The IB Indirect Purchaser Rule?*, The National Law Review, February 2, 2018.

13 Davis & Lande 2013, table 11, *Toward an empirical and theoretical assessment of private antitrust enforcement*, Seattle Univ. Law Rev. 36(3):1269.

14 Schinkel M, Tuinstra PJ, Rüggeberg J, *Illinois walls: How barring indirect purchaser suits facilitates collusion*, RAND J. Econom. 39(3):683–698.

15 See Monti, *Effective Private Enforcement of EC Antitrust Law*, Sixth EU Competition Law and Policy Workshop, June 2001 at https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_01_258 (accessed April 20, 2018).

other hand, if the role of private enforcers is restricted, then policy makers may either need to increase the level of regulatory monitoring (and hence, bear higher administrative costs) or suffer the adverse consequences of anticompetitive behavior in the market.

IV. MITIGATING THE *IB* CONUNDRUM WITH SUPPLY CHAIN INSIGHTS

The solution to the *IB* conundrum may lie in improving the ability of public enforcers to identify the firms that are most likely to commit IB-enabled antitrust violations. Since the *IB* ruling weakens the incentives of private enforcers to act, one can examine whether supply chain interactions can be used to improve public enforcement. Specifically, we recommend that the regulators focus on the procurement contracts between direct trading firms, for example, a manufacturer and its direct purchasers.

A choice of contractual agreement between two supply chain members not only determines the supply chain's overall efficiency, but it is also instrumental in determining how the resulting profits are allocated. Building on this line of inquiry, in Jain et al. (2021) we compare the extent to which five common contractual structures — wholesale price (WP), minimum order quantity ("MOQ"), wholesale price plus fixed fee ("WPFF"), revenue sharing ("RS"), and quantity discount ("QD") — facilitate anticompetitive (collusive) decision making among firms.[16,17] If these contract types do differ on that score, then public enforcers can enact simple rules that will improve their ability to select appropriate cases for investigation of antitrust violations and thereby, reinforce the IB framework.

In Jain et al. (2021) we model a three-tier supply chain that consists of manufacturers, retailers (direct purchasers), and consumers (indirect purchasers) in the context of the IB ruling. For each of five different contractual structures we study the propensity of manufacturers to collude. Jain et al. (2021) finds that the five types of contracts are quite distinctive in their ability to facilitate collusion. Specifically, no collusion is feasible under the wholesale price, minimum order quantity, revenue- sharing, and quantity discount contracts. Although manufacturers could earn more profit by colluding under these four contract types, those structures would reduce retailer profits in comparison with a competitive decision-making scenario. Retailers would take legal action against any collusive behavior by manufacturers under such contracts and, as a result, manufacturers would not be able to sustain a cartel.

In contrast, the wholesale price WPFF structure facilitates collusion via a side payment from manufacturers to retailers — sometimes referred to as a slotting fee — and it enables manufacturers not only to form but also to sustain a cartel. In the presence of the I*B* ruling, manufacturers are no longer indifferent towards the five contractual structures: there is a clear preference for WPFF in light of the IB ruling. Under collusion, manufacturers set a higher wholesale price than under competition. In terms of social welfare, both consumer surplus and total surplus are lower as compared to a competitive scenario.

The feature that any WPFF contract must have for collusion to be feasible is the use of slotting fees. Under a WPFF contract, manufacturers agree to pay a fixed fee to retailers (similar to the slotting fees observed in practice), compensating them for stocking fewer, higher-cost items than they would under perfect competition. Slotting fees, in short, make retailers indifferent to manufacturer collusion because they do not suffer as a result of it.

V. *IB* FACILITATED COLLUSION: THE ROLE OF PRODUCT CATEGORY AND MARKET STRUCTURE:

In Jain et al., we found that the manufacturers incentive to collude varies by the product category and market structure. Specifically, they found that the manufacturers' likelihood to collude is sensitive to a product's demand uncertainty (i.e. the ability of a firm or industry to accurately predict consumer demand for its products or services). Manufacturers are more likely to collude in product categories for which demand uncertainty is high. For instance, based on publicly available data, we identify food products like cereal, butter and margarine to have high demand uncertainty. Likewise, we identify non-food category products like stationery and school supplies.

With respect to the market structure, the incentive for manufacturers to collude increases with the number of retailers. Robust retailer competition leads to lower prices, lower supply chain profit, and lower profits for individual retailers. But by colluding, manufacturers are effectively able to control retailers' supply to the market and, thus, drive the supply chain profits upwards. Hence the presence of a greater number of retailers makes it more likely that manufacturers will form a cartel using WPFF contracts. In contrast, given the challenges involved in coordinating anticompetitive behavior among larger numbers of firms, the incentive for manufacturers to collude decreases as the number of (and competition among) manufacturers increases.

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16 Cachon GP, K¨ok AG, *Competing manufacturers in a retail supply chain: On contractual form and coordination*. Management Sci. 56(3):571–589, 2010.

17 Chen Y, Ozer O, *Supply chain contracts that prevent information leakage*. Management Sci. 65(12):5619–5650, 2019.

VI. ANTITRUST AND SUPPLY CHAINS: A FEW MORE EXAMPLES

A few more studies have illustrated the role of supply chain and operations management lens in encouraging or deterring firms' anticompetitive actions. For instance, Krishnan et al. (2010) show an example of business model innovation that can invoke anticompetitive actions from other members of the supply chain.[18] Specifically, the authors show that in response to a retailer's reduced sales efforts because of the supply chain innovation of "quick response" ("QR") fulfilment, the manufacturers might partake in anticompetitive actions — for instance, engaging in exclusivity terms when offering QR service. Likewise, Cho (2013)[19] and Yang et al. (2017)[20] demonstrate that the effect of mergers and multichannel distribution strategies on antitrust activities depends on the structure of a supply chain and the ensuing strategic decisions of its members.

VII. IN SUMMARY

Policymakers can enable more effective framing and enactment of antitrust framework if they understand the interplay between supply chain interactions and regulations. For example, the findings of Jain et al. (2021) illustrate that public enforcers can sharpen their case selection of business conduct, for monitoring of antitrust violations using the example of profiling the most likely offenders under the *IB* ruling.

18 Krishnan, H., Kapuscinski, R. & Butz, D.A., *Quick Response and Retailer Effort*, Management Sci. 56(6):962–977.

19 Cho, S.H., *Horizontal Mergers in Multitier Decentralized Supply Chains*. Management Sci. 60(2):356–379.

20 Yang Z., Hu, X., Gurnani H., & Guan H., *Multichannel Distribution Strategy: Selling to a Competing Buyer With Limited Supplier Capacity*, Management Sci. 64(5):2199–2218.

TETHERING VERTICAL MERGER ANALYSIS

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1 Microfoundations, www.microfoundations.com. Technical notes that support this paper appear in "Tethering Vertical Merger Analysis – Technical Notes," hereinafter Technical Notes, available at https://www.microfoundations.com/technical.

I. INTRODUCTION

Antitrust practitioners are mis-applying simple vertical merger screening techniques (e.g. vertical foreclosure arithmetic, price pressure analysis) to reach flawed and internally inconsistent conclusions about vertical mergers. Specifically, practitioners have struck on a formula for claiming harm from vertical mergers: They argue that relatively low upstream margins mean that, post-merger, the merged firm has an *incentive* to disadvantage rivals' access to the upstream product thus driving more sales to the merged firm's relatively more profitable downstream product. Yet, in doing so, they ignore the implications of the relatively low upstream margin for whether the upstream firm has the *ability* to divert sales in this way: If it did, it should be using that power to make more money pre-merger.

In more technical terms, practitioners use departure and diversion rates in their vertical math that are *untethered* from the relative margins that are at the heart of their incentive arguments. The result is a contradiction that leads to wrongful condemnation of vertical mergers — assuming that the upstream firm has a critical input but for some reason cannot use it to capture large margins pre-merger, with the "harm" from the vertical merger being that the merger somehow unlocks the power of what was already a critical input.

The problem is closely related to the misapplication of critical loss analysis that, for years, led practitioners to believe that horizontal mergers were less likely to be harmful if pre-merger margins were high rather than low.[2] In the same way, simple screening techniques that have become prominent in the analysis of vertical mergers indicate that they are *more* likely to lead to anticompetitive foreclosure or raising rivals' cost ("RRC") effects when upstream margins are *lower*. This reasoning, without more, is backwards for the same high-level reason that standard critical loss is flawed — in both cases, the analysis is not tethered to a coherent and internally consistent economic framework that explains the pre-merger margins that serve as critical inputs into the analysis.

The remainder of this paper refers to the class of out-of-equilibrium screening techniques currently being used to analyze vertical mergers as "untethered vertical math," or "UVM." The paper explains why tethering the vertical math to a coherent model — which often boils down to tethering the assumed departure and diversion rates to observed relative margins — substantially changes and very often reverses the predictions of vertical math models, particularly once the long-recognized efficiencies from vertical mergers (e.g. elimination of double marginalization, related benefits from combining complements) are incorporated. The goal is to be constructive — not to tear down vertical math, but to explain both intuitively and rigorously what is wrong when it is untethered, and to describe (in general terms) how to repair vertical math by tethering it.

II. UVM IS INCONSISTENT WITH THE ECONOMICS OF VERTICAL CONTRACTING AND VERTICAL MERGERS

A. Illustrative Example and Intuition

An example representing a typical vertical merger scenario illustrates the problems with UVM. Suppose an upstream firm sells an input used by two competing downstream firms to produce a product. There is some competition in the input market, although the extent of that competition is in dispute, and the upstream firm is argued by at least some to be "dominant." The upstream firm and one of the downstream firms propose to merge.

The following fact — prevalent in many recent vertical merger cases — is known: The upstream profit margin per unit of final output is small relative to total unit profit margin generated by merging upstream product.[3] To be concrete, suppose upstream profit is one-tenth the total profit generated using the upstream firm's input, including the margin on downstream sales. Based on this fact, a complainant seeking to block the merger makes the following argument:

- The cost of foreclosing (withholding input supply from the unintegrated downstream firms) per unit foreclosed is the upstream unit margin.
- The benefit of foreclosure per unit foreclosed is the integrated firm's unit margin, which includes the downstream margin.
- Because the upstream unit margin is only one-tenth the total (integrated) unit margin, the benefit of foreclosure will exceed the cost if at least 10 percent of the units lost by the upstream firm divert to the merged firm.
- Because it is likely that more than 10 percent of the units lost by the upstream firm due to foreclosure will be recaptured by the merged

2 See Daniel P. O'Brien & Abraham Wickelgren (2003), "A Critical Analysis of Critical Loss Analysis," *Antitrust Law Journal*, 71:161 and Michael Katz & Carl Shapiro (2002) "Critical Loss: Let's Tell the Whole Story," *Antitrust*, 17:49.

3 Unit margins (profit per unit) rather than percentage margins are the critical variables for analyses like vertical arithmetic and vertical pricing pressure.

firm — based on an argument that the upstream firm is "dominant" — foreclosure is likely to be profitable, and it would harm competition.

This simple cost-benefit analysis illustrates the "foreclosure arithmetic" variant of UVM; similar logic underlies pricing (e.g. vGUPPI) versions of the argument. Analysis like this appears regularly in Agency dialog with parties proposing vertical mergers, and it appears in recent formal complaints against such mergers.[4] In the author's recent experience, it is the single most prominent line of argument currently used by the Agencies to determine whether to challenge vertical mergers.

To introduce the flaws in this line of argument, I start with a simple, intuitive inference based on the upstream firm's profit share in the distribution chain. A premise of the UVM in the illustration is that the upstream firm has high market power and thus the *ability* to foreclose downstream competitors. If true, one would expect the upstream firm to capture a relatively large share of the total profits generated by its presumptively critical input. However, the upstream firm's share of the profit generated by its presumptively critical input in the illustration is only ten percent — and that small share is critical to the argument about incentives to foreclose.

Despite the relatively small observed upstream share, the complainant alleges that the upstream firm will have the *power* to foreclose unintegrated rivals and raise price post-merger, and the UVM presented indicates that the foreclosure would be profitable. An obvious question presents itself: If the upstream firm will have the power to foreclose unintegrated rivals after the merger, why is it getting only 10 percent (or any small percentage) of the profit generated by its critical input prior to the merger?

This question is not a rhetorical question, but rather one that must be answered. And an answer should be available within the same analytical framework — here the foreclosure variant of UVM — used by the complainant to predict anticompetitive merger effects. If the framework can be adjusted (parameters calibrated) to explain the per-merger margins, then this should be done before using the framework. In contrast, if the framework cannot explain critical pre-merger observables like relative profit margins, why would one possibly expect it to predict merger effects accurately?

UVM makes no attempt to explain why the upstream firm's profit share would be so small if it has the power to harm competition by foreclosing unintegrated competitors. UVM is an out-of-equilibrium analysis that simply takes pre-merger observables as given without drawing any inferences about what they mean for the competitive environment. Note that none of this is a condemnation of vertical math, rather it is a condemnation of the lack of tethering, which can create problems in any out-of-equilibrium economic analysis, viz., standard critical loss analysis.

Basic economic intuition and the more rigorous economics presented below would interpret the upstream firm's low profit share as an indication that the upstream firm likely does not have the power to foreclose competition significantly after the merger. Indeed, standard economic logic implies that the lower the upstream profit share, the lower the potential for anticompetitive foreclosure, which is precisely the opposite prediction from that made by UVM.

B. Inferences from the Economics of Vertical Pricing

Standard economics of vertical pricing allow clear inferences to be made about upstream market power based on pre-merger upstream and downstream unit margins. These inferences are missed in UVM, which uses profit margins and rates of diversion in response to foreclosure or RRC strategies as inputs into the analysis without tethering to observed margins the upstream firm's power to induce that diversion. In the example above, the upstream firm's profit share is small. If the upstream firm had the power to foreclose or raise the costs of unintegrated downstream competitors after the merger significantly, it would charge a much higher price and capture a higher profit share.

To see this more formally, consider the classic textbook case of linear demand for the downstream product, constant marginal cost, fixed proportions between the input and output (e.g. one unit of the input is required to produce one unit of the output), and take-it or leave-it ("TIOLI") price-setting by the upstream monopolist (I discuss bargaining below). If the upstream firm has monopoly power and sells to a monopolist in the downstream market (not the relevant scenario but informative as will become clear), its unit margin will be two times higher than the downstream firm's unit margin.[5] If instead the upstream firm sells to multiple competitors in the downstream market, downstream unit margins will be smaller,

4 *In the Matter of Nvidia and Arm:* "Post-Acquisition, the combined firm would likely have a substantial incentive to engage in foreclosure strategies because the profits from additional sales of [each of three relevant products] would be higher than any foregone proceeds of licensing Arm Processor Technology to Nvidia's [relevant product] rivals." There are other recent examples at Agencies in the US and Europe.

5 See any textbook, e.g. Dennis Carlton & Jeffrey Perloff (2005), *Modern Industrial Organization*, 4th ed, pp. 415-417; Roger Blair & David Kaserman (2009), *Antitrust Economics*, 2nd ed, Chapter 14; and Jean Tirole (1988), *The Theory of Industrial Organization*, MIT Press, Exercise 4.1, p. 175.

and the upstream firm's unit margin will be *more than two times higher than the downstream unit margin*.[6] That is, an upstream monopolist will earn substantially greater unit margins than the downstream sellers that use its input, a far cry from the recent cases in which upstream margins far below downstream margins are used to argue for vertical harm.

The basic point is that upstream monopoly power means the upstream firm can extract a large share of the available rents. This point applies more generally than the textbook case with linear demand and can be illustrated in a variety of ways. For example, one method used in the economic literature shows that if the upstream firm had upstream monopoly power, the ratio of the upstream unit margin to downstream unit margins would equal the "Numbers Equivalent" measure of the effective number of downstream competitors divided by the industry pass-through rate:[7]

$$\frac{\text{Upstream Unit Margin}}{\text{Downstream Unit Margin}} = \frac{\text{Numbers Equivalent}}{\text{Pass-through Rate}}$$

To interpret this expression, suppose as an example that the number of downstream competitors is at least 2 and the pass-through rate is no higher than 1. Then if the upstream firm had monopoly power, the upstream unit margin would be at least two times the downstream margin.

Contrasting this result from economic theory with the actual margins in the illustration (in which the upstream firm captured only ten percent of profits) makes clear that the upstream firm in the illustration does not have anything approaching monopoly power. Its share of the profit generated by its "monopoly" input is only a small fraction of what that share would be if it had monopoly power. There is a sharp disconnect between the relative margins used to argue for an incentive to foreclose and the asserted ability to do so.

The most plausible explanation for the upstream firm's small profit share — which indicates that the upstream firm has little ability to extract a significant share of downstream rents — is that it faces competitive constraints in the upstream market. These constraints could come from some combination of alternative suppliers of its products, self-supply by downstream firms, purchases of alternative substitute products, and the option not to purchase. The relative margins of upstream firms tell us these constraints must exist, and if they do not show up in shares in a putative market or in a selection of documents, then those shares and documents are missing important constraints. Put simply, if there were not such constraints, the upstream firm would be extracting much more value from downstream firms than it actually is. And because these constraints are unlikely to meaningfully lessen with the merger, theories of harm that do not account for these constraints are not coherent as a matter of economics and are very likely to predict a risk of merger harm where none exists.

III. BARGAINING AND NONLINEAR PRICING DO NOT SAVE UVM

A. Bargaining

In some recent merger cases (e.g. *AT&T-Time Warner*), the government has focused on bargaining-based theories of harm, pursuing the idea that even if traditional take-it-or-leave-it models did not produce harm from vertical mergers, bargaining models might. Similarly, one might postulate that the contradiction between upstream market power and low upstream unit margins could disappear if input prices were determined through bargaining. It does not. This section explains that allowing for bargaining still leaves the core tension that plagues UVM: Relatively low upstream margins imply that the upstream firm faces some form of competition giving the downstream firms options that must be — but often are not — accounted for in an analysis of vertical merger effects.

For illustration, suppose that the demand for the final product is described by the following inverse demand function, $P = 100 - Q$, where P is the final price of the downstream product and Q is total quantity produced by downstream firms. Assume that one unit of the input is required for one unit of output, and for simplicity (but without any loss of generality), assume that all firms have zero production costs.

In the textbook model where the upstream firm has all the bargaining power and sets the input price unilaterally, the profit maximizing input price under these assumptions is $50. If the downstream firm is also a monopolist, the profit-maximizing final price is $75, and the down-

6 *Id.*

7 For a derivation of this result, see Technical Notes. The Numbers Equivalent in the downstream market is the number of equally-sized Cournot competitors that would yield the observed downstream margins under whatever form of rivalry prevails. See, e.g., Morris Adelman (1969), "Comment on the 'H' Concentration Measure as a Numbers-Equivalent," *Review of Economics and Statistics*, pp. 99–101.

stream margin is $25 [= 75 – 25], while (given zero production costs) the upstream margin is $50. Consistent with the earlier discussion, the upstream profit margin is two times the downstream margin.

When bargaining power is equally distributed, the profit margins change. Suppose the upstream firm engages in simultaneous Nash bargaining ("Nash-in-Nash" bargaining) with each of N downstream competitors.[8] If downstream firms are Cournot competitors, it can be shown that the Nash-in-Nash solution under standard assumptions about disagreement profits yields a wholesale price equal to $25 irrespective of the number of downstream firms.[9] Thus the upstream unit margin is $25 irrespective of the number of downstream firms. If there are N downstream firms, the downstream price is $p(N) = \left(100 + 25N\right)/(N + 1)$. If , price is $50, and the downstream unit margin is the same as the upstream unit margin: $25. As the number of downstream firms increases from 2, the downstream unit margin falls so that the upstream unit margin exceeds the downstream unit margin. Thus, when foreclosure or RRC concerns are issues (meaning that there are downstream competitors that could be foreclosed, i.e. $N \geq 2$), the model predicts that, with an upstream monopolist and downstream Cournot competition, the upstream unit margin is never less than the downstream unit margin. And recall that UVM predicts that foreclosure is profitable only when the upstream unit margin is less than half the downstream unit margin. This never happens in the linear bargaining model with an upstream monopolist and downstream Cournot competition.

What is the appropriate conclusion if pre-merger evidence shows that, in cases where the input prices are negotiated, the upstream firm earns a small fraction of the total industry profit? The Nash-in-Nash bargaining model presented above, in which there is an upstream monopolist and downstream firms have no outside options, simply cannot explain these facts. Instead, to explain this pattern in the relative margins, downstream firms must have credible threats to pursue outside options,[10] such as alternative suppliers, backward integration, or a credible threat to take some action that hurts the supplier if it prices too high (e.g. invest to create a new supplier in the future). Critically, in this case, as long as the merged firm continues to sell to unintegrated downstream firms post-merger, the merger would likely be pro-competitive because the outside option would determine the input price charged to unintegrated downstream firms both before and after the merger and the merging downstream firm's effective marginal cost would fall due to the elimination of double marginalization.

The bargaining models discussed above assume as Nash did that upstream and downstream firms have equal "bargaining weights." One alternative approach in the literature to try to square small upstream profit margins with high upstream market power is to assume that the upstream firm has little bargaining power in negotiations with downstream firms, as reflected in a lower bargaining weight that puts smaller weight on the upstream firm's preferences than on the downstream firm's preferences. In my view, there are intuitive, theoretical, and antitrust policy problems with this approach, which render it an unsatisfying way to explain low upstream profits shares.[11]

At an intuitive level, why would an upstream monopolist that has high market power have so little bargaining weight that it receives only a small fraction of the profits generated by its critical input? In a real sense, this approach is quite non-economic — rather than use relative margins to derive implications about the extent of competition, as is standard in antitrust, this approach simply adjusts a "bargaining power" term that allows any pre-merger margins to be reconciled with a pre-conceived notion that the upstream firm has market power. At a theoretical level, modern bargaining theory associates relative bargaining weights with firms' relative degrees of patience in bargaining.[12] There is no reason to believe that the discount rate of an upstream firm is many times higher than the discount rates of downstream firms, which would be required to generate bargaining weights that explain a small upstream profit share. As a matter of antitrust policy, such an approach would favor enforcement to block mergers in situations where upstream firms control critical inputs but have little bargaining power to capture returns on those inputs,

8 Following standard theory, Nash bargaining requires specifying the profits earned by the bargaining parties upon reaching agreement and the disagreement profits they earn should they disagree. I assume that when only one downstream firm has an agreement, it operates as a monopolist, and the upstream firm earns a disagreement profit equal to the wholesale profits from selling to a downstream monopolist at the equilibrium wholesale price. I assume that each downstream firm has a disagreement profit of zero. These are standard assumptions.

9 See Daniel P. O'Brien (1989), "Section 4.1: N-Firm Bargaining," and "Section 4.4: Other Applications: Vertical Integration," from his doctoral dissertation. See https://www.microfoundations.com/technical. As discussed in the Vertical Integration section, a vertical merger between an upstream monopolist and a downstream Cournot oligopolist in the linear simultaneous bargaining model predicts an anticompetitive price increase if there are three or more downstream firms. However, the upstream profit share exceeds 50 percent in all of those cases. If the upstream profit share is less than 50 percent, the implication is that downstream buyers have outside options that are not accounted for in the model (or in UVM).

10 An outside option for a downstream firm in negotiations with an upstream firm is the downstream firm's ability to choose an outside alternative in lieu of an agreement with the upstream firm. Outside options act as constraints on the Nash bargaining solution. See Ken Binmore, Ariel Rubinstein & Asher Wolinsky (1986), "The Nash Bargaining Solution in Economic Modelling," *The RAND Journal of Economics*, pp 176-188.

11 This approach is proposed in Gloria Sheu & Charles Taragin (2022), "Simulating Mergers in a Vertical Supply Chain with Bargaining," forthcoming in The RAND Journal of Economics.

12 See Binmore et al. (1986), *supra* note 10.

and thus would tend to lock in situations in which upstream firm have little ability to capture returns on investment in their product and thus little incentive to invest.[13]

B. Nonlinear Pricing and Bargaining

It is well known that nonlinear pricing can alter the implications of the textbook model of vertical pricing. However, nonlinear pricing with or without bargaining does not save UVM. The core problem with UVM is that it does nothing to reconcile the upstream firm's profit share with the assumption that the upstream firm has substantial market power. This problem is present with or without nonlinear pricing just as it is present with or without bargaining.

To see this, consider the economic environment known to be most conducive to anticompetitive effects from vertical mergers: bilateral bargaining over nonlinear contracts (let's say two-part tariffs) that are private information to downstream firms who have passive beliefs. In this setting, the upstream firm and each downstream firm choose a wholesale price equal to marginal cost and negotiate fixed transfers to divide bilateral surplus.[14] If the transfers are negotiated through Nash bargaining, the upstream profit share will exceed 50 percent. The reason is that Nash bargaining selects transfers to equalize the upstream and each downstream firms' bilateral gains from trade. Because an upstream monopolist's disagreement profit in bilateral bargaining exceeds that of each downstream firm (because the upstream firm sells to multiple downstream firms), the fixed fee that equalizes bilateral gains from trade gives the upstream firm more than half the bilateral profits.[15] So, even with non-linear pricing, the assumption of upstream monopoly power is inconsistent with relatively small upstream profit margins.

C. Application to vGUPPI Analysis

The discussion to this point has focused on the foreclosure arithmetic variant of UVM, but it is important to recognize that price pressure variants (e.g. vGUPPI) of UVM raise the same high-level issue — the contradiction between low upstream profit shares and the assumption that the upstream firm has substantial market power. vGUPPIs, for example, predict greater upward pressure on the input price the greater the value of sales diverted from unintegrated rivals to the merging downstream firm in response to a RRC strategy. Holding diversion and final prices fixed, the vGUPPI is higher the smaller the upstream profit share because a smaller upstream profit share means a greater downstream profit share and thus a higher value of sales diverted to the downstream partner. The critical phrase here is "holding diversion fixed," as it runs into the same logical problem as UVM: Of course, an upstream firm that makes little profit but would have the power to divert substantial sales to its downstream partner would choose to exercise this power in order to increase its profits. But if it has such power, then why are its profits low? Even pre-merger it should be able to use its power to determine to demand a high share of profits. Thus, the logical problems that arise with the foreclosure variant of UVM also arises with vGUPPIs.

Similarly, in the recent cases involving mergers in the cable industry, rather than vGUPPIs, analyses of price pressure were used that assumed that input prices are negotiated. Those analyses were much like vGUPPIs except for the bargaining element. As explained above, bargaining does not reconcile the observation of low upstream profit shares with the assumption that the upstream firm has substantial market power.

IV. TETHERING VERTICAL MERGER ANALYSIS

A lot of economics is buried in the "diversion" that occurs in response to a foreclosure or RRC strategy. Focusing on foreclosure, when the merged firm withholds inputs required to produce 10 units of output from an unintegrated downstream firm, some of the foreclosed firm's customers who would have purchased those units "divert" to an alternative. The customer's alternatives include: (i) stop purchasing the product altogether; (ii) switch to a competing downstream firm that uses a competing input; (iii) switch to a competing downstream firm that uses the merged firm's input (unlikely if all competing downstream firms are foreclosed); and (iv) purchase the product produced by the foreclosed downstream firm

13 One might argue that the upstream firm could sell itself to a non-strategic buyer that is better at bargaining. But note that this increase in bargaining power would itself lead to higher upstream prices *without* generating the efficiencies (such as elimination of double marginalization) that come from a vertical merger.

14 See Oliver Hart & Jean Tirole (1990), "Vertical Integration and Market Foreclosure," *Brookings Papers on Economic Activity: Microeconomics*, 205-286 (the case of downstream Cournot competition); and Daniel P. O'Brien & Greg Shaffer (1992), "Vertical Control with Bilateral Contracts," *The RAND Journal of Economics*, 299-308 (the case of downstream Bertrand competition).

15 Suppose that downstream firm A's profits excluding the fixed fee are Π and the fixed fee is F. The downstream firm's gains from an agreement with the upstream firm are then $\Pi - F$. Because the upstream firm sells to multiple downstream firms, its earns a positive disagreement profit $\bar{\Pi}$ if it does not reach agreement with downstream firm A. Thus, the upstream firm's gains from agreeing with downstream firm A are $\Pi + F - \bar{\Pi}$. The fixed fee that equalizes gains from trade between the upstream firm and downstream firm A is $F = (\Pi + \bar{\Pi})/2$, which gives the upstream firm more than half the bilateral profits.

using a competing input. These possibilities can be summarized in two variables: the diversion ratio from foreclosed downstream firm(s) to the merged downstream firm, which is in the first three effects; and the departure rate, which is in the fourth effect.

The diversion ratio in this context is standard — it is the ratio of the increase in the merged firm's unit sales to the reduction in the unit sales of the foreclosed firms in response to the foreclosure, which measures the degree of product substitution in the downstream market.

The departure rate — which depends on the ability to use an alternative input—is where the bodies are buried. The departure rate is the ratio of the change in the foreclosed firm's unit sales to the unit sales foreclosed, which a measure the rate at which units *depart* foreclosed firms in response to the foreclosure strategy. The departure rate measures product substitution in the upstream rather than the downstream market. Obviously, the departure rate will be smaller the greater the number of competitive options downstream firms have — that is, the greater the extent of competition, in various forms, that the upstream firm faces.

This critical role of the departure rate is made clearer by writing out the expressions for profitable foreclosure and vertical upward pricing pressure. In the foreclosure variant of UVM, foreclosure is profitable when[16]

$$\text{Diversion Ratio} \times \text{Departure Rate} > \frac{\text{Upstream Unit Margin}}{\text{Upstream Unit Margin} + \text{Downstream Unit Margin}}.$$

In the vGUPPI variant of UVM, the gross upward pricing pressure component of the index (before dividing by price to create an index), is

$$\text{vGUPPI} = \text{Diversion Ratio} \times \textit{Departure Rate} \times \textit{Downstream Unit Margin}.$$

These expressions show that both foreclosure arithmetic and vGUPPI analysis predict less harm from a vertical merger the smaller the departure rate. The idea is that if unintegrated downstream firms have options that constrain upstream pricing, an attempt to foreclose them or to raise their costs would create little harm because downstream firms would respond by pursuing those options such that the departure rate would be small.

The biggest problem with UVM is that the departure rate typically is not *tethered* in any serious way to pre-merger information about the competitive constraints the upstream firm faces. In many cases, including recent vertical merger complaints, UVM is presented with no reference to the distinction between the diversion ratio and the departure rate. In cases where the distinction is discussed, no attempt is made to check the consistency of the assumed departure rate with the upstream profit share.

The resolution to this problem is to use an economic framework that recognizes the implications of the upstream profit share for the ability of the downstream firms to discipline the merging upstream, i.e. a framework that tethers the departure rate to the upstream profit share.

There are at least three ways to accomplish this resolution: (A) empirically estimate the departure rate and using it appropriately in tethered vertical math ("TVM");[17] (B) use an economic model that considers the implications of upstream profit margins to determine the departure rate to use in TVM; or (C) use an economic model (e.g., a calibrated simulation model) to predict merger effects. While full discussion of these three potential solutions are beyond the scope of this paper, the basic idea of each is simple: (A) with sufficient variation in the data, one could econometrically estimate the departure rate if the upstream input is made more expensive or withheld; (B) one could add a parameter for the departure rate to vertical math or vGUPPI models and calibrate it such that pre-merger margins are matched; (C) or one could develop a full simulation model, in which the market is in equilibrium pre-merger, with all shares and margins explained by the model, and then one simulates the effect of the merger. Any of these can potentially solve the problem, but all are challenging, and there is scope for additional work — to which I and colleagues intend to contribute — on proper application of each. What is clear is that some such method must be used, as the untethered methods in practice today are internally contradictory and yield flawed results, just as the untethered critical loss analysis, which was once popular, was shown to do.

16 For a rigorous derivation of these formulas, see Technical Notes.

17 A proxy sometimes used for the departure rate is the upstream firm's market share, the idea being that the lower the upstream firm's share the more competition it faces and the lower the departure rate. This approach is far from a complete analysis. For example, in settings where downstream firms choose a single supplier, the incumbent's share might be high even though downstream firms would switch to alternative suppliers in the event of a price increase, in which case the relevant departure rate would be low.

CONTRACTING AROUND THE ANTITRUST LAWS: THE AUTOMOTIVE SUPPLY CHAIN EXAMPLE

BY SHELDON KLEIN[1]

1 Shareholder, Butzel.

I. INTRODUCTION

Supply chains are a creature of contract and thus can be adapted to meet the business needs of the contracting parties. Antitrust law is not. In the automotive supply chains, several buyers have adopted contractual provisions designed to better fit antitrust law to close that gap. This Article attempts to provide an overview of how and why those buyers have done so.

In ordinary language, Ford, Toyota, etc. make cars. In industry parlance they are "Original Equipment Manufacturers" or "OEMs." But "maker" and "manufacturer" have almost become a misnomer. It was said of the Ford Rouge Plant that "iron ore, sand and coal went in one end, cars came out the other.[2] The Rouge Plant survives, but the extraordinary vertical integration which it embodied does not. Now, the OEMs themselves typically provide less than one-quarter of the vehicle value; [3] the remainder is provided by a multi-tiered supply chain in which the OEM buys vehicle components[4] from "Tier 1" suppliers, which in turn buy from "Tier 2" suppliers, and so on.[5] The components, at least manufactured components,[6] are typically vehicle-specific and purchased pursuant to long-term fixed price contracts following a competitive bidding-process.

History (and, perhaps, economic theory) has proven that this business model and antitrust law are not good fits. First, competitive bidding for relatively few bidding opportunities from a relatively small number of buyers invites bid-rigging. As discussed in Section III A, we now know that many component suppliers accepted the invitation, resulting in a vast supplier bid-rigging conspiracy[7] and many resulting criminal and civil proceedings. For convenience, these proceedings will be collectively referred to as the "Auto Parts Cases."[8] Second, there is an inherent *Illinois Brick* problem when a conspiracy is targeted at Tier 2 and lower tier suppliers.

It is hardly an insight to observe that antitrust litigation is slow, expensive, and generally unsatisfactory, and that is all the more so given the structure of the automotive supply chain and the scope of the Auto Parts conspiracy. In response, two OEMs, Ford and FCA US LLC ("FCA") (originally Chrysler, now Stellantis) have added an antitrust specific provision to their standard purchasing terms, with Ford's being directed to the unsatisfactory nature of litigation and FCA's to *Illinois Brick*.

This Article will first provide an overview of the automotive supply chain; then of the Auto Parts Cases and other conspiracies afflicting the supply chain. It will then review the contractual responses, focusing on the substance of the provisions, the underlying difficulties of antitrust law they are aimed at, and whether similar contractual provisions are potentially valuable to other buyers.

II. THE AUTOMOTIVE SUPPLY CHAIN

There are few OEMs[9] and many Tier 1 suppliers. A typical OEM has 300-500 Tier 1 production suppliers of any scale.[10] Of course, for any given component the number of potential suppliers is far lower. Further, geography is important – for many components, OEMs require geographical proximity to the assembly plant, which further narrows potential suppliers for those components.[11]

2 Ingrassia & White, "Comeback: The Fall & Rise of the American Automobile Industry," p. 384.

3 Purchased components represent approximately 72 percent of an OEM's operating costs. Bank of America Global Research, Global Automotive Supplier Review, p. 29 (June 10, 2020).

4 This article uses "components" to refer to whatever product the buyer purchases from the seller. Increasingly the components supplied by Tier 1s are complex systems encompassing many distinct parts.

5 Omri Ben-Shahar & James J. White, *Boilerplate and Economic Power in Auto Manufacturing Contracts*, 104 Mich. L. Rev. 953, 955 (2006) ("Shahar & White").

6 Raw materials are less likely to be purchased under the contract model described in the text.

7 It would be customary to preface references to the conspiracy with a stilted "alleged," but given the large number of guilty pleas and jail sentences, this Article will not do so. That does not mean, of course, that every allegation is true or that every supplier caught up in the litigation was in fact a conspirator.

8 The author represented a party in the Auto Parts Cases, as well as the *Polyurethane* case discussed in Section III B. Of course, no confidential or privileged information learned in those representations was used in writing this Article.

9 There are roughly a dozen OEMs manufacturing at scale in North America, although there are now many emerging autonomous or electric vehicle manufacturers attempting to reach scale.

10 The estimate is based on the author's experience and discussions with industry experts.

11 However, it is not unusual for a supplier to build a plant near the OEM site if needed to obtain a significant award.

Components are typically sourced through a non-public competitive bidding process, beginning with a request for proposal ("RFP"), which leads to an award of a sole-sourced, fixed-price requirements contract to the successful bidder. The bidding process typically occurs approximately two years before the components go into production.[12] The practical duration[13] of the awards is for the life of the program, which typically varies from four to eight years, and sometime longer.[14] Thus, the successful bidder bears all risk of fluctuations in input costs, volumes, and program duration,[15]

Both sole-sourcing and life of the program commitments are driven by certain economic fundamentals. The successful supplier typically must make a large, unreimbursed, fixed investment in equipment, facilities, engineering, design, development, and other activities to get from the program award to a vehicle ready part.[16] Dual sourcing would require duplication of those large fixed investments, and it would require the supplier to recover its fixed investments over a smaller quantity of goods. Further, once the award is made, switching suppliers involves very high switching costs for the OEM, both because of duplicative investments and the significant complexities and risks of switching suppliers in the course of high-volume production.[17]

Life of the program awards means that new bidding opportunities generally arise only when a new vehicle program is launched. Thus, new vehicle launches are a rough proxy for the number of sourcing opportunities. In 2020, for example, it is estimated that the Detroit 3 had only 13 vehicle launches.[18] Although a new vehicle launch may involve many scores of RFPs, any given Tier 1 is likely invited to bid on only a few, or even one.

The components themselves are largely defined by the OEMs in the RFP, which are typically program specific, with dimensions, materials, performance requirements and other attributes rigidly defined by the OEM.[19] As a result, competition is largely price driven.[20]

Although many Tier 1 suppliers are large and sophisticated,[21] the OEMs have overwhelming contracting power, with the vast majority of components purchased pursuant to standard form boilerplate contracts with no opportunity for negotiation.[22]. As summarized by Shahar & White, "sophisticated [OEMs] use rigid boilerplate forms to govern tens of billions of dollars of sales every year. The drafters of these forms are not the least embarrassed in admitting that they draft every term in a one-sided, self-serving manner. It turns out that such unrestrained economic power in contracting is exercised not merely against the weak and ill advised, but also against sophisticated partners to relational contracts"[23]

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12 Shahar & White, *supra* at 973.

13 "Practical duration of the award" is distinct from the nominal duration of the written agreement, which ranges between OEMs from one year (complicated by an array of automatic renewals and extension options). to the life of the program. In addition, every OEM reserves to itself the right to terminate the contract for convenience. The Supplier, on the other hand, rarely has the ability to end the contract.

14 Shahar & White, *supra* at 981.

15 In theory, the supplier would also get the benefit of favorable changes in costs, volumes, or duration, but in practice it is common-place that OEMs recoup those favorable benefits through a variety of contractual and commercial means. Indeed, the Auto Parts Cases alleged not only a conspiracy to rig bids, but a conspiracy to coordinate their response to price reductions demanded by the OEMs. See e.g. Consolidated Amended Class Action Complaint, ¶ 110, *In Re Automotive Wire Harness Sys.s Antitrust Litig.*, No. 2:12-md-02311-MOB, Doc # 86 (May 14, 2012).

16 Shahar & White, *supra* at 959.

17 *Id.* at 973-974.

18 Bill Bregar, *Auto tooling forecast projects rough* 2020, Rubber News (11/18/19), available at https://www.rubbernews.com/automotive/auto-tooling-forecast-projects-rough-2020 (last visited March 12, 2022).

19 John M. Connor, Twilight of Prosecutions of the Global Auto-Parts Cartels, American Antitrust Institute (July 17, 2019), p. 14, available at https://www.antitrustinstitute.org/wp-content/uploads/2019/07/Auto-Parts-Ca the conspiracies rtel-Twilight-of-AAI-WP_7.17.19.pdf. ("Connor 2019") (last visited Feb. 26, 2022).

20 *Id.* It should be noted that over time, the OEMs have gradually turned to Tier 1 suppliers for "solutions," as opposed to rigidly specified parts, which allows room for competition across more than price.

21 For example, Magna, the largest North American based Tier 1 supplier had 2020 revenues of $32.6 billion. *Selected North American automotive suppliers in 2020, based on OEM automotive parts sales*, Statista (available at https://www.statista.com/statistics/199797/10-leading-north-american-automotive-original-equipment-suppliers/#:~:text=In%202020%2C%20Magna%20International%20ranked,12.7%20billion%20U.S.%20dollars%2C%20respectively). (last visited Feb. 25, 2022)

22 Shahar & White, *supra* at 981.

23 *Id.* at 957. The particulars of the contracts and the volume of business have changed in the 16 years since Shahar & White's article was published, but the fact of non-negotiable boilerplate contracts with enormous buyer power remains. In fact, many OEMs attempt to foreclose the mere possibility of negotiation by requiring a prospective bidder to accept the standard form terms as condition of even viewing the RFP.

III. ANTITRUST CASES AFFECTING THE SUPPLY CHAIN

A. The Auto Parts Antitrust Cases

The automotive supply chain (principally, but not exclusively, the OEMs) was the target of a multi-product bid-rigging conspiracy among tiered suppliers[24] which the Department of Justice has characterized as "the largest criminal investigation the Antitrust Division has ever pursued, both in terms of its scope and the potential volume of commerce affected by the alleged illegal conduct."[25] Predictably, the criminal investigation triggered a cavalcade of civil class action litigation, consolidated under the name *In re Automotive Parts Antitrust Litigation*[26] ("*Auto Parts*").

The scope of the *Auto Parts* conspiracy and the resulting civil and criminal proceedings was extraordinary. The United States class action proceedings alone involved 41 distinct component class actions, with most of those 41 cases including, in addition to the federal direct purchaser class, satellite state law indirect purchaser class actions for both auto dealers and "end payors." [27] According to a 2019 accounting, in the United States, 169 executives have been indicted[28] and 68 have received prison sentences.[29] The Department of Justice has imposed approximately $3.2 billion in fines.[30] Class action settlements total approximately $1.75 billion.[31]. Moreover, the OEMs opted out of the class settlements and are believed to have privately resolved their claims against their conspiring suppliers without litigation.[32] Those OEM amounts are not public, but it is probable that the value of the OEM private resolutions significantly exceed the approximately $422 million paid to direct purchasers in the class action settlements.

One study[33] offers an explanation,[34] of the market structure and forces that led to the conspiracies. He points to, (i) for some components, there are few capable suppliers, and thus high concentration, for reasons of expertise and geography; (ii) easy communication between competitors, through industry events and management connections (e.g. management often moves between competing suppliers); (iii) the rigid OEM component specifications and requirements in the RFQ, leading to competition largely based on price. The complaints in the *Auto Parts* class actions identify overlapping, but not identical, market factors. The complaint in the *Automotive Wire Harness* cases[35] is illustrative of the alleged structural factors: (i) concentration; (ii) high barriers to entry because of high capital investment; and (iii) opportunities to conspire.

24 The conspiracy was global, but this Article focuses on United States legal proceedings.

25 Remarks of Acting Assistant Attorney General Sharis A. Pozen, available at https://www.justice.gov/opa/speech/acting-assistant-attorney-general-sharis-pozen-speaks-briefing-department-s-enforcement (visited Feb. 24, 2022).

26 Master File No. 12-md-02311 (E.D. Mich)

27 A full inventory is available through PACER under the "Associated Cases" subpage of the Master MDL. A telling, if not sad, reflection of the scope of the proceedings is that the list of parties and counsel consumes 199 pages of the PACER docket.

28 Connor 2019, *supra* at 7.

29 *Id.*

30 *Id.* at 25.

31 *Id.* at 26, n.94. A different itemization of the settlements is contained at https://www.autopartsclass.com/faq#:~:text=Automotive%20Parts%20Antitrust%20Litigation%20%241.2%20Billion%20Settlements (last visited Feb. 25, 2022).

32 *Id.*

33 *Id.* at 13-14.

34 To be clear, the Author does not agree with Connor's explanation in its entirety. To give but one example, Connor states that "there is little evidence that the OEMs were financially stressed" during the period of the conspiracies. *Id* at 13. The assertion is puzzling, in light of the fact that the period and its immediate aftermath included bankruptcies of OEMs (General Motors and Chrysler), large suppliers (e.g. Delphi, Lear, Federal-Mogul and Dana), large wage concessions given by the UAW.

35 *In Re Automotive Wire Harness Systems Antitrust Litigation* ¶¶ 99 - 114, No. 2:12-md-02311-MOB, Doc # 86 (May 14, 2012).

B. Other Cases

The Auto Parts Cases do not stand alone. For example, there have been alleged conspiracies targeting the automotive supply chain for polyurethane foam[36] and automotive glass,[37] and a host of cases relating to chemicals and other raw materials used extensively in the industry, although not necessarily targeted at the industry.[38]

IV. THE OEMS' CONTRACTUAL RESPONSE

Both FCA and Ford have added antitrust specific terms to their boilerplate terms of purchase.

A. FCA

In 2010, FCA[39] added the following:

> **Assignment of Antitrust Claims**. Upon FCA US's request (which FCA US may make, in its discretion, provided it has a material interest in any claim described herein), Seller will execute a written assignment of [] all causes of actions under any applicable antitrust laws arising out of or relating to Seller's purchase of raw materials or ingredients used in goods sold or resold to FCA US. If FCA US recovers damages on account of any such assigned claim, and a portion of such damages is reasonably allocable to Seller, FCA US will, net of its attorneys' fees in liquidating the claim, return such allocable amount to Seller.[40]

The intent of the FCA provision is clear – to avoid *Illinois Brick*.[41] And it offers a simple "solution" to the problems that *Illinois Brick* was aimed at: the complexity of determining pass through and the risk of double recovery.[42] It cuts through the complexity by making FCA the sole arbiter of whether to require the assignment and the amount of pass-through. Given that the automotive supply chain is built on long term fixed price contracts, and thus that FCA would seemingly be largely insulated from the effect of downstream conspiracies entered into after the price for a particular component was set, there is an obvious risk that the Tier 1 supplier will be under-compensated. Although the provision allows FCA to return a portion of any recovery if it determines that portion is "reasonably allocable" to the recovery, the reliability of that part of the provision is questionable.

Does FCA's solution work? In terms of enforceability, probably. The weight of authority is that antitrust claims are assignable, at least if the assignment specifically identifies antitrust claims.[43], [44] Although there has been no public litigation regarding the enforceability of the FCA provision, there is no obvious reason why it would not be.

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36 See "Three Foam Manufacturers Plead Guilty in Price Fixing Scheme," Department of Justice Release, January 27, 2014, available at https://www.justice.gov/opa/pr/three-foam-manufacturers-plead-guilty-price-fixing-scheme (visited Feb. 24, 2022) and *In re Polyurethane Foam Antitrust Litig.*, No. 10-MD-2196 (N.D. OH).

37 *In re Flat Glass Antitrust Litig.*, 385 F.3d 350, 377 (3d Cir. 2004). It should be noted that the case involved the replacement market, not the original equipment market, but there was evidence of an original equipment market conspiracy.

38 See, e.g. *In re Polyester Staple Antitrust Litig.*, No. MDL No. 3:03CV1516, 2007 WL 2111380, at *2 (W.D.N.C. July 19, 2007) (yarn used in automobile fabrics); *In re Rubber Chemicals Antitrust Litig.*, 504 F. Supp. 2d 777 (N.D. Cal. 2007) (chemicals used in tires); *In re Ethylene Propylene Diene Monomer (EPDM) Antitrust Litig.*, 256 F.R.D. 82, 84 (D. Conn. 2009); *In re Urethane Antitrust Litig.*, 251 F.R.D. 629, 631 (D. Kan. 2008), *aff'd,* 768 F.3d 1245 (10th Cir. 2014).

39 Then Chrysler, now Stellantis.

40 The substance of the 2010 Term has been carried forward to the present without any variation material to this Article. See FCA "Production and Mopar Purchasing General Terms and Conditions" dated 1/2017 ("FCA Terms"), Section 30. The 2017 FCA Terms, as well as the current terms of most OEMs manufacturing in the United States, are available in the Butzel Automotive Terms & Conditions Resource Center, available at https://www.butzel.com/resources-automotive. FCA (now Stellantis) recently issued new terms with a similar provision.

41 *Ill. Brick Co. v. Illinois*, 431 U.S. 720 (1977).

42 *Id* at 731 - 732.

43 See generally Philip Areeda & Herbert Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* ¶ 362 ("Areeda").

44 There is a possible complication if the rights being assigned are not assignable under the contract between the assignor and the wrongdoer. In other words, if the contract between the conspiring Tier 2 supplier and the Tier 1 prohibits assignment of claims, there is a question as to whether the Tier 1 has the right to assign its antitrust claims to FCA. The answer in part depends on the wording of the anti-assignment clause, but there is also disagreement. See *United Food and Comm. Workers Local 1776 v. Teikoku Pharma USA, Inc.*, No. 14–md–02521–WHO, 2015 Wl 4397396, *4-6, (N.D. Cal. July 17, 2015) for an overview of pertinent case law.

As to efficacy, there are a few notable limitations. First, the provision is limited to the Tier 1's "purchase of raw materials or ingredients." Neither term is defined, but a fabricated component purchased by a Tier 1 from a price-fixing Tier 2 supplier is not easily described as a raw material or ingredient. If so limited, it would not, for example, apply to any of the components at issue in the Auto Parts Cases. Second, the provision is in a contract between FCA and a Tier 1. It would allow for the assignment of a Tier 1's claim against a conspiring Tier 2 but does not on its face protect FCA from conspiracies below the Tier 2 level. There, the *Illinois Brick* barrier remains.

In sum, the FCA provision would seem to be at least a partial solution to the *Illinois Brick* problem in a tiered supply chain. And the two limitations noted in the preceding paragraph are at least partially fixable. The provision need not be limited to raw material and ingredients. And the privity problem could be partially addressed by a mandatory flowdown provision,[45] although such provisions are difficult to draft, police and enforce.

B. Ford

Ford's provision, added in 2021, has a different and more ambitious goal than FCA's. It provides:

> **Anticompetitive Practices** If the Supplier is found [] to have violated [] a Competition Law [] or [] admits or pleads guilty to a violation of a Competition Law for a commodity purchased by [Ford], including pursuant to a Government antitrust leniency program, the Supplier shall: (a) produce to [Ford] all documents, data, and other information produced to all Government authorities globally that is related to an investigation of a Competition Law violation, within 4 weeks of a finding or guilty plea; and (b) participate in binding arbitration to resolve any Buyer claims related to the violation. If, during arbitration, Supplier is found to have violated competition laws with respect to [Ford], the Supplier agrees to pay Buyer 15% of the purchase price of all Goods impacted by the anticompetitive conduct []. If the Supplier is found to have violated the Sherman Act in the United States, [Ford] shall be entitled to treble the amount paid [] for all purchases governed by the Sherman Act. The payment required by [this section] shall not be the sole or exclusive remedy of for Competition Law violations, and Buyer is entitled to any available statutory damages at arbitration.***[46]

There are several notable aspects of this provision. First, there is a difficult threshold question of whether disclosure is required at all. The provision requires disclosure for "a commodity purchased by [Ford]" for which "the supplier admits or pleads guilty to [an antitrust] violation." So, the provision is triggered only if the criminal proceeding and the Ford purchases involve the same commodity. To. the extent that a supplier can plausibly contest whether the Ford provision is triggered at all, Ford's ability to speed up and simplify antitrust recoveries is compromised.

"Commodity" is not a defined term (or otherwise used) in the contract. Although not defined in the Sherman Act, it is used in other antitrust laws to refer to tangible property (as opposed to services).[47] But that cannot be what Ford means – there must be some type of connectedness between the "commodities" at issue in the criminal proceedings and those purchased by Ford for the provision to make any sense. Alternatively, "commodity" is often used to refer to fungible or staple products.[48] Again, that cannot be what Ford means, because most components are not commodities in that meaning of the word. Further, components that might share a high-level description are often highly heterogenous. For example, the first of the Auto Parts class actions involved "wire harnesses." "Wire harness" encompasses a broad array of diverse products[49] that have little in common other than they are used to connect other components that require electricity. The products range from small, inexpensive bundles of wires to marvels of electrical engineering. If Ford purchases only a small bundle of wires and the criminal proceedings involved only the engineering marvels, does the provision apply? That and similar difficult questions have no clear and indisputable answer, so, again, Ford may find itself litigating the threshold question of whether the provision applies at all.

45 In fact, broad flowdown provisions are common in the industry. For example, Magna's standard terms provide: "Where. the. Goods. [are sold] by. [Magna] to. an. original. equipment. manufacturer [directly. or. indirectly] Seller. shall [] do. all. [] things. [] necessary. [] to. enable [Magna] to. meet. [its] obligations [] to. the. Customer."

46 Ford "Production Purchasing Global Terms and Conditions" dated July 1, 2021 ("Ford Terms"), Section 38.09, also available in the Butzel Automotive Terms & Conditions Resource Center.

47 See e.g. Areeda, *supra* ¶ 2314a (Robinson Patman Act).

48 See (Online) Merriam-Webster Dictionary, Definition 1c. ("a mass-produced unspecialized product."), available at https://www.merriam-webster.com/dictionary/commodity, (visited March 10, 2022)

49 For example, one of the Wire Harness complaints defined the relevant product to include "wire harnesses and the following related products: automotive electrical wiring, lead wire assemblies, cable bond, automotive wiring connectors, automotive wiring terminals, high voltage wiring, electronic control units, fuse boxes, relay boxes, junction blocks, and power distributors." Consolidated Amended Class Action Complaint, *In Re Automotive Wire Harness Systems Antitrust Litigation* ¶ 10, No. 2:12-md-02311-MOB, Doc # 86 (May 14, 2012). Not all "wire harness" defendants provided all of those items.

Assuming the provision applies, the 15 percent damage amount (trebled for Sherman Act violations) is notable. The 15 percent figure is essentially stipulated or liquidated damages. In general, such damages must be reasonable.[50] There is at least some empirical literature supporting 15 percent as a reasonable approximation of a typical overcharge. For example, a recent study identified the median overcharge in bid-rigging conspiracies during the most recent time period studied (2000-2016) as 17.55 percent. [51]. At the same time, empirical literature suggests that actual private recoveries in civil litigation is far less than the actual overcharges, let alone trebled overcharges.[52] This data[53] suggests that 15 percent is of great practical benefit to Ford, which is to say that it offers Ford recoveries approximating likely actual damages (subject to trebling) and greatly in excess of the recoveries likely through civil litigation, with significantly greater speed and less expense.

Note that the 15 percent stipulated damages recovery applies to "all Goods impacted by the anticompetitive conduct . . . ." Under Section 4 of the Clayton Act, 15 USC 15, "any person who shall be injured []by reason of anything forbidden in the antitrust laws [] shall recover threefold the damages by him sustained []." Is there any difference between recoverable damages under the contractual and statutory language? It is unclear. Perhaps an arbitrator would conclude that the Ford contract provision is intended to be read *in para materia* with the statute. But certainly, the language of the two provisions need not be read identically. Section 4 brings with it a more than a century of case law glosses on the simple statutory language, both as to proximate causation and the calculation of damages.[54] To the extent that the contract and the statute aren't read *in pari materia*, the differences will need to be explored case by case and, because it will be done through arbitration, without the benefit of precedent.

The automatic disclosure of documents produced to the government is likewise of great, perhaps even greater, practical benefit to Ford. It is common-place that in civil litigation document production is slow, expensive, and grudging. A party under government investigation, and especially a leniency applicant, is likely to be far more forthcoming with the government.[55] Thus, mandatory and prompt disclosure greatly benefits Ford.

V. SO WHY AREN'T THESE TYPES OF PROVISIONS MORE COMMON?

Ford and FCA are unique among OEMs in trying to address antitrust concerns in their terms of purchase and, to the author's obviously limited knowledge, unique among other standard purchasing terms. Why is that so? More specifically: (i) why haven't other OEMs followed suit; and (ii) why haven't buyers in other industries done so? As to why other OEMs have not followed suit, it is likely that at least part of the answer is that they don't think it necessary. The OEMs have such enormous practical commercial power that they may believe that they do not need formal legal proceedings to obtain compensation. Recall that in the Auto Parts Cases, with one isolated exception, no OEM filed suit, instead relying on private commercial resolutions. Second, and mundanely, the other OEMs may simply not have gotten around to it. The OEM terms change rarely – Ford's 2021 terms were the first significant change in their terms since 2004. It might be that others will follow. As to why other industries have not followed suit, it again likely starts with the OEMs' power to largely dictate contractual terms, even harsh terms to sophisticated Tier 1 suppliers. Such terms might meet counter-party resistance in most other industries. Further, the sheer scope and volume of OEM purchasing and the susceptibility of the supply chain to antitrust abuses might mean that such provisions make economic sense for OEMs, but not for all but a few buyers in other industries.

Nevertheless, the Ford and FCA Terms discussed in this Article provide meaningful, though imperfect, benefits to a buyer that is affected by seller antitrust violations. There are no doubt other contractual provisions that could provide the buyer advantages. Whether or not other buyers in and outside of the automotive supply chain turn to contract law for this purpose remains to be seen but doing so should at lest be considered by counsel advising on purchasing terms and conditions.

50 Since the Ford provision is in a contract for the sale of goods, arguably UCC 2-718 would apply. Under 2-718, "[d]amages for breach []may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty."

51 Connor, John M. & Werner, Dan P., Variation in Bid-Rigging Cartels' Overcharges: An Exploratory Study (October 27, 2018), Table 4, p. 20. Available at https://ssrn.com/abstract=3273988. (visited March 10, 2022).

52 One study found that the median recovery in a civil overcharge case which was preceded by a criminal conviction was 52.4 percent of actual estimated damages (before trebling). John M. Connor & Robert H. Lande, *Not Treble Damages: Cartel Recoveries Are Mostly Less Than Single Damages*, 100 Iowa L. Rev. 1997, 2010 (2015).

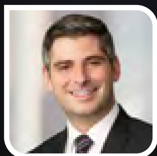
53 To be clear, these empirical studies are used only as a crude touch point for assessing the efficacy of the Ford provision, not as an adoption of either the methodology or the conclusions of the studies, which is beyond the scope of this article and the mathematical skills of the Author.

54 See generally, Areeda, *supra* ¶¶ 338 and 340.

55 See generally, Department of Justice Frequently Asked Questions about the Antitrust Division's Leniency Program and Model Leniency Letters," available at https://www.justice.gov/atr/page/file/926521/download, (visited 3/9/22).

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

BY ZACH TERWILLIGER & EVAN SEEDER[1]



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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

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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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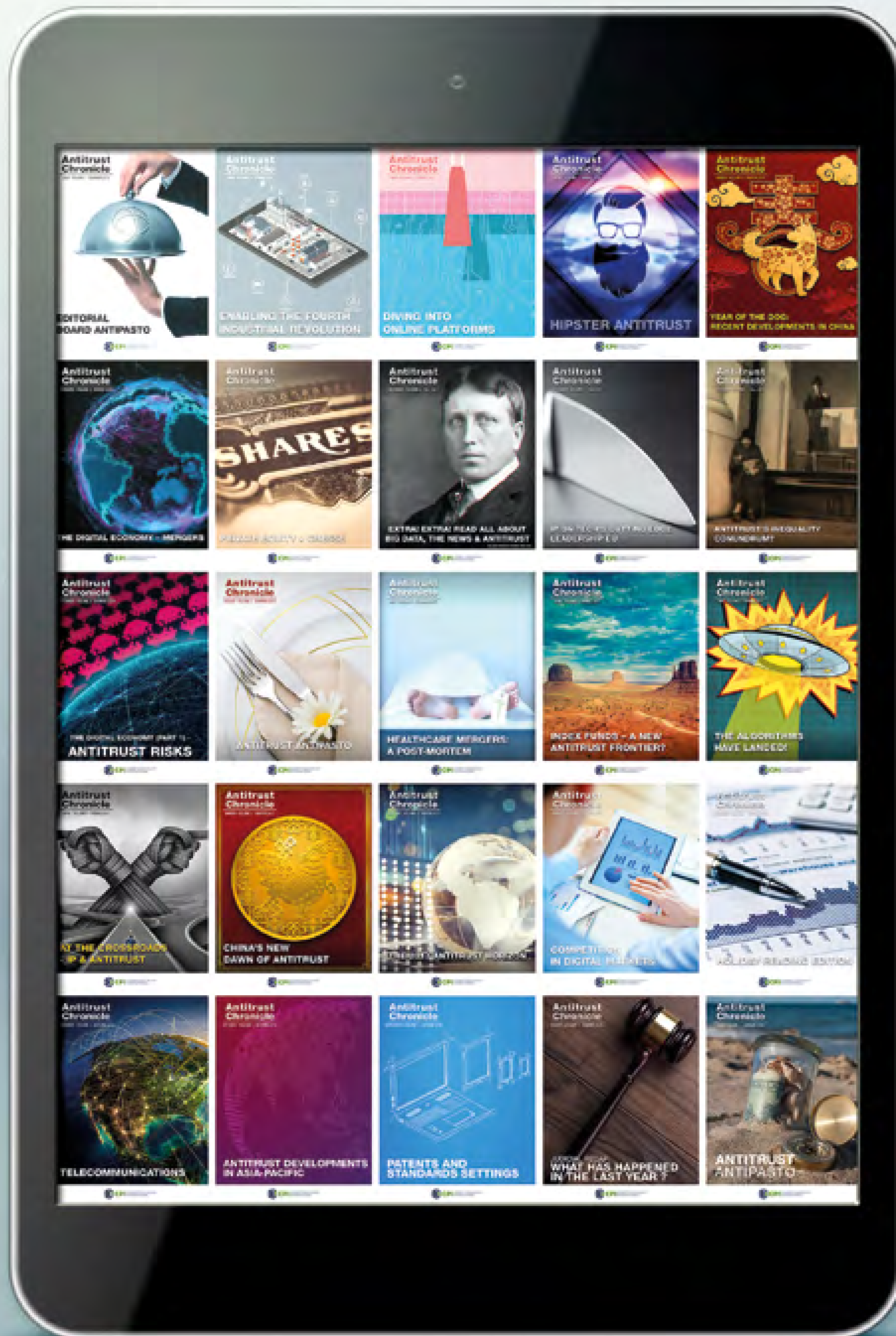

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