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Avoiding Hub-and-Spoke Liability: Recent Antitrust Cases and Practical Advice for Vertical and Horizontal Players

Distinguishing a Series of Independent Vertical and Horizontal Agreements From a Hub-and-Spoke Conspiracy

WEDNESDAY, JULY 12, 2017

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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Avoiding Hub-and-Spoke Liability

Recent Antitrust Cases and Practical Advice for Vertical and Horizontal Players

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I. "Hub-and-Spoke Conspiracy"

- Origin of the Term
  - Criminal, non-antitrust cases
- *Kotteakos v. United States* (1946)
  - Housing fraud
  - "[T]he pattern was that of separate spokes meeting in a common center . . . without the rim of the wheel to enclose the spokes."
- For *antitrust* hub-and-spoke conspiracies, there must be a rim that connects the spokes.
- Hub-and-spoke conspiracies are considered agreements between or among competitors.
- Government agencies and private plaintiffs often sue the "hub"; the "hub" is considered a horizontal conspirator even if it is a supplier or customer of each "spoke."

II. *Interstate Circuit, Inc. v. United States* (1939)

- A monopolist first-run movie theater operator sent a letter to eight competing movie distributors.
  - All distributors were copied on the same letter
  - No evidence of direct communication between the distributors
- Two demands
  - Minimum price for second-run movies
  - Policy against double features
- Clear purpose was to protect the monopolist first-run exhibitor from competition from second-run exhibitors.
- All distributors accepted the demands.
- The agreement was a radical departure from previous business practices and caused a drastic increase in prices.

II. *Interstate Circuit, Inc. v. United States* (1939) (cont'd)

- SCOTUS (Stone, J.)
  - "Taken together, the circumstances of the case . . . justify the inference that the distributors acted in concert and in common agreement."
  - "It was enough that, knowing that concerted action was contemplated and invited, the distributors gave their adherence to the scheme and participated in it."
  - The Court drew an adverse inference from the lack of testimony from high-level executives of the distributors.

A. Modern Interpretation of *Interstate Circuit*

- Conspiracy may be inferred when:
  1. Two or more competitors enter into vertical agreements with a single upstream or downstream company;
  2. The vertical agreements could benefit each competitor only if its rivals enter into similar agreements; and
  3. The facilitator of all the vertical agreements persuades each competitor that its competitors will take a similar action.
- Courts quite correctly ignore the language in *Interstate Circuit* that "an unlawful conspiracy may be and often is formed without . . . agreement on the part of the conspirators."

III. Subsequent Supreme Court Cases on Hub-and-Spoke Conspiracy

- *United States v. Masonite Corp.* (1942)
- *Klor's v. Broadway-Hale Stores* (1959)
- *United States v. Parke, Davis & Co.* (1960)
- *United States v. General Motors Corp.* (1966)

A. *United States v. Masonite Corp.* (1942)

- Masonite, which held a patent for hardboard, entered into agency agreements with nine competitors to sell Masonite hardboards.
- Each seller knew that the other sellers signed the same agency agreement, but there was no direct communication between the sellers.
- Under the agency agreement, Masonite had the power to set the hardboard prices for all agents.
- Upon entering the initial agreements, the resellers:
  - Negotiated only with Masonite and had no discussions with each other
  - Desired the agreement, regardless of what anyone else did
  - Did not condition acceptance upon others entering into similar agreements

A. *United States v. Masonite Corp.* (1942) (cont'd)

- The agency agreements were later modified.
  - Each agent knew that the others were entering into identical agreements with Masonite.
  - The new agreements were conditioned – they became effective only when all agents agreed.
- SCOTUS: "It is not clear at what precise point of time each [agent] became aware of the fact that its contract was not an isolated transaction but part of a larger arrangement. But it is clear that, as the arrangement continued, each became familiar with its purpose and scope."
- In isolation, each agency agreement was a valid agreement that did not fix prices, but the Court followed *Interstate Circuit* and inferred a horizontal agreement among the agents.

B. *Klor's v. Broadway-Hale Stores* (1959)

- Broadway-Hale Stores, a large retailer in San Francisco with "monopolistic buying power," required numerous appliance suppliers "either not to sell . . . or to sell . . . [on] highly unfavorable terms" to Klor's, a retailer that operated next to a Broadway-Hale store.
- The suppliers complied.
- SCOTUS: "We think Klor's allegations clearly show one type of trade restraint and public harm the Sherman Act forbids. . . . Group boycotts, or concerted refusals by traders to deal with other traders, have long been held to be in the forbidden category."
- N.B.: The defendants did not challenge the allegations; modern courts are unlikely to infer a horizontal conspiracy from a set of vertical restraints without more evidence supporting an inference of a horizontal agreement. In addition, there were potential legitimate justifications for the restraints in *Klor's*.

C. *United States v. Parke, Davis & Co.* (1960)

- Parke, Davis & Co. told its wholesalers that it would terminate any wholesaler that sold its product to retailers who sold Parke products below the MSRP.
- The Company:
  - Discussed the policy with its wholesalers and retailers to ensure compliance;
  - Brokered an agreement among its retailers not to advertise Parke products below the MSRP, and;
  - Amended the Company policy to reflect the negotiations.
- The program violated the Sherman Act because Parke Davis "actively [brought] about substantial unanimity among the competitors."

D. *United States v. General Motors Corp.* (1966)

- Pressured by multiple Chevrolet dealers in the Los Angeles area, GM entered into vertical agreement with each dealer in Los Angeles not to do business with discount retailers of Chevrolet.
- GM and the dealers association policed these agreements.
- SCOTUS: "It was acknowledged from the beginning that substantial unanimity would be essential if the agreements were to be forthcoming. And once the agreements were secured, General Motors both solicited and employed the assistance of its alleged co-conspirators in helping to police them."

IV. Modern Court of Appeals Cases

- *Toys "R" Us, Inc. v. Federal Trade Commission* (7th Cir. 2000)
- *Dickson v. Microsoft Corp.* (4th Cir. 2002)
- *Pepsico, Inc. v. Coca-Cola Co.* (2nd Cir. 2002)
- *United States v. Apple, Inc.* (2nd Cir. 2015)
- *In re Musical Instruments & Equip. Antitrust Litigation* (9th Cir. 2015)

A. *Toys "R" Us, Inc. v. Federal Trade Commission* (7th Cir. 2000)

- Toys "R" Us entered into approximately ten vertical agreements in which each toy manufacturer agreed to restrict distribution of its toys to discount warehouse club stores.
- The Seventh Circuit found that Toys "R" Us acted as the hub and coordinated a horizontal agreement among the toy manufacturers.
  - FTC: "[Toys "R" Us] acted as the central player in the middle of what might be called a hub-and-spoke conspiracy, shuttling commitments back and forth between toy manufacturers and helping to hammer out points of shared understanding."
- "[This] case presents a more compelling case for inferring horizontal agreement than did *Interstate Circuit*."

B. *Dickson v. Microsoft Corp.* (4th Cir. 2002) *Pepsico, Inc. v. Coca-Cola Co.* (2nd Cir. 2002)

- "Rimless hub-and-spoke" theories were invoked and rejected in both cases.
- Both the Second and Fourth Circuits held that proving hub-and-spoke conspiracy requires evidence of the rim that connects the spokes.
- *Dickson*: Vertical distribution agreement between Microsoft and three OEMs
- *Pepsico*: Vertical distribution agreement between Coca-Cola and distributors that forced the distributors to choose between Coca-Cola and Pepsi

C. *United States v. Apple, Inc.* (2nd Cir. 2015)

- Apple entered into vertical agreements with five of six largest publishers in the United States that contained a pricing structure incentivizing raising the prices of ebooks.
- The CEOs of the publishing houses regularly held in-person meetings.
- The Second Circuit cited the hub-and-spoke cases we have discussed – *Klor's*, *General Motors*, and *Toys "R" Us* – and found that the horizontal agreement Apple organized among the publishers to raise ebook prices was *per se* illegal.
- Vertical agreements can, in context, be "useful evidence to prove the existence of a horizontal cartel."

D. *In re Musical Instruments & Equip. Antitrust Litigation* (9th Cir. 2015)

- Guitar Center entered into vertical agreements with five leading guitar manufacturers, which forced the manufacturers to establish minimum-advertised-price (MAP) policies.
- There was no direct evidence of horizontal conspiracy, so the plaintiff alleged that parallel conduct in conjunction with "plus factors" demonstrated the existence of horizontal conspiracy.
- The Ninth Circuit recognized that "the line between horizontal and vertical restraints can blur," but ultimately held that the plaintiffs did not show sufficient evidence to meet the *Twombly* standard of pleading.

V. Recent District Court Cases

- *Wallach v. Eaton Corp.* (D. Del. 2011)
- *In re Disposable Contact Lens Antitrust* (M.D. Fla. 2016)
- *Meyer v. Kalanick* (S.D.N.Y. 2016)
- *In re K-Dur Antitrust Litigation* (D.N.J. 2016)
- *In re McCormick & Co.* (D.D.C. 2016)

A. *Wallach v. Eaton Corp.* (D. Del. 2011)

- Plaintiffs: Trucking Companies
- Defendants: Truck Manufacturers (OEMs) and Eaton (Truck Transmissions Manufacturer)
- Goal of the Conspiracy: To drive ZF Meritor, Eaton's competitor, out of business
- Vertical Agreement: Eaton entered into Long-Term Agreements with Truck OEMs that promised them sizable rebates if they bought a certain percentage of Eaton transmissions annually

A. *Wallach v. Eaton Corp.* (D. Del. 2011) (cont'd)

- "In the present case, plaintiffs have alleged the existence of a single rimmed hub-and-spoke conspiracy, in which Eaton individually agreed to work with each OEM and the OEMs in turn agreed to work together."
- "Defendants contend that the existence of such a conspiracy has not been sufficiently pled because the plaintiffs have not alleged anything more than parallel conduct by the OEMs."

A. *Wallach v. Eaton Corp.* (D. Del. 2011) (cont'd)

- "The court finds that sufficient parallel conduct and plus factors have been set forth."
  - "Eaton and each OEM negotiated and put into place similar LTAs that provided for lucrative rebates in exchange for meeting shared penetration goals."
  - "The LTAs also contained other provisions that minimized ZF Meritor's market share."
  - Plus Factors: "Contrary to their self interest, the OEMs' parallel action essentially resulted in the installation of a monopolist (Eaton) in their supply chain and the elimination of a supplier with admittedly desirable products."
  - "An OEM could gain a competitive advantage over the others by not entering into a restrictive LTA with Eaton and instead working closely with ZF Meritor, but this did not occur, suggesting that the OEMs agreed with each other to enter into the LTAs and eliminate ZF Meritor in exchange for a share in the profits from the resulting monopoly."

B. *In re Disposable Contact Lens Antitrust* (M.D. Fla. 2016)

- Plaintiffs: Retail purchasers of disposable contact lenses
- Defendants: Disposable contact lens manufacturers and ABB, a wholesaler of disposable contact lens
- Goal of the conspiracy: To maintain a minimum resale price for disposable contact lenses
- Vertical Agreements: Agreements between ABB, the wholesaler, and lens manufacturers to implement and enforce “Unilateral Pricing Policies”

B. *In re Disposable Contact Lens Antitrust* (M.D. Fla. 2016) (cont'd)

- "Parallel conduct infers a conspiracy where the plaintiff establishes that each defendant engaged in the parallel action contrary to its economic self-interest, and plus factors tend to establish that the defendants were not engaging merely in oligopolistic price maintenance or price leadership but rather in a collusive agreement to fix prices or otherwise restrain trade."
- "The UPPs are contrary to the Manufacturer Defendants' economic self-interest, if not adopted in tandem. "

B. *In re Disposable Contact Lens Antitrust* (M.D. Fla. 2016) (cont'd)

- "The UPPs were actively enforced by the Manufacturer Defendants, ABB and ECPs alike, a fact also known by all Manufacturer Defendants, and any retailer not complying with the mandatory minimum price, faced elimination from the competition to sell the contact lens products. Plaintiffs' allegations plausibly infer participation in a horizontal conspiracy by all."
- The Manufacturer Defendants had "regular opportunities to meet, exchange information, and signal their intentions" at meetings and through publications of industry organizations, which disseminates market and sales data for strategic planning to manufacturers.

C. *Meyer v. Kalanick* (S.D.N.Y. 2016)

- Plaintiff: Uber Customer
- Defendants: Travis Kalanick, CEO of Uber
- Goal of the conspiracy: Fixing Uber prices
- Vertical Agreements: Uber's Terms of Service with its drivers, in which the drivers agree that Uber may charge certain fares
- "Plaintiff has alleged that drivers agree with Uber to charge certain fares with the clear understanding that all other Uber drivers are agreeing to charge the same fares. These agreements are organized and facilitated by defendant Kalanick, who as at least an occasional Uber driver, is also a member of the horizontal conspiracy."

C. *Meyer v. Kalanick* (S.D.N.Y. 2016) (cont'd)

- "While Mr. Kalanick asserts that Uber's pricing algorithm facilitates its market entry as a new brand, this observation - which is fairly conclusory - does not rule out a horizontal conspiracy among Uber drivers, facilitated by Mr. Kalanick both as Uber's CEO and as a driver himself. The Court therefore finds that plaintiff has adequately pleaded a horizontal antitrust conspiracy under Section 1 of the Sherman Act."

D. *In re K-Dur Antitrust Litigation* (D.N.J. 2016)

- No hub-and-spoke conspiracy.
- Schering, a drugmaker, sued Upsher and ESI, two generic drugmakers, for selling a generic version of K-Dur, Schering's potassium chloride tablet.
- Schering and the drugmakers eventually reached settlement, which was structured to incentivize Upsher and ESI to leave the generic market for K-Dur.
- The Plaintiffs, comprised of the purchasers of K-Dur from 1998 until 2001, alleged a single hub-and-spoke conspiracy, with Schering as the hub and with Upsher and ESI as spokes due to their respective settlements with Schering, working together to eliminate generic competition for K-Dur.

D. *In re K-Dur Antitrust Litigation* (D.N.J. 2016) (cont'd)

- The court found that the plaintiffs failed to produce evidence that showed "at least a reasonable inference of a horizontal agreement between the spokes."
- "Plaintiffs do not offer facts that this Court can construe as showing any type of agreement between Upsher and ESI. In fact, as part of the settlement with Schering, Upsher agreed to not assist ESI with its ongoing patent litigation against Schering, and to not assist any other party challenging the . . . patent. And there is no evidence on this record that ESI even knew about the Schering-Upsher settlement until after it occurred."

E. *In re McCormick & Co.,* (D.D.C. 2016)

- No hub-and-spoke conspiracy.
- Plaintiffs, retail purchasers of black pepper, alleged that McCormick, manufacturer of canned black pepper, agreed with large retailers to reduce the amount of ground black pepper contained in the McCormick-supplied, store-branded tins, even though the actual size of the tins remained the same.
- Plaintiffs further alleged that McCormick and the large retailers agreed to maintain the original retail price for the new “slack-filled black pepper containers.”
- Plaintiffs could not provide specific communications or documents evidencing such an agreement, but they alleged that McCormick and the large retailers had regular opportunities to meet and exchange information.

E. *In re McCormick & Co.,* (D.D.C. 2016) (cont'd)

- "Here plaintiffs allege that McCormick was in a position to act as the 'hub' in a 'hub-and-spoke' conspiracy, but their allegations focus on the relationship and communication between McCormick and each retailer. There is no explicit allegation that the retailers made an agreement with each other. If there were such an allegation, plaintiffs would also need to allege supporting facts. Plaintiffs have not done this. In fact, plaintiffs do not even name the retailers who allegedly made agreements, other than Wal-Mart and Publix. Therefore, the alleged agreement on quantity cannot be deemed illegal per se as a hub-and-spoke conspiracy."

VI. Conclusions from the Cases

- How to Prove the “Rim”
- Communication/Knowledge Between the “Spokes”
- Independent Business Interest
- Plus Factors

A. How to Prove the "Rim"

- Explicit agreement among the "Spokes" (rare)
  - The "hub" may be unnecessary in such cases
- Circumstantial Evidence
  - Parallel Conduct AND
  - Plus Factors
- Parallel Conduct
  - "Spokes" acted "similarly" around the same time
  - Could be shown by vertical agreements or implicit inference
- Plus Factors
  - Factors that tend to exclude the possibility that a person or entity is acting independently

B. Communication/Knowledge Between the Spokes

- Required to prove *per se* horizontal agreement
- Evidence of communications between competitors, which may be through the "hub"
- At minimum, evidence must shows how competitors knew about the hub's communication of similar agreements with other competitors.
  - Interstate Circuit's "carbon-copied letter"
  - Toys "R" Us' circulation of "I'll stop if they stop" message

C. Independent Business Interest

- Does the vertical agreement align with independent business interest of the "spokes?"
- "[M]arket interdependence giving rise to conscious parallelism" versus "where individual action would be so perilous in the absence of advance agreement that no reasonable firm would make the challenged move without such an agreement." – *In re Musical Instruments* (Guitar Center)

D. Plus Factors

- Conditioning an agreement on the participation of other competitors
- Actions that reflect a marked departure from previous business practices
- Spokes assisting the hub in enforcing vertical agreements

VII. Practical Advice

- Avoid communications, or facilitating communications, between horizontal competitors regarding major suppliers/buyers or product pricing.
- Do not enter into agreements that are contingent on other competitors entering similar agreements.
- Always consider the company's interest before entering vertical agreements.
  - It must be a unilateral business decision.
- Take extra compliance measures when meeting with competitors (industry conferences, etc.) and properly document the meeting.
- Consult with a counsel first before communicating with competitors.
- Avoid making an abrupt decision to change a course of dealing with a supplier, buyer, or competitor.

Thank You

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