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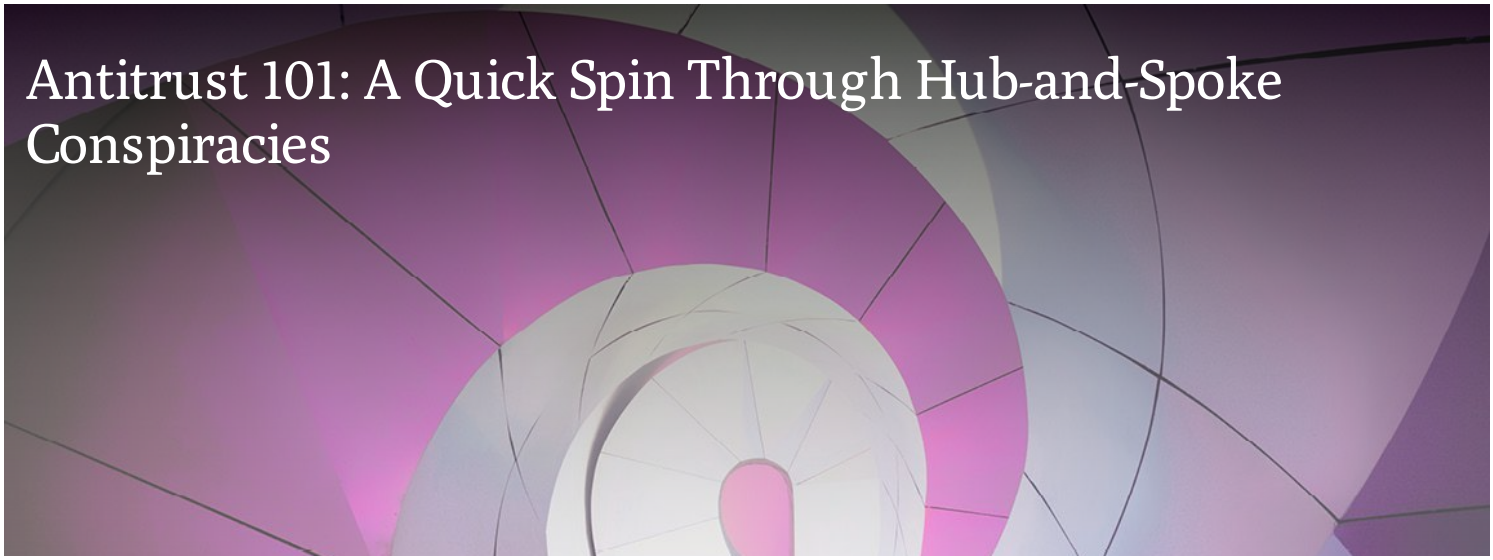
BLOG

Antitrust 101: A Quick Spin Through Hub-and-Spoke Conspiracies



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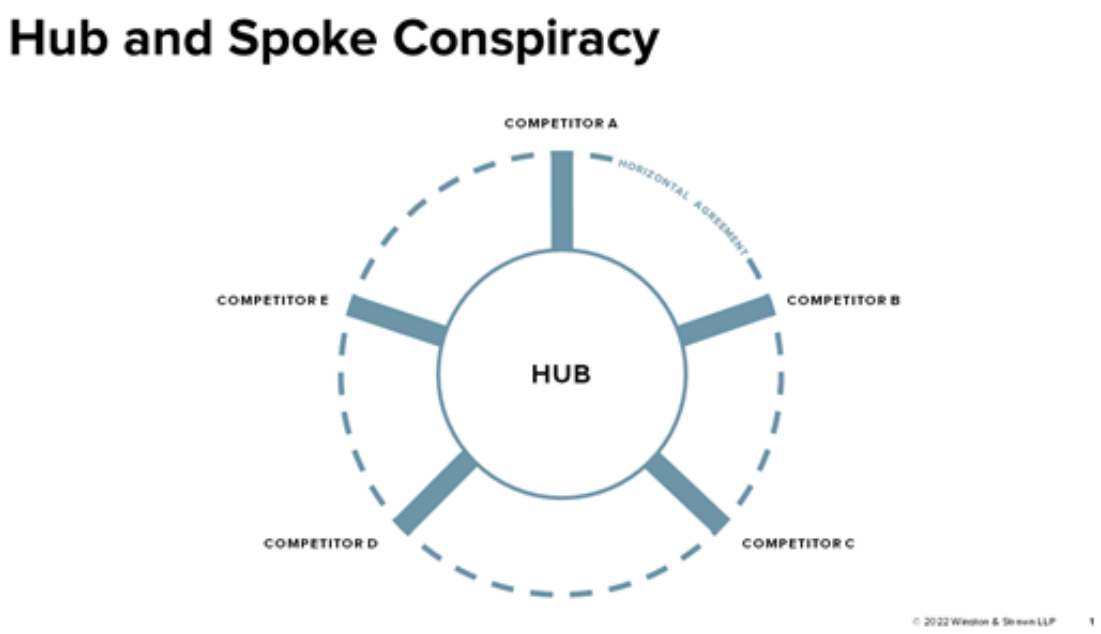
Each alleged violation of Section 1 of the Sherman Act requires proof of an agreement to unreasonably restrain interstate commerce or trade. There are two well-recognized types of agreements between market participants to unreasonably restrain trade: horizontal and vertical agreements.

- **Horizontal agreements.** The classic example of a horizontal agreement is any arrangement or understanding between or among direct competitors to fix or maintain prices, allocate markets, or rig bids. Because these agreements between direct competitors lack any justifiable procompetitive benefit, they are deemed *per se* illegal under the Sherman Act, meaning evidence establishing an agreement among competitors to restrain trade is enough to impose liability upon all participants in the conspiracy without analysis of actual market effects, if any.
- **Vertical agreements.** Conspiracies with vertical agreements involve entities at different levels of the market structure, usually at different levels of a supply chain (e.g., manufacturer and buyer). Not all vertical agreements are deemed illegal, and many can be justified by procompetitive benefits. Courts find vertical agreements to be unlawful only after an analysis of market effects to determine whether the restraint of trade is unreasonable, which is known as the rule-of-reason analysis.

Counsel and companies should also be aware of hub-and-spoke conspiracies, which include both vertical and horizontal components. These types of restraints can also be subject to *per se* scrutiny, particularly where a plaintiff can establish the existence of a rim.[1] A hub-and-spoke conspiracy has three parts: the hub, the spokes, and a rim. Essentially, it is a series of separate vertical agreements between a central actor, who is at one level of the supply chain (the hub), and a number of actors on a different level of the supply chain (the spokes); and a horizontal agreement among the spokes to the same scheme that each spoke reached individually with the hub (the rim).



Absent direct evidence of the "agreements" in a hub-and-spoke scenario, common indirect evidence used by plaintiffs and government agencies to substantiate allegations of a hub-and-spoke conspiracy include communications between the conspirators. Courts often also look at evidence that the defendants' actions were adverse to their independent business interests, and that the parallel conduct was conditioned on similar conduct by other competitors. These factors are explored further below. It is worth noting, however, that no single factor is outcome determinative.

Avoid communicating with competitors, even through a third-party

Communication among competitors is hallmark evidence of a horizontal conspiracy and is frequently invoked as evidence of a hub-and-spoke conspiracy, especially when the communications are facilitated by the hub. Sometimes horizontal competitors do not need to speak directly with one another for the court to find the "rim" in a hub-and-spoke conspiracy.

In two well-recognized hub-and-spoke cases, *Interstate Circuit v. United States*[2] and *Toys "R" Us, Inc. v. F.T.C.*,[3] courts found that hub-and-spoke conspiracies existed mainly through evidence that the hub of the conspiracy relayed communications to competitors, which led to concerted anticompetitive action. In *Interstate*, a movie exhibitor sent a demand letter to its eight movie distributors, naming on the face of the letter the addressees, setting a minimum price for first-run movies and a prohibition on double features.[4] The Supreme Court relied on the letter in finding a rim, noting that by identifying the recipients on the face of the letter, the movie exhibitor alerted all distributors that the proposal was being considered by others and that there was profit to be made through coordination, leaving "a strong motive for concerted action."[5] Similarly, in *Toys "R" Us*, Toys "R" Us, the hub of the conspiracy, communicated assurances among competing toy manufacturers (the spokes), even going so far as communicating the message, "I'll stop if they stop." The court found this a "compelling case for inferring a horizontal agreement."[6]

Some cases *do* involve direct communications between competitors. In *United States v. Apple*, for example, the court found that the hub, Apple, orchestrated a hub-and-spoke conspiracy with the nation's top publishers, the spokes, to increase prices in the electronic-book ("e-book") market.[7] In finding there was a hub-and-spoke conspiracy, the court found that the five publishing companies met to discuss problems facing the industry (e.g., Amazon); were in frequent contact with one another throughout negotiations with Apple, through telephone and

email; and assured each other that each would participate to achieve the desired effect of raising prices on Amazon.[8]

Courts can consider other factors to infer a rim in a hub-and-spoke conspiracy

Courts have also relied on evidence that a spoke acted against its self-interest or conditioned its acceptance of a particular term or arrangement on other competitors' aligned conduct to infer a rim. Taking action that is against a company's independent business interest suggests a collaborative agreement to act anticompetitively.[9] Moreover, many conspiracies are predicated on unanimous, collective action to reach the desired anticompetitive effect. Orchestrating collective action, where each company's participation is dependent on another's, is strong inferential evidence supporting the existence of an agreement and conspiracy to fix prices.[10]

Enforcement Examples

To further explore this topic, below are examples of government enforcement actions, and the result of each action relating to anticompetitive hub-and-spoke conspiracies.

- *United States v. Apple*, 791 F.3d 290 (2d Cir. 2015) (affirmed the district court's finding of a hub-and-spoke conspiracy)
- *Toys "R" Us, Inc. v. FTC*, 221 F.3d 928 (7th Cir. 2000) (affirmed the Commission's finding that TRU engaged in a hub-and-spoke conspiracy)
- *United States v. All Star Industries*, 962 F.2d 465 (5th Cir. 1992) (affirmed criminal conviction of corporations and individual officers for engaging in a hub-and-spoke conspiracy)
- *Interstate v. United States*, 306 U.S. 208 (1939) (first SCOTUS case to find a hub-and-spoke conspiracy)

There is also the risk of private enforcement. Courts' analyses in private actions do not differ from the criminal or government enforcement proceedings, and plaintiffs still must adequately plead direct evidence of a conspiracy, or at least a sufficient factual basis for plus factors that adequately support a conspiracy under federal pleading standards. For instance, in *In re Musical Instruments & Equipment Antitrust Litigation*,[11] the court found that despite manufacturers' unanimously agreeing to Guitar Center's minimum-advertised-price (MAP) policies, the plaintiffs failed to allege more than parallel conduct that could be explained by independent action. The fact that manufacturers agreed to conditions imposed by a dominant customer was insufficient to establish a conspiracy because there were "ample independent business reasons why each of the manufacturers adopted and enforced MAP policies even absent an agreement among the defendant manufacturers."[12]

Takeaway

The law surrounding hub-and-spoke conspiracies continues to evolve, as do enforcement methods employed by the government and plaintiffs. Businesses should be wary of orchestrating agreements among multiple levels of the distribution chain, facilitating communications among direct competitors, or following competitors' conduct where it goes against the company's unilateral business interest.

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[1] Courts dispute whether the vertical participants' conduct in a hub-and-spoke conspiracy receives *per se* scrutiny or rule-of-reason analysis and frequently analyze the conspiracy under the rule-of-reason analysis in the alternative. For some courts, it might depend more on the sort of restraint alleged as a result of the conspiracy than on the status of the participant (i.e., vertical or horizontal actor). In *Apple v. United States*, 791 F.3d 290, 321–25 (2nd Cir. 2015), a two-judge majority in the Second Circuit determined that even the vertical participants' conduct received *per se* analysis when the objective of the conspiracy is horizontal price fixing—a traditional hardcore cartel.

[2] 306 U.S. 208 (1939).

[3] 221 F.3d 928 (7th Cir. 2000).

[4] *Interstate Circuit*, 306 U.S. at 216–18.

[5] *Id.* at 222.

[6] *Toys "R" Us*, 221 F.3d at 932, 935.

[7] 791 F.3d at 297.

[8] *Id.* at 300, 318–19.

[9] *See Toys "R" Us, Inc.*, 221 F.3d at 935–36.

[10] *See, e.g.*, *Apple*, 791 F.3d at 303–04, 316–17.

[11] *See In re Musical Instruments & Equipment Antitrust Litigation*, 798 F.3d 1186, 1195, 1198 (9th Cir. 2015).

[12] *Id.* at 1195.

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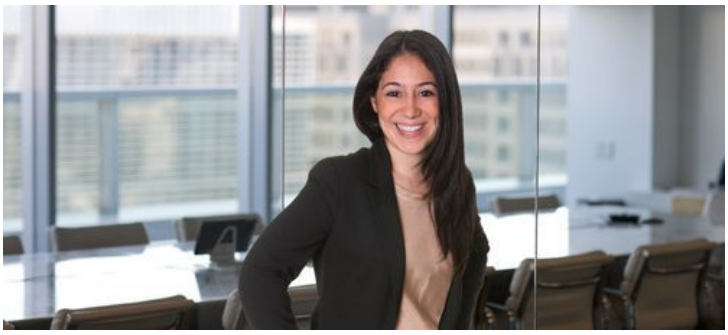

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