

Practical Advice for Avoiding Hub-and-Spoke Liability

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It is axiomatic that the federal and state antitrust laws prohibit unreasonable agreements in restraint of trade. Most often, such agreements take one of two forms: (1) horizontal agreements made between competitors and (2) vertical agreements made up and down a supply chain, like those between a supplier and its distributors. Certain horizontal agreements, like agreements among competitors to fix prices or divide markets, and certain forms of group boycott agreements, are deemed per se illegal. In those circumstances, once the agreement's existence is established, no further inquiry into the parties' intentions or the practice's actual impact on the market is necessary to establish a violation. Vertical agreements, by contrast, are analyzed under the rule of reason, which involves an examination of the particular context in which the restraint was adopted, including its effect on the relevant product market and any procompetitive justifications for the restraint. Sometimes, however, "the line between horizontal and vertical constraints can blur."¹

In particular, companies and their counsel must be on the watch for so-called hub-and-spoke agreements, which by their nature combine elements of both horizontal and vertical restraints. In the typical "hub-and-spoke" case, a dominant purchaser or supplier in a relevant market (the "hub") is alleged to have entered into a series of vertical agreements with its distributors or suppliers (the "spokes"). Considered alone, these agreements might be lawful, vertical restrictions. For example, Distributor A, at the behest of its customer, Supplier A, might agree to forgo doing business with Supplier B. A firm generally has the unrestricted right to choose with whom it deals.² Thus, such a restraint would normally be evaluated under the rule of reason. However, the analysis may change, and greater scrutiny afforded, if Supplier A has also secured similar agreements from Distributors B, C, and D. With evidence of a "rim"—that is, an agreement between Distributors A, B, C, and D to accede to Supplier A's demand and essentially boycott Supplier B—all participants could potentially be found per se liable for participating in an unlawful hub-and-spoke conspiracy.

Recent years have seen an increased invocation of hub-and-spoke theories of liability by both government enforcement agencies and private plaintiffs, some of which have caught traction with the courts.³ Plaintiffs have a strong incentive—the promise of potential per se liability—to plead hub-and-spoke conspiracies.⁴ Establishing that a rim exists is often a dispositive hurdle in these cases because, absent a rim, the conspiracy will be evaluated as a series of vertical arrange-

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¹ *In re Musical Instruments & Equip. Antitrust Litig.*, 798 F.3d 1186, 1192 (9th Cir. 2015).

² *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919) ("In the absence of any purpose to create or maintain a monopoly, the [Sherman] [A]ct does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal . . .").

³ See, e.g., *In re Musical Instruments*, 798 F.3d 1186; *United States v. Apple Inc.*, 791 F.3d 290 (2d Cir. 2015).

⁴ *In re Musical Instruments*, 798 F.3d at 1192–93 n.3 ("The prospect of establishing a violation per se is much more appealing to plaintiffs than the potential difficult and costliness of proving a § 1 claim under the rule of reason.")

ments, which plaintiffs will have to prove unreasonable under the rule of reason. In a small number of cases, a rim is readily established through direct evidence of an explicit agreement between the spokes. More often, it must be inferred from circumstantial evidence.

Thus, an important question facing both antitrust practitioners and their clients is: Absent direct evidence of an agreement among the alleged spokes, what suffices to establish a rim in a hub-and-spoke conspiracy?⁵ And, equally important, what steps should business entities take to avoid creating the incorrect appearance of a tacit agreement to join a hub-and-spoke agreement?

Distinguishing a Series of Independent Agreements from a Hub-and-Spoke Conspiracy

Consider the following scenario: A dominant manufacturer sends a letter to its suppliers, which outlines two prerequisites to continued distribution of the manufacturer's products. The suppliers, competitors of one another, are all copied on the same letter. The conditions, viewed independently, might be lawful vertical restrictions, provided they enhance competition. But is the letter an invitation to collude? Do the suppliers risk being labeled as part of a hub-and-spoke conspiracy and held per se liable for violating Section 1 of the Sherman Act if they all agree to the requirements? What if the competing suppliers never explicitly agree amongst themselves to accede to the manufacturer's conditions?

In *Interstate Circuit, Inc. v. United States*, the Supreme Court affirmed a decision holding a number of horizontal competitors liable for participating in a conspiracy with a common distributor under similar circumstances.⁶ There, the manager of the two dominant movie theater operators across a number of cities sent a letter to eight representatives of movie distributors, all of which were in active competition with one another to distribute films for first-run showings. In the letter, on which all eight distributors were copied, the movie theater operator asked the distributors to comply with two demands: a minimum price for first-run theaters and a policy against evening double features. There was no direct evidence of an agreement between the distributors, but the Court found that “[i]t was enough that, knowing that concerted action was contemplated and invited, the distributors gave their adherence to the scheme and participated in it.”⁷

A closer look at that case, as well as an examination of subsequent case law, demonstrates that mere knowledge that rivals may be adopting similar policies at the request of a distributor or manufacturer is probably not sufficient to alone establish liability. But that knowledge, combined with parallel action on the part of the competitors and other “plus” factors, may lead a court to infer a conspiracy among horizontal actors who enter into vertical agreements with a common hub. These plus factors can include action that would be against a participant's independent business interests, conditioning an agreement on the participation of other competitors, and action that reflects a marked departure from previous business practices.

Establishing that a rim exists is often a dispositive hurdle in these cases because, absent a rim, the conspiracy will be evaluated as a series of vertical arrangements, which plaintiffs will have to prove unreasonable under the rule of reason.

⁵ Some courts have spoken of “rimless” hub-and-spoke conspiracies. See *Elder-Beerman Stores Corp. v. Federated Dep’t Stores, Inc.*, 459 F.2d 138, 146 (6th Cir. 1972). Most courts, however, have adopted an approach more consistent with general antitrust principles and rejected the application of the hub-and-spoke theory to such cases, noting that “‘without the rim of the wheel to enclose the spokes,’ a single, wheel conspiracy cannot exist but instead is a series of multiple conspiracies between the common defendant and each of the other defendants.” *United States v. Swafford*, 512 F.3d 833, 842 (6th Cir. 2008) (quoting *Kotteakos v. United States*, 328 U.S. 750, 755 (1946)); see also *United States v. Bustamante*, 493 F.3d 879, 885 (7th Cir. 2007) (“For a hub and spoke conspiracy to function as a single unit, a rim must connect the spokes together, for otherwise the conspiracy is not one but many.”); *In re Musical Instruments*, 798 F.3d at 1192 (describing a hub-and-spoke theory as one in which “the rim of the wheel . . . consists of horizontal agreements among the spokes”).

⁶ 306 U.S. 208 (1939).

⁷ *Id.* at 226.

In *FTC v. Toys “R” Us*, the FTC successfully defended a verdict against Toys “R” Us and a number of toy manufacturers for participating in a hub-and-spoke conspiracy.⁸ The Seventh Circuit upheld a finding that Toys “R” Us acted as the hub and coordinated a horizontal agreement among the toy manufacturers through a network of vertical agreements in which each toy manufacturer agreed with Toys “R” Us to restrict the distribution of its products to low-priced warehouse club stores on the condition that other manufacturers would do the same.⁹ In *United States v. Apple*, the Second Circuit upheld the district court’s finding of a per se violation of the antitrust laws by Apple, where it had entered into a series of vertical agency agreements with e-book publishers.¹⁰ In a 2–1 decision, the Second Circuit concluded that, through its vertical conduct, Apple “orchestrated” an agreement among publishers to raise e-book prices and that the district court did not err in characterizing this agreement as a horizontal price fixing-conspiracy subject to per se liability.¹¹

The Ninth Circuit, however, recently rejected plaintiffs’ allegations of a hub-and-spoke conspiracy in *In re Musical Instruments & Equipment Antitrust Litigation*, where individual guitar manufacturers had agreed to adopt minimum advertised price (MAP) policies at the request of Guitar Center, a large musical-instrument retailer.¹² The court found “ample independent business reasons why each of the manufacturers adopted and enforced MAP policies even absent an agreement among the defendant manufacturers” and thus found that their “decisions to heed similar demands made by a common, important customer do not suggest conspiracy or collusion.”¹³

A few common threads run through the cases in which courts have found either allegations or evidence sufficient to infer a horizontal agreement between competitors from circumstantial evidence. From those decisions, common principles can be extracted to assist in analyzing proposed business opportunities for competition risk.

The easiest way to prove a horizontal agreement in a hub-and-spoke conspiracy is the same as in any Section 1 case: through direct evidence of an express agreement. That, of course, turns what is termed a rim into a plain vanilla horizontal agreement. But what do courts do absent such express evidence? They turn to the allegations or evidence that is most suggestive that such an agreement was tacitly reached: evidence of direct communications between horizontal competitors.

1. Are there communications between the horizontal competitors or, at the very least, knowledge that other competitors are entering into similar agreements? Most cases in which courts have either imposed per se liability on horizontal competitors for engaging in a hub-and-spoke conspiracy or allowed such claims to proceed past a pleadings challenge have involved evidence of communications between the competitors or, at the very least, evidence that competitors were

⁸ 221 F.3d 928 (7th Cir. 2000).

⁹ *Id.* at 930.

¹⁰ *United States v. Apple Inc.*, 791 F.3d 290, 314 (2015), *cert. denied*, 136 S. Ct. 1376 (2016). The Second Circuit did not affirm the district court’s finding that a rule of reason violation had also been established; the two-judge majority split on that issue.

¹¹ *But see*, *Leegin Creative Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 893 (2007) (holding that a rule of reason analysis would apply to a vertical agreement “entered upon to facilitate . . . [a] cartel”); *see also* *Toledo Mack Sales & Service, Inc. v. Mack Trucks, Inc.*, 530 F.3d 204, 225 (3d Cir. 2008) (holding that “[t]he rule of reason analysis applies even when . . . the plaintiff alleges that the purpose of the vertical agreement between a manufacturer and its dealers is to support illegal horizontal agreements between multiple dealers.”).

¹² 798 F.3d 1186.

¹³ *Id.* at 1195.

aware of common communications with the hub about similar terms.¹⁴ Conclusory allegations that the spokes had mere knowledge of one another's participation in an alleged conspiratorial scheme, by contrast, are not sufficient even to withstand a motion to dismiss—"there must be factual allegations to plausibly suggest as much."¹⁵

In *Interstate Circuit*, there was no evidence of direct communications or agreement among the competitors, but all were copied on the same correspondence from the hub and acted in parallel to the requests therein—facts the Court found sufficient to demonstrate implicit agreement. The Court found that an inference of agreement was "supported and strengthened" by the defendants' failure to offer the testimony "of any officer or agent of a distributor who knew, or was in a position to know, whether in fact an agreement had been reached among them for concerted action."¹⁶ Silence, in that circumstance, was tantamount to a concession. And *Toys "R" Us* included the "direct evidence of communications that was missing in *Interstate Circuit*."¹⁷ In that case, Toys "R" Us, acting as the hub, communicated the message that "'I'll stop if they stop' from manufacturer to manufacturer," resulting in an essential boycott of the club stores by almost all major toy manufacturers.¹⁸

The fact that a firm does not speak directly with competitors about an agreement will not allow it to avoid liability if there is evidence that it used the hub or another third party as a conduit to communicate with competitors.

Practice tip: *Communications with competitors about dealings with a mutual supplier or buyer create heightened risks. The fact that a firm does not speak directly with competitors about an agreement will not allow it to avoid liability if there is evidence that it used the hub or another third party as a conduit to communicate with competitors.*

2. Would the contemplated action be in your independent interest regardless of whether or not competitors take a similar action? A key factor in many courts' analyses of whether indirect evidence supports a finding of a hub-and-spoke conspiracy is whether the agreement is in the individual participant's independent business interest. In *Monsanto Co. v. Spray-Rite Service Corp.*, the Supreme Court held that "antitrust law limits the range of permissible inferences from ambiguous evidence in a § 1 case."¹⁹ Accordingly, under this standard, conduct that is "as consistent with permissible competition as with illegal conspiracy does not, standing alone, support an inference of antitrust conspiracy."²⁰

In *Interstate Circuit*, the Supreme Court explained that the cooperation of all the horizontal players was "essential" to the success of the planned change in cinema practices.²¹ Each competitor theater operator knew that if the others did not adopt the requested restrictions on a market-wide basis, it stood to lose substantial business and good will. And at the same time, each knew that if *all* the competitors did adopt the restrictions, then they *all* faced the prospect of increased

¹⁴ Compare *Toys "R" Us*, 221 F.3d at 935 (noting "direct evidence of communications") with *In re Pool Products Distrib. Market Antitrust Litig.*, 940 F. Supp. 2d 367, 393 (E.D. La. 2013) (dismissing a horizontal and/or hub-and-spoke claim where "complaint does not specifically allege any contacts among or between manufacturers") (citing *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 564–70 (2007)).

¹⁵ *Howard Hess Dental Labs, Inc. v. Dentsply Int'l, Inc.*, 602 F.3d 237, 255 (3d Cir. 2010) (citing *Twombly*, 550 U.S. at 564).

¹⁶ *Interstate Circuit*, 306 U.S. at 225.

¹⁷ 221 F.3d at 935.

¹⁸ *Id.* at 932.

¹⁹ *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 588 (1986) (citing *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984)).

²⁰ *Matsushita*, 475 U.S. at 588 (citing *Monsanto*, 465 U.S. at 764).

²¹ 306 U.S. at 226.

profits.²² Likewise, in *Toys “R” Us*, the Seventh Circuit found that “the sudden adoption of measures under which [toy manufacturers] decreased sales to the clubs ran against their independent economic self-interest.”²³ The court cited evidence demonstrating that “each manufacturer was afraid to curb its sales to the warehouse clubs alone, because it was afraid its rivals would cheat and gain a special advantage in that popular new market niche.”²⁴

The Ninth Circuit, in *In re Musical Instruments & Equipment Antitrust Litigation*, distinguished cases in which action reflective of “market interdependence giving rise to conscious parallelism” occurs from cases “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,” finding that the latter “may suggest a prior agreement” among competitors.²⁵ On their face, the MAP policies central to the alleged conspiracy might be against a given manufacturer’s self-interest insofar as they restrict the degree to which retailers could discount and thus increase sales of its products. The court, however, declined to find this suggestive of conspiracy in the circumstances where the complaint also “provide[d] ample independent business reasons why each of the manufacturers adopted and enforced MAP policies even absent an agreement the defendant manufacturers.”²⁶

Practice tip: *A firm should avoid agreeing to adopt a restriction or enter into an agreement that runs contrary to its individual interests, such that it would only consider doing so if it knew its competitors were doing the same.*

3. Is your agreement to a course of conduct conditioned on the agreement of your horizontal competitors to that same course of conduct? This question is closely linked to an assessment of whether the contemplated conduct would be in a firm’s independent business interest. The fact that a firm feels that it must condition its agreement to certain terms upon the agreement of its competitors to those same terms can suggest that the terms are not in its independent interests. In *Toys “R” Us*, testimony from both toy company executives and Toys “R” Us “to the effect that the only condition on which each toy manufacturer would agree to Toys “R” Us’ demands was if it could be sure its competitors were doing the same thing” weighed heavily in the court’s finding that a horizontal agreement existed among the “spokes.”²⁷ And, as noted above, in *Interstate Circuit*, the failure of the distributors to offer any testimony or evidence suggesting that the companies had, in fact, acted independently was viewed as dispositive of the fact of agreement.

Practice tip: *Seeking assurances from a counterparty that competitors are entering into similar agreements may serve as evidence that a given course of conduct is not in the firm’s independent business interests and thus support a finding of an agreement among the alleged rim. Adherence to agreements should be a truly unilateral business decision.*

²² *Id.* at 222.

²³ *Toys “R” Us*, 221 F.3d at 932.

²⁴ *Id.* at 936.

²⁵ 798 F.3d at 1195.

²⁶ *Id.*; see also *Howard Hess Dental Labs. Inc. v. Dentsply Int’l, Inc.*, 602 F.3d 237, 255 (3d Cir. 2010) (“[S]imply because each Dealer, on its own, might have been economically motivated to exert efforts to keep Dentsply’s business and charge the elevated prices Dentsply imposed does not give rise to a plausible inference of an agreement among the Dealers themselves.”).

²⁷ *Toys “R” Us*, 221 F.3d at 928.

An abrupt decision to change a course of dealing with a supplier, buyer, or competitor at the request of another supplier, buyer, or competitor carries heightened risk of the inference of a conspiracy. In such circumstances, adhering to best antitrust risk practices is paramount.

4. Does the contemplated action represent a significant departure from previous business practices? A recent decision by the Fifth Circuit highlights the importance of this factor in avoiding an inference of agreement. In *MM Steel, L.P. v. JSW Steel (USA) Inc.*, the court affirmed the liability of a steel manufacturer that allegedly participated in a conspiracy with steel distributors to exclude a new steel distributor from the market where the manufacturer abruptly changed its course of dealing with that new entrant following threats it received from the distributors.²⁸ Pointing to this “abrupt decision” to no longer deal with the new entrant, as well as statements made by the manufacturer regarding that decision, the court found that a reasonable juror could have concluded that the evidence “tended to exclude the possibility of conduct that was independent of the distributors’ conspiracy.”²⁹ The court, however, reversed judgment as to another steel manufacturer, where it found that defendant’s decision not to deal with the new entrant “was either consistent with its incumbency practice, or at most, consistent with a vertical agreement with [a] long-standing customer.”³⁰

This follows other hub-and-spoke cases in which liability has been established without direct evidence of an agreement. In *Interstate Circuit*, the Supreme Court noted that the distributors’ agreement with the manufacturer’s proposal involved a “radical departure from the previous business practices of the industry” and a “drastic increase in . . . prices.”³¹ Similarly, in *Toys “R” Us*, the court described the manufacturers’ decision to stop dealing with the club stores “an abrupt shift from the past.”³²

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A Special Case: Collaborative Industry Initiatives

Dangers arise and risk increases where firms face particular unilateral issues (e.g., how to deal with the increase of the price of labor or how to deal with a particularly troublesome supplier) and then discuss them—or have the opportunity to discuss them—with other industry participants. Collaborative industry initiatives that include actual or potential competitors, especially where they involve exchanges of competitively sensitive information, can attract the attention and scrutiny of competition law enforcers. Moreover, private plaintiffs can try to use evidence of such meetings to establish communications between or a meeting of the minds among the rim of an alleged hub-and-spoke conspiracy.

For example, before the plaintiffs filed their complaints in *In re Musical Instruments Antitrust Litigation*, the FTC had initiated an investigation into possible price fixing in the music products industry, alleging that the National Association of Music Merchants (NAMM) organized various meetings and events at which “competitors discussed the adoption, implementation, and enforcement of minimum advertised price policies; the details and workings of such policies; appropri-

²⁸ *MM Steel, L.P. v. JSW Steel (USA) Inc.*, 806 F.3d 835, 844–45 (5th Cir. 2015), *petition for cert. filed*, 84 U.S.L.W. 3685 (U.S. Jan. 9, 2016) (No. 15-1492).

²⁹ *Id.* at 845.

³⁰ *Id.* at 846.

³¹ 306 U.S. at 222.

³² 221 F.3d at 935.

ate and optimal retail prices and margins; and other competitively sensitive issues.”³³ The FTC’s complaint was resolved through a consent decree that included no admission of liability. Plaintiffs, however, seized upon these allegations and the defendants’ attendance at NAMM meetings as supporting an inference of horizontal agreement between the guitar manufacturers to adopt MAP policies.³⁴

The Ninth Circuit majority rejected such an inference, noting that “mere participation in trade-organization meetings where information is exchanged and strategies are advocated does not suggest an illegal agreement.”³⁵ The three judge panel, however, was not in agreement on this point. In a strongly worded dissent, Judge Pregerson argued that the fact that the FTC had alleged that the trade association’s meeting “had the purpose, tendency, and capacity to facilitate collusion,” made it “more plausible” that an illegal agreement was reached and that “discussions at NAMM-sponsored events of specific mutually agreeable terms are a ‘circumstance pointing toward a meeting of the minds’”³⁶

It is the case that both vertical players and horizontal competitors may participate in joint standard-setting activities—providing a fertile ground for hub-and-spoke allegations to arise absent caution.

Accordingly, a firm’s participation in joint industry collaborations can give rise, at the very least, to an opportunity for the suggestion of collusion. When participating in industry collaborations, such as trade associations or standards-setting bodies, it is critical to remember that competitors should avoid discussing or sharing competitively sensitive information, especially information regarding pricing, costs, or market share data. Competitors should also avoid discussing plans for current or future commercial activities. It is the case that both vertical players and horizontal competitors may participate in joint standard-setting activities—providing a fertile ground for hub-and-spoke allegations to arise absent caution. In such cases, it is important to remember that any standards adopted should be supported by legitimate, pro-competitive business justifications. Examples of such justifications include enhancing the industry’s reputation, deterring undesirable conduct, assuring quality products, and promoting innovation. Participants should be cautious about applying standards to companies that are not participating in the meeting, or using standards as an exclusionary tool. Standards should not restrict any participant’s freedom to make independent business decisions. Finally, trade association meetings should always be guided by an agenda and discussions should adhere to that agenda, so that any allegations of conspiratorial purpose can be rebutted.

Practice tip: *To minimize risk when meeting with competitors, an agenda should be prepared in advance of the meeting and reviewed by counsel. All discussions should adhere to that agenda. Minutes should be kept and reviewed after the meeting. Consider inviting antitrust counsel to participate in the meeting.*

Looking Toward the Future of Hub-and-Spoke Liability

This area of law remains a developing one, with often unique factual situations that can leave companies, their counsel, and courts wading through arguably ambiguous territory between per se liability and lawful, vertical agreements. As more plaintiffs invoke hub-and-spoke theories, one hopes that the courts will continue to refine and harmonize the answer to what evidence suffices to support an inference of conspiracy among horizontal competitors who entered into similar vertical agreements with a common supplier or distributor. In the meantime, companies and their counsel should remain watchful for circumstances that could arguably give rise to such liability. ●

³³ *In re Musical Instruments*, 798 F.3d at 1190.

³⁴ *See id.* at 1196.

³⁵ *Id.*

³⁶ *Id.* at 1199–1200 (quoting *Twombly*, 550 U.S. at 557).