Navigating 4th Circ.'s Antitrust Burden In Hybrid Relationships

By **Dan Anziska, Kim Veklerov and Megan Rahman** (December 2, 2024)

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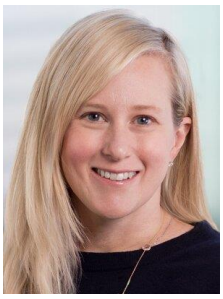

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On Nov. 12, the U.S. Supreme Court declined certiorari for the U.S. v. Brewbaker decision in the U.S. Court of Appeals for the Fourth Circuit, leaving undisturbed the ruling that heightens the burden on antitrust prosecutors when the target companies have a hybrid horizontal-vertical relationship.

The Fourth Circuit's Dec. 1, 2023, Brewbaker decision diverges from other circuits, so companies should remain cautious when collaborating with competitors, regardless of the nature of their relationship.

In Brewbaker, the Fourth Circuit concluded that the rule of reason, not the per se rule, applies when the restraint involves a so-called hybrid relationship that contains both vertical and horizontal components.

A hybrid relationship might involve, for instance, companies that simultaneously bid on the same contracts and have a manufacturer-distributer relationship with each other, or franchises where the franchisors both supply and compete with their franchisees.

Courts and the government have long distinguished between horizontal and vertical restraints of trade under Section 1 of the Sherman Act. Vertical restraints are agreements between firms at different levels of distribution and are subject to the rule of reason.

For example, companies in supplier or distributor relationships would be considered to be in a vertical relationship. courts applying the fact-intensive rule of reason must evaluate surrounding circumstances to determine whether the restraint at issue harms competition.

Horizontal restraints, on the other hand, are agreements between firms competing at the same level, such as the same product, market or services, to fix prices, divide markets or rig bids. Horizontal restraints are generally subject to the per se rule, meaning they are necessarily illegal without inquiry into the specific anticompetitive effects of an action.

The government generally reserves criminal prosecutions for per se violations, leaving other restraints of trade for civil enforcement.

Brewbaker stemmed from an alleged scheme to rig bids for construction contracts awarded by a state agency. The agency paid contracted firms to build aluminum structures to prevent flooding, and Pomona Pipe Products and Contech Engineered Solutions regularly bid for those contracts as direct competitors.

A federal grand jury indicted Contech and its sales manager, Brent Brewbaker, on one count of committing a per se violation of Section 1 of the Sherman Act by conspiring to rig bids. Prosecutors alleged that Pomona would share its planned bid price with Contech, and

Contech would then submit a higher bid.

Contech's inflated submission helped ensure that Pomona would win the contract. Pomona would then complete the construction projects, in part, using aluminum it purchased from Contech in a vertical supply relationship.

The Fourth Circuit explained that "the relationship of the parties, not just the nature of the limitation imposed" matters when determining whether a restraint is horizontal or vertical.

The court reasoned that a price-fixing agreement between two competing companies "produces different effects on competition" than one between companies that "simultaneously compete and collaborate."

The court applied the rule of reason because the restraint alleged in the indictment "would not invariably lead to anticompetitive effects." The court reasoned that if the restraint boosted Contech's sales of aluminum to Pomona, it could theoretically increase competition between Contech and other aluminum manufacturers.

Therefore, because the per se rule categorically condemns all agreements of a particular type, and does not consider procompetitive benefits of such agreements, it would be inappropriate to apply it to this particular circumstance.

Seeking relief from the Fourth Circuit decision, the U.S. Department of Justice had urged the Supreme Court to grant certiorari, noting the ubiquity of hybrid relationships in today's economy.

It also pointed to the growing circuit split on the issue; the Second and Seventh Circuits have applied the per se rule to competing firms that agree on how they will compete, even when they simultaneously had vertical relationships.

In the 1981 decision in U.S. v. Koppers Co., the U.S. Court of Appeals for the Second Circuit held that a bid-rigging and market-allocation agreement was a per se violation where firms were in a hybrid relationship with vertical and horizontal aspects.

In a later case, the 2015 decision in U.S. v. Apple Inc., the Second Circuit held that an agreement relating to distribution of ebooks was per se unlawful, despite being a vertical relationship, because it involved what is known as a so-called hub-and-spoke conspiracy.

In hub-and-spoke conspiracies, a supplier or distributor, or the hub, enforces anticompetitive agreements between its customers or suppliers, or the spokes. Courts, therefore, will often hold that hub-and-spoke conspiracies are per se violations of the Sherman Act.

In an Aug. 25, 2023, decision in Deslandes v. McDonald's USA LLC, the U.S. Court of Appeals for the Seventh Circuit held that an agreement to allocate labor was a per se violation of the law between a franchisor and franchisee in what the Justice Department describes as a hybrid horizontal-vertical relationship.

Notably, the Seventh Circuit does not discuss vertical relationships in its decision.

Until the Supreme Court resolves these apparent conflicts, the Fourth Circuit's approach will be "far more accommodating to antitrust defendants," the Justice Department warned in its petition.

However, the varying outcomes for companies in hybrid relationships provides little comfort to these companies. For now, the fact that companies are in such a relationship is an additional argument, but not one on which a defendant should feel confident standing alone.

In the meantime, attorneys advising clients that supply or are supplied from, or distribute through or are distributed by, competitors must understand the nature of their relationship and the extent of competition between the parties.

If a hybrid relationship does exist, clients should be advised to document the procompetitive aspects of their relationships with competitors, such as decreased cost, increased investment in research and development, or access to new supplies or products, and be thoughtful about how to structure agreements to emphasize such pro-competitive benefits.

Clients should be counseled that these facts are not dispositive, but could be helpful in the right circumstances, and with the right decision-maker.

Additionally, in connection with government procurement processes, companies should be counseled to exercise caution when considering supply agreements or collaborating with competitors. This is especially the case if the competition extends to services within the scope of the project.

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