Antitrust Red Flags For Green Product Initiatives

By **Andre Geverola, Francesca Pisano and Caleb Song** (April 7, 2023)

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As businesses increasingly engage in industrywide environmental, social and governance initiatives, these activities are coming under scrutiny, thanks to aggressive antitrust enforcement and a politicized focus on ESG.

Just last month, President Joe Biden issued the first veto of his administration, rejecting a bill that would have barred investment managers from considering ESG factors.[1] Meanwhile, opponents of ESG have argued that ESG collaborations may run afoul of antitrust laws.[2]

Antitrust laws cover all aspects of competition — including competition over product features and quality — and the leaders of the Federal Trade Commission and the U.S. Department of Justice's Antitrust Division have confirmed that there is no exemption from the antitrust laws for ESG activities.[3]

State attorneys general have joined the fray by publicizing antitrust scrutiny of certain ESG activities.[4] And international regulators are also actively reviewing ESG activities for potential competition issues.[5]

This article discusses the antitrust risks that may result from ESG-focused collaborations involving product features — such as green product initiatives — and suggests ways to mitigate the risk.

Antitrust Scrutiny Into Product Feature Collaborations and Standards

Two recent examples of ESG-related collaborations in the automotive industry illustrate how agreements on product features might prompt antitrust scrutiny — and possibly result in significant penalties.

In 2019, the DOJ launched an antitrust investigation into an alleged conspiracy among four automobile manufacturers that announced an agreement with the state of California on automotive emission standards.[6]

Although the investigation was closed without action, the DOJ's investigation reportedly was based on a concern that the emissions agreement might result in an artificial limit on the types of cars and trucks offered by the manufacturers — whereas absent such an agreement, the automobile manufacturers may have offered a wider range of vehicles.[7]

In explaining the probe, then-Assistant Attorney General Makan Delrahim stated that "even laudable ends do not justify collusive means in our chosen system of laws."[8]

The European Commission and the Korean Fair Trade Commission also recently investigated automotive industry initiatives involving emissions. This probe was known as the AdBlue investigation.

Regulators discovered that in response to updated EU vehicle emissions targets, representatives from several German automobile manufacturers had allegedly met to discuss technical engine updates that would be required to meet these new standards. However, the manufacturers also allegedly reached an agreement that each would meet — but not exceed — the emission targets.

In 2021 the European Commission fined the manufacturers €875.2M — about $939 million — alleging that the agreement allowed the competitors to "avoid competition … to clean [emissions] better than what is required by law."[9]

Likewise, in 2023, the KFTC fined the manufacturers 2.3 billion won — about $33.5 million — alleging that the agreements "limited competition for developing innovative clean technology and consumer choice to buy more clean cars."[10]

Each of the above examples was driven by concern that an industry collaboration might negatively affect consumer options for competitors' products. In the California matter, the DOJ reportedly was focused on whether the collaboration would limit the types of vehicles available on the market.

And in the European/Korean matter, the enforcers were concerned with whether the collaboration would limit the range of emissions capabilities of the manufacturers' vehicles. Such collaborations may be viewed by enforcers and courts as potential output restriction agreements, giving rise to antitrust liability.

Antitrust Implications of Agreements Affecting Output

An agreement among competitors that limits or decreases output generally is treated as per se unlawful under Section 1 of the Sherman Act — that is, presumed to be unreasonable without detailed inquiry into the anti-competitive impact of, or procompetitive justifications for, the conduct.[11]

In NCAA v. Board of Regents, for example, the U.S. Supreme Court observed in 1984 that output limitations ordinarily are "condemned as a matter of law under an 'illegal per se' approach because the probability that these practices are anticompetitive is so high."[12]

ESG-related collaborations may be deemed to be output restrictions, not only where the result is a reduction in the quantity of products, but also where the result is a reduction in the quality of products. This risk could arise in the following ways: (1) private lawsuits; (2) FTC or DOJ civil enforcement; (3) DOJ criminal enforcement; and (4) state attorney general enforcement.

Private Litigation Risk

In connection with the conduct underlying the AdBlue investigation discussed above, private plaintiffs brought an antitrust suit in the U.S. District Court for the Northern District of California, In re: German Automotive Manufacturers Antitrust Litigation, in 2019.

The plaintiffs alleged that the automobile manufacturers violated the Sherman Act, in part by colluding to slow the rate of feature and performance innovation in new automobiles. Although the court granted the defendants' motion to dismiss the amended complaint, the court found that "an agreement to make a product of inferior quality ... counts as an output reduction, and agreements to restrict output are per se illegal under § 1."[13]

Despite finding that "an agreement to reduce quality is tantamount to output reduction," the court ruled it was not clear from the complaint that the alleged agreement — even if it existed — "necessarily constituted agreements to reduce quality."[14]

This case nevertheless is notable because the court recognized that an agreement to limit competition on product features may be an output restriction in violation of the antitrust laws, so long as the agreement results in lower product quality.

FTC or DOJ Civil Enforcement Risk

If a product feature collaboration is viewed as potentially reducing product quality or quantity, this may also open the door to an FTC or DOJ civil challenge. Two FTC cases, in particular, offer notable comparisons to ESG-related product collaborations.

In 1964, the FTC challenged an agreement among macaroni manufacturers. The agency alleged that, during a drought affecting durum wheat production, the macaroni manufacturers fixed the quality of macaroni products by agreeing among themselves to only offer macaroni blends of 50% durum wheat and 50% other kinds of wheat, as opposed to higher quality 100% durum macaroni.[15]

The FTC alleged that the purpose of this agreement was to "ward off price competition for durum wheat" used in macaroni, by reducing demand for durum wheat.[16] The manufacturers appealed to the U.S. Court of Appeals for the Seventh Circuit.

In National Macaroni Manufacturers Association v. FTC, the court found in 1965 the agreement was illegal per se, holding that "price fixing is contrary to the policy of competition. … It makes no difference whether the motives of the participants are good or evil; whether the price fixing is accomplished by express contract or by some more subtle means."[17]

In 1986, the FTC found that an agreement among criminal defense lawyers to limit accepting certain representations was a per se violation of antitrust law. The lawyers — through an association — had agreed among themselves not to accept new indigent appointments unless there was an increase in the fees for such work.

The association argued that the boycott was justified by the public's interest in obtaining better legal representation for indigent defendants, through increased rates for such representations.[18]

But in 1990, in FTC v. Superior Court Trial Lawyers Association, the Supreme Court disagreed, and found that the agreement was a "'restraint' on price and output" and that the "social justifications proffered for [the] restraint of trade thus do not make it any less unlawful."[19]

Current FTC leadership has signaled that it intends to scrutinize a wide range of business conduct as potential antitrust violations — including through the recently announced expanded approach to Section 5 enforcement.[20] In addition, the DOJ may also bring civil enforcement actions, and has formed a Civil Conduct Task Force to investigate alleged anti-competitive practices.[21]

Accordingly, agreements among competitors affecting their product offerings may be subject to FTC or DOJ enforcement actions, regardless of their social justifications or the participants' good motives.

DOJ Criminal Enforcement Risk

It is also worth considering whether an agreement among competitors regarding product features might expose companies and individuals to criminal antitrust liability.

Criminal liability typically applies only to hardcore collusive agreements to fix prices, rig bids or allocate markets.[22] However, output restrictions can facilitate and enforce hardcore collusion, and thus be part of a criminal antitrust conspiracy.[23]

Notably, in prior criminal cases brought by the DOJ, product and feature standardization has been alleged to facilitate collusion in the same way as output restrictions.

In U.S. v. American Radiator & Standard Sanitary Corp., the U.S. Court of Appeals for the Third Circuit in 1970 upheld criminal price-fixing convictions for companies and executives in the plumbing-fixture manufacturing industry.[24]

The DOJ had alleged that, as part of the conspiracy, the defendant companies "agreed to discontinue the manufacture of regular enameled cast iron plumbing fixtures which were lower-priced than acid-resistant enameled cast iron plumbing fixtures," among other allegations of anti-competitive behavior.[25]

Despite the fact that the U.S. Department of Commerce made such acid-resistant products an industry standard, the Third Circuit nevertheless found that, where the companies agreed to discontinue a lower-priced product line (regular plumbing fixtures) in favor of a price-fixed product line (acid-resistant plumbing fixtures), such conduct was part of an agreement in violation of Section 1 of the Sherman Act.[26]

In U.S. v. Lischewski, the DOJ indicted the former CEO of Bumble Bee Foods LLC in the U.S. District Court for the Northern District of California in 2018 for allegedly participating in a conspiracy to fix prices of canned tuna.

The DOJ asserted that the conspiracy included an agreement to "limit and restrict competition between the conspirators as to certain types and categories of products, including, but not limited to, competition for products based on certain types of fishing methods"[27] that were purported to have less environmental impact than other fishing methods.

The DOJ argued that this agreement supported the price-fixing conspiracy by limiting alternatives to the price-fixed products.[28] In 2019, the CEO was convicted at trial and sentenced to 40 months' imprisonment.[29]

Both these cases show that product features may facilitate anti-competitive agreements among companies, and that the DOJ will be aggressive in investigating the full scope of industry collaborations — including pursuing criminal prosecutions where appropriate.

State Attorney General Enforcement

State attorneys general can bring suit under the Sherman Act in the same way as private plaintiffs, and can also bring enforcement actions under state antitrust and consumer protection laws.

For example, a letter from Arizona Attorney General Mark Brnovich to the CEO of BlackRock Inc. dated Aug. 4, 2022, raised potential antitrust issues in ESG activities, including whether certain net-zero pledges by financial institutions might constitute "[g]roup boycotts, restraining trade, or concerted refusals to deal," in violation of antitrust laws.[30]

Specifically, several state attorneys general have accused financial institutions of agreeing to limit financial investments in certain emissions-producing industries. It remains to be seen whether this scrutiny will expand to green product collaborations, but it is important not to overlook the high level of state attorney general interest in ESG issues.

Takeaways

Although ESG initiatives often serve socially beneficial goals, it is important to remember they are not immune from antitrust scrutiny. There may be particular risk when competitors collaborate to adopt rules that may have the effect of limiting competition for product features — such as industry standards involving green products.

If a collaboration affects product quality or choices, it may be seen as per se unlawful regardless of the benefits. And if the collaboration is seen as supporting a collusive agreement on prices, the conduct may give rise to criminal antitrust scrutiny.

This is particularly true in today's era of increasingly aggressive antitrust enforcement covering what Assistant Attorney General Jonathan Kanter described at a U.S. Chamber of Commerce event as "different dimensions of competition."[31]

It is generally lawful for companies to collaborate with other industry participants to design industry standards, but all participants should remain free to compete and must unilaterally decide whether to make products that comply or do not comply with the standard. Accordingly, when competitors collaborate on product standards, they should keep the following guardrails in mind:

- Companies should decide independently whether — and how — to comply with standards.
- Companies should avoid jointly setting artificial limits for product features or characteristics, and remain free to compete based on the attributes of their products — including pricing, marketing and features.
- Companies also should be careful in exchanging competitively sensitive information with their competitors, even as part of ESG initiatives.
- Industry standards should be designed so as not to disadvantage smaller or new competitors.

In sum, although not all ESG initiatives will trigger antitrust scrutiny, ESG collaborations affecting product features are an emerging risk area, and should be addressed by a company's antitrust compliance program.[32]

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Disclosure: While working for the DOJ, Andre Geverola was involved in U.S. v. Lischewski.

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[2] Judiciary Republicans: Woke Companies Pursuing ESG Policies May Violate Antitrust Law, House Judiciary Committee (Dec. 6, 2022), available at https://judiciary.house.gov/media/press-releases/judiciary-republicans-woke-companies-pursuing-esg-policies-may-violate.

[3] Oversight of Federal Enforcement of the Antitrust Laws, Before the Subcommittee on Competition Policy, Antitrust, and Consumer Rights of the Senate Committee On the Judiciary, 117th Cong. (Sept. 20, 2022), Statement of Jonathan Kanter, Assistant Attorney General for the Antitrust Division, DOJ, https://www.judiciary.senate.gov/committee-activity/hearings/oversight-of-federal-enforcement-of-the-antitrust-laws.

[4] See, e.g., Mark Brnovich, Arizona Attorney General et al., https://www.azag.gov/sites/default/files/2022-08/BlackRock%20Letter.pdf; Allegra Fradkin, Nineteen State AGs Launch Investigation Into Six Major Banks, Bloomberg L. (Oct. 19, 2022, 1:29 PM), https://news.bloomberglaw.com/banking-law/nineteen-state-ags-launch-investigation-into-six-major-banks.

[5] See, e.g., Eur. Comm'n, Antitrust: Commission fines car manufacturers €875 million for restricting competition in emission cleaning for new diesel passenger cars (July 8, 2021), available at https://ec.europa.eu/commission/presscorner/api/files/document/print/en/ip_21_3581/IP_21_3581_EN.pdf; Byun Hye-Jin, German carmakers fined over emissions collusion, Kor. Herald, (Feb. 9, 2023), https://www.koreaherald.com/view.php?ud=20230209000662.

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[10] Byun Hye-Jin, German carmakers fined over emissions collusion, Kor. Herald (Feb. 9, 2023), https://www.koreaherald.com/view.php?ud=20230209000662.

[11] Broadcast Music Inc. v. CBS, 441 U.S. 1, 19-20 (1979) (citing U.S. v. U.S. Gypsum Co., 438 U.S. 422, 441 n.14 (1978)) (discussing practices that "always or almost always tend to restrict competition and decrease output").

[12] NCAA v. Board of Regents, 468 US 85, at 100 (1984).

[13] Order re: Defendants' Motions to Dismiss, In re: German Automotive Manufacturers Antitrust Litigation (N.D. Cal. June 17, 2019).

[14] Order re: Defendants' Motions to Dismiss, In re: German Automotive Manufacturers Antitrust Litigation (N.D. Cal. March 31, 2020). The Ninth Circuit affirmed. Memorandum, In re: German Automotive Manufacturers Antitrust Litigation (9th Cir. 2021) (unpublished).

[15] National Macaroni Mfrs. Ass'n v. FTC, 345 F. 2d 421, at 424, 426 (7th Cir. 1965).

[16] Id. at 426.

[17] Id. at 427.

[18] FTC v. Superior Ct. Trial Lawyers Ass'n, 493 U.S. 411, 419 (1990).

[19] Id. at 424.

[20] Debbie Feinstein et al., FTC Announces New Guidelines for its Section 5 Enforcement Efforts, Arnold & Porter (Nov. 17, 2022), https://www.arnoldporter.com/en/perspectives/advisories/2022/11/ftc-announces-new-guidelines-for-its-section-5-enf.

[21] U.S. Dep't of Just., Civil Conduct Task Force, https://www.justice.gov/atr/civil-conduct-task-force.

[22] U.S. Dep't of Just., Title 7: Antitrust, https://www.justice.gov/jm/jm-7-2000-prior-approvals#7-2.200.

[23] See, e.g., U.S. v. Andreas, 216 F.3d 645, 667 (7th Cir. 2000) ("At bottom, the lysine cartel's agreement was a conspiracy to limit the producers' output and thereby raise prices. Functionally, an agreement to restrict output works in most cases to raises prices above a competitive level and for this reason, output restrictions have long been treated as per se violations").

[24] U.S. v. Am. Radiator & Standard Sanitary Corp., 433 F.2d 174, 180 (3d Cir. 1970).

[25] Id. at 181.

[26] Id. at 186.

[27] Indictment, U.S. v. Lischewski, 3:18-cr-00203 (May 16, 2018 N.D. Cal.).

[28] U.S.' Opp'n to Mot. to Dismiss or for an Order That the Rule of Reason Applies, at 11, Apr. 03, 2019, U.S. v. Lischewski, 3:18-cr-00203 ("He is charged with joining price-fixing conspiracy accomplished, in part, by an agreement not to offer certain products").

[29] Press Release, U.S. Dep't of Just., Former Bumble Bee CEO Sentenced To Prison For Fixing Prices Of Canned Tuna (June 16, 2020), https://www.justice.gov/opa/pr/former-bumble-bee-ceo-sentenced-prison-fixing-prices-canned-tuna.

[30] Letter from Mark Brnovich, Arizona Attorney General, et al. to L. Fink, CEO, BlackRock Inc. (Aug. 4, 2022), https://www.azag.gov/sites/default/files/2022-08/BlackRock%20Letter.pdf. A response from other attorneys general suggested that public statements in support of ESG goals without any actual agreement on concrete steps would not raise antitrust concerns. Letter from Karl Racine, Attorney General for D.C., et al. to Sen. Sherrod Brown, et al. (Nov. 21, 2022), https://oag.dc.gov/sites/default/files/2022-11/ESG%20Letter_Final_11.18.22.pdf.

[31] Bryan Koenig, DOJ Antitrust Head Keen On 'Dimensions of Competition', Law 360, (Feb. 14, 2023, 7:57 PM), https://www.law360.com/articles/1576359.

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