Identifying Antitrust 'Safety Zones' During The Pandemic

By **Kelly Lear Nordby and Michael McDonald** (May 18, 2020)

Kelly Lear Nordby

Michael McDonald

On March 24, the Antitrust Division of the U.S. Department of Justice and the Bureau of Competition of the Federal Trade Commission issued a "Joint Antitrust Statement Regarding COVID-19" recognizing that addressing the spread of COVID-19 may require "unprecedented cooperation" among private businesses, including competitors.[1]

In their joint statement, the agencies referred to the Antitrust Division's "business review" and the Federal Trade Commission's "advisory opinion" processes, through which parties can ask the agencies to evaluate proposed collaborations and receive statements advising whether the agencies would challenge that conduct under the antitrust laws.[2] The agencies stated they "aim to respond expeditiously to all such COVID-19-related requests" and to resolve those requests that address public health and safety within seven calendar days, rather than the several months such requests typically take.[3]

In addition to the agencies' review processes, the joint statement referred to the National Cooperative Research and Production Act, which provides protections from possible antitrust damages for research and development or production joint ventures that notify the Antitrust Division and the Federal Trade Commission in advance of their membership and activities.[4]

Consumers and the economy more broadly stand to benefit from pro-competitive collaborations that help meet demand for critical medical supplies and equipment, such as personal protective equipment, ventilators, drugs and advance development of a vaccine. In their joint statement, the agencies recognized that joint efforts that are "limited in duration" may be "a necessary response to exigent circumstances" in order to provide Americans with these types of products currently in high demand.

To assess cooperation and collaboration among competitors when responding to the COVID-19 crisis, the agencies' joint statement referred to the U.S. Department of Justice and FTC's 2000 Antitrust Guidelines for Collaborations Among Competitors, the DOJ/FTC 1996 Statement of Antitrust Enforcement Policy in Health Care, and an FTC statement concerning information exchange.[5]

These guidelines identify antitrust "safety zones" for collaborations among competitors that, absent extraordinary circumstances, the agencies will not challenge.[6]

In this article, we summarize some of the competitor collaborations and information exchanges that the DOJ and FTC treat as falling within an antitrust safety zone, and present a stylized example of possible competitive effects of a collaboration among competitors.

What constitutes antitrust safety zones for competitor collaboration in the U.S.?

According to the DOJ/FTC Antitrust Collaboration Guidelines, barring extraordinary circumstances, the agencies will not challenge competitor collaboration[7] when:

- The market shares of the collaboration and its participants account for no more than 20% of each relevant market where competition may be affected;[8] or

- At least three independently controlled research efforts, in addition to the collaboration, possess specialized assets or characteristics and incentives necessary to engage in R&D that is deemed a "close substitute."[9]

In addition, according to the DOJ/FTC Statement of Antitrust Enforcement Policy in Health Care, most joint purchasing arrangements among health care providers, particularly those that reduce transaction costs or secure volume discounts, do not raise antitrust concerns.[10] More specifically, joint purchasing arrangements among healthcare providers fall within an antitrust safety zone if:

- Purchases account for less than 35% of total sales of the purchased product or service in the relevant market; and

- The cost of the products and services purchased jointly accounts for less than 20% of total revenue from all products and services sold by each competing participant in the joint purchasing arrangement.[11]

In general, agreements among competing firms that collectively account for a large share of a market could be alleged to facilitate coordination or potentially foreclose existing or nascent competitors. However, as discussed immediately below, a large collective share does not necessarily preclude DOJ/FTC approval of an agreement among competitors.

Collaboration outside antitrust safety zones can still be pro-competitive or competitively neutral.

Agreements that the DOJ/FTC have found "always or almost always" raise price or reduce output — such as horizontal agreements among competitors to fix prices or output, rig bids, or share or divide markets — are considered anti-competitive and, therefore, are likely to be challenged by the agencies as per se illegal.[12] However, the DOJ and FTC recognize a variety of pro-competitive benefits from competitor collaboration, including the offering of goods and services at lower prices, higher quality, and faster time to market.[13]

Agreements not considered per se illegal, and agreements that might otherwise be deemed per se illegal, but that are "reasonably related to, and reasonably necessary to achieve procompetitive benefits from, an efficiency-enhancing integration of economic activity," are examined under the "rule of reason."[14] Those agreements through which parties collaborate to perform one or more business functions, such as production, marketing, buying, distribution, or R&D, to benefit consumers are considered "efficiency-enhancing."[15] These are the types of collaborative agreements likely to be entered into by firms responding to the COVID-19 crisis.

A rule-of-reason analysis assesses the likely anti-competitive effects of the collaboration and, if any, weighs them against the pro-competitive benefits to determine the overall net

impact of the collaboration on competition.[16] As the Antitrust Collaboration Guidelines state:

The central question is whether the relevant agreement likely harms competition by increasing the ability or incentive profitably to raise price above or reduce output, quality, service, or innovation below what likely would prevail in the absence of the relevant agreement.[17]

Under the rule of reason, the DOJ and FTC start by examining the nature of the collaborative agreement, including its business purpose and the participants' intent.[18] According to the Antitrust Collaboration Guidelines, the initial analysis results in one of three outcomes:

- The DOJ/FTC conclude "the nature of the agreement and the absence of market power together may demonstrate the absence of anticompetitive harm," and therefore do not challenge the agreement.[19]

- The DOJ/FTC conclude the likelihood of harm is evident from the nature of the agreement, or harm has already occurred with no offsetting benefits, and may challenge the agreement with no further analysis.[20]

- The DOJ/FTC conclude the nature of the agreement raises competitive concerns, then the DOJ/FTC conduct a "detailed market analysis" that typically defines the relevant markets, calculates market shares and concentration, assesses the nature of competition and any entry barriers, and examines other market factors that affect participating firms' incentives and abilities to compete.[21]

If the detailed analysis indicates no potential for anti-competitive harm, the DOJ and FTC do not proceed with considering the potential pro-competitive benefits.[22] However, if the detailed examination indicates anti-competitive harm is likely, then the DOJ and FTC consider whether the agreement is "reasonably necessary" to achieve the resulting pro-competitive benefits that would likely offset the anti-competitive harms.[23]

Let's look at a stylized example of joint collaboration.

When determining whether to challenge a joint collaboration among competitors, the antitrust agencies evaluate whether the collaboration will result in efficiency-enhancing activities that will lower price and/or increase output, quality or speed to market, or instead result in an exercise in market power that will increase price and decrease output relative to outcomes that would be observed without the collaboration.

A stylized depiction of this evaluation is provided in Figures 1 and 2 for a hypothetical product.[24] For ease of presentation, we depict a perfectly competitive market to illustrate a potential benefit of pro-competitive joint collaboration. Similar benefits and risks would be present in oligopoly markets with fewer firms.[25]

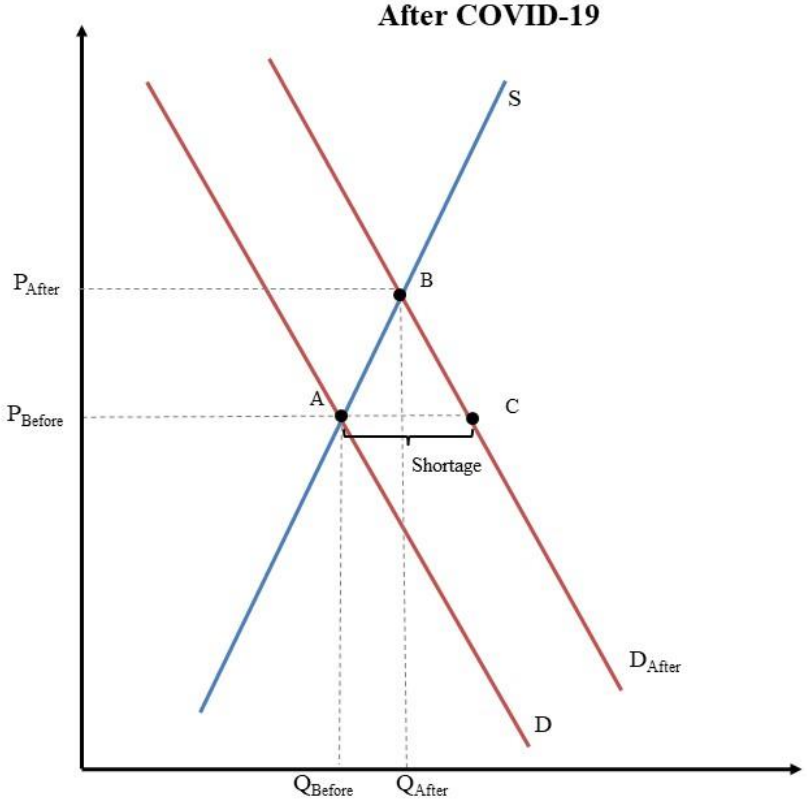
In Figure 1, the market equilibrium price for a COVID-19-related PPE before the pandemic is

denoted as PBefore, where the supply and demand lines intersect (point A). The COVID-19 virus has resulted in an increase in demand for PPE. This is depicted by the outward shift in demand from D to DAfter, and, at PBefore, results in an imbalance between supply (point A) and demand (point C).

In the short run, existing suppliers change their variable inputs and use available capacity to respond to the increase in demand. In equilibrium, the quantity supplied would increase from Q Before to Q After, and the market price would increase from PBefore to PAfter (point B).[26] In economics, this is known as the "rationing function" of price. That is, price increases to eliminate the imbalance, inducing some buyers to purchase less and suppliers to supply additional units given their current available capacity.[27]

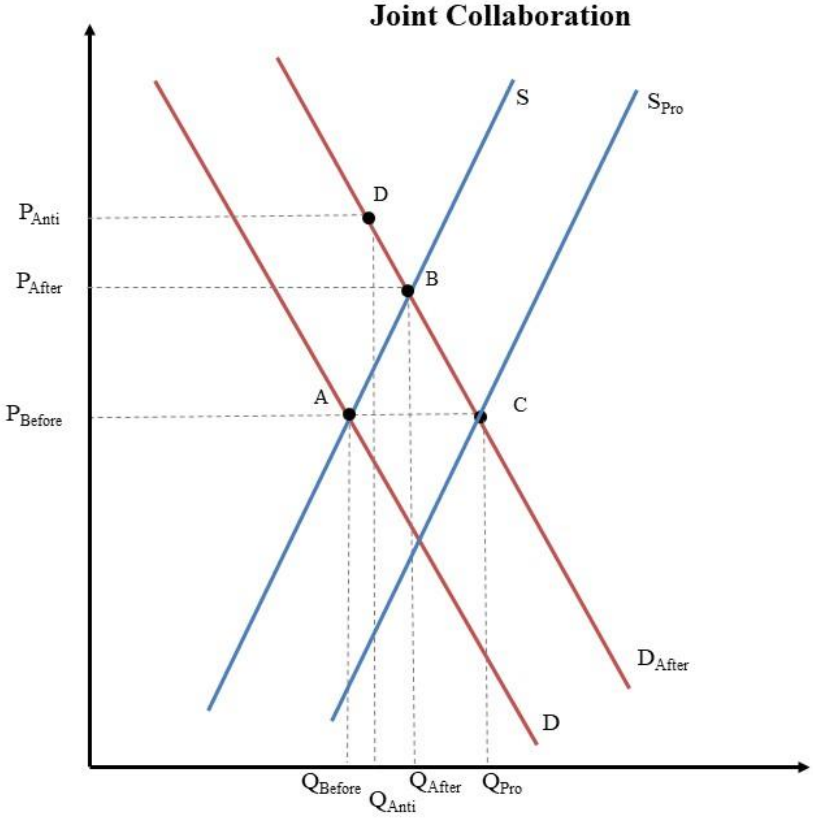
In the current crisis, other factors, such as concerns about price gouging and existing supply contracts, may limit price increases. In the long run, higher market prices attract entry or output expansion. This is commonly referred to as the "guiding function" or "allocating function" of price, through which, as Adam Smith put it, the "invisible hand" of the market guides the allocation of resources to their most valued use. However, the current situation requires a more immediate supply response.

Figure 1
Hypothetical PPE
After COVID-19



Consumers that purchase PPE would be better off if the quantity supplied were greater than QAfter, such as the price and quantity at point C. In order to move from point B to point C, current suppliers will need to increase their fixed factors of production, such as capacity, and/or new suppliers will need to enter the market to increase the supply of PPE.[28]

Figure 2
Hypothetical PPE
Joint Collaboration



One public policy tool available to antitrust agencies is to expeditiously offer assurance that they will not challenge a proposed joint collaboration among existing or potential future competitors. A potential effect of such collaboration is depicted in Figure 2 by an outward shift in supply that results in an increase in quantity from Q After to Q Pro (compare output at point B with point C). In the simple example depicted in Figure 2, the increase in supply is sufficient to return the price to the price that existed before COVID-19 (PBefore).

Even if the price does not return to PBefore, the collaboration would still be beneficial provided there is an increase in supply resulting in a price less than PAfter and quantity greater than Q After (i.e., the price and quantity without collaboration). Assuming no other anti-competitive effects, the collaboration would be considered pro-competitive.

Moreover, if, after the collaboration, the collaborating parties exercise some degree of market power and set price above or output below the perfectly competitive level (point C), the collaboration could still be pro-competitive if it expands output and reduces price relative to the equilibrium without the collaboration (point B).

The potential pro-competitive benefit of increased output from Q After to QPro can be compared to the potential anti-competitive outcome wherein the collaborating parties instead jointly increase price and reduce output. This is depicted in Figure 2 by the increase in price from PAfter to PAnti and the reduction in output from Q After to QAnti (compare price and output at point B with point D). Such anti-competitive effects, while possible in the short run, are also a concern if they spillover into other geographic or product markets,

or if they persist beyond the temporary period of the pandemic.

Antitrust safety zones are designed to help market participants identify those joint collaborations where the risk of collaborating parties being able to jointly raise price is low due to the small number and size of the collaborating parties relative to the number and size of the remaining firms participating in the market.[29]

When joint collaborations fall outside the antitrust safety zones, the antitrust agency conducts a rule-of-reason analysis to evaluate whether the joint collaboration will likely result in a lower price and more output (move from point B to C in Figure 2) or a higher price and less output (move from point B to D in Figure 2). If the agency determines joint collaboration would likely result in a higher price and less output, the agency will likely challenge the joint collaboration.

What is an antitrust safety zone for exchanges of information between competitors collaborating in the U.S.?

Firms should take care when sharing information with competitors, because such exchanges may be later alleged to facilitate collusion. Antitrust lawyers remind firms to ensure the information exchanged is not "competitively sensitive information" and does not "spillover" into unprotected areas.[30]

The DOJ and FTC state that "reasonableness" of information exchange depends on the nature of the information being shared. All else equal:

- Sharing of company-specific data is more likely to raise concerns than sharing of aggregate data.

- Sharing of information related to prices, output, customers, costs or strategic planning is more likely to raise competition concerns than sharing of less sensitive information.

- Sharing of current operating and future business plans is more likely to raise competitive concerns than sharing of past information.[31]

Information exchanges fall within an antitrust safety zone if:

- The exchange is managed by a third party;

- The information provided is more than three months old; and

- At least five participants provide the data underlying each shared statistic, no single provider's data contributes more than 25% of the "weight" of any statistic, and the shared statistics are aggregated so that no one participant can discern the data of another participant.[32]

Similar to the guidelines regarding collaborations discussed above, information exchanges that are outside the safety zone may be lawful provided "the exchange promotes competition."[33]

Is expedited assurance enough during the COVID-19 crisis?

In the U.S., the agencies announced that, in addition to expedited assurance, they "will also account for exigent circumstances in evaluating efforts to address the spread of COVID-19 and its aftermath," recognizing that businesses may "temporarily combine production, distribution, or service networks to facilitate production and distribution of COVID-19 supplies they may not have traditionally manufactured or distributed."[34] However, at the same time, the agencies reminded firms that they are committed to prosecuting civil or criminal violations of antitrust laws.[35]

One can imagine situations where allocation of markets or customers would be a necessary and efficient means of satisfying demand for certain products, especially when there are noncoincident peak demands. This sort of allocation is typically, however, considered a per se violation of antitrust laws. While the agencies' efforts in the U.S. are useful, other countries have taken further steps to alleviate possible antitrust concerns during this crisis. In Europe, some regulators have taken steps to relax antitrust laws temporarily during the pandemic.[36]

In the U.S., the DOJ has issued two business review letters to date under its expedited procedures for the COVID-19 pandemic, stating it would not challenge joint collaboration between medical/surgical distributors to acquire and distribute critical medical supplies.[37] It remains to be seen how many more joint collaborations in the U.S. will pursue the expedited approval process offered by the DOJ and FTC to help alleviate potential antitrust litigation risk, or if additional reassurance will be forthcoming.

Moreover, antitrust litigation risk is just one obstacle firms may face when considering production of a new product to help combat COVID-19. For example, firms also consider costs, challenges associated with gaining technical know-how, and risks of product and intellectual property litigation. In the U.S., the president can rely, and has relied, on the Defense Production Act, which provides immunity from some potential liabilities, including antitrust liability.[38]

Kelly Lear Nordby, Ph.D., and Michael J. McDonald, Ph.D., are directors at Berkeley Research Group LLC.

[1] U.S. Department of Justice (DOJ), Antitrust Division and the Federal Trade Commission

(FTC), Bureau of Competition. "Joint Antitrust Statement Regarding COVID-19" (March 24, 2020), https://www.justice.gov/atr/joint-antitrust-statement-regarding-covid-19.

[2] See DOJ, Antitrust Division, "Business Reviews" (updated March 24, 2020), https://www.justice.gov/atr/business-reviews; and FTC, "Competition Advisory Opinions," https://www.ftc.gov/tips-advice/competition-guidance/competition-advisory-opinions.

[3] Any such statements of the Agencies' enforcement intentions are good for one year from the date of response. DOJ and FTC (2020).

[4] See, e.g., DOJ, Antitrust Division, "Filing a Notification Under the NCRPA" (updated September 6, 2018), https://www.justice.gov/atr/filing-notification-under-ncrpa#entities.

[5] FTC and DOJ, Antitrust Guidelines for Collaboration Among Competitors (April 2000), https://www.ftc.gov/sites/default/files/documents/public_events/joint-venture-hearings-antitrust-guidelines-collaboration-among-competitors/ftcdojguidelines-2.pdf; DOJ and FTC, Statement of Antitrust Enforcement Policy in Health Care (August 1996), https://www.justice.gov/atr/page/file/1197731/download; and Bloom, Michael. "Information Exchange: Be Reasonable," Bureau of Competition, FTC (December 11, 2014), https://www.ftc.gov/news-events/blogs/competition-matters/2014/12/information-exchange-be-reasonable.

[6] The DOJ and FTC guidelines note that these "safety zones" do not apply to competitor collaborations that are: (i) considered per se illegal, (ii) would be challenged without a "detailed analysis" (discussed further herein), or (iii) do not terminate within a "sufficiently limited period" (typically ten years, which instead are analyzed using the framework set out in the DOJ/FTC Horizontal Merger Guidelines). FTC and DOJ (2000), at 26-27. See also: 1992 DOJ/FTC Horizontal Merger Guidelines, revised in 1997 and replaced in 2010, https://www.ftc.gov/system/files/documents/public_statements/804291/100819hmg.pdf.

[7] Specifically, the Antitrust Collaboration Guidelines define "competitor collaboration" as "a set of one or more agreements, other than merger agreements, between or among competitors to engage in economic activity, and the economic activity resulting therefrom." FTC and DOJ (2000), at 2.

[8] Id., at 26. In determining the relevant goods or services market, the DOJ/FTC will rely on the approach described in the Horizontal Merger Guidelines. In determining relevant technology and innovation markets, the DOJ/FTC will rely on the approach described in the Intellectual Property Guidelines. See Id., at 16-17.

[9] Id., at 26-27. ("In determining whether independently controlled R&D efforts are close substitutes, the Agencies consider, among other things, the nature, scope, and magnitude of the R&D efforts; their access to financial support; their access to intellectual property, skilled personnel, or other specialized assets; their timing; and their ability, either acting alone or through others, to successfully commercialize innovations.")

[10] DOJ and FTC (1996), at 53. Antitrust safety-zones for, and analysis of, hospital high-technology joint ventures are discussed at 13-19.

[11] Id., at 54-55. The Statement of Antitrust Enforcement Policy in Health Care references the Horizontal Merger Guidelines for how the DOJ/FTC will define the relevant market. See,

Id., at 76 and 114.

[12] FTC and DOJ (2000), at 3 and 8. This includes potential criminal prosecution by the DOJ.

[13] Id., at 6 and 23.

[14] Id., at 4. See also: Id., at 8.

[15] Id., at 8. For example, collaboration on R&D is typically deemed procompetitive. Antitrust analysis of competitor collaborations involving R&D is also governed by provisions of the NCRPA, 15 U.S.C. §§ 4301-02. Id., at 14.

[16] Id., at 4. The Agencies evaluate the competitive effects at the time of possible harm to competition, which may be at the time of the agreement or a later date. Id., at 7.

[17] Id., at 10.

[18] Id., at 6-7 and 10-11.

[19] Id., at 4.

[20] Id., at 4 and 10-11.

[21] Id., at 11.

[22] Id., at 11.

[23] Id., at 11-12.

[24] For simplicity, we present linear demand and supply functions. If supply with existing capacity is insufficient to meet demand after COVID-19, the supply line would be vertical from the point at which producers maximize their output (at Q less than QAfter in Figure 1).

[25] In an oligopoly market, price could be higher and output lower than presented in Figures 1 and 2. Collaborations in markets characterized by a small number of firms (with larger shares) and barriers to entry are more likely to attract the attention of regulators. Collaborations in perfectly competitive markets are typically unlikely to warrant antitrust scrutiny given the typically large number of firms (with small shares) selling a homogenous product and easy entry.

[26] For ease of exposition, we present no change in supply, but note that supply after the pandemic may be less than supply before the pandemic given evidence that imports of some medical supplies have decreased. See, e.g., Mendoza, Martha, and Juliet Linderman. "Imports of medical supplies plummet as demand in US soars," Associated Press (March 21, 2020), https://abcnews.go.com/US/wireStory/imports-medical-supplies-plummet-demand-us-soars-69719400 ("The AP [Associated Press] found that in the past month, hand sanitizer and swab imports both dropped by 40%, N95 mask imports were down 55%, and surgical gowns, typically sourced from China, were at near normal levels because the sourcing was shifted to Honduras.").

[27] Demand for essential goods is less elastic than demand for nonessential goods. In addition, in the short run, demand is generally less elastic than in the long run. Therefore,

the quantity demanded may be less responsive to price increases in the short run.

[28] Joint collaboration may also help ensure efficient and quick allocation to regional markets with the greatest need.

[29] The stylized example presents a collaboration among competitors in a market with an increase in demand. Antitrust safety zones would also be used to help identify joint collaborations where the risk is low that parties could maintain prices at existing levels and resist the downward pressure on price in response to a decrease in demand.

[30] See, e.g., Koenig, Bryan. "Coordination, Not Collusion: Threading The COVID-19 Needle," Law360 (April 7, 2020), https://www.law360.com/articles/1260443/print?section=whitecollar.

[31] FTC and DOJ (2000), at 15-16.

[32] Bloom (2014).

[33] Id.

[34] FTC and DOJ (2020), at 2.

[35] Ibid.

[36] See, e.g., Treloar, Stephen. "Norway Temporarily Suspends Competition Regulation for Airlines," Bloomberg Law (March 18, 2020), https://news.bloomberglaw.com/mergers-and-antitrust/norway-temporarily-suspends-competition-regulation-for-airlines; Gov.UK. "Supermarkets to join forces to feed the nation," press release (March 19, 2020), https://www.gov.uk/government/news/supermarkets-to-join-forces-to-feed-the-nation; European Competition Network. "Antitrust: Joint statement by the European Competition Network (ECN) on application of competition law during the Corona crisis" (March 23, 2020), https://ec.europa.eu/competition/ecn/202003_joint-statement_ecn_corona-crisis.pdf; Finnish Competition and Consumer Authority. "Exceptional Circumstances caused by the coronavirus to affect the application of Finish Competition Act," press release (March 23, 2020), https://www.kkv.fi/en/current-issues/press-releases/2020/23.3.2020-exceptional-circumstances-caused-by-the-coronavirus-to-affect-the-application-of-the-competition-act/; European Commission. "Temporary Framework for assessing antitrust issues related to business cooperation in response to situations of urgency stemming from the current COVID-19 outbreak" (April 8, 2020), at 4, https://ec.europa.eu/info/sites/info/files/framework_communication_antitrust_issues_related_to_cooperation_between_competitors_in_covid-19.pdf.

[37] Delrahim, Makan. U.S. Department of Justice, Antitrust Division. Letter to Ms. Schechter, Ms. Mayer & Messrs. Ettinger, Liberman, and Pace, re: McKesson Corporation, Owens & Minor, Inc., Cardinal Health, Inc., Medline Industries, Inc., and Henry Schein, Inc. Business Review Request Pursuant to COVID-19 Expedited Procedure (April 4, 2020), https://www.justice.gov/atr/page/file/1266511/download. See also: Dubrow, Jon B. and McKinney Fischer, Ashley. "DOJ Issues Antitrust Guidance on Competitor Collaboration to Combat COVID-19," The National Law Review (April 11, 2020), https://www.natlawreview.com/article/doj-issues-antitrust-guidance-competitor-collaboration-to-combat-covid-19; DOJ, Department of Public Affairs. "Justice Department Issues Business Review Letter to Amerisource Bergen Supporting Distribution of Critical Medicines Under Expedited Procedures for COVID-19 Pandemic Response," press release

(April 20, 2020), https://www.justice.gov/opa/pr/justice-department-issues-business-review-letter-amerisourcebergen-supporting-distribution.

[38] 50 U.S.C. §4558(j), Section 708 of the Defense Production Act provides a legal defense to parties of voluntary agreements or plans of action for "preparedness programs and expansion of production capacity and supply," provided "the person asserting the defense demonstrates that the action was specified in, or was within the scope of, an approved voluntary agreement initiated by the President and approved in accordance with this section or a plan of action adopted under any such agreement and approved in accordance with this section," and "the President or the President's designee has authorized and actively supervised the voluntary agreement or plan of action." See: 50 U.S.C. §4558(j), Section 708, https://uscode.house.gov/view.xhtml?path=/prelim@title50/chapter55&edition=prelim. See, e.g., Morrison, Sara. "Ford and GM are making tens of thousands of ventilators. It may already be too late." Vox (April 10, 2020), https://www.vox.com/recode/2020/4/10/21209709/tesla-gm-ford-ventilators-coronavirus.