Navigating ESG Collaborations Under Heightened Antitrust Scrutiny

As the world moves toward the end of the first quarter of the 21st century, companies around the globe find themselves under increased pressure from stakeholders and the communities in which these organizations operate to address major global challenges: climate change, sustainability, socioeconomic inequality among them.

And what has become clear is that meeting these challenges will require collaboration that includes the public and private sector, not least to agree on principles and set measurable standards.[1] There have been efforts in some industries in the United States to seek common ground and work together. Yet increased scrutiny and vocal criticism by the U.S. federal and state legislators and regulators has, understandably, unsettled those passionately committed to moving forward on necessary and beneficial corporate ESG initiatives.

In 2019, for example, the U.S. Department of Justice (DOJ) conducted an investigation into a consortium of four automakers working together with the California Air Resources Board to reduce carbon emissions from automobiles. Officials at the Justice Department sought to determine whether this agreement between competitors was collusive, and thus, would reduce available options and/or increase prices for consumers—a litmus test for most antitrust cases.[2] Importantly, the case was dropped in 2020, when the DOJ told the automakers they violated no laws.[3] More recently, in March, 2023, twenty one Republican states' Attorneys General[4] sent a strongly-worded letter to all major asset managers arguing that their ESG initiatives conflict with their fiduciary duties to their clients and their compliance requirements with the US antitrust laws.[5]

To be sure, vigilance to protect consumers from anti-competitive behavior has a long pedigree in the U.S. Nevertheless, based on our extensive experience in advising both industry associations as well as providing expert competition economics advisory services, we see the antitrust threat to ESG collaboration – and thus far, it has only been a threat – as overblown. Indeed, the context of U.S. antitrust regulation and the types of activities that cross legal lines provides a map that should give companies confidence and help them navigate a path forward with productive ESG collaborations.

Antitrust 101

The central question U.S. antitrust law enforcers focus on is whether the conduct in question would "harm competition and consumers 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 that conduct.[6] Included among anticompetitive behaviors, and especially relevant when looking at antitrust threats to ESG cooperation, are horizontal collaborations between competitors and vertical collaborations among upstream and downstream partners that adversely affect consumers.

Horizontal business relationships, where companies operate on the same level of the supply chain and are usually in the same industry, are subject to the biggest antitrust risk because this type of coordinated conduct can risk being seen as an opportunity for parties to do things like discuss and collude to raise prices, reduce output, or scuttle innovation.

To assess whether a particular horizontal competitor collaboration causes antitrust harm, antitrust regulators and enforcers typically examine: (1) participants' ability to reach and implement a common understanding of price or output; (2) internal and external sustainability of that common understanding; (3) removal of or prevention of entry by a "maverick" competitor; and (4) impact of that common understanding on prices, output, and innovation over time.[7]

Now consider vertical business relationships. These collaborations cover the conduct of a company taking an action related to its upstream and/or downstream partners. An example would be multiple firms taking a coordinated action related to their upstream and/or downstream partners, which, because of its coordinated nature, would get higher scrutiny from antitrust law enforcers. Take an input joint venture by two smartphone manufacturers, where the two companies enter into a joint venture agreement with an existing supplier to produce a foldable smartphone screen. They will develop the screens together that they then use in their respective products and sell separately. This conduct might raise antitrust concerns if the cooperation at the upstream level facilitates collusion in other areas. For example, such a joint venture might allow confidential information exchange between the two companies to facilitate collusion or increase the parties' ability to detect defection from the collusion. In such a case, an antitrust enforcer would examine any evidence of the companies' tacit or overt collusion as well as the impact of their joint venture on competition in the relevant market. This deal might also get scrutinized if the smartphone manufacturers bar the supplier producing the foldable screens from selling its product to any of their competitors, effectively foreclosing them from this input.

ESG Collaboration Through an Antitrust Lens

Despite the heightened rhetoric around antitrust violations, companies looking for ways to collaborate on ESG need to know that competitor collaboration is common. Many companies engage in lawful collaborations routinely as part of their normal course of business. Among the many initiatives that companies may participate in along with their competitors are outsourcing agreements, joint ventures, product licensing agreements, collaborative standard-setting activities, cooperative research, common trade association, and co-investment in early-stage downstream companies.

So where might antitrust concerns about horizontal collaboration in the ESG space emerge?

For example, if members of an industry association refused membership to one of their low-cost competitors because of the inadequacies of that competitor's ESG commitments, that might invite concern. Alternatively, there will be antitrust risk if members of an ESG-driven initiative share competitively sensitive information (*e.g.*, future product or investment plans to ensure compliance with carbon reduction goals) as part of their ESG standard setting work.

Importantly, collusion is not the only economic behavior that attracts antitrust scrutiny in horizontal business relationships. ESG efforts might also be scrutinized for their unilateral competitive effects. Many unilateral horizontal interactions such as product licensing agreements or renewable energy technology sharing are efficiency enhancing and procompetitive. However, they bring out a higher level of antitrust scrutiny if undertaken by direct competitors. To assess the competitive effects of these relationships, antitrust regulators and enforcers examine the parties' market power and their ability to

affect prices, the overall market concentration, the extent to which parties have the ability and incentive to compete independently, and whether their relationship would pose a barrier to entry to other potential competitors.

To take another example of a set of horizontal business relationships in the ESG space, say companies form an industry standard setting group for carbon emissions. Member companies independently form and join this group to work together to achieve their ESG commitments. But if the standards end up acting like a barrier to entry for lower cost producers in an already concentrated industry, it might attract antitrust scrutiny.

With respect to vertical relationships that might invite scrutiny, take a company requiring its supplier to comply with the company's packaging reduction targets as an example. This action by itself has minimal antitrust risk. However, if the company adds restrictive conditions and requires the supplier not to sell to any of the company's competitors when they do not have similar packaging reduction targets, that might increase the company's antitrust risk.

Finding a Path Forward

Some of the biggest ESG challenges – like addressing climate change, building a fair and equitable workplace, and embedding sustainability throughout an organization – will require massive collaboration among nations and companies to address. Seeing through the smoke of rhetoric and shouts of "competitor collaboration" with an eye on settled and existing antitrust law can help companies make choices as they carry their ESG initiatives forward, look for collaborators and identify where they will need to draw upon outside experts – antitrust lawyers and economists among them – to understand the risks and tradeoffs they face.

SO, WHAT CAN COMPANIES DO?

- **Assess relevant ESG initiatives through an antitrust lens:** What steps are you planning or now taking, unilaterally or with other organizations, to advance ESG initiatives across your industry? Work backwards from the logic of antitrust law outlined above. Do these steps carry the risk of being seen as anticompetitive? How might they affect competitors, suppliers, and consumers? Might they be perceived as stifling competition in your industry?
- **Weigh your risks:** Measure short-, medium-, and long-term gains from collaboration on ESG initiatives against the potential risks of action at the state and federal level.
- **Know who and when to call on for expert advice:** General Counsel can provide initial guidance, but as the general description in Antitrust 101 above should suggest, data-driven determinations may require additional expertise. Know where to look for experts who have experience in responding to regulatory or legislative actions, working with data to understand competitive dynamics and who can provide strategic guidance before the initiative starts and once it's under way.

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1 United Nations, "Sustainable Development Goals: Goal 17: Revitalize the global partnership for sustainable development," (n.d.), https://www.un.org/sustainabledevelopment/globalpartnerships/#:~:text=It%20requires%20partnerships%20between%20governments,in%20our%20journey%20to%20development.

2 Timothy Puko and Ben Foldy, "Justice Department Launches Antitrust Probe into Four Auto Makers," The Wall Street Journal (6 September 2019), https://www.wsj.com/articles/justice-department-launches-antitrust-probe-into-four-auto-makers-11567778958.

3 *Ibid.*

4 Coral Davenport, "Justice Department Drops Antitrust Probe Against Automakers That Sided With California on Emissions," New York Times (7 February 2020), https://www.nytimes.com/2020/02/07/climate/trump-california-automakers-antitrust.html.

5 For the letter see: Office of the Attorney General for the State of Missouri, "Press Release: Attorney General Bailey Warns Asset Managers Over ESG Investments as Proxy Season Begins" (30 March 2023), https://ago.mo.gov/attorney-general-bailey-warns-asset-managers-over-esg-investments-as-proxy-season-begins/. In September 2023, they sent a similar letter to all financial services providers who were signatories of the Net Zero Financial Service Providers Alliance. See "Tennessee Attorney General Leads Multistate Letter Expressing Concerns over Net Zero Financial Service Providers Alliance," Office of the Attorney General of the State of Tennessee (13 September 2023), https://www.tn.gov/attorneygeneral/news/2023/9/13/pr23-37.html/.

6 *Antitrust Guidelines for Collaborations Among Competitors*, Federal Trade Commission and the U.S. Department of Justice (April, 2000), https://www.ftc.gov/sites/default/files/documents/public_events/joint-venture-hearings-antitrust-guidelines-collaboration-among-competitors/ftcdojguidelines-2.pdf.

7 *Merger Guidelines*, U.S. Department of Justice and the Federal Trade Commission (18 December 2023), https://www.justice.gov/d9/2023-12/2023%20Merger%20Guidelines.pdf).