US Enforcement Update: The Federal Trade Commission's Split Decision in *McWane* Serves as Warning on Exclusive Dealing Practices

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On January 30, 2014, the Federal Trade Commission ("FTC" or "Commission") issued its decision in *In re McWane*.[1] In a 3-1 vote with Commissioner Wright dissenting, the Commission upheld the finding of the Administrative Law Judge ("ALJ") that McWane unlawfully monopolized the market for domestically manufactured ductile iron pipe fittings ("DIPF") in violation of Section 5 of the FTC Act.[2] Although it is widely recognized that exclusive dealing practices can be procompetitive, in this decision the Commission makes clear that such practices can run afoul of the antitrust laws when a firm has a significant market presence. The decision in this case sheds light on how the Commission can construe and evaluate express or de facto exclusive dealing arrangements. It also illustrates that the Commission is willing to define the relevant market narrowly where it can readily identify a segment of customers that may be harmed by the practice.

Background on the ALJ's Monopolization Findings

The Commission, comprised of only four members at the time, voted unanimously to issue the seven count Complaint in January 2012.[3] The Complaint alleged that McWane, Inc., Sigma Corporation and Star Pipe Products, Ltd. agreed to fix or stabilize prices for DIPF products. McWane, Star and Sigma accounted for the overwhelming majority of DIPF sales in the United States. The Complaint also alleged that McWane, the largest of these three manufacturers, sought to unlawfully maintain a monopoly in the market for DIPF products produced in the United States. In particular, the Complaint alleged that McWane used exclusive distribution arrangements to unlawfully maintain monopoly power in domestic DIPF products. All seven counts in the complaint were brought under Section 5 of the FTC Act.

In May 2013, just over 16 months after the Complaint issued, the ALJ released his findings in a 464 page decision.[4] On the monopolization count, the ALJ agreed with FTC Complaint Counsel. He found that the "buy American" provisions of the American Recovery and Reinvestment Act of 2009 ("ARRA") and other similar state and federal procurement requirements supported a distinct relevant market for domestically produced DIPF products. The ALJ also found that McWane, with two domestic manufacturing plants, possessed monopoly power in this relevant market.

The ALJ found that McWane unlawfully maintained its domestic monopoly power by implementing an exclusive dealing policy to prevent others, such as Star, from entering or expanding, and by inducing Sigma to abandon its efforts to enter the domestic market. At issue was McWane's "full support" policy with its distributors. Under this policy, McWane informed distributors that if they did not buy McWane's full line (if readily available) on an exclusive basis, McWane might not meet their demand on a timely basis, and distributors could lose accrued rebates on DIPFs and other products. In addition, in September 2009, McWane and Sigma entered into a Master Distribution Agreement ("MDA") whereby McWane would become Sigma's exclusive supplier of domestically

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[1] Opinion of the Commission, *In re McWane*, Dkt. No. 9351 (Jan. 30, 2014) ("Opinion"), *available at* http://www.ftc.gov/enforcement/cases-proceedings/101-0080b/mcwane-inc-star-pipe-products-ltd-matter.

[2] 15 U.S.C. § 45. Finding monopolization, the Commission declined to address the ALJ's finding of attempted monopolization. The Commission also considered and dismissed four counts alleging collusion and agreements in restraint of trade as well as conspiracy to monopolize. The Commission was evenly split on two counts alleging unlawful conspiracy and information exchange among competitors and because of the absence of a majority, dismissed those counts in the interests of justice. The Commission also reversed the ALJ and dismissed a count alleging the distribution agreement between McWane and Sigma discussed *infra* constituted an agreement in restraint of trade. This summary thus focuses on the Commission analysis of Count 6, which alleged that McWane's full support program constituted unlawful monopolization.

[3] Complaint, *In re McWane*, Dkt. No. 9351 (Jan. 4, 2012), *available at* http://www.ftc.gov/sites/default/files/documents/cases/2012/01/120104ccwanestaradmincmpt.pdf.

[4] Initial Decision, *In re McWane*, Dkt. No. 9351 (May 1, 2013), *available at* http://www.ftc.gov/sites/default/files/documents/cases/2013/05/130509mcwanechappelldecision.pdf.

produced DIPFs. Under the MDA, Sigma agreed to a similar policy when reselling McWane's domestic products. The ALJ found that as a result of McWane's practices, distributors were unwilling to switch business to Star.

While Star entered the domestic market through the use of third party manufacturing in 2009, the ALJ found that McWane's conduct limited the scope of Star's entry. Following implementation of McWane's policy, Star's 2010 sales were less than half of its original estimates, and were insufficient to justify the cost of opening its own U.S. foundry. Instead Star imported partial fittings and finished them in the U.S. The higher production costs were found to have rendered Star a less effective competitor. Star's limited sales in the domestic market did not alter the ALJ's conclusion that McWane's conduct constituted unlawful monopoly maintenance in the domestic market.

FTC Affirms ALJ Domestic Market Definition & Monopoly Power Findings

On appeal, the Commission affirmed that the relevant product market included all DIPFs 24 inches and smaller in diameter, even though this "cluster" market encompasses thousands of different fittings that are not all interchangeable or substitutable.[5] The Commission held that a cluster definition is appropriate when the applicable competitive conditions are identical or nearly identical for the entire class of products at issue. The Commission also agreed that the "buy American" laws applicable to fittings supported a geographic market limited to domestically produced fittings.[6] Based on McWane's high market share in the domestically produced market, and what the Commission concluded were meaningful barriers to entry, the Commission affirmed the ALJ's finding that McWane possessed monopoly power.[7] The Commission also relied on evidence that McWane's prices did not decline despite Star's limited entry to support its conclusion that McWane had monopoly power in the domestic market.[8]

The Commission rejected a number of McWane's arguments against the ALJ's conclusions on market definition and monopoly power. First, the Commission disagreed with McWane's claim that econometric evidence is required to establish a relevant market. It held that while econometric work can be a valuable tool, courts routinely rely on "qualitative economic evidence."[9] The Commission was also not persuaded by McWane's claim that projects with legally-imposed domestic fittings requirements constituted only a small fraction of all projects. The Commission held the size of the market did not inform whether imported fittings could substitute for domestic ones in such projects.[10]

McWane also argued that Star's domestic entry in 2009 ran contrary to the ALJ's conclusion that McWane possessed monopoly power, demonstrating instead low barriers to entry in the relevant market. Here too the Commission disagreed, finding that Star's entry did not displace McWane's monopoly position, either as measured by market share or pricing power.[11]

Accordingly, the Commission held that McWane possessed monopoly power in the domestic market despite Star's entry.

FTC Affirms McWane's Exclusive Arrangements Constituted Unlawful Monopolization

Having found monopoly power in the relevant domestic market, the Commission affirmed the ALJ's conclusion that McWane's "full support" policy constituted unlawful maintenance of that monopoly power by impairing the ability of rivals to grow and erode its dominant position.[12] The Commission considered the procompetitive and anticompetitive effects of the conduct. Relying on McWane's internal business documents, the Commission found

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[5] Opinion at 14.

[6] *Id.* at 14-15.

[7] *Id.* at 16-18. The Commission highlighted in particular difficulties associated with either establishing a new domestic foundry or arranging for an existing one to supply an entrant's full-line production needs.

[8] *Id.* at 18.

[9] *Id.* at 15.

[10] *Id.* at 16.

[11] *Id.* at 18.

[12] *Id.* at 18-20.

that McWane implemented its exclusive dealing policy to capitalize on its position as the only full line supplier of domestic fittings, and foreclose competition from Star and Sigma.[13] The Commission did not accept McWane's argument that its need to maintain volume for its domestic plants trumped the anticompetitive harm from its full support program. Indeed, it found McWane had failed to provide a cognizable procompetitive justification because the tools it employed to maintain volume did not benefit consumers.[14]

McWane disagreed that its practices impaired Star's ability to compete. It highlighted the non-binding nature of the full-support policy. The policy announcement to customers stated that McWane's domestic fittings and accessories would be available to customers who "elect to fully support McWane branded products for their domestic fitting and accessory requirements" and those who did not "may forego" unpaid rebates or shipments of their domestic fittings for up to 12 weeks.[15] The Commission found this to be "soft language" however, because it was accompanied by threats that customers would be cut off entirely if they bought from Star.[16]

In his dissent, Commissioner Wright took issue with the sufficiency of the evidence of competitive harm.[17] Commissioner Wright emphasized that Complaint Counsel did not offer independent evidence of the minimum efficient scale for Star compete effectively, which left the Commission with no benchmark for foreclosure analysis.[18] Moreover, he found there was insufficient quantification of the volume of sales Star would have made but for McWane's policy, and a lack of evidence linking any foreclosure to competitive harm.[19] Commissioner Wright found such deficiencies notable in light of evidence that some distributors would have bought from McWane regardless of its policy, and the fact that Star made sales to over 100 distributors.[20] Commissioner Wright also noted that McWane only enforced its policy for one year after Star's domestic entry, which would have permitted empirical analysis of the policy's impact. Commissioner Wright found that Star's ability to maintain the same level of domestic growth during and after McWane's enforcement of the exclusive policy was inconsistent with competitive harm.[21]

The Commission emphasized that the relevant standard is not total foreclosure. While the Commission acknowledged that McWane's policy may not explain all of the sales McWane realized, the Commission found that McWane's policy was a significant contributing factor in limiting Star's growth potential.[22] While Star had some domestic sales, it could not secure a sufficient volume to justify opening its own U.S. plant, which kept it from emerging as a real competitive threat. According to the Commission, the result was harm to competition, not merely competitors. The Commission held that McWane's policy also limited customer choice for domestic fittings.[23]

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[13] *Id.* at 20-21.

[14] *Id.* at 30-31.

[15] *Id.* at 21.

[16] *Id.*

[17] Dissenting Statement of Commissioner Joshua D. Wright, *available at* http://www.ftc.gov/system/files/documents/cases/140206mcwanestatement.pdf

[18] *Id.* at 28-33.

[19] *Id.* at 34-37.

[20] *Id.* at 38, 45.

[21] *Id.* at 45.

[22] Opinion at 26-27.

[23] *Id.* at 28.

Commission's Remedy Places Restrictions on McWane's Future Sales Practices

In its Final Order,[24] the Commission required McWane to cease and desist from conditioning sales to customers on their exclusivity with McWane for any product, including DIPFs. The Commission also ordered that pricing and services not be conditioned on exclusivity or any commitment of DIPF business at or above 50%. The Commission did allow McWane to continue to offer volume-based discounts when they are above average variable cost and not retroactive and to offer discounts to meet competition. The Final Order has a term of 20 years in general, and a 10 year prohibition against retroactive incentives.

[24] Final Order, *In re McWane*, Dkt. No. 9351 (Jan. 30, 2014), *available at* http://www.ftc.gov/enforcement/cases-proceedings/101-0080b/mcwane-inc-star-pipe-products-ltd-matter.