FTC Flushes McWane in a Big Eleventh Circuit Exclusive Dealing Win

April 22, 2015 | Alert | By **Bruce D. Sokler**, Helen Kim, Timothy Slattery

VIEWPOINT TOPICS

- Antitrust
- Health Care

RELATED PRACTICES

- Antitrust

RELATED INDUSTRIES

The situations where exclusive dealing policies, explicit or tied to an aggressive discounting program, cross the line under the rule-of-reason remain far from clear. Because it involved appellate review of a Federal Trade Commission ("FTC" or the "Commission") ruling — where deference to the agency on certain findings played an important part — the Eleventh Circuit's April 15th decision upholding the FTC's ruling that McWane, Inc. ("McWane") enforced an illegal exclusive dealing policy requiring distributors to purchase all of their domestic ductile iron pipe fittings from McWane (or face losing all rebates and being without supply for 12 weeks) provides important guideposts. The Court held that McWane's program prevented international competitors from entering the domestic market, effectively maintained McWane's monopoly on domestic fittings, and affirmed the FTC's order on all counts.

Factual and Procedural Background

Ductile iron pipe fittings join pipes and direct the flow of pressurized water in municipal water pipeline systems. Despite thousands of potential and custom configurations, the vast majority of the demand is for about 100 common fittings. When municipalities issue specifications for pipeline development, they can specify for either "open" fittings — which allows fittings made anywhere in the world — or "domestic" fittings, which are only those made in the United States. The pipe fittings market, regardless of whether open or domestic, has been largely controlled by three major manufacturers: McWane, Star Pipe Products ("Star") and Sigma Corporation ("Sigma"), who combined own nearly 90% of national market share.

In the domestic fittings market, McWane held the entire market until mid-2009 when Star announced it would begin offering domestic fittings. In response, McWane instituted its "Full Support Program" "to protect [its] domestic brands and market position," by informing customers that without purchasing their full requirements from McWane, hose customers would not receive domestic fitting rebates and their shipments would be delayed by 12 weeks.[1] McWane's executives stated internally that the purpose of the program was to raise Star's costs and stop Star from competing in the domestic fittings market. As a result of the program, Star never opened a domestic foundry of its own and was relegated to a nominal domestic fittings market share.

In May 2013, the FTC's administrative law judge issued an opinion finding that McWane's program constituted unlawful exclusive dealing that had foreclosed Star from the domestic fittings market and illegally maintained its monopoly. The Commission, on appeal of the ALJ's decision, affirmed the ruling. McWane appealed to the Eleventh Circuit.

The Court's Analysis Largely Defers to the FTC's Determinations

On appeal, McWane challenged three specific Commission determinations: (1) that the domestic fittings market was the relevant antitrust market, (2) that McWane monopolized the relevant market, and (3) that the Full Support Program harmed competition. Critically, much of the Court's decision turned on the question of whether the appealable question was factual, economic, or legal. To the extent McWane's challenges were factual or economic conclusions, the Court deferred to the Commission's findings.

The Court affirmed the Commission's market definition because municipal customers who were limited by federal, state, or local laws to purchase domestically-manufactured fittings had no viable alternative when faced with McWane's repeated price increases. The Court rejected McWane's arguments calling the Commission's economic expert insufficient for failing to evaluate the cross-elasticity of demand, stating that "there appears to be no support in the case law for McWane's claim that such a technical analysis is always required."[2] The qualitative economic evidence and the *Brown Shoe* factors were sufficient evidence to uphold the Commission's relevant market.

The Court found that the Commission's determination that McWane had monopoly power was supported by substantial evidence, even if some of that evidence cut harshly against the Commission's ruling. When the Full Support Program was implemented, McWane held the entire market, but the next three years saw Star slowly eroding McWane's share to 90%. The fact that Star picked up 10% share suggested to the Court that entry was possible and not limited by McWane's efforts. But, crucially, the court found that McWane's ability to repeatedly increase domestic fittings' prices precluded it from overturning the FTC's finding of monopoly power.

The Court then addressed whether McWane's program constituted monopoly maintenance under an exclusive dealing theory. The Court employed a modified rule-of-reason burden-shifting regime to assess the question but noted that in an exclusive dealing context, it must consider whether the alleged scheme caused substantial market foreclosure.[3]

- First, the Eleventh Circuit rejected McWane's argument that its program was presumptively legal because it was both short-term and voluntary. Instead, the Court found that the program had the practical effect of requiring compliance for distributors to remain competitive — it was "economically infeasible for distributors" to switch to Star.[4]
- Second, the program resulted in substantial foreclosure of competition by preventing Star from accessing the two major distributors who control over 60% of the downstream domestic pipe fittings market, and several critical distributors denied Star any business for fear of losing their McWane supply. Plus, direct pricing evidence showed that McWane maintained supracompetitive prices in the domestic market, which it monopolized, when compared with the imported market, in which it faced significant competition.
- Finally, the Court held that the program held none of the traditional procompetitive benefits of an exclusive dealing contract, such as firms competing for exclusivity by offering lower prices, better services, and other benefits. Exclusive dealing, though, can be anticompetitive if it results in raising rivals' costs to prevent them from becoming effective competitors. Here, the program was "unilaterally imposed by fiat" and showed no resulting procompetitive benefits.[5]

McWane argued two benefits: (1) the program retained sufficient sales to keep its domestic foundry from going out of business, and (2) the Full Support Program was necessary to keep Star from only producing the 100 fittings that account for nearly 80% of the fittings market. The Court found that neither was an unlawful act, but that neither was a procompetitive justification. Perhaps more importantly, McWane's own internal documents, to which the Court refers, say that the "chief concern" was to lock Star out of the market.[6]

Lessons Learned: Qualitative Economics, The Right Appeal, and Bad Documents

This decision in favor of the agency has a few critical takeaways to color future agency (and private plaintiff) exclusive dealing cases. First, antitrust liability can result even if the alleged exclusive dealing conduct only slows a competitor's entry into the market. Here, McWane's program did not completely prevent Star from entering, but instead only limited their market growth to 10% market share in domestic fittings during the period McWane enforced the program. Despite that substantial entry, the Court found that slowing, as opposed to stopping or completely foreclosing, entry was sufficient to hold McWane liable.

Second, though some academic literature suggest that cross-elasticity of demand is the holy grail of market definition, qualitative measures, the hypothetical monopolist test, and other more traditional means of antitrust market definition remain viable. There is no requirement — at this time and under this decision — for a plaintiff or the government to prove its market definition through such an expansive test. Though this holding is definitively more plaintiff-friendly, there are opportunities for a defendant to use the more rigorous cross-elasticity measures to demonstrate that the proffered market definition cannot be accurate.

Third, it is a difficult appealable position to challenge the FTC's factual and economic determinations, particularly when the standard of review on appeal is so deferential to the agency. Structuring those challenges as appeals to the FTC's application of the law of those facts will provide defendants with a second bite at the proverbial apple by requiring the appeals court to conduct its own *de novo* review, rather than simply deferring to the agency's judgment and requiring the defendant to overcome those presumptions.

Finally, as has often been the case in merger contexts, bad documents here again "poisoned the well" for the defendant. The court cited often to those McWane's documents that "patted themselves on the back" for their efforts to shut Star out of the market by requiring distributors to buy the full line of McWane fittings. The boasting, the frank commentary, and the internal exchange of the program's success only served to further bolster the Commission's claims that the conduct had significant anticompetitive effects. Not only do the documents help color, if not prove the government's case, but they also make it challenging for the court to endorse a defendant's procompetitive justifications.

As FTC Chairwoman Edith Ramirez has immediately positioned the decision, "The Eleventh Circuit's decision affirms that monopolists must compete on the merits rather than resorting to anticompetitive tactics to exclude would-be market entrants."

Endnotes

[1] *McWane, Inc. v. FTC*, Slip Op., No. 14-11363 (11th Cir. April 15, 2015), available at **https://www.ftc.gov/system/files/** documents/cases/150415mcwanedecision.pdf.

[2] *Id*. at 26.

[3] *Id*. at 40.

[4] *Id*. at 37.

[5] *Id*. at 37-38 (citing ALJ Op.)

[6] *Id*. at 54.

Authors

Bruce D. Sokler, Member / Co-chair, Antitrust Practice

Bruce D. Sokler is a Mintz antitrust attorney. His antitrust experience includes litigation, class actions, government merger reviews and investigations, and cartel-related issues. Bruce focuses on the health care, communications, and retail industries, from start-ups to Fortune 100 companies.

Helen Kim

Timothy Slattery