CLIENT ALERT

FTC Decides *McWane*: Muddy Waters on Tap?

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The Federal Trade Commission has issued its much-anticipated decision in the appeal of *In the matter of McWane, Inc.* Commenters have complained that it brings only limited clarity on the Commission's views on exclusive dealing. But *McWane* still contains valuable lessons on the importance of contemporaneous evidence to the Commission's analysis of Section Five cases. Given recent Senate Committee reapproval of President Obama's nomination of Terrell McSweeny – currently DOJ's Chief Counsel for Competition Policy and Intergovernmental Relations – to round out the Commission, *McWane*'s most interesting insights may be about the Commission's future, rather than its present.

In the decision, the Commission:

- Affirmed by a 3-1 majority the Administrative Law Judge's (ALJ) decision faulting McWane's exclusive dealing program for preventing its rival Star Pipe Products, Ltd. from reaching a scale at which it could become truly competitive (a finding from which Commissioner Wright dissented);
- Unanimously reversed the ALJ's finding that an "exclusive distribution agreement" between McWane and its distributor Sigma Corporation constituted both a market allocation between McWane and the distributor and an unreasonable vertical restraint on the distributor by McWane; and
- Deadlocked with respect to the ALJ's findings that the Complaint Counsel had not sufficiently proven that McWane and the other two original defendants (Sigma and Star) had conspired over pricing (Chairwoman Ramirez and Commissioner Brill would have reversed the ALJ's findings and found collusion).

Exclusive Dealing

The opinion provides at least some visibility into how the current Commission views exclusive dealing arrangements – and is likely to continue to do so. McWane, the only U.S. manufacturer and largest seller of domestically-produced ductile iron pipe fittings (DIPF) (while the Commission redacted shares from its final opinion, it compared them to shares cited in the *Dentsply* case, which were in the 75-80 percent range), faced potential competition from two other sellers it supplied, Sigma and Star, neither of which manufactured its own DIPF.

Dynamics in the DIPF industry changed in 2009, when the American Recovery and Reinvestment Act (ARRA) introduced increased "Buy American" requirements into ARRA-funded projects (ARRA expired in 2011 and was not reenacted). In response, Star began to source DIPF from U.S. foundries that were not previously active in DIPF manufacture. In turn, McWane instituted a "Full Support Program," under which it announced it would no longer sell its domestic DIPF to distributors who bought the product from other sources. McWane's documents reflected the defensive nature of the program, emphasizing the "need to make sure that [Star] do[esn't] reach any critical mass that will allow it to continue to invest and receive a profitable return," and fretting that Star's entry would result in lower prices.

The program appeared to have the desired effect, reducing Star's sales, and Star decided not to purchase its own domestic manufacturing facility. The Commission found that McWane's exclusive dealing "foreclosed Star and other potential entrants from accessing a substantial share of distributors," and ultimately "den[ied] Star the scale necessary to operate its own foundry." According to the Commission, this "increased Star's costs and denied it the ability to compete effectively" and therefore constituted illegal monopoly maintenance.

The Commission's formulation of an illegal exclusive dealing arrangement is closely aligned with that articulated by the Third Circuit in *Dentsply* and *ZF Meritor*: monopolist firms may not impose a *de facto* exclusive dealing arrangement likely to foreclose enough of a market to prevent a less-efficient competitor from growing large enough to compete. As in other recent agency enforcement cases, such as the DOJ's merger challenge in *Bazaarvoice*, the Commission relied heavily on contemporaneous evidence of intent as expressed in McWane's documents.

By contrast, Commissioner Wright's dissent focused on 1) a lack of evidence demonstrating exactly what scale Star needed to achieve to compete successfully; and 2) a foreclosure analysis that "is incomplete and offers little illumination regarding the competitive effect" of McWane's conduct. For Commissioner Wright, evidence that McWane intended to exclude Star was insufficient where Star had gained *some* sales traction. It's impossible to say definitively, but a future Commissioner McSweeny seems more likely to side with the majority than with Commissioner Wright.

Make/Buy Situations

The Commission considered allegations that McWane's distribution agreement with Sigma was itself a market allocation or an unreasonable vertical restraint of trade. That agreement, which required that Sigma distribute only McWane DIPF products, was referred to in McWane documents as an "insurance policy" against Sigma's independent entry into the sale of domestic DIPF products. However, relying principally on evidence of Sigma's poor finances and the expense of securing an independent supply of domestic DIPF, the Commission found there was no "reasonable probability that Sigma would have been McWane's competitor in the domestic fittings market." Reversing the ALJ, the Commission found no violation of Section Five.

Pricing Agreements

Perhaps more interesting is the *McWane* opinion's predictive value for the future FTC's views on price conspiracies. The ALJ had rejected allegations that McWane had agreed with Sigma and Star (its supposed monopolization victim) to eliminate project-specific pricing, which allegedly destabilized prices, and had participated in an industry data exchange in order to police a broader agreement about market share and pricing.

Citing to *Twombly* and its progeny, the ALJ's decision found that the litany of circumstantial evidence – an extensive presentation by Complaint Counsel that included numerous examples of mindful signaling through public announcements and internal documents that reflected McWane's hope that its conduct would induce others to follow – was insufficient in the absence of any direct evidence of an agreement.

The ALJ's decision stands, but only by dint of the current 2-2 deadlock. According to the Commission's decision, "Chairwoman Ramirez and Commissioner Brill find, by a preponderance of the evidence, that McWane, Sigma, and Star engaged in concerted action in violation of the law."

Chairwoman Ramirez and Commissioner Brill similarly found that the companies' participation in a data exchange sponsored by an industry group was an "unlawful facilitating practice" in furtherance of a price conspiracy, while Commissioners Wright and Ohlhausen would not have found a violation. The data exchange in question provided McWane, Sigma, and Star access to aggregated data, roughly 45 days to 2 months old, showing total industry sales volumes (not prices). Although the exchange did not satisfy the "safe harbor" for information exchanges set out in the Commission's "Statements of Antitrust Enforcement Policy in Health Care," its structure, focused on historical, aggregated non-price information, was hardly extreme (which is perhaps why Chairwoman Ramirez and Commissioner Brill limited their decision to finding that the data exchange was only a facilitating device, and not an independent violation).

While there is little on the public record to support a nuanced reading of Ms. McSweeny's views in this area, there is little reason to think they will differ substantially from those of her future Democratic colleagues. The potential consequence could be an uptick in the use of Section Five to address coordinated or collusive behavior that does not appear likely to be addressed criminally, or that occurs in tandem with other conduct the FTC takes issue with under Section Five.

Conclusion

Many expected *McWane* to provide real guidance on the Commission's vision for Section Five. But the headline may be that the case's exceptional facts provide little predictive value for other firms. After all, the market for "domestic" DIPF was to some extent a creation of ARRA, and a fleeting one at that. It is impossible to know whether Star or others would have allocated more capital to entering the domestic market had it appeared likely to last longer. But it seems reasonable to at least ask, as Commissioner Wright does, whether at least part of the reason McWane maintained a monopoly in domestic DIPF is that others were scared off by the uncertainty of ARRA's lifespan.

Even so, other firms can draw lessons from the types of evidence the Commission, and the dissenting minority, will find compelling in future monopolization-type cases brought under Section Five. The majority's finding relied heavily on McWane's own documents and communications as evidence of its anticompetitive intent; only Commissioner Wright felt strongly that extrinsic evidence of competitive impact would also be necessary.

Likewise, the Commission may be near a tipping-point with respect to the evidence necessary to apply Section Five to horizontal collusion. The Democratic Commissioners would credit evidence of parallelism and signaling, when coupled with documents showing intent to influence competitors' decision-making; the Republican Commissioners would press for more. When Ms. McSweeny is confirmed, the evidentiary needle is likely to move, at least slightly, in the direction of cases based on circumstantial evidence and inference of agreement.

So *McWane* is best read as providing direction, if not total clarity, on how the Commission is likely to apply Section Five to future challenges to exclusive dealing, vertical restraints, or horizontal agreements. Still, there are a few ways firms can protect themselves from getting dragged in to a McWane-style mess that will not change:

- First and foremost, control the creation of documents. In nearly every single count of its Complaint, the FTC featured McWane documents that supported inferences that hurt the company's case. Without explicit references to McWane's intent to stop price erosion, lead its competitors to specific actions, and otherwise avoid competition, the case might have been much more limited.

- Second, monopolists should consider carefully how they cast programs designed to inspire loyalty. It's impossible to know whether a loyalty rebate/discount program, without more, would have landed McWane in hot water, but that case would have been more challenging for the FTC to win.
- Third, consider the real value of industry data reporting. If this data exchange – which included only volumes (not prices), only past data (not present or future), and was fully aggregated – would run afoul of Section Five in an FTC of the future, firms must carefully consider whether their participation in industry data exchanges serves some purpose (other than maintaining prices) that cannot be addressed using any other source of competitive intelligence.
- Fourth, beware "unusual" markets that are distorted by legislation or other external factors. Where non-economic factors lead to situations where a firm enjoys unusually high share or pricing, it is worth thinking twice about the most aggressive competitive tactics.

The full opinion and dissent can be accessed here.

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