FTC at a Crossroads: The McWane Case

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Anyone familiar with the antitrust newstream realizes there is a tremendous amount of controversy about the Federal Trade Commission's administrative litigation process. Unlike the Antitrust Division which fights its litigation battles in Federal Court, the FTC has a distinct home court advantage. FTC antitrust cases are typically litigated administratively with a trial conducted before an FTC administrative law judge, who issues an initial decision, followed with an appeal to the full Commission for a final decision. I have authored a couple of recent articles as have others that question the fairness of the FTC acting as both prosecutor and judge. These concerns have only been amplified since for the last 19 years the FTC has always found a violation of law. As one Congressman noted the FTC has "an unbeaten streak that Perry Mason would envy."

All of this will come to a head later this month in an FTC case against McWane, Inc., a modest firm that makes ductile iron pipe fittings (DIPF). In this case the FTC brought a complaint against McWane alleging collusion with competitors to stabilize and raise prices and exclusion of competitors in the domestically manufactured DIPF market. The case was tried like greased lightning – it went from complaint to trial in 9 months. The trial before the administrative law judge (ALJ) involved over 2,000 exhibits, 16 live witnesses and 53 total witnesses, 25 trial days, 6,045 pages of trial transcript, and culminated in a 464-page decision – possibly the longest FTC decision in history. Ultimately, the ALJ split his decision and found for McWane on the collusion counts and for the FTC on the exclusion counts. Both parties have appealed and the case is currently under consideration by the Commission. The case was argued before the Commission on August 22, 2013, and a decision by the Commission is expected by January 25.

The McWane case provides an excellent lens to examine where the FTC may be headed in administrative litigation and the policing of dominant firm conduct. For this reason I will be writing a series of posts explaining the case and why a finding of a violation may be a risky path for the development of the law on collusion and exclusion, and what proof is needed to show such violations. This first article will explain the state of the market that led to the filing of a complaint.

McWane is a producer of domestically manufactured DIPF, which are used to join pipe in pressurized water transportation systems. DIPF can join pipe in straight lines or change, divide or direct the flow of water. DIPF are usually sold to municipal and regional water authorities through independent wholesale distributors. DIPF are commodity products that are produced to American Water Works Association standards. This makes all DIPF that meet the standards, whether foreign or domestically produced, completely interchangeable.

The DIPF market used to be dominated by domestic producers; however that has changed over the past 20 years. Project managers and municipalities can stipulate on their specifications whether the fittings for a particular project are to be domestically produced, imported, or open to all bids. Since the mid-1980s cheap foreign fittings and dumping has caused most of these specifications to be flipped from domestic-only to open. The period of 2003-2008 saw the biggest decline in domestic DIPF – from about 70% to 15-20%. This led many domestic fittings producers to either dramatically reduce their production or exit the market entirely. The International Trade Commission unanimously determined in 2003 that a flood of cheap fittings from China was causing “market disruption” and “material injury” to domestic fittings producers. McWane became the last domestic DIPF producer with a full-line foundry dedicated to DIPF in the United States and that foundry is only operating at 30% capacity, which puts it in danger of being closed. McWane was previously forced to shut down its other U.S. foundry and open a foundry in China, measures taken to compete with the low cost of foreign production.

There are still some specifications that require domestically produced fittings. This may be due to preference (ex. patriotism) or legal rules, but both of these can (and did) change with frequency to permit the purchase of imported fittings. In addition, the “Buy American” provisions of the American Recovery and Reinvestment Act (ARRA) did create a brief increase in the demand of domestically produced fittings. However, the numerous waivers and temporary nature meant that the sale of domestic fittings only rose to about a third of all sales before falling back to their pre-ARRA levels when ARRA expired in 2010. Domestic-only specifications and the ARRA period encouraged foreign fittings companies to consider producing DIPF products domestically. Star entered shortly after the passage of ARRA and Sigma entered into a Master Distribution Agreement (MDA) with McWane to supply domestic fittings during the ARRA period. It was these conditions that produced the FTC complaint.

McWane's actions to keep its domestic foundry open led to the FTC complaint. McWane's rebate program, designed to help it increase production at its foundry, became the basis of the FTC's claim that McWane was excluding Star from the market. McWane's MDA agreement with Sigma, which also helped expand its reach to Sigma's customer base and to increase its domestic foundry production, was seen by the FTC as excluding Sigma from the market. McWane was also charged with colluding with Star, who successfully entered the market, to raise and stabilize prices.

The FTC's complaint is divided into two parts with counts 1-3 alleging collusion and counts 4-7 alleging exclusionary actions by McWane. The collusion counts charge conspiracy to restrain price competition in the relevant Fittings market (Count One); conspiracy to exchange competitively sensitive sales information (Count Two); and invitation to collude (Count Three). The exclusionary counts charge that the MDA was an agreement in restraint of trade (Count Four); a conspiracy between McWane and Sigma to monopolize the Domestic Fittings market (Count Five); exclusionary acts constituting willful practices to acquire, enhance, or maintain monopoly power in the relevant Domestic Fittings market (Count Six); and specific intent to monopolize the Domestic Fittings market (Count Seven). The ALJ dismissed counts 1-3, finding that the FTC's conspiracy allegations were "weak," "unverified," "unpersuasive," "strained," and "unsupported," amounting to a "daisy chain of assumptions." The ALJ went on to find that Star, who was a "a less efficient supplier" than McWane, "clearly" entered the Domestic Fittings market in 2009, and that its market share went "from zero to almost 10% in 2011." He also found that "Sigma was in a precarious position overall in financial terms" and "regardless of whether Sigma had the financial capability to produce Domestic Fittings . . . it did not have the time required to do so" before the end of the ARRA period, but nonetheless found that counts 4-7 were proven by a preponderance of the evidence.

The McWane case is unusual for several reasons as I will describe in future posts. The FTC alleges collusion to raise and stabilize prices and exclusionary conduct but the time period of any alleged wrongful conduct seems incredibly short. The FTC alleges that the victim of McWane's supposed exclusionary tactics, Star, also conspired with McWane to raise prices – a contradiction that FTC Commissioner Rosch had trouble with. The FTC relies heavily on a domestic market definition even though there is strong evidence that foreign competition had driven all domestic suppliers out of the market except for McWane and that any domestic only market, if it exists, does not appear to be large enough or stable enough to support an industry. Finally, The FTC relies on structural and plus factors to prove collusion rather than direct evidence of price agreements or communications or economic evidence and analyses showing any supra-competitive price effects.

This post is the first in a series of posts by David Balto about the FTC's McWane case. The next article will explain the ALJ's factual findings in relation to the alleged violations and pose some of the challenges the Commission faces.

This post originally appeared on the Truth on the Market website.