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McWane in the 11th Circuit: When Is Exclusive Dealing Anticompetitive?

Steven J. Cernak (Bona Law PC) · Wednesday, January 7th, 2015

Who would have thought that ductile iron pipe fittings would make for such an interesting antitrust case? While the product might be prosaic, the convoluted facts of the *McWane v. FTC* case in the 11th Circuit could be used as a law school exam question (and some of us already have). The issues are now boiled down to one of the most controversial ones in antitrust: when is an exclusive dealing arrangement by a monopolist anticompetitive? The appeal of the FTC's finding of liability is now fully briefed and awaiting oral argument late next week – but it is Commissioner Josh Wright's dissent from that finding that continues to drive the parties and their respective amicus supporters.

McWane is the only U.S. producer of these fittings and one of a small number of such sellers in the United States. It was accused of excluding one of its few rivals from a market for domestically produced fittings through a loyalty rebate program that acted like an exclusive dealing arrangement. Specifically, McWane threatened to delay payment of rebates earned if distributors purchased any domestic fittings from its rivals. Because one of its rivals, Star, had not yet developed a full line of domestic fittings from its supplier foundries, some distributors chose to purchase only from McWane to ensure access to a complete line. According to Star, that loss of sales prevented it from generating enough sales to justify purchasing its own foundry and matching McWane's cost of production. In a 3-1 vote, the FTC found such actions constituted illegal exclusion. (Commissioner McSweeny was not yet on board.) The briefs of the parties and their amicus supporters offer a range of views for when illegal exclusion can be found and whether the evidence supported such a finding here.

McWane's briefs do not just repeat the criticisms of the FTC's opinion made in Wright's dissent; instead, they focus on Star's entry and expansion into the market in the face of McWane's marketing efforts. While Star did not own a foundry, it was able to source enough products from other U.S. foundries to gain nearly 10 percent of the market. Such "actual entry of a new competitor or expansion by an existing competitor precludes a finding that exclusive dealing is an entry barrier of any significance," according to McWane's briefs. McWane also argued that its exclusivity program had the hallmarks of programs found to be presumptively legal because they were unlikely to lead to competitor foreclosure: the policy was in effect only for four months and was easily and immediately terminable; and the penalty for not following it was only a 12-week delay in payments.

While the FTC and various amicus briefs respond to McWane's brief, all of them also spend pages upon pages taking on Wright's dissent. In that opinion, Wright agreed that Commission Complaint Counsel "articulated a coherent theory of economic harm: McWane's exclusive dealing policy raised Star's distribution costs, which prevented Star from achieving [minimum efficient scale or MES], which enabled McWane to maintain power over price," however, Wright believed the evidence was insufficient to support that theory. In particular, Wright asserted that Complaint Counsel and the Commission majority simply calculated the percentage of distributors from which Star was foreclosed (and miscalculated the percentage at that) and declared it "substantial" and therefore a violation. They did not sufficiently link that foreclosure to Star's failure to achieve MES and effectively challenge McWane, mostly because they did not show what MES in the industry was. The majority relied on the only evidence proffered – Star's assertion that sales sufficient to operate its own foundry constituted MES and an ability to effectively compete with McWane. Other evidence in the record – Star's initial success in selling domestic fittings made at others' foundries and another competitor's long-term success selling non-domestic fittings outsourced to other foundries – supported the opposite conclusion. As a result of this evidentiary failure, Wright dissented.

An amicus brief supporting the appeal and signed by 19 prominent antitrust professors, including Dan Crane, Damien Geradin and Bill Page, largely mimicked Wright's dissent. The brief accepted that the Commission articulated a plausible theory of competitive harm but argued that the supporting evidence was insufficient. The Commission offered no direct evidence of competitive harm, like increased prices or reduced output. Its indirect evidence miscalculated the foreclosure of Star from the necessary distribution channel and failed to show the MES for the industry. Unlike Wright's dissent, this brief also criticized the Commission for discounting McWane's justification that what was essentially a full-line forcing program was necessary to prevent Star from cherry-picking the most popular fittings and destroying the final domestic full-line source, to the detriment of customers. (The other amicus brief in support of McWane, filed on behalf of the United Steelworkers union, made similar points, as described in this earlier post.)

The FTC's brief followed closely the Commission's opinion, including explaining that any sales made by Star were made after the FTC started its investigation; fit into exceptions McWane allowed in the program; and were small enough to be consistent with a finding of significant foreclosure that harms competition. McWane's argument that its written program lacked the hallmarks of anticompetitive exclusive dealing missed the point, according to the FTC, that it was the unwritten threat to stop sales of the domestic fittings to disloyal distributors that made the program so effective. The FTC quickly brushed aside the antitrust professors' cherry-picking argument, saying that the professors' "string of assumptions" necessary for the argument "have no basis in this record and have never been asserted by McWane."

The FTC brief, like the Commission majority opinion, also took on Wright's dissent. First, the brief cites the D.C. Circuit's *Microsoft* opinion to support its assertion that it need not explicitly prove what the MES was because that would give it the difficult burden to "reconstruct the hypothetical marketplace absent a defendant's anticompetitive conduct." Second, the brief also claims now that there was sufficient evidence to show that competition was harmed even if Star never would have achieved MES. For support of this theory, the FTC's brief cites to a new article (see here) written by Prof. Steven Salop, who has been the leading proponent of such "raising rival's costs" theories for decades.

Prof. Salop's articles, both old and new, also are featured prominently in the amicus briefs supporting the FTC decision from several state attorneys general (led by New York's) and the

American Antitrust Institute (AAI). Both briefs also spend at least as much time challenging the Wright dissent below as they do McWane's actual appeal. The states argue that Wright and his professor supporters would improperly require a plaintiff to provide "direct evidence that an exclusionary practice actually affected prices or quantities, or proof that a competitor would actually have gained a much larger share of the market absent the monopolist's exclusivity agreements." Instead, "substantial foreclosure" (a term left undefined) of a key input by a monopolist should trigger a presumption, not rebutted here, of competitive harm.

AAI's brief also argues that "McWane … Wright … and Academic Amici have put forward unprecedented evidentiary standards." AAI claims that Wright would require plaintiffs to show "higher prices and reduced output" from a precisely calculated foreclosure rate to establish a prima facie case of competitive harm. The brief claims such a standard is incorrect, especially in a monopoly maintenance case like this one where "anticompetitive harm is proved by evidence that the market outcome *remains the same*" (emphasis in original).

Of course, the appellate court need not reach many of these arguments – it is the Commission's majority opinion, not Wright's dissent, that is being appealed. Still, those two opinions agree that a plausible anticompetitive story can be told about McWane's pricing program and that such a theory could be supported by direct or indirect evidence. The majority opinion found the evidence presented was sufficient to support that theory; the dissent did not. Counselors for other companies can hope that the 11th Circuit's summary of that same evidence goes beyond hand-waving about "substantial foreclosure" and provides clearer guidance about when exclusive dealing by a monopolist harms competition. Oral argument is scheduled in Atlanta for Friday January 16.

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