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ANTITRUST

Expert Analysis

FTC Condemns Pipe Maker's Exclusive Dealing Arrangements

By
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The Federal Trade Commission (FTC) ruled that the only domestic manufacturer of iron pipe fittings violated antitrust law when it implemented exclusive dealing arrangements that foreclosed foreign importers from the U.S. market. The Department of Justice won a trial charging that the combination of two online ratings and reviews platforms was an unlawful merger to monopoly, persuading a federal judge to accept a limited relevant market definition and reject the claim that social media companies could enter the market rapidly. The FTC also won a merger trial involving the acquisition of a medical practice group by an Idaho hospital system.

Other antitrust developments of note included the imposition of the longest antitrust prison sentence on a former executive of a water freight carrier for participating in a price-fixing and bid-rigging conspiracy and the European Commission's acceptance of Google's proposed remedies to resolve concerns that the online search company abused its dominant position by displaying biased search results.

Exclusive Dealing

The Federal Trade Commission found McWane, Inc. liable for unlawfully maintaining a monopoly in the domestic market for iron pipe fittings by entering into exclusive arrangements with distributors, but dismissed other charges of unlawful collusion, information exchange, and restraint of trade. The decision addresses the relationship between companies that produce the same products in different geographic markets and reflects the impact of protectionist legislation on domestic competition.

McWane is the only domestic manufacturer of iron pipe fittings, which direct the flow of pressurized water through pipeline systems. Until 2009, McWane had nearly 50 percent of the U.S. market and its two main competitors, Star Pipe Products, Ltd. and Sigma Corp., sold imported fittings domestically but lacked domestic production facilities. In February 2009, Congress imposed domestic-only specifications through the American Recovery and Reinvestment Act (ARRA) by requiring domestically produced fittings to be used in waterworks projects funded by the ARRA. The commission stated that the new law made McWane a monopolist in the domestic fittings market because imported fittings were no longer interchangeable with domestic fittings and there were substantial barriers to entry.

Star and Sigma explored options to enter the domestic production market in 2009 to overcome these barriers. According to the FTC's complaint, McWane responded to the potential competition by implementing an exclusive dealing policy with distributors and entering into a distribution agreement with Sigma. The FTC brought an administrative action against McWane alleging a variety of anticompetitive conduct, and the administrative law judge (ALJ) ruled against McWane on some of the claims. On appeal, the FTC commissioners affirmed in part.

Exclusive Dealing. The commission found that McWane unlawfully maintained its monopoly by imposing an exclusive dealing arrangement on distributors purchasing fittings for the domestic market. McWane told distributors that its domestic fittings would only be available to those who fully supported McWane products and that the distributors would be cut off from McWane products if even one of their branches purchased domestic fittings from another company.

Star, the only competitor to enter the domestic fittings market on its own after passage of the ARRA, asserted that distributors largely stopped requesting quotes after McWane imposed its exclusivity policy. Star was unable to achieve sales on a sufficient scale to build its own domestic foundry and instead chose the costlier option of contracting with independent foundries to supply domestically produced

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raw castings that Star later finished at its own facility.

In a 3-1 decision, the commission found that the lack of access to distributors made Star less efficient and prevented it from competing effectively. Though the commission recognized that in some circumstances exclusivity arrangements can have competitive benefits, it found that McWane harmed the competitive process because as a monopolist its use of an exclusive arrangement hindered Star's ability to achieve efficient scale to compete and deprived it of downstream market access. Commissioner Joshua Wright dissented on the ground that Star's inability to build its own domestic foundry was insufficient to demonstrate a failure to achieve scale and anticompetitive harm.

Unaided by protectionist legislation, it is unlikely that McWane would have been able to leverage its power and effectively foreclose the foreign importers from the U.S. market. As the FTC observed, exclusive dealing arrangements are often lawful. But they may raise serious antitrust concerns when imposed by a firm that capitalizes on significant market power and barriers to entry to keep rivals from gaining access to the market.

Market Allocation. The ALJ also found unlawful McWane's entry into an agreement with (potential) rival Sigma, which made Sigma a distributor of McWane products for about a year in 2009. The distribution agreement required Sigma to purchase its domestic fittings solely from McWane, sell at no less than a minimum price set by McWane, and sell only to distributors that had entered into an exclusive dealing arrangement with McWane.

Despite evidence that McWane entered into the distribution agreement with the anticompetitive intent to prevent Sigma from entering the domestic fittings market independently, the commission reversed the ALJ and found the agreement did not have an anticompetitive effect because Sigma did not have the resources to enter the market on its own. In the absence of a reasonable probability that Sigma could have become McWane's competitor, the commission rejected the complaint's allegation that the arrangement was an unlawful horizontal agreement in restraint of trade. The FTC's reasoning underscores the prominence of effects over intent in antitrust jurisprudence.

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The commission also rejected the alternative theory that the Sigma distribution agreement was an unlawful vertical agreement. Despite requirements that Sigma purchase only from McWane and sell only at minimum prices set by McWane, complaint counsel did not demonstrate actual or likely anticompetitive effects because Sigma was not a probable entrant in the domestic market.

Conspiracy. The commission dismissed charges of conspiracy among McWane, Star, and Sigma to set prices. The complaint alleged that McWane caused two rounds of price increases in 2008 by agreeing to support higher published list prices if Sigma and Star curtailed unpublished project pricing discounts. The ALJ dismissed these charges because the evidence merely showed parallel conduct without an actual agreement. The complaint also alleged that McWane supported higher list prices in exchange for monthly shipment information that Sigma and Star shared through an industry association. The ALJ dismissed this charge because the information exchanged was not pricing data that could have facilitated price coordination but rather aggregate, historic shipment volumes. The commission upheld the ALJ's dismissal of the conspiracy and information exchange charges after splitting 2-2 on these counts.

In re McWane, FTC Docket No. 9351 (Jan. 30, 2014)

Online Ratings Merger

A federal district court in California ruled that Bazaarvoice, the provider of ratings and reviews (R&R) platforms to companies engaged in electronic commerce, violated Section 7 of the Clayton Act by acquiring its primary competitor, PowerReviews, in 2012. *United States v. Bazaarvoice*, 2014-1 CCH Trade Cases ¶78,641 (N.D. Cal. Jan. 8, 2014). The Department of Justice investigated and sued Bazaarvoice even though the Hart-Scott-Rodino Act's premerger notification rules did not require the transaction to be reported.

The court found a reasonable likelihood that the merger would lessen competition because the companies were the only meaningful commercial competitors in the R&R market, with Bazaarvoice traditionally serving large retailers and PowerReviews providing cheaper services to smaller entities, and barriers to entry were high.

Central to the court's decision was the determination of the relevant market. The government argued that R&R platforms constitute a separate product market, but Bazaarvoice argued for a broader definition that would include all social commerce tools, including Q&As, blogs, forums, and social networks. The court chose the government's narrower definition because the companies themselves and the larger industry view the R&R platform market as distinct.

The companies often described product reviews as a necessary feature for online retail sites to attract purchasers and one that retailers could never eliminate even if they removed other social commerce products from their websites. Also, in referring to themselves as a duopoly and regularly pointing to each other as their only competitors, the court noted, the companies implicitly recognized that the R&R platform market is distinct.

The court resisted broadening the market to all social commerce products because R&R platforms have a limited and unique purpose—providing product feedback to consumers at the point of purchase. Rather than other social commerce products serving as substitutes, the court found that they serve as complements because online retailers use them in combination with R&R platforms.

The court limited the relevant geographic market to the United States because domestic consumers have certain linguistic and cultural preferences that in practice tend to limit syndication of R&R platforms to the domestic market.

The court deferred determination of the appropriate relief to a later date. The Department of Justice proposed a remedy that would require Bazaarvoice to sell all of PowerReviews' assets, provide syndication services to the divestiture buyer, and waive trade-secret restrictions. The proposed remedy would also require Bazaarvoice to license its latest R&R platform to the divestiture buyer if the asset sale would not transfer a large base of customers.

Medical Practice Acquisition

In another successful court challenge to a merger that was not reportable under the Hart-Scott-Rodino (HSR) Act, a district court granted the FTC and Idaho Attorney General's request to unwind a hospital system's acquisition of a physician practice group. *St. Alphonsus Medical Center-Nampa v. St. Luke's Health System*, 12-cv-00560 (D. Idaho Jan. 24, 2014). The government complaint asserted that St. Luke's Health System's acquisition of Saltzer Medical Group P.A., Idaho's largest independent, multispecialty physician practice group, would have given St. Luke's the market power to demand higher rates from insurers and other third-party payors for health care services provided by primary care physicians in and around Nampa, Idaho, ultimately leading to higher costs for consumers. The FTC and Idaho filed their complaint, *FTC v. St. Luke's Health System*, 13-cv-00116 (D. Idaho), in March 2013, after St. Alphonsus Medical Center, a local rival, had brought a private antitrust suit challenging the acquisition.

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The two merger enforcement actions in *Bazaarvoice* and *St. Luke's* serve as yet another reminder that under U.S. law, transactions that do not meet the premerger reporting thresholds are not beyond the reach of antitrust law and that the enforcement agencies do not hesitate to investigate and challenge closed mergers. Though the merging parties may have procedural advantages when the HSR Act does not prohibit closing the combination prior to agency review, unwinding the transaction can turn out to be complex and costly if the merger is found to be unlawful and the two companies have become integrated and not easily "unscrambled."

Freight Shipping Cartel

The former president of Sea Star Line LLC, a water freight carrier, was sentenced to five years in prison for conspiring to fix rates and surcharges and rig bids for water transportation services between the continental United States and Puerto Rico. This is the longest prison sentence ever imposed for antitrust violations. Five other individuals as well as Sea Star Line and two other water freight carriers pleaded guilty to the conspiracy and have been ordered to serve prison sentences and pay fines.

Web-Search Bias

The European Commission accepted a revised proposal from Google addressing the anticompetitive concerns raised in a lengthy investigation into the company's online search and search advertising practices. European Commission press release, Antitrust: Commission obtains from Google comparable display of specialised search rivals, IP/14/116 (Feb. 5, 2014).

Google agreed to alter four business practices to avoid a ruling that it violated European laws prohibiting abuse of a dominant position. First, Google agreed to visibly display rival search services whenever it displays its own specialized search services. This addresses the commission's concern that Google's practice of displaying its own results without giving visibility to rival services or informing consumers that it is promoting its own service impairs the ability of consumers to compare and choose a potentially more relevant service.

In contrast, the U.S. FTC closed an investigation into anticompetitive search bias last year after determining that Google's changes to the display of search results reflected legitimate product design improvements without the primary purpose to exclude competitors, as reported in the Jan. 17, 2013, column.

In other proposals to address the European Commission's concerns, Google also agreed to give original content providers the ability to opt out from Google's use of their content in specialized search services, to remove exclusivity requirements from agreements for search advertisements, and to eliminate restrictions on the transferability of search advertising campaigns to rival platforms.