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EXCLUSIVE DEALING

Dominance

FTC's Actions on Exclusive Dealing Arrangements Indicate Additional Antitrust Risk Factors for Dominant Firms

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In affirming the FTC's order enjoining a manufacturer's exclusive dealing arrangements with distributors, the Eleventh Circuit in *McWane Inc. v. FTC*[1] highlighted some antitrust risk factors for dominant firms that use such arrangements. Other FTC actions confirm these risks, including the recent *Cardinal Health Inc.* complaint and consent decree.[2] Exclusive dealing arrangements that foreclose potential competitors and do not verifiably advance interbrand competition are likely targets for antitrust enforcement.

McWane

In *McWane, Inc. v. FTC*, the Eleventh Circuit affirmed an FTC ruling that exclusive dealing policies imposed on distributors by the dominant pipefittings manufacturer constituted illegal maintenance of monopoly. Prior to 2009, the manufacturer, McWane, Inc., was the only supplier of domestic pipe fittings. In anticipation of federal programs, in late 2009, Star Pipe Products, a manufacturer of imported fittings, sought to enter the domestic fittings market. In response, McWane informed distributors that purchases of domestic pipe fittings from other manufacturers would cost distributors their rebates from McWane and risked cutting off their ability to purchase any fittings from McWane for up to three months. McWane's policy limited Star's expansion into the domestic pipe fittings market to approximately 5 percent of the market, which, among other things, made it unprofitable for Star to develop its own foundry. During the period at issue, McWane increased its prices for domestic pipefittings.

In January 2012, the FTC brought an administrative complaint, the relevant portion of which was successfully tried before an administrative law judge. The ALJ's decision held McWane's program to be an exclusive dealing arrangement that foreclosed Star from a substantial share of the domestic fittings market, thereby unlawfully maintaining McWane's monopoly. The decision was affirmed by the Commission, and McWane then sought review in the Eleventh Circuit.

In affirming, the Eleventh Circuit emphasized that it reviewed FTC findings of fact and economic conclu-

[1] 783 F.3d 814, 2015 BL 106438 (11th Cir. 2015).

[2] *FTC v. Cardinal Health,* Complaint, 15 CV 3031 (ER) filed April 20, 2015 (S.D.N.Y.) (available at www.ftc.gov/system/files/documents/cases/150420cardinalcmpt.pdf); Final Order and Stipulated Permanent Injunction, 15-cv-3031(ER), filed April 23, 2015 (available at www.ftc.gov/system/files/documents/cases/150415cardinalorder.pdf).

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sions under a substantial evidence standard, while legal conclusions and application of facts to law were reviewed de novo. With respect to the legal standard, the court stated: ''[E]xclusive dealing arrangements are not per se unlawful, but they can run afoul of the antitrust laws when used by a dominant firm to maintain its monopoly.''[3] Based on *Microsoft*, the Eleventh Circuit held this inquiry first required a showing that ''the monopolist's conduct had the 'anti-competitive effect' of 'harm[ing] competition, not just a competitor.' ''[4] If the government succeeds in demonstrating this anti-competitive harm, the burden then shifts to the defendant to present pro-competitive justifications for the exclusive conduct, which the government can refute.

In arguing that the FTC's decision was flawed, McWane first contended that its program was presumptively legal and could not harm competition because the arrangements were short term and voluntary, citing authority that exclusive dealing agreements of less than one year and that were easily terminated were presumptively legal. The Eleventh Circuit rejected this ''formalistic'' argument based on evidence that the ''practical effect'' of exclusive dealing was anti-competitive where use of distributors was essential to compete in the market. The court also pointed to FTC findings that the program was unilaterally imposed by McWane and did not reflect competition for exclusive dealing among distributors in exchange for pro-competitive inducements.

With respect to the ''harm to competition element'', the court noted *Tampa Electric's*[5] substantial foreclosure test, but concluded that, while a useful screen as a proxy for anti-competitive harm, it was not sufficient. The court found substantial evidence supporting the FTC's determination of substantial foreclosure, as the two major distributors subject to the policy controlled approximately 50-60% of distribution. In addition, the FTC had direct pricing evidence, including McWane's price increases. Applying a deferential standard of review, the court confirmed the FTC's determination of harm to competition. Alternative channels of distribution were not available to Star and the FTC presented McWane's internal documents reflecting ''clear anti-competitive intent'' that McWane's program was intended to harm competition. Lacking any pro-competitive justifications from McWane for its exclusive dealing program, the Eleventh Circuit affirmed.

The FTC's Cardinal Complaint

The FTC's recent consent agreement with Cardinal Health Inc. provides further insights regarding when the FTC views exclusive dealing arrangements as potentially anti-competitive, as well as the splintered views among the Commissioners on when disgorgement is an appropriate remedy. Where *McWane* involved a manufacturer imposing exclusivity on distributors to prevent a potential competing manufacturer from entering the market, Cardinal involved a distributor pressuring manufacturers to not compete in distribution and not to license other distributors.

Cardinal is one of the largest distributors of pharmaceuticals, and operated a network of radiopharmacies in the U.S. The low-energy type of radiopharmaceuticals at issue are used by hospital and clinics for nuclear imaging and other procedures. Because the isotopes decay, hospitals and clinics require local sources of supply. The FTC alleged Cardinal illegally monopolized the market for the sale and distribution of radiopharmaceuticals to hospitals and clinics in 25 geographic markets where Cardinal operated the only radiopharmacy. [6]

Cardinal allegedly required the two manufacturers of the most used type of radio pharmaceutical to provide defacto exclusive distribution rights for Cardinal. To foreclose competing radio pharmacies, Cardinal threatened each manufacturer that it would shift purchases to the rival's product if the manufacturer licensed or supplied a competing radiopharmacy. By preventing potential competitors from obtaining this radiopharmaceutical, the FTC alleged, Cardinal was able to monopolize local markets and charge higher prices.

To remedy this conduct, the FTC settlement included injunctive relief and required Cardinal to disgorge $26.8 million.[7] Cardinal agreed not to enter into more than one exclusive arrangement for overlapping radiopharmaceuticals, was barred from coercing or retaliating against manufacturers who sold to other distributors, was required to notify its customers that they could terminate low-energy radiopharmaceutical contracts, and to provide prior notice of any proposed acquisition of any radiopharmacy. Cardinal also agreed to implement an antitrust compliance program and to retain an antitrust compliance officer. The FTC also was to appoint a monitor with authority to assure implementation of the customer contract relief over a 3-year period.

The disgorgement remedy was discussed in a statement by Chairman Ramirez, Commissioners Brill and McSweeney,[8]and in separate dissenting statements by Commissioners Ohlhausen[9] and Wright.[10] The majority

[3] *McWane v. FTC*, 783 F.3d at 832

[4] *Id.* (quoting in part *United States v. Microsoft Corp.*, 253 F.3d 34, 58-59 (D.C. Cir. 2001) (en banc).

[5] *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320 (1961).

[6] *FTC v. Cardinal Health*, Complaint, at ¶ ¶ 1, 14-16, 15 CV 3031 (ER) filed April 20, 2015 (S.D.N.Y.) (available at www.ftc.gov/system/files/documents/cases/150420cardinalcmpt.pdf).

[7] Final Order and Stipulated Permanent Injunction, 15-cv-3031(ER), filed April 23, 2015 (available at www.ftc.gov/system/files/documents/cases/150415cardinalorder.pdf).

[8] Statement of the FTC in the Matter of Cardinal Health, Inc. (available at www.ftc.gov/system/files/documents/public_statements/637781/15420cardinalhealthcomnstmt.pdf).

[9] Dissenting Statement of Commissioner Maureen K. Ohlhausen, Cardinal Health, Inc. (available at https://www.ftc.gov/system/files/documents/public_statements/637761/150420cardinalhealthohlhausen.pdf).

[10] Dissenting Statement of Commissioner Joshua D. Wright, Cardinal Health Inc. (available at https://www.ftc.gov/

statement emphasized that the conduct by Cardinal prevented entry in the markets that Cardinal had obtained monopoly profits, and that Cardinal had no efficiency or other legitimate business justification for the exclusive dealing arrangements. In justifying disgorgement, the majority claimed the amount reasonably approximated Cardinal's ill-gotten gains and noted that private suits likely were time-barred.

Commissioner Wright noted his concerns that disgorgement risked over-deterrence with respect to single firm conduct, discouraging pro-competitive conduct. He also joined Commissioner Ohlhausen in urging that the FTC provide written policy guidance concerning when it would or would not seek monetary remedies. Both dissenting Commissioners urged restoring the FTC's 2003 Policy Statement on Monetary Equitable Remedies in Competition Cases. [11]

IDEXX

Another FTC settlement reflects similar concerns about exclusive dealing arrangements developed by a dominant firm in the market. The FTC's complaint in *IDEXX Laboratories, Inc.*,[12] addressed use of exclusive dealing agreements by the dominant manufacturer of diagnostic testing equipment for veterinarians. The overwhelming majority of veterinarians relied on distributors for such equipment. The manufacturer, IDEXX, entered into exclusive distribution agreements with all five major national or regional distributors, which precluded them from carrying competing brands of equipment. Characterizing IDEXX as a "'must carry' " supplier, the FTC alleged that its agreements with distributors responsible for 85% of the market effectively foreclosed competing manufacturers from reaching large segments of the veterinarian market, and improperly maintained IDEXX's monopoly power.

In its Analysis to Aid Public Comment,[13] the FTC rejected that interbrand free riding required the use of exclusive dealers, noting that promotional efforts applied only to IDEXX products.

Conclusion

McWane, *Cardinal*, and *IDEXX* reflect that where exclusive dealing arrangements are used to entrench a dominant firm from competitors and lack verifiable pro-competitive justifications, antitrust risks increase. Shorter time periods for exclusivity or the absence of written agreements are no guarantee against antitrust liability. The risks are significantly greater where the exclusive arrangements are extended to all major distributors, foreclosing their use by competitors and undermining pro-competitive rationales for exclusivity. As shown by the disgorgement remedy in *Cardinal*, the costs of missteps may be substantial monetary loss, in addition to intrusive injunctive relief.

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system/files/documents/public_statements/637771/150420cardinalhealthwright.pdf).

[11] The FTC's 2003 Policy Statement outlining the circumstances when the FTC would seek monetary equitable remedies was withdrawn effective July 31, 2012. *See* 77 Fed. Reg. 47070 (Aug. 7, 2012). The withdrawal notice stated that the Policy Statement created an "overly restrictive view" of the FTC's options. *Id.* at 47070.

[12] Complaint, *In re IDEXX Laboratories, Inc.*, Dkt. no. C-4383 (available at www.ftc.gov/sites/default/files/documents/cases/2012/12/121221idexxcmpt.pdf)

[13] 78 Fed.Reg. 300-03 (Jan. 3, 2013).