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Expert Analysis

'McWane': Tacit Coordination Versus Illegal Agreement

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For the first time in nearly two decades, Federal Trade Commission staff "lost" an administrative complaint as the commission dismissed price-fixing allegations against McWane Inc. In the case, *McWane Inc. Ltd.*, the commission affirmed the exclusive dealing claim against the company, but it deadlocked 2-2 (along party lines) on the price-fixing claims. Unfortunately, the lack of a fifth commissioner to break the tie left observers without a clear statement on how—at least within the FTC—to dissect price-fixing allegations and proof, and immediate reactions to the decision expressed disappointment at the lack of guidance. Nevertheless, there are at least a few lessons to draw from *McWane*.

First, the ALJ's underlying finding in favor of defendants shows how the analytical framework of *Twombly*—a pleading case (see note 10)—and *Matsushita*—decided on summary judgment (see note 12)—also impact the assessment of evidence on a full trial. In oligopoly markets, proof of tacit coordination (i.e., expected interdependent behavior) will not be enough; there needs to be a preponderance of evidence demonstrating the parties' conscious commitment to a common plan or scheme to fix prices. Second, actually engaging in lawful, tacit coordination in an oligopolistic market still remains a very dangerous thing to do. The Democratic commissioners, in particular, are increasingly placing emphasis on centralization of pricing authority as a "super plus factor," which could become dispositive if incoming commissioner Terrell McSweeny sees eye to eye with her Democratic colleagues. We explore these issues below.

Allegations Against McWane

McWane is the largest U.S. supplier of ductile iron pipe fittings. Pipe fittings are used in municipal and regional water distribution systems and are used to join pipes, valves and hydrants and to change, direct or divide the flow of water. McWane, along with its main competitors, Sigma Corporation and Star Pipe Products Ltd., are responsible for over 90 percent of fittings sales in the United States.[1]

Staff brought seven claims for unfair competition under the FTC Act, three of which related to alleged price-fixing between McWane, Sigma and Star. Relevant here is Count One, which alleged the companies conspired to curtail "project pricing"—an especially important form of price competition. In the pipe fittings industry, the base price a consumer pays generally includes two components: the nationwide list price and regional discounts referred to as "multipliers." These components are generally similar, if not the same, across competitors and readily observable by each supplier. In addition to these dimensions of competition, suppliers engage in "project pricing," which involves offering additional concessions and discounts to secure contracts. Project pricing tends to be less transparent and is "the primary form of competition among suppliers."[2]

Complaint Counsel, invoking no less than 13-plus factors, alleged a conspiracy to eliminate project pricing. The lynchpin of their case was a document they referred to as the "Tatman plan." The "plan," set forth in an internal document, suggested (in Complaint Counsel's view) that McWane would support list price increases in exchange for greater "price stability and transparency," through the elimination of project pricing.[3] According to Complaint Counsel, the Tatman plan was circulated within McWane, which was then followed by unexplained communications between high-level executives at the allegedly conspiring companies. Soon after,

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events started to unfold as the Tatman plan recommended: Starr and Sigma greatly reduced their project pricing and McWane responded by increasing list prices.[4]

Complaint Counsel detailed a series of plus factors that attempted to accomplish the following: locate the agreement in time (plus factors two and three), detail alleged inter-firm communications facilitating the practices (plus factors four, eight, nine, 11, 12 and 13), demonstrate changes in business practices in keeping with the conspiracy, including some that were allegedly against companies' independent business interests (plus factors five, six and seven) and expand on how the market structure was conducive to collusion (plus factors one and 10).[5]

Opinion of ALJ

Despite these factors, the administrative law judge was not convinced that Complaint Counsel had established a conspiracy. He noted that, "circumstantial evidence alone cannot support a finding on conspiracy when the evidence is equally consistent with independent conduct. In such a case, the evidence of conspiracy would not preponderate."[6] The ALJ then discussed the analytical challenges posed by an oligopolistic marketplace. He explained that "recognized interdependence" characterizes oligopoly markets such that pricing decisions are made "(1) in response to the ones preceding it and (2) in hope or expectation of the ones that follow it."[7] To evaluate an alleged conspiracy in such a market, the fact finder must "distinguish between mere tacit collusion, on the one hand, which is a function of interdependence…and is not unlawful, and an agreement, which requires finding a 'conscious commitment' to a common unlawful plan."[8]

Section 1 reaches tacit agreements (i.e., those agreements reached through conduct rather than words), but does not reach tacit coordination.[9] The ALJ continued, quoting from *Twombly*, "conduct indicating an agreement, particularly in the context of conscious parallelism, is 'conduct [that] indicates the sort of restricted freedom of action and sense of obligation that one generally associates with agreement.'"[10] On the other hand, "mere interdependence unaided by an advance understanding among the parties" does not support a finding of conspiracy.[11] A similar point was made in *Matsushita*: "[A]ntitrust law limits the range of permissible inferences from ambiguous evidence in a §1 case.… [W]e [have] held that conduct as consistent with permissible competition as with illegal conspiracy does not, standing alone, support an inference of antitrust conspiracy."[12]

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This framework, drawn partially from *Twombly* and *Matsushita*, significantly impacted the ALJ's analysis of Complaint Counsel's plus factors. *In re Flat Glass Antitrust Litigation* classified plus factor evidence into three categories: "(1) evidence that the alleged conspirator had a motive to enter into the price fixing conspiracy; (2) evidence that it acted contrary to its self-interest; and (3) evidence implying a traditional conspiracy."[13] However, "in the context of parallel pricing, the first two factors largely restate the phenomenon of interdependence." Thus, the ALJ determined here that "evidence under the third factor above, evidence indicating an 'actual, manifest agreement,' is the key to a proper determination."[14]

The ALJ then concluded that Complaint Counsel failed to produce evidence of a conspiracy.[15] The Tatman Plan, according to the ALJ, was not proved to be a "'plan' for a 'conspiracy'… as opposed to an independently formed pricing strategy."[16] The actions of Sigma and Star allegedly taken in response to the Tatman plan were not evidence of an "understanding" or "acceptance" to an "offer" from McWane, "as opposed to independent conduct or lawful conscious parallelism."[17]

Although there was undoubtedly a great deal of tacit oligopolistic coordination, the ALJ was not convinced that Complaint Counsel had presented evidence that pushed the behavior into the realm of tacit agreement: "Complaint Counsel's conspiracy theory is not implausible; it is indeed 'possible' that there is some truth in the story Complaint Counsel tells …[however,] when fairly and objectively scrutinized and weighed, the evidence fails to prove that McWane conspired with Sigma and Star to raise and stabilize prices in the Fittings market." "At best," he concluded, "the evidence shows interdependent or consciously parallel conduct, unaided by an agreement, which is not illegal."[18]

Difficulty of Proving

On appeal, Complaint Counsel argued that the "'ALJ failed to evaluate the evidence as a whole,' instead 'dissect[ing] each piece of the evidentiary puzzle, asking whether it alone made collusion more likely than not.'"[19] For its part, McWane emphasized that the ALJ had support for the conclusion that the company did not agree with its rivals. Because the commission could not reach a majority on the price-fixing counts, the claims were dismissed in the public interest.[20] The bare-bones statement from the deadlocked commission disappointed many observers looking for more analysis, and many pointed out the split was along party lines. However, in the context of Section 1 conspiracy law, there appears to be more than politics at play here.

The line separating lawful interdependent behavior and illegal agreement is very fine. The ALJ admitted as much, stating: "'Although the line between coordination through recognized interdependence and some commitment is shadowy, the distinction is important

so long as antitrust law allows the former but condemns the latter.' Such cases therefore 'must be resolved by rules of law allocating burdens of proof or creating presumptions that certain behavior will—or will not—be treated as an agreement.'"[21] While cases alleging tacit agreement frequently survive the pleadings—and perhaps even summary judgment—*McWane* helps to illustrate the uphill battle that private plaintiffs, and possibly the FTC, face when they bear the burden to prove an agreement, as opposed to just oligopolistic coordination, by the preponderance of the evidence.

Centralized Pricing Authority

Of course, while Complaint Counsel "lost" its administrative complaint against McWane, tacit coordination, even if not amounting to proof of an agreement, is still very dangerous for defendants. The evidence pointing toward tacit agreement was strong enough that McWane had to proceed to a full trial and spend over two years defending itself against the commission's claims. In addition, the expected confirmation of Terrell McSweeny will prevent another split at the FTC. If McSweeny's views as commissioner are in line with her Democratic colleagues, otherwise ambiguous facts may become less so for an FTC majority.

Defendants also should be aware of the arguments in *McWane* supporting so-called "super plus factors." In *McWane*, the centralization of pricing authority was mentioned as a potential super plus factor.[22] Complaint counsel alleged that during the conspiracy period, Sigma told its sales force to emphasize price [i.e., higher price] over volume, and Sigma's competitors, McWane and Star, contemporaneously centralized pricing authority so that management had to clear any project pricing.[23] In support of the permissible inferences to be drawn from such conduct, Complaint Counsel cited to an article written by former FTC Chairman William Kovavic titled, "Plus Factors and Agreements in Antitrust Law."[24] The article discussed "super plus factors"—behaviors that Kovacic believes lead to a strong inference of explicit collusion.[25] One of those factors is a shift in the incentives of the sales force. Kovacic wrote, "In an industry where the product made by different firms is largely homogeneous, a shift in the incentives of sales forces across firms in an industry to 'price before volume'…is a super plus factor."[26] At oral argument, Commissioner Julie Brill picked up on this particular point, referencing the article and suggesting that centralization should be considered a super plus factor.[27]

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The emphasis, both by Complaint Counsel and Brill, is particularly noteworthy because their broad reading of Kovacic's article. Complaint Counsel alleged that Sigma "shift[ed] the incentives of [its] sales force," but for McWane and Starr, the allegation was only that pricing authority was centralized. While this practice might be worthy of the commission's attention (especially when taken in conjunction with Sigma's behavior), it is some distance from the super plus factor-behavior outlined by Kovacic.

As McWane's counsel pointed out during oral argument, "companies can unilaterally decide to consolidate pricing authority in a given person for lots of legitimate reasons."[28] Indeed, McWane argued that industry conditions—including a significant drop in demand, increases in raw material prices and the presence of large, sophisticated buyers—necessitated this change in policy.[29] Just how any so-called "super" plus factors may play out at the FTC will have to wait another day.

1. Opinion of the Commission at 5-7, *McWane, Inc.*, Docket No. 9351 (F.T.C. Jan. 30, 2014).
2. Id. at 7.
3. Complaint Counsel's Appeal Brief at 18, *McWane, Inc.*, Docket No. 9351 (F.T.C. June 4, 2013). Complaint Counsel listed the "Tatman Plan" as the second plus factor.
4. Id. at 20.
5. See generally, id. at 18-38.
6. Initial Decision at 256, *McWane, Inc.*, Docket No. 9351 (F.T.C. May 8, 2013).
7. Id. at 258.
8. Id. at 259-60 (citing 6 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶1401a at 68 (3rd ed. 2010); *Monsanto Co. v. Spray-Rite Serv. Corp*., 465 U.S. 752, 764 (1984)).
9. Id. at 260.
10. Id. (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 554, 557 n.4 (2007) (quoting with approval Michael D. Blechman, "Conscious Parallelism, Signalling and Facilitating Devices: The Problem of Tacit Collusion Under the Antitrust Laws," 24 N.Y.L.S. L. REV. 881, 899 (1979))).
11. Id. at 287. (citing *Twombly*, 550 U.S. at 557 n.4).
12. *Matsushita Electric Industrial Co. v. Zenith Radio Corp*., 475 U.S. 574, 588 (1986) (citing *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 104 S.Ct. 1464, 79 L.Ed.2d 775 (1984)).
13. Id. at 286 (quoting *In re Flat Glass Antitrust Litig.*, 385 F.3d 350, 360 (3d Cir. 2004); see also *Re/Max Int'l v. Realty One*, 173 F.3d 995, 1009 (6th Cir. 1999) (listing plus factors); *Apex Oil Co. v. DiMauro*, 822 F.2d 246, 254 (2d Cir. 1987) (internal quotation marks omitted) (same).
14. Id. at 287 (quoting *In re High Fructose Corn Syrup Antitrust Litig.*, 295 F.3d 651, 661 (7th Cir. 2002) ; *Flat Glass*, 385 F.3d at 361).
15. Id. at 351.
16. Id. at 350.
17. Id.
18. Id.
19. Opinion of the Commission at 38, *McWane, Inc.*, Docket No. 9351 (F.T.C. Jan. 30, 2014) (quoting Complaint Counsel's Appeal Brief at 11, *McWane, Inc.*, Docket No. 9351 (F.T.C. Aug. 22, 2013)).
20. Id. at 38, 39.
21. Initial Decision at 351 (quoting 6 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶1410c at 74 (3rd ed. 2010).
22. Complaint Counsel's Appeal Brief at 27-28, *McWane, Inc.*, Docket No. 9351 (F.T.C. Aug. 22, 2013) (plus factor seven).
23. Id. at 27.
24. Id.
25. William E. Kovacic et al., "Plus Factors and Agreement in Antitrust Law," 110 MICH. L. REV. 393, 393 (2011).
26. Id. at 422.
27. Transcript of Oral Argument at 9:19-10:7, *McWane, Inc.*, Docket No. 9351 (F.T.C. Aug. 22, 2013) ("[L]et's talk about one of the most significant plus factors…Former Chairman Bill Kovacic wrote a very interesting article called "Plus Factors and Agreements in Antitrust Law," which came out in 2011, and what he cited as a super plus factor was when firms, in an oligopoly situation, centralize pricing authority, take away authority from their field and bring it into a central location. And isn't that what happened here? And why shouldn't we consider that a super plus factor, which would lead to a strong inference, according to Kovacic, of explicit collusion.").
28. Id. at 10:23-25.
29. Id. at 10:25-11:12.