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USA: The role of economic analysis in the assessment of vertical restraints

ABSTRACT

Vertical restraints commonly serve as devices to establish property rights to customers generated by costly promotional efforts. In some cases, rights to customers brought to dealers by a supplier are protected by exclusive dealing. In others, dealer efforts generate the customers, and those customers are protected by customer restraints, territories, resale price maintenance, or other restraints to prevent free riding by rival dealers. The legal treatments of these vertical restraints have evolved from per se illegality to broad acceptance. Exceptions to that acceptance in two recent cases, Poolcorp and MM Steel, can occur when economic analysis is either attenuated or dispensed with. This paper suggests that failure to analysis the economics of such cases with care can lead to inefficient outcomes.

Les restrictions verticales servent habituellement à établir les droits des consommateurs générés par de coûteux efforts de promotions. Dans certains cas, les droits des consommateurs imposés aux revendeurs par un fournisseur sont protégés par une négociation exclusive. Dans d'autres cas, les efforts des revendeurs créent des clients et ceux-ci sont protégés par des restrictions de consommateurs, par des territoires, par l'entretien des prix de revente, ou, par d'autres restrictions qui empêchent un free riding par des revendeurs rivaux. Le traitement légal de ces restrictions verticales a évolué de par son illégalité et sa large acceptation. Des exceptions à cette acception dans deux cas récents, Poolcorp et MM Steel, peuvent se produire lorsque l'analyse économique est atténuée ou supprimée. Cet article suggère que l'échec de l'analyse économique dans de tels cas, peut conduire à des résultats inefficaces.

*The views expressed herein are solely those of the authors, who are responsible for the content, and do not necessarily represent the views of Cornerstone Research. Neither author has consulted with any of the parties in the cases discussed below.

*Les opinions exprimées ici sont uniquement celles des auteurs, qui sont responsables du contenu, et ne représentent pas nécessairement les opinions de Cornerstone Research. Aucun des auteurs n'a consulté les parties dans les cas décrits ci-dessous

I. Introduction

1. Suppliers of goods and services and their distributors and dealers collaborate to put products on the market. Their relationships often involve vertical restraints that impose contractual limitations on one or both parties. For example, a distributor may agree not to sell the products of other suppliers, or a supplier may commit to sell its products exclusively through one dealership in a geographic or customer territory. These restraints were long considered to be restrictions on competition that disrupted free access to consumers and were therefore treated as per se violations of U.S. antitrust laws. For economists, the key question was the motivation of companies to consent to such limitations. For example, why would a producer accept a limitation on competition that raised dealer margins and, all else equal, reduced its wholesale price? Economic analysis concluded that, if the suppliers were not coerced by powerful distributors to take actions contrary to their own interests, the restraints must have improved economic efficiency and allowed suppliers to compete more effectively.

2. The economic inquiry into the effects of vertical restraints thus focused on their potential to increase the demand for a producer's products. If the dealer brought a producer more customers, that producer would be willing to pay for those customers, and this compensation could be accomplished through vertical restraints. Over the years, economic analysis has identified an increasing variety of ways in which dealers and distributors affect demand. In response, the legal treatment of vertical restraints has moved away from per se illegality to a rule of reason approach that allows for the possibility of demand-increasing, and therefore procompetitive, effects of vertical restraints.

3. In Section II we briefly review the economics of how vertical restraints establish "property rights" to protect dealer access to customers that the efforts of a dealer generate. Similarly, vertical restraints can establish property rights for a supplier over the consumers that its promotional efforts drive to its dealers. We then consider in Section III two recent cases, where an inquiry into the economic justifications of vertical restraints in question was bypassed. In the case *In the Matter of Pool Corporation*, the Federal Trade Commission (FTC) took a "quick look" at the vertical issues between a large distributor and suppliers and effectively reverted to the previous view that a restraint of trade is obviously anticompetitive if demanded by a relatively large dealer or distributor. In *MM Steel L.P. v. JSW*

Steel (USA) Inc. et al., the court condemned a vertical restraint under a per se rule. The case involved allegations of two existing steel distributors pressuring certain steel producers not to deal with a new entrant distributor. We argue that in both cases an analysis of the economic justifications of the vertical restraints in question might well have led to a very different outcome. Section IV provides concluding remarks.

II. Property rights and vertical restraints

4. A supplier and its distributors collaborate not only to deliver a product to the market but also to attract customers to the product. Often, the parties' incentives in this relationship may not be aligned, causing inefficiencies in competing against other products. Vertical restraints can provide a solution to the misaligned incentives. The most common incentive problem is that an entity that attracts customers to a product finds those customers poached by a firm that has not incurred the costs necessary to attract the customers in the first place. This is the well-known free-rider problem. The solution to the free-rider problem is to provide to the firm that has incurred the cost of attracting customer a property right over them. Vertical restraints put the property rights in place.

5. Consider the case where a supplier wants distributors to take actions to increase the demand for its products, for example, by promoting products, offering presale services, carrying year-round inventory, or stocking a full line of products. The distributor needs assurance, however, that its costly efforts are rewarded and the customers attracted by its efforts are not poached by another distributor that has not undertaken similar efforts. It is difficult for a supplier to induce these efforts through upfront payments. A distributor that is paid up front may shirk and not provide the services. Similarly, if a distributor does not have to share the cost of keeping inventory, it may order indiscriminately and carry too much inventory. Exclusive distributorships and territories solve this problem by assigning property rights for customers that the distributors' efforts generate in these markets.[1] Note that the property right serves only to limit competition by other distributors offering the same brand (intra-brand competition). It has no effect on the distributors offering rival brands apart from stimulating the distributor that was granted the property right to compete vigorously to attract customers from those rival brands.

6. If the supplier has been responsible, at least in part, for bringing customers to its dealers, the supplier, too, will want to be compensated for its costly promotional activities. The supplier could, of course, charge dealers directly for customers, but doing so is risky—customers visiting a dealership might not generate increased sales, and, moreover, a supplier that charged up front for customers might not pick an effective method for delivering the customers. It is likely to be more efficient to charge the dealer only when a sale is made. This explains why franchisors recover their brand value from dealers in the form of royalties rather than franchise fees, and also explains why an effectively promoted product may carry a higher wholesale price than a rival product whose brand name is less familiar. But a dealer for the promoted brand can avoid the supplier's charge by offering a rival product at a lower price, relying on the promoted brand to attract the customers to its door and then switching the customer to a substitute. Exclusive dealing, where the dealer is prohibited from offering rival brands, prevents such bait-and-switch by establishing a property right to the customers attracted by the supplier.[2]

7. These property rights aspects of vertical restraints have been long recognized in the legal treatment of vertical restraints, starting with the *GTE Sylvania* decision[3] almost 40 years ago. The FTC's *Beltone Electronics* decision[4] adopted the free-rider argument for exclusive dealing, the *State Oil* decision[5] applied it to maximum resale price maintenance, and the *Leegin* decision completed the process for minimum resale price maintenance. Each of these decisions substituted a rule of reason evaluation for the vertical practice in question in place of the per se illegality that had been in force.[6]

8. As the law has evolved from per se illegality to rule of reason, the rule of reason has proven to be predisposed toward the procompetitive side of the balance. This has been especially true for vertical restraints where suppliers establish property rights for dealers to encourage demand-increasing efforts and strengthen inter-

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1 Resale price maintenance is another way to induce dealer efforts. When intra-brand customer poaching is done by a free-rider dealer offering the branded product at a discount, the supplier may wish to control discounting through resale price maintenance. This restraint permits dealers to compete with one another through non-price means, keeping the dealers on their toes but not posing an efficiency issue so long as the methods with which they compete are not subject to free riding.

2 Note that maximum resale price maintenance solves a similar problem. A dealer that obtains a customer from a supplier's promotion may not see that customer again. If the dealer takes advantage of its short-run monopoly position vis-à-vis its customer by charging a price above the supplier's preferred level, the dealer achieves a higher margin but the supplier's brand is damaged and the supplier may lose repeat business from the customer. *See*, e.g., , 522 U.S. 3 (1997), where a Union 76 gasoline dealer, Khan, advertised a low price for regular grade gasoline to attract customers but charged high prices for other non-advertised gasoline grades. Customers seeking non-regular grade gasoline attracted by Khan's low regular grade price might pay a high price for a single tank once rather than driving on, thereby benefitting Khan, but would be unlikely to fall for the same inducement again, and would be leery of buying at other Union 76 (State Oil's brand) stations in the future.

3 *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977). The economic analysis of vertical restraints goes back even further, to Lester Telser's famous article on resale price maintenance: L. G. Telser, Why Should Manufacturers Want Fair Trade? Journal of Law & Economics 3 (October 1960): 86–105.

4 *Beltone Elecs. Corp.*, 100 F.T.C. 68 (1982).

5 *State Oil Co. v. Khan*, 522 U.S. 3 (1997).

6 The exclusive dealing as in has not been considered per se illegal, but it has been and remains difficult to employ for any firm with a substantial market share.

brand competition. These practices, such as exclusive distributorships, are generally seen as self-limiting and therefore not a threat to competition.[7] Although these restraints are designed to exclude competing dealers from handling a supplier's products, they are agreed to by the suppliers. The suppliers have every incentive to keep the restrictions to the minimum level necessary to induce the customer generation efforts by dealers. The self-limiting nature of such vertical restraints was well described in the context of a price floor imposed by a producer of wood-burning stoves by Judge Posner in *Isaksen v. Vermont Castings, Inc.*, 825 F.2d 1158 (7th Cir. 1987, Posner, J.): "*If the floor were set higher than necessary to induce dealers to provide the point-of-sale services that would maximize the sales of [the manufacturer's] stoves, [the manufacturer] not only would be transferring wealth from itself to its dealers (and why would it want to do that?) but would be pricing its stoves out of the market; consumers would switch to competing products whose retail prices were not inflated by resale price maintenance. It is easy to see, however, why, whether or not it possessed any market power,* [the manufacturer] *might want to set the lowest floor under the retail prices of its stoves that would induce its dealers to provide the level of point-of-sale services that maximizes the welfare of consumers* [at 1161]."

9. Thus, the combination of a producer's desire to provide the least amount of dealer compensation possible together with the competitive pressure applied by the supplier's rivals is likely to ensure that the use of vertical restraints is efficiency enhancing.

10. However, vertical restraints are not always procompetitive. When a supplier and a dealer also interact with each other's rivals, vertical restraints may alter the supplier's and the dealer's relationships with each other's competitors and, under certain circumstances, may lead to anticompetitive effects.[8] Most economists now believe that although vertical restraints generally improve the efficiency of supplier-dealer relationships and are procompetitive, it is not possible to predict the competitive effects of vertical restraints without examining the circumstances in which they are imposed. In two recent cases, with allegations of dealers pressuring or coercing suppliers to stop doing business with rival dealers, liability decisions bypassed any economic analysis of justifications of vertical actions in question. In the *PoolCorp* matter, the FTC's decision did not indicate a detailed analysis of the procompetitive justifications of the alleged conduct.[9] In the *MM Steel* matter, the court found that a "*there was sufficient evidence for a reasonable juror to conclude*" that steel manufacturer (JSW) conspired with its distributors to exclude a rival distributor. The court applied a per se approach, which automatically presumed harm. Next, we review the publicly available facts of the cases and argue that a full rule-of-reason analysis could have uncovered procompetitive justifications of the alleged actions. These examples show that, when it comes to vertical restraints, abbreviated treatment avoiding the complexities of economic analysis can lead to antitrust results that are counter to the goal of obtaining competitive and efficient markets.

III. Two recent cases

1. *PoolCorp*

11. Pool Corporation ("PoolCorp") is the largest distributor of swimming pools products.[10] In its 2012 Complaint, the FTC alleged that "*PoolCorp has unlawfully maintained its monopoly power by threatening to refuse to deal with any manufacturer that sells its pool products to a new distributor entering the market, thereby foreclosing potential rivals from an input necessary to compete*."[11] The FTC's investigation resulted in a consent decree where PoolCorp basically agreed not to alter its relationship with manufacturers depending on manufacturers' dealings with other distributors. Civil class action cases by direct and indirect purchasers followed the FTC investigation. In the civil cases, the plaintiffs alleged that PoolCorp conspired with three pool products manufacturers to prevent manufacturers from selling to certain distributors and to adopt policies that disadvantaged dealers buying groups. U.S. District Judge Sarah S. Vance granted summary judgment to PoolCorp in a series of decisions in 2016.[12]

12. The FTC's decision was based on a finding of monopoly power in local markets and PoolCorp's ability to force manufacturers, against their independent interests, not to supply to new entrant distributors by threatening retribution.[13] The Commission's Analysis to Aid Public Comment stated that "[t]*here are no procompetitive efficiencies that justify PoolCorp's conduct*" but

7 In exclusive dealing, a supplier establishes property rights by excluding rival suppliers from its distribution channels over customers it generates and delivers to dealers. Because the supplier establishes property rights for itself, exclusive dealing does not have the self-limiting aspect. For this reason, exclusive dealing is generally considered more problematic.

8 The economic literature has not developed a unified theory of harm of vertical restraints. The literature focuses on "possibility results," showing examples of rare conditions under which vertical restraints may cause injury to customers. "[T] (…) (…)" M. D. Whinston, (The MIT Press, 2006), p. 178.

9 Commissioner Rosch's dissenting statement discusses the legitimate reasons for pool equipment manufacturers not to sell to some dealers. Dissenting Statement of J. Thomas Rosch , FTC File No. 101-0115, November 21, 2011.

10 PoolCorp refers to Pool Corporation together with its wholly owned distributors, SCP and Superior Pool Products. Pool products include, among others, pumps, filters, heaters, covers, cleaners, steps, rails, diving boards, pool liners, pool walls, and the parts necessary to maintain pool equipment. Federal Trade Commission Complaint, , FTC File No. 101-0115, January 2012. The FTC proceedings can be found at https://www.ftc.gov/enforcement/cases-proceedings/1010115/pool-corporation.

11 Federal Trade Commission Complaint, , FTC File No. 101-0115, January 2012.

12 Three manufacturers had settled with the direct and indirect purchasers.

13 Statement of Commissioners Julie Brill, Jon Leibowitz and Edith Ramirez Regarding the Complaint and Proposed Consent Order in , November 21, 2011. Commissioner Thomas Rosch dissented. Dissenting Statement of J. Thomas Rosch , FTC File No. 101-0115, November 21, 2011.

did not provide any details or indicate that a searching economic analysis was performed.[14] In fact, as we discuss below, there is ample evidence that points to economic justifications for PoolCorp's and manufacturers' vertical conduct. These economic justifications primarily stem from the services that PoolCorp provides to manufacturers and smaller entrants' ability to free ride on these services.

13. As described by the FTC, distributors purchase pool products from manufacturers, warehouse them, and then resell the products to dealers (e.g., pool retail stores, pool service companies, and pool builders). Dealers, in turn, sell the pool products to the ultimate consumer: owners of residential and commercial swimming pools.[15]

14. Distributors play a critical role in the distribution chain. Most importantly, they warehouse pool product inventory for manufacturers, allowing them to produce stable amounts of product year round. Further, manufacturers are better able to ensure supplies to dealers in a timely fashion because distributors hold inventories of their products. Distributors also display a full range of products and answer the dealer's product-related questions. Other services provided by distributors include extending credit to dealers and helping administer manufacturers' rebate and warranty programs.[16] These services allow manufacturers to effectively compete in the market place but impose costs on the distributors. Distributors recoup the costs of these services through the margins they earn on sales made to dealers.

15. Some national dealers and dealer buying groups, composed of large dealers, were able to purchase directly from manufacturers and receive the same wholesale prices as distributors.[17] However, these direct sales to large national retailers and dealer buying groups were a small percentage of manufacturers' sales, with one manufacturer calculating its direct sales to dealers as less than 8%.[18] If smaller dealers were allowed to receive wholesale prices from manufacturers and were allowed to resell to other dealers, they could undercut distributors' prices because they did not incur the costs associated with the presale services provided by distributors. This practice would make it unprofitable for distributors to offer the services that the manufacturers want distributors to provide.

16. PoolCorp had a legitimate concern to prevent dealers from free riding on the services it provided to manufacturers to attract customers to their products. PoolCorp's concern with free riding is consistent with its request that manufacturers stop dealing with "new entrants." The FTC admitted that PoolCorp sought to restrict supply to incumbent distributors or established distributors looking to expand into new markets.[19] Although the FTC claimed that PoolCorp targeted companies "*that were most likely to compete aggressively on price*," PoolCorp's requests seemed to be targeting smaller dealers that did not incur the costs of services that PoolCorp provided but stole its customers through lower prices.[20]

17. Documents produced in the civil litigation indicate that free riding by smaller dealers threatened the efficiency of the vertical relationship between manufacturers and distributors and restrictions on their access to manufacturer pricing was in the self-interest of manufacturers.[21] For example, a manufacturer document expressed concern about the increasing number of smaller dealers bypassing distributors and accessing wholesale pricing: "[T]*hese groups historically were small in membership, made up of higher end builders with protected exclusive territories. This all changed over the past 4–5 years* (…) *This was due to virtually allowing anyone at any time in any territory to join. The conflict created by them caused an unnecessary disruption to our distribution channel due to loss of business, lower distributor margins as dealers received our pricing and was a complete no win situation for Pentair. Distribution is 85% of our business and we must have distributors financially health*[y] *in order for Pentair to be successful*."[22] Judge Vance concluded that "*there is ample record evidence suggesting that the Manufacturer Defendants viewed direct sales to Dealers as less desirable than their sales through distribution*."[23]

18. The FTC's "quick look" at the vertical restraint in the *PoolCorp* matter, therefore, appears to have been far less searching than appropriate for a conventional vertical restraint investigation. More detailed economic analysis might have identified the reason why the restraint in question was requested by PoolCorp in the first place and concluded that it was unlikely to have an anticompetitive impact.

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14 Federal Trade Commission, Analysis to Aid Public Comment, , File No. 101-0115, November 28, 2011.

15 Federal Trade Commission, Analysis to Aid Public Comment, , File No. 101-0115, November 28, 2011, p. 2.

16 , Order and Reasons, January 27, 2016, p. 36. Note that not all distributor services are subject to free riding.

17 Manufacturer documents discuss four types of direct sale customers: distributors, dealer buying groups, large national retailers, and internet/catalog. , Order and Reasons, January 27, 2016, p. 30.

18 , Order and Reasons, January 27, 2016, p. 31.

19 Federal Trade Commission Complaint, , FTC File No. 101-0115, January 2012, p. 3.

20 The FTC's Complaint discusses only one instance of exclusion of a PoolCorp rival, which was in Baton Rouge. This firm was started by a former dealer. The firm (Hilton) was acquired by an established distributor and, after the acquisition, was able to expand to several other locations, where it competed with PoolCorp. , Order and Reasons, July 1, 2016, p. 7.

21 The civil litigation also made it clear that PoolCorp, large as it was compared to its many rivals, was in no position to extract monopoly profits. The company's national market share was stuck throughout the period when the restraint was in effect in the mid-30s. (, Order and Reasons, July 1, 2016, p. 30.) With a raft of competitors coupled with easy entry into local markets in which it had a large share, it would seem likely that PoolCorp's policy was motivated by a desire to protect its presale service provision from free riding. PoolCorp identified "." Order and Reasons, July 1, 2016, p. 36.

22 , Order and Reasons, January 27, 2016, p. 35.

23 , Order and Reasons, January 27, 2016, p. 36.

19. Even though the FTC's look at the vertical restraint in PoolCorp was quick, it was still more detailed than required under the per se treatment, which was adapted in *MM Steel*.

2. *MM Steel*

20. MM Steel was a Houston (Gulf Coast) distributor of steel plate products formed by two employees of another Gulf Coast steel plate distributor, Chapel Steel Corp. ("Chapel"). The two had previously been employed by yet a third distributor, American Alloy Steel, Inc. ("AmAlloy"), before decamping for Chapel. The new venture failed in mid-2013, leading MM Steel to file a complaint that Chapel and AmAlloy had conspired to pressure at least three steel plate manufacturers (Nucor, SSAB, JSW) not to supply it with steel. MM Steel argued that the conduct should be judged under the per se standard, and the district court agreed. A jury found the defendants liable and the district court trebled damages to $156 million. Defendant distributors and one of the defendant manufacturers (SSAB) settled. On appeal, the Fifth Circuit affirmed the judgment against JSW but reversed it as to Nucor. The Fifth Circuit's decision was not based on an analysis of the economics of the case; it also applied the per se approach. The appeals court found that there was enough evidence for a reasonable jury to conclude that JSW was aware of the horizontal conspiracy of dealers and it joined the conspiracy under pressure from the dealers.[24] With respect to Nucor, the court found that it had acted independently of any conspiracy between dealers. By applying the per se approach, the district court and the Fifth Circuit bypassed any inquiry into whether the alleged agreement actually harmed competition and ignored any possible efficiency justification of the vertical conduct.

21. Just as in *PoolCorp*, an economic analysis of the vertical restraint at issue in *MM Steel* is helpful to answer two questions: whether the defendants possessed market power necessary to present significant harm to competition and whether the alleged conduct's efficiency justifications outweigh the possible countervailing effect on rivals. Analysis of the underlying economics in the *MM Steel* matter would have shown that the vertical conduct in question is unlikely to harm the competition and that there were significant efficiency justifications for steel manufacturers not to deal with the plaintiff.

22. "Steel plate" is the general term for steel in the form of a plate typically used for structural or construction applications. Steel plates are manufactured in many different types, grades, and dimensions depending on their end use. Buyers of steel plates typically customize their purchases for their applications and require intermittent deliveries over long periods. Although steel manufacturers can sell directly to customers, distributors provide both presale and post-sale services and thereby play an important role in the steel plate market.

24 The court found that: "." , Case: 14-20267, November 25, 2015, p. 10.

23. The steel plate industry appears to be highly competitive both at the manufacturer and the distribution level. Several major U.S. producers of steel plate compete with each other and with significant volume of plate imports.[25] Domestic plants, scattered throughout the country, ship steel plates nationwide.[26] Further, there has been entry in the industry.[27]

24. According to an industry publication, the top four distributors of metal products account for less than 10% of industry revenue nationwide.[28] Steel distributors must compete not only with each other, but also with steel manufacturers who sell meaningful shares of their production directly to customers.[29] Publicly available documents in the docket indicate that other metal service centers have successfully entered the distribution market.[30] Without market power by distributor and manufacturer defendants, alleged vertical conduct and the exclusion of a new distributor are unlikely to present any significant harm to overall competition in the industry.

25. Economic analysis also indicates that, whether or not there were questions of market power, steel manufacturers had significant efficiency justifications for not dealing with MM Steel. As mentioned above, many end customers need to purchase steel plates customized for their uses. Full-service dealers (also called "service centers") work with these customers to understand their needs, provide technical assistance such as the type of steel to order, and work with producers to propose an efficient supply chain to customers. Through the provision of these presale services, dealers win the business of new customers and bring them to steel manufacturers, who have agreed to support their bids for the new business. These presale services are costly. The costs are reflected in the prices dealers charge the customers for the initial sale and repeat sales.[31] But once the business is won and the orders begin, the information developed by the original dealer can be used by another

25 In addition to the defendant manufacturers, ArcelorMittal and Evraz produce steel plate in the U.S. and many foreign mills export their products, primarily through the Gulf Coast region. There are also smaller mills, such as Joy Global. Importers shipped the majority of their products to distributors and service centers. International Trade Commission, Investigation Nos. 701-TA-388-391 and 731-TA-817-821, 2011, Cut-to-Length Carbon-Quality Steel Plate from India, Indonesia, Italy, Japan, and Korea.

26 International Trade Commission, Investigation Nos. 701-TA-388-391 and 731-TA-817-821, 2011, Cut-to-Length Carbon-Quality Steel Plate from India, Indonesia, Italy, Japan, and Korea.

27 Nucor entered the steel plate industry in 2000. JSW is a more recent entrant.

28 IBIS World, Metal Wholesale in the U.S. There are a large number of active distributors and service centers in the industry—30 distributors and service centers responded to International Trade Commission's questionnaire. International Trade Commission, Investigation Nos. 701-TA-388-391 and 731-TA-817-821, 2011, Cut-to-Length Carbon-Quality Steel Plate from India, Indonesia, Italy, Japan, and Korea.

29 In 2011 U.S. producers shipped almost 60% of their steel plate production to distributors and service centers and sold 40% directly to end users.

30 Docket entry 493, Exhibit A, p. 29.

31 Full-service dealers also provide various after-sale services such as processing steel. There is no problem of free riding on these services as dealers can charge for them as they deliver the services.

dealer or even the manufacturer to cut the original dealer out of the business. Therefore, the dealer pursuing the original business needs assurances that its presale efforts are rewarded. Manufacturers also want to assure dealers marketing their steel to customers that they will be able to recoup their investments. Manufacturers solve this problem by assigning property rights for customers that the distributors' efforts generate. In essence, once a dealer brings a customer's business to a steel manufacturer, the manufacturers refuse to shift that customer's business to another dealer or sell to that customer directly.

26. Nucor's practice in this respect is informative. According to case documents, Nucor supports distributors (sometimes multiple distributors pursuing the same customer) in their bids to win new business. If one of these distributors succeeds in obtaining the new business, Nucor recognizes the "incumbency" of the distributor and prefers to work with the original distributor for subsequent orders. The economic justification of Nucor's incumbency approach is to prevent free riding on distributor's presale efforts and induce the efficient provision of presale services for its own steel, which allow Nucor to compete with other manufacturers for new business.

27. It appears that MM Steel's entry strategy was not to bring in new customers to manufacturers but instead to sell to customers MM Steel's founders had serviced while they were sales people at Chapel and AmAlloy.[32] MM Steel's owners' previous experience at each of the defendant distributorships provided them familiarity with the steel needs of many customers. According to a Nucor employee, MM Steel did not present Nucor any new end-user customers that were not Nucor's existing customers.[33] Apparently, one of MM Steel's founders also admitted that MM Steel never had a conversation with Nucor about bringing new business.[34]

28. MM Steel's strategy presented a threat to the efficient vertical operation between manufacturers and full-service dealerships. Chapel and American Alloy faced the prospect of losing customers that they had won thanks to the provision of costly presale services. MM Steel did not incur these costs but yet was in a position to take advantage of the information developed by its rivals. Chapel and American Alloy had every incentive not to work with manufacturers that did not recognize their "property rights" over the customers they had developed and brought to the manufacturer. Similarly, steel manufacturers had independent efficiency justifications not to deal with MM Steel. Agreeing to sell to their existing customers through MM Steel, instead of their incumbent dealerships, would have harmed their competitiveness on the market. If steel manufacturers flipped existing businesses from incumbents to MM Steel, they would have discouraged other distributorships from providing the optimal level of presale services to new customers.

29. Nucor was particularly concerned about the need to protect the customers brought to it by distributors, given that its dependence of distributors for 70–90% of its sales exceeded the industry average of 50%of sales through distributors. It made economic sense for it to have a policy in place not to deal with a broker like MM Steel, a policy that was invoked to deny MM Steel requests for steel prior to receiving any complaints from Chapel or AmAlloy.[35] Specifically, Nucor had an incumbent preference practice once a distributor invests time and money into winning the end-user account. This practice essentially established property rights to distributors over the customers they brought to Nucor. Similarly, ArcelorMittal and Evraz refused, but did so without having received complaints from rival distributors.[36]

30. If Nucor was behaving in its own interest in respecting the rights of the Chapel and AmAlloy to sell to the customers brought to Nucor by those distributors, then it is not surprising that Chapel and AmAlloy would have complained about existing customers siphoned away by MM Steel to other rivals. Of course, had MM Steel offered Nucor business that the MM Steel principals had driven to a rival steel company while at Chapel or AmAlloy, Nucor's policy would not have applied and Nucor would presumably have been willing to sell steel to or through MM Steel to such customers. But the record seems not to contain examples of such business.[37]

31. If the business offered by MM Steel to the other steel companies, JSW and SSAB, was also business which the companies were already serving, the steel producers would have had strong incentives to behave similarly to Nucor. JSW's mistake was to not have in place a policy similar to that of Nucor, but instead to respond to complaints from Chapel and AmAlloy. Note, however, that its refusal placed it on the same footing as that of Vermont Castings in responding to the loud and similar complaints of its many dealers upset with Isaksen's discounting.

32 Docket entry 435, p. 1.

33 Docket entry 493, p. 17.

34 Docket entry 493, pp. 17–18. Evidence of MM Steel's strategy of pursuing its previous customers also comes from the lawsuit between Chapel and MM Steel. It appears that Chapel sued MM Steel and obtained an injunction preventing MM Steel from selling to some Chapel customers for a limited time. MM Steel admitted that not being able to pursue these customers slowed down its business. Docket entry 435, pp. 1–2.

35 Docket entry 493, Appendix A, p. 27. The document discusses a number of instances in which Nucor sold to new distributors who brought new business to Nucor but refused to sell to distributors offering to sell to existing Nucor customers of another distributor. pp. 21–22.

36 MM Steel did not charge either Evraz or ArcelorMittal with refusing to deal, but MM Steel's expert, Stephen P. Magee's expert report July 24, 2013, pp. 22–23, § 81, stated that "."

37 The jury awarded significant damages to MM Steel based upon the business it lost due to Nucor's refusal to supply it with steel. But given that Nucor's refusal was deemed legal, and given that the business was not readily transferrable to, for example, JSW Steel, it is difficult to see why such damages should have been assessed at all.

IV. Conclusion

32. This paper has described the increasing penetration of economics into the analysis of vertical restraints, showing that vertical restraints often serve to establish property rights to benefit from customers attracted by costly promotional efforts. But there remain cases in which the economic component of a vertical restraints analysis has been dispensed with. In both *PoolCorp* and *MM Steel*, it appears that doing so has led to questionable outcomes. At a minimum, consideration of economic factors in such matters seems appropriate. ■

Concurrences

Concurrences est une revue trimestrielle couvrant l'ensemble des questions de droits de l'Union européenne et interne de la concurrence. Les analyses de fond sont effectuées sous forme d'articles doctrinaux, de notes de synthèse ou de tableaux jurisprudentiels. L'actualité jurisprudentielle et législative est couverte par onze chroniques thématiques.

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