Published on *The National Law Review* https://natlawreview.com

Fourth Circuit Affirms Divestiture Remedy in Molded Door Market Merger Challenge

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Three competitors is better than two.

Calling the case a “poster child for divestiture,” the Fourth Circuit Court of Appeals affirmed the divestiture of a company in the door manufacturing industry in response to a private merger challenge. The plaintiffs claimed that the deal harmed and even eliminated suppliers and competitors and secured the defendant’s position in a resulting duopoly (*Steves and Sons, Inc. v. JELD-WEN, Inc.,* 4th Cir., No. 19-1397).

Steves and Sons, Inc. and JELD-WEN, Inc. (JW) sell molded doors. Made by fitting a composite skin over a wood frame, these doors can be found in most homes in the United States. JW also makes the doorskins for its products and sells them to independents, including Steves. There were only five independent doormakers in 2015. Prior to that, from 2001 to 2012, there were three vertically integrated doorskin makers. Masonite had 46% of the market, JW 38%, and CMI 16%.

Steves and JW had an agreement that covered 90% of Steves’ products. Steves ended the agreement in 2010 when JW raised prices. Steves turned to Masonite and CMI which offered lower prices. But in 2012 Steves contracted with JW to produce 80% of its doorskins, with provisions that allowed Steves to buy from Masonite or CMI should JW’s pricing and quality become an issue. Jilted by Steves, Masonite, which had offered low prices in hopes of getting Steves’ business, cancelled all orders with the door seller.

In 2012, JW acquired CMI which made doorskins and trim board in Towanda, Pa., reducing the number of doorskin makers to two and leaving Masonite as the only alternative source. JW didn’t notify DOJ until after it signed long-term contracts with Steves and two other independents. This, JW thought, would allay anticompetitive concerns the DOJ might have had, because it appeared to protect the independents from price increases or refusals to sell. DOJ opened an investigation into the JW/CMI Towanda deal. Steves didn’t oppose the merger.

Steves' arrangement with JW soured. JW's prices went up even though its costs went down. Product quality began to suffer. When it launched new products, JW charged Steves more than their agreement permitted. JW justified this, saying new products were not covered by the contract. The relationship worsened when a new JW CEO wanted a new, higher-priced agreement with Steves. To make matters worse, Masonite decided to stop selling doorskins to independents like Steves which, according to one Masonite executive, would protect the doorskin duopoly it shared with JW, and made survival of independents "less likely."

Mediation fails. Litigation begins.

The Steves / JW relationship grew more acrimonious, deteriorating into accusations, threats, and heated exchanges. JW threatened to terminate the agreement with Steves. Steves explored making its own doorskins. Mediation failed to repair the rift. Litigation ensued, as Steves sued JW for breach of contract and violation of Section 7 of the Clayton Act which bars mergers that may substantially lessen competition. The Clayton Act also provides for treble damages for private plaintiffs.

In March 2019, U.S. Senior Judge Robert E. Payne of the Eastern District of Virginia, after a jury trial and verdict in favor of the plaintiff, did the following:

- Awarded Steves $36.4 million a treble past antitrust damages in lieu of contact damages for the same injury.
- Ordered JW to divest the CMI Towanda business or, if the divestiture fails, to pay Steves $139.4 million in treble antitrust damages for future lost profits, or, if those damages are set aside on appeal, to pay Steves $9.9 million for breach of contract.
- Appointed a special master to oversee JW's operation of the Towanda plant pending appeal of the divestiture order and eventual divestiture.
- Awarded JW $1.2 million against Steves for misappropriation of JW's trade secrets.

Divestiture available to private plaintiffs.

JW appealed to the Fourth Circuit, claiming among other things that the divestiture order of an acquisition consummated long ago should not be available to plaintiffs in a private merger challenge. But the Department of Justice filed an amicus brief arguing that the passage of time (a defense known as "laches") doesn't categorically bar divestiture in a private suit, even after a merger is consummated. This is particularly so, the DOJ said, when the plaintiff cooperates with the government before bringing the action, which Steves did. The DOJ also argued that its own decision not to challenge the merger had no "evidentiary significance," because there could be many reasons the Antitrust Division might not sue to block a particular deal.

A panel of the Fourth Circuit rejected JW's argument that the divestiture order was improper under the doctrine of laches. For the defense to succeed, the court said, JW would have had to prove both that Steves unreasonably delayed bringing suit and that the delay unduly prejudiced JW. The court found that waiting to sue until it could know whether the merger would threaten its supply chain was reasonable and that Steves had exhausted alternative remedies before bringing suit.

Four equitable factors.

JW also argued that the District Court misapplied the four equitable factors that must be satisfied before equitable relief (such as divestiture) could be ordered. The factors require a threat of irreparable injury and that legal remedies (such as damages) are inadequate. The Fourth Circuit affirmed the District Court finding that Steves' was threatened with irreparable injury, writing that the right to continue operating a 150-year-old family business is "not measurable entirely in monetary terms."

JW also argued for a less drastic remedy than divestiture, which the court chose as a reasonable means of restoring competition. However, alternative relief, such as a behavioral remedy, the court said, would have been only temporary. Without the divestiture, the court wrote, the "threat to Steve's survival would persist, as there would be only two American doorskin manufacturers, each of whom would be vertically integrated."

Promoting and restoring competition is a guiding principle of the Clayton Act. "A remedy that helped only Steves wouldn't promote competition in the doorskin market, conflicting with the principle that antitrust law protects competition, not competitors," the court said. "[I]f courts were required to choose the remedy least burdensome to the defendant – rather than the one that best promotes competition – conduct remedies would be the norm because they generally burden defendants less."

As for the third equitable factor – that the benefits of the equitable remedy may not be outweighed by the harm to the defendant – the court noted that Steves would have faced collapse without recourse. The increased costs and reduced output that JW would suffer, on the other hand, were hardships it would weather.

Addressing the fourth factor, which prohibits equitable remedies that are not in the public interest, the court found that adding a third supplier to the market was in the public interest. JW argued that CMI Towanda won't be able to compete effectively on its own, that the identity of other buyers was unknown, and that it wouldn't help increase competition if Steves bought CMI Towanda.

Divested company can compete.

The District Court had rejected JW's arguments that the divested company could not be profitable without JW's support and would fail to attract a suitable buyer. The District Court found that a divested CMI Towanda would be able to compete. The Fourth Circuit found no abuse of discretion because "substantial evidence" supported the finding that the divested company could be competitive. The appellate court also saw no reason to disturb the trial court's finding that CMI Towanda would attract a competitive buyer. Steves could have been ordered by the District Court to submit more proof of potential buyers, the court said, but declining to do so was within the trial court's sound discretion.

As for JW's concern that Steves could purchase CMI Towanda, the panel noted that, even so, "three is better than two."

"[T]his case," the court wrote, "is a poster child for divestiture. A merger has resulted in a duopoly. Each doorskin supplier is vertically integrated. Evidence indicates that they've used their market power to threaten the Independents' survival. And it's reasonable to expect that a third supplier—even one that's vertically integrated—will promote competition, as CMI did before the 2012 merger. Thus, the district court acted within its discretion by ordering divestiture."

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National Law Review, Volume XI, Number 167

Source URL:https://natlawreview.com/article/fourth-circuit-affirms-divestiture-remedy-molded-door-market-merger-challenge