UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION

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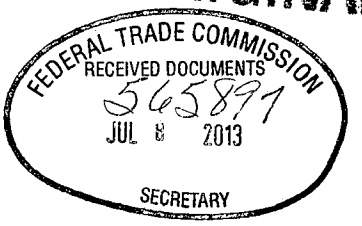

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In the Matter of	)	**PUBLIC**
McWANE, INC., **Respondent.**	)	DOCKET NO. 9351

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I. INTRODUCTION

In 2009, McWane was confronted with the threat of competition in the Domestic Fittings market from potential market entrants Star and Sigma. McWane responded with a two-pronged strategy to maintain its Domestic Fittings monopoly. First, McWane implemented an "all-or-nothing" Exclusive Dealing Policy; it threatened to terminate any Distributor that dared to purchase Domestic Fittings from Star. Second, McWane negotiated a "Master Distribution Agreement" or "MDA" with Sigma; McWane induced Sigma to abandon its independent entry plans and instead to distribute McWane's Domestic Fittings at non-competitive prices determined by McWane. McWane's strategy was successful. McWane maintained more than { } of the Domestic Fittings market, and continued to sell Domestic Fittings at supracompetitive prices.

Importantly, McWane adopted both strategies with the specific intent to monopolize the Domestic Fittings market. McWane adopted its Exclusive Dealing Policy in order to handicap Star and to prevent competition ("[a]voids the job by job auction scenario"); McWane feared that Domestic Fittings prices would "get[] creamed" if Star, a historically aggressive competitor, entered the market successfully. IDF1149, 1162. Likewise, McWane executed the MDA with Sigma because it determined that a loss of margin on sales to Sigma was better for McWane than competing with an independent Sigma. IDF1527 (describing "choice of evils"). There is no legitimate efficiency justification for this conduct.

Because McWane's Exclusive Dealing Policy and MDA with Sigma constitute unlawful monopolization, attempted monopolization, restraint of trade in, and conspiracy to monopolize the Domestic Fittings market, the Commission should adopt Judge Chappell's relevant liability findings and enter judgment against McWane on Counts IV-VII.

II. STATEMENT OF FACTS

A. Industry Background

Ductile iron pipe fittings (24" or less in diameter) manufactured in the United States ("Domestic Fittings") are functionally interchangeable with imported Fittings. IDF322-324, 517.[1] Like the imported Fittings market, the Domestic Fittings market has high barriers to entry. IDF1044-1050. Suppliers of imported and Domestic Fittings also use the same wholesale waterworks distributors ("Distributors") to sell their products to municipalities, regional water authorities, and the contractors they hire to construct waterworks projects ("End Users"). IDF10-11, 373-374, 381-382; CCPF475-479. Distributors are "critical" to the suppliers' success. IDF400-412. Two large, nationwide Distributors (HD Supply and Ferguson) account for more than 50% of Fittings sales in the United States; the remaining Distributors consist of hundreds of small, local companies and a few regional Distributors. IDF222-223, 227-228, 375-377.

There are three key distinctions between the Domestic Fittings market and the overall Fittings market. First, from 2006 through late 2009, McWane was the sole full-line supplier of Domestic Fittings. IDF1040. In late 2009, Star entered the Domestic Fittings market by contracting with independent, domestic foundries to produce castings for Domestic Fittings, with Star "finishing" them at its Houston plant. IDF1094-1144. Even after Star entered, McWane maintained a { } or higher market share, and had monopoly power in the Domestic Fittings market. IDF1042-1043, *in camera*.

[1] Unless otherwise noted, "Domestic Fittings" refers to domestically-manufactured Fittings sold into Domestic-only Specifications (as defined *infra*).

Second, due to legal requirements or political preference, some End Users explicitly specify that the Fittings used in their waterworks projects must be manufactured in the United States ("Domestic-only Specifications"). IDF346-347; 519-523. In contrast, "Open Specifications" allow Distributors to supply either imported or Domestic Fittings. IDF349-350.

In February 2009, the size of the Domestic Fittings market grew with the enactment of the American Recovery and Reinvestment Act of 2009 ("ARRA"). IDF1033-1034; CCPF1647-1654. ARRA allocated over $6 billion to water infrastructure projects built with domestically-produced materials, including Domestic Fittings (the "Buy American" requirement). IDF7, 524, 526-527. Although there were several waivers to the Buy American requirement, the application of those waivers to Fittings was commercially insignificant. IDF527, 531-533, 537; ID249.

Third, as compared to its imported Fittings transactions, McWane charges "substantially higher" prices, earns substantially higher gross profits, and offers far fewer special discounts off published prices (called "Project Pricing") on sales of Domestic Fittings – because it does not face competitive pressure. IDF547, 550, 1072-1076, 1091.

B. Challenged Conduct

The enactment of ARRA motivated Star and Sigma to enter the Domestic Fittings market. McWane responded to this competitive threat by developing and pursuing a two-pronged strategy to protect its Domestic Fittings monopoly. First, it "block[ed]" Star's entry by implementing an all-or-nothing exclusive dealing policy. Second, it co-opted Sigma's independent entry by entering into a Master Distribution Agreement ("MDA"). IDF1145-1597.

1. McWane Implemented an Exclusive Dealing Policy to "Block Star"

Star entered the Domestic Fittings market in 2009 with the ability to sell the most commonly used Domestic Fittings, and a plan to expand its offerings over time to include infrequently used, "oddball" Domestic Fittings. IDF1120, 1130-31. Presented with a new

entrant with an incomplete product line and an untested supply chain, many Distributors were willing to give Star some of their Domestic Fittings business, but few were willing to give Star all of that business. ID390-397; CCPF1894-1902. McWane forecast that Star's unimpeded entry, even with an incomplete product line, would substantially discipline McWane's pricing of Domestic Fittings. IDF1148-1154. McWane's "chief concern" was that Star, with its history of aggressive discounting, would cause "the domestic market [to] get[] creamed from a pricing standpoint just like the non-domestic market has been driven down in the past." IDF1149.

The head of McWane's Fittings business, Mr. Richard Tatman, therefore proposed that McWane implement a new exclusive dealing policy with Distributors that would "block Star" from the Domestic Fittings market and avoid competition ("[a]voids the job-by-job auction scenario"). IDF1148, 1155, 1162, 1519, 1580. McWane formally announced its new policy (the "Exclusive Dealing Policy" or "Policy") in a September 22, 2009, letter to Distributors, stating:

> [E]ffective October 1, 2009, McWane will adopt a program whereby our domestic fittings and accessories will be available to customers who elect to fully support McWane branded products for their domestic fitting and accessory requirements....
>
> ....
>
> Customers who elect not to support this program may forgo participation in any unpaid rebates for domestic fitting and accessories or shipment of their domestic fittings and accessory orders of Tyler Union or Clow Water products for up to 12 weeks.

IDF1173.

Despite the soft "may/or" language of the September 22, 2009 letter, McWane notified Distributors that "[o]nce they use Star, they can't EVER buy domestic from us." IDF1179, 1183-1185, 1187-1192. McWane's documents show that the market understood McWane's Policy to mean that McWane "will" – not "may" – cut off Distributors' access to McWane's Domestic Fittings if they buy any Domestic Fittings from Star, and that for Distributors with

multiple branches, "if one branch uses Star, every branch is cut off." IDF1179-1183. McWane's Exclusive Dealing Policy effectively deterred Distributors from dealing with Star. ID407; IDF1183-1185, 1187-1192. By impeding Star's Domestic Fittings sales, the Exclusive Dealing Policy prevented Star from gaining a sufficient scale to compete effectively and constrain McWane's monopoly prices. ID408; IDF1381-1401.

2. The MDA Co-opted Independent Entry by Sigma

Sigma also sought to enter the Domestic Fittings market, and considered sourcing Domestic Fittings to be its "#1a priority." CCPF2176. It pursued two potential avenues: (1) obtaining Domestic Fittings from McWane; and (2) entering domestic production independently using the same "virtual manufacturing" model that it used overseas. IDF1423-1424. By early June 2009, it was prepared to "{

}" IDF1455, *in camera*.

Sigma formed an "SDP" team to develop and carry out its independent domestic entry plan. The team visited foundries, secured offers to produce Domestic Fittings, and conducted a series of production trials. IDF1446-1447, 1449-1463; CCPF2211-2248. Sigma had the expertise and resources needed to develop and manufacture a competitive range of Domestic Fittings, and absent an agreement with McWane, Sigma likely would have entered the Domestic market. CCPF2266-2267.

McWane executives believed that Sigma had the capability and financing to enter the Domestic Fittings market, and that it was in McWane's best interest to share its monopoly margins with Sigma by selling its Domestic Fittings to Sigma for re-sale – as an "insurance policy" against independent competition from Sigma. IDF1441, 1518, 1530. In September 2009, McWane and Sigma signed the MDA, and agreed that:

McWane would sell Domestic Fittings to Sigma at a 20% discount from McWane's published prices, and Sigma would re-sell those Domestic Fittings at a weighted average of at least 98% of McWane's published prices (IDF1529, 1548-1557);

McWane would be "Sigma's sole and exclusive source for Domestic Fittings," thereby ending Sigma's independent entry efforts (IDF1540); and

Sigma would enforce McWane's Exclusive Dealing Policy by refusing to sell Domestic Fittings to any Distributor that purchased Domestic Fittings from Star (IDF1558-1570).

McWane and Sigma specifically intended that their agreement would make it even harder for Star to enter the market. IDF1575-1581.

III. LEGAL ANALYSIS

A. McWane Has Monopoly Power in the Domestic Fittings Market

Judge Chappell correctly found that McWane has monopoly power in the Domestic Fittings market. ID383.[2] As Complaint Counsel's economic expert explained, the hypothetical monopolist test demonstrates that Domestic Fittings is a relevant price discrimination market, and direct and indirect evidence prove McWane's monopoly power.

1. Domestic Fittings is a Relevant Price Discrimination Market

A relevant product market consists of all products that are reasonably interchangeable "for the purposes for which they are produced – price, use and qualities considered." *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 404 (1956). Thus, the two main factors for defining a relevant product market are (i) the similarity in character and use of the products from the buyer's perspective, and (ii) the cross-elasticity of demand between the product and potential substitutes. *FTC v. Arch Coal, Inc.*, 329 F. Supp. 2d 109, 119-20 (D.D.C. 2004); *FTC*

[2] McWane does not contest Judge Chappell's cluster market findings aggregating all fittings sized 24" and smaller, or that the relevant geographic market is the United States. IDF498-516, 554.

v. Swedish Match, 131 F. Supp. 2d 151, 157 (D.D.C. 2000); *E.I. du Pont*, 351 U.S. at 400 (demand cross-elasticity analysis considers "responsiveness of the sales of one product to price changes of the other"). The Horizontal Merger Guidelines analyze demand cross-elasticity by determining whether a hypothetical monopolist could profitably impose a small but significant and non-transitory price increase ("SSNIP"). U.S. Dep't of Justice & Fed. Trade Cmm'n, Horizontal Merger Guidelines, at §4.1.1 (2010). If a SSNIP of the hypothetically-monopolized products is profitable, then the market is properly defined to include only those products. *Id.; see also FTC v. Whole Foods Mkt., Inc.*, 548 F.3d 1028, 1038 (D.C. Cir. 2008) (describing SSNIP test as a way to define relevant product market).[3]

a) Imported and Domestic Fittings Are Not Substitutes

There are no reasonable substitutes for Domestic Fittings. ID248-251. Although Imported Fittings are functionally equivalent to Domestic Fittings (IDF517), they are not a substitute for, and do not constrain prices of, Domestic Fittings. IDF350, 537, 547-550; ID248-249. Distributors uniformly testified that imported Fittings are not interchangeable with or a reasonable substitute for Domestic Fittings when Domestic-only Fittings are specified by the End User. ID250; IDF549 ("Regardless of price, a Distributor will not purchase an imported Fitting if the End User's specification calls for a Domestic Fitting.").

When McWane sells Domestic Fittings into Domestic-only Specifications, it charges 25% more than its prices for the same Fittings (or imported Fittings) sold into an Open

[3] Because market definition standards are the same under the Sherman and Clayton Acts, *see, e.g., United States v. Grinnell Corp.*, 384 U.S. 563, 572-573 (1966), reliance upon the Horizontal Merger Guidelines and the hypothetical monopolist test to define a market in a non-merger case is not, as McWane contends, "controversial;" it is well-accepted practice. *See, e.g., Coastal Fuels, Inc. v. Caribbean Petroleum Corp.*, 79 F.3d 182, 197 (1st Cir. 1996); *Park W. Radiology v. CareCore Nat'l LLC*, 675 F. Supp. 2d 314, 327-28 (S.D.N.Y. 2009).

Specification job, reflecting the low cross-elasticity of demand between Domestic and imported Fittings. ID251-252; IDF1075-1077. Where, as here, suppliers can profitably charge different prices (net of costs) to different customers depending on known customer preferences, the relevant market is defined by the purchasing requirements of those customers vulnerable to the price increase. 2010 Horizontal Merger Guidelines §4.1.4 (price discrimination market appropriate when dominant supplier could "profitably target a subset of customers" even if supplier lacked power over other customers); *United States v. Archer-Daniels-Midland Co.*, 866 F.2d 242, 248 (8th Cir. 1988) (significant price differential between functionally interchangeable products evidenced low demand cross-elasticity and two different product markets); *Geneva Pharms. Tech. Corp. v. Barr Labs., Inc.* 386 F.3d 485, 496-97 (2d Cir. 2004) (same); Areeda & Hovenkamp, *Antitrust Law* ¶534d (same) (hereinafter "*Areeda*").[4]

McWane's complaint that Judge Chappell defined the relevant market without relying on a quantitative analysis (RAB6) is irrelevant; markets may be defined without algorithmic precision. *E.g.*, 2010 Horizontal Merger Guidelines §4.1.3 (market may be defined using "any reasonably available and reliable evidence," including information on how buyers would respond to price change, sellers' business documents, legal requirements, *etc.*). Because a hypothetical monopolist of Domestic Fittings can profitably raise prices above the competitive level – and because that monopolist has actually raised prices (IDF547-550, 1074-1077) – Judge Chappell's finding of a discrete Domestic Fittings market should be affirmed.

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[4] The finding of a distinct Domestic Fittings market is also supported by the following facts: Imported and Domestic Fittings prices do not move in parallel (indicating different demand curves) (IDF547-550; CCPF632-633), and McWane's internal documents recognize a separate Domestic Fittings market (IDF1148-1154). *See Areeda* ¶562a ("Without correlation in their price changes, two products are probably in separate markets."); *FTC v. CCC Holdings Inc.*, 605 F. Supp. 2d 26, 41-43 (D.D.C. 2009) (taking into account "industry recognition" of separate markets, including as reflected in internal business documents).

b) Distributors' Limited Opportunity to Flip Specifications Does Not Establish a Larger Market

McWane's primary argument against a Domestic Fittings market (RAB5) is the claim that customers can "flip" specifications from Domestic-only to Open (allowing imported Fittings to be used), and that such competition constrains the price of Domestic Fittings. This argument fails for two reasons.

First, as McWane's expert concedes, some Domestic-only Specifications are mandated by law, and cannot reasonably be "flipped." ID250 ("the evidence overwhelming[ly] showed these regulations did in fact limit substitution"); RX-712A (Normann Rep. at 28) ("It is unlikely that state laws could be easily changed based on short-term fluctuations in relative prices."); *United States v. Syufy Ents.*, 903 F.2d 659, 673 (9th Cir. 1990) (considering government regulations in defining relevant market).[5]

To overcome this defect, McWane wrongly asserts that ARRA Domestic-only Specifications were flipped "routinely" to permit imported Fittings, through waivers of the ARRA Buy American requirement. RAB4. McWane's argument does not address any of the Domestic-only Specifications required by laws other than ARRA. *See* IDF519-523. It also ignores the overwhelming evidence showing that the use of ARRA-related waivers was commercially insignificant. IDF530-546; ID249. In fact, McWane – which was well positioned to observe the use of any waivers – admitted that it could not identify a single instance where an

[5] McWane also seeks to minimize the number of legally-required Domestic-only Specifications. RAB3. This argument fails as a matter of law: legally-required Domestic-only Specifications are more than a *de minimis* market. *See* IDF519-529 (listing federal, state, and local laws requiring Domestic-only Specifications). And a relevant product market can be comprised of even a single customer. *FTC v. Alliant Techsystems Inc.*, 808 F. Supp. 9, 20 (D.D.C. 1992); 2010 Horizontal Merger Guidelines §4.1.4 ("[T]he hypothetical monopolist test may suggest relevant markets that are as narrow as individual customers.").

imported Fitting was used in an ARRA-funded project. IDF538. Other Fittings suppliers and Distributors confirmed that, as a practical matter, ARRA waivers were not used for Fittings. IDF537-546.

Second, contrary to McWane's assertion, the decline in Domestic Fittings sales over the last 15-20 years does not show competition between Open and Domestic-only Specifications. This assertion is factually incorrect.[6] It is also legally insufficient because the fact remains that domestic producers "compete for core consumers within a [Domestic Fittings] market, even if they also compete on individual products for marginal consumers in the broader [Fittings] market." *See Whole Foods*, 548 F.3d at 1037. In *Whole Foods*, the D.C. Circuit held that:

> a core group of particularly dedicated, "distinct customers," paying "distinct prices," may constitute a recognizable submarket, whether they are dedicated because they need a complete "cluster of products," because their particular circumstances dictate that a product "is the only realistic choice," or because they find a particular product "uniquely attractive"

Id. at 1039 (internal citations omitted). Likewise here, End Users of Domestic-only Specifications constitute a core group of "distinct customers" who pay "distinct [and significantly higher] prices" for Domestic Fittings. This is strong evidence that imported and Domestic Fittings are separate markets.

2. McWane Possesses Monopoly Power, or a Dangerous Probability of Achieving Monopoly Power, in the Domestic Fittings Market

As Judge Chappell correctly found, McWane's monopoly power (or dangerous probability of achieving monopoly power) in the Domestic Fittings market is established by

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[6] Whereas the number of Domestic Fittings sold may have declined, the share of *Domestic-only Specifications* has remained relatively constant. According to McWane witnesses before the ITC in 2003, Domestic-only Specifications constituted approximately 10%-20% of the overall Fittings market – similar to McWane's 20% estimate today. IDF1026, 1029-1031.

circumstantial evidence of McWane's high market shares and high entry barriers, and by direct evidence of McWane's ability to control prices and exclude competitors. ID371, 383; *United States v. Microsoft Corp.*, 253 F.3d 34, 51 (D.C. Cir. 2001).

The record evidence proves that: (i) McWane's share of the Domestic Fittings market was over { } percent (ID372-375; IDF1040-1144); (ii) barriers to entry were substantial (ID375-377; IDF1044-1071); (iii) McWane charged supra-competitive prices for Domestic Fittings (ID378-381; IDF1072-1093); and (iv) McWane effectively excluded Star from becoming an efficient rival (ID381-383; IDF1381-1420). This evidence is more than sufficient to establish that McWane possesses monopoly power, or a dangerous probability of achieving monopoly power, in the Domestic Fittings market. *See Microsoft*, 253 F.3d at 51; *see also Eastman Kodak Co. v. Image Tech. Servs.*, 504 U.S. 451, 481 (1992) (80% share sufficient to infer monopoly power); *Defiance Hosp., Inc. v. Fauster-Cameron, Inc.*, 344 F. Supp. 2d 1097, 1117 (N.D. Ohio 2004) (market shares sufficient to support a monopolization claim can also support attempted monopolization).; *Todd v. Exxon Corp.*, 275 F.3d 191, 206 (2d Cir. 2001) (exclusionary conduct "is a strong indicator of market power").

McWane concedes that its market share is at the monopoly level, and does not appeal Judge Chappell's findings that *de novo* entry is expensive, difficult, and time consuming, and thus prevents "new rivals from timely responding to an increase in price above the competitive level." *Microsoft*, 253 F.3d at 51; *see* IDF1044-1050; ID375-376. McWane contends, however, that Star's small-scale entry into Domestic Fittings precludes a finding of entry barriers and monopoly power. RAB25-27. This is incorrect. It is unquestionably easier for imported Fittings suppliers like Star (or Sigma) to enter the Domestic Fittings market than it is for *de novo* entrants. IDF1051-1055. However, Star's market entry in late 2009 would negate a finding of

monopoly power ***only if*** the "magnitude, character and scope" of Star's entry was sufficient to discipline McWane. *See* ID376-377; *contra* RAB20 (incorrectly suggesting that any new entry disproves market power); *see also* 2010 Horizontal Merger Guidelines §§9, 9.3; *In re Polypore Int'l, Inc.*, 2010 FTC LEXIS 97, at *87 (Dec. 13, 2010) (entry must be "large enough to constrain prices"); *Rebel Oil Co. v. Atlantic Richfield Co.*, 51 F.3d 1421, 1440-41 (9th Cir. 1995) ("The fact that entry has occurred does not necessarily preclude the existence of 'significant' entry barriers."); *Oahu Gas Service, Inc. v. Pacific Resources, Inc.*, 838 F.2d 360, 367 (9th Cir. 1988) (entry of two rivals did not preclude monopolization finding); *Reazin v. Blue Cross & Blue Shield of Kansas, Inc.*, 899 F.2d 951, 971-72 (10th Cir. 1990) (upholding monopoly power finding because "no other entrant remotely approached Blue Cross' domination of the market").

As discussed more fully at Part III.B.3, *infra*, Judge Chappell correctly found that McWane's Exclusive Dealing Policy impeded Star's Domestic Fittings sales and made it unprofitable for Star to purchase a domestic foundry, thereby increasing Star's production costs and, ultimately, its prices. ID398-411. Star's entry was insufficient to constrain McWane's monopoly prices, and it therefore does not defeat a finding of monopoly power. *See* ID383; *United States v. Dentsply Int'l, Inc.*, 399 F.3d 181, 189 (3d Cir. 2005) (recognizing exclusive dealing as entry barrier because it can prevent new entrant from being able to compete effectively against incumbent firm).

This conclusion is confirmed by Judge Chappell's finding that McWane controlled Domestic Fittings prices *after* Star's entry – McWane earned { } higher gross profits on Domestic Fittings sales than imported Fittings sales, did not need to lower prices in response to competition from Star, and imposed a price increase *after* Star's entry. IDF1083, 1090, 1091.

McWane does not contest these findings. Accordingly, McWane has monopoly power in the Domestic Fittings market. *See* ID381.

B. McWane Monopolized and/or Attempted to Monopolize the Market for Domestic Fittings (Counts Six and Seven)

After Star announced that it would begin selling Domestic Fittings in Fall 2009, McWane willfully and improperly maintained its monopoly power in the Domestic Fittings market by impeding Star's entry. ID407-411; IDF1145-1176. The centerpiece of McWane's strategy was its "all or nothing" Exclusive Dealing Policy: McWane threatened Distributors that they would lose access to McWane's Domestic Fittings and forfeit their accrued and future Domestic Fittings rebates if they purchased Domestic Fittings from Star. IDF1173, 1176, 1179-1192. Judge Chappell correctly found that McWane unlawfully monopolized or attempted to monopolize the Domestic Fittings market in violation of Section 2. ID419.

The offense of monopolization has two elements: "(1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen or historic accident." *United States v. Grinnell Corp.*, 384 U.S. 563, 570-571 (1966). Attempted monopolization requires proof "(1) that the defendant has engaged in predatory or anticompetitive conduct with (2) a specific intent to monopolize and (3) a dangerous probability of achieving monopoly power." *Spectrum Sports v. McQuillan*, 506 U.S. 447, 456 (1993). McWane's monopoly power, or dangerous probability of attaining monopoly power, is discussed at Part III.A, *supra*.

Conduct is exclusionary when it tends to exclude competitors "on some basis other than efficiency," *i.e.*, when it "tends to impair the opportunities of rivals" but "either does not further competition on the merits or does so in an unnecessarily restrictive way." *Aspen Skiing Co. v.*