PUBLIC

UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION

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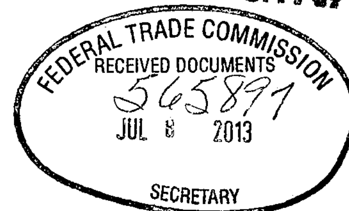

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In the Matter of

McWANE, INC.,
Respondent.

PUBLIC

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*.

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[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*

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[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

[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.*

Aspen Highlands Skiing Corp., 472 U.S. 585, 605 & n.32 (1985) (citations omitted). Here, McWane's Exclusive Dealing Policy harmed competition by foreclosing a substantial share of the "critical" distribution channel, thereby impeding entry. More specifically, McWane's Policy prevented rivals from gaining a sufficient scale to constrain McWane's exercise of monopoly power.

1. McWane Implemented an Exclusive Dealing Policy

McWane broadly denies that it launched and implemented an exclusive dealing policy. These arguments simply ignore Judge Chappell's amply-supported findings.

The Exclusive Dealing Policy was not, as McWane contends, a mere rebate program. RAB28-29 (repeating arguments that Judge Chappell found to "mischaracterize the nature and effects of the Full Support Program." ID402). "Extensive evidence" establishes that McWane's Policy was an "all-or-nothing" exclusive dealing program: Distributors were notified that they could not purchase Domestic Fittings from both McWane and a rival supplier. ID403.

McWane asserts that the company terminated its Exclusive Dealing Policy in early 2010, citing IDF1173. RAB38-39. Finding 1173 says no such thing. McWane's Exclusive Dealing Policy has never been withdrawn and, from the perspective of Distributors, it continues to prevent them from purchasing from Star today. McWane admits that it never publicly abandoned its Policy. CCPF2012-2014, 2064-2067.

This was also not a "short-term" restraint. Because only McWane offered a full line of Domestic Fittings, it was not economically practical for most Distributors to drop McWane and switch to Star. ID405-407. In this context, McWane's all-or-nothing Policy is effectively of indefinite duration. The Third Circuit endorsed this analysis in *Dentsply*, explaining that the coercive effect of a policy of terminating customers that deal with a rival can "realistically" make a nominally at-will arrangement "as effective" a mechanism of exclusion as a long-term

contract. 399 F.3d at 193; *see also Lorain Journal Co. v. United States*, 342 U.S. 143, 149-50 (1951) (unilateral conduct of indefinite duration by incumbent monopolist with a "practically indispensable" service "forced numerous [customers] to refrain from" dealing with its rival). In addition, McWane told Distributors that if they purchased Domestic Fittings from Star "they can't buy from us EVER again." IDF1179. This message reinforced the coercive effect.

Finally, McWane's claim that it did not meaningfully enforce its Exclusive Dealing Policy (RAB29 n.7) is belied by its termination of Hajoca for purchasing Domestic Fittings from Star. Hajoca was not reinstated as a Domestic Fittings Distributor until after McWane became aware of the Commission's investigation. IDF1193-1227; *see also Hosp. Corp. of Am. v. FTC*, 807 F.2d 1381, 1384 (7th Cir. 1986) (events after respondent becomes aware of investigation are "subject to manipulation ... [and] entitled to little or no weight").

2. McWane Acted with a Specific Intent to Monopolize

Whereas for monopolization "the mere intent to do the act" is sufficient, *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 431-32 (2d Cir. 1945), attempted monopolization requires proof that the defendant had a "specific intent to destroy competition or build monopoly." *Times-Picayune Publ'g Co. v. United States*, 345 U.S. 594, 626 (1953); *accord Spectrum Sports*, 506 U.S. at 456.

Here, McWane "implemented the Full Support Program with the specific intent of preventing Star from entering and lowering prices in the Domestic Fittings market." ID416-418; *see also* IDF1154 (McWane keeping Distributors from Star because "[t]hat's how the cancer starts"). For example, McWane's National Sales Manager wrote regarding the Policy: "We don't want the market [prices] tumbling and if we keep everyone on board [using the Policy] we shouldn't have to drop prices." IDF1153.

McWane's goal to maintain high prices by preventing Star from becoming a legitimate competitor does not – as McWane contends – merely reflect an "'intent' to beat a competitor." RAB33. McWane did not want to out-compete Star by providing better services, products or prices, but instead wanted to avoid having to compete with Star at all, by keeping it weak or out of the market. *E.g.* IDF1152. McWane's intent to ***avoid*** competition is distinct from the laudable intent to ***win*** competition. *See Aspen Skiing*, 472 U.S. at 609 n.39 (specific intent shown by documents and testimony that defendant intended to "drive others from the market by means other than superior efficiency").

3. McWane's Exclusive Dealing Policy Injured Competition

In exclusive dealing cases, a *prima facie* case of competitive harm is established by demonstrating: (1) a significant degree of market foreclosure; and (2) the impairment of one or more significant rivals' ability to compete. *ZF Meritor, LLC v. Eaton Corp.*, 696 F.3d 254, 271 (3d Cir. 2012); *Dentsply*, 399 F.3d at 188-190, 194-96 (considering foreclosure and impairment on rivals' ability to compete); *Microsoft*, 253 F.3d at 69 (same); *In re McWane, Inc.*, 2012 FTC LEXIS 155, at *63 (Sept. 14, 2012) ("[T]he question here is whether McWane's conduct foreclosed a substantial portion of the effective channels of distribution, and whether the conduct had a significant effect in preserving McWane's monopoly."). McWane's specific intent to harm competition is also useful in understanding the Policy's likely effects. *See Bd. of Trade of the City of Chicago v. United States*, 246 U.S. 231, 238 (1918) (intent helpful to "interpret facts and to predict consequences"); *Aspen Skiing*, 472 U.S. at 602-03 (same).

a) McWane's Exclusive Dealing Policy Foreclosed a Substantial Share of the Domestic Fittings Market

Foreclosure percentages are traditionally calculated by determining the percentage of the downstream market subject to the challenged policy. *Omega Envtl., Inc. v. Gilbarco Inc.*, 127

F.3d 1157, 1162 (9th Cir. 1997) (calculating market foreclosure percentage as the percentage of market sales made by the defendant subject to the exclusivity policy). Here, McWane sold { } of all Domestic Fittings in 2010, roughly 99% of those sales were through Distributors, and all Distributors were subject to McWane's Exclusive Dealing Policy, resulting in a foreclosure percentage of { }. *See* IDF357, *in camera*; CCPF475. This traditional foreclosure percentage is more than sufficient for a monopolization claim. *Microsoft*, 253 F. 3d at 70 (foreclosure of less than 50 percent may be sufficient); *Areeda* ¶1821 (foreclosure above 50 percent is "routinely condemned"). As Judge Chappell found, the unforeclosed distributors did not provide Star with sufficient sales opportunities to operate at an efficient scale. ID410-411.[7]

A more conservative approach measures foreclosure only among those customers that were ready, willing, and able to shift some sales to the rival but-for the policy at issue. Joshua D. Wright, *Moving Beyond Naïve Foreclosure*, 19 GEO. MASON L. REV. 1163, 1165 (2012). This methodology, although not required by existing case law, excludes from the foreclosure percentage those customers that were disinterested in doing business with the rival (at current prices) for reasons entirely unrelated to the challenged policy. Under this approach, when the foreclosed sales opportunities that would have been otherwise available to the rival are greater than the additional sales volume that the rival needs to become a more efficient competitor, foreclosure is substantial, a *prima facie* case of monopolization has been established (assuming power has been shown), and efficiencies should be examined.

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[7] The traditional approach is useful because it "is potentially an easily administrable, relatively low-cost filter for identifying exclusion claims unlikely to raise competitive concerns." Joshua D. Wright, *Moving Beyond Naïve Foreclosure Analysis*, 19 GEO. MASON L. REV. 1163, 1182 (2012); *see also Microsoft*, 253 F.3d at 69 ("[T]he requirement of a significant degree of foreclosure serves a useful screening function.").

Even under this conservative approach, McWane's Exclusive Dealing Policy caused substantial foreclosure. Under McWane's Policy, Distributors interested in giving some business to Star would be forced to rely entirely on Star (a company with an incomplete line) for all of their Domestic Fittings needs. This was a cost that Distributors could not accept. ID405-407; CCPF2091-2095. Specifically, Star was unable either to compensate Distributors for the commercial risk imposed by McWane's Policy (IDF1393), or to compete on the all-or-nothing terms imposed by McWane. ID407 (the Policy was "unilaterally imposed on Distributors; there was no competition to become the exclusive supplier" of Domestic Fittings). Important national, regional and local Distributors (and U.S. Pipe) did not deal with Star, specifically because of McWane's Policy. ID390-397, 407-409.[8] These are the deterred Distributors. For example, after McWane issued its Policy, HD Supply and Ferguson forbade their branches from purchasing Domestic Fittings from Star unless those purchases fell into one of the Policy's two exceptions. IDF1239-1251; 1261 1263; CCPF1938-1953; *see also* IDF1282-1312 (U.S. Pipe); IDF1331-1345 (WinWholesale); IDF1313-1330 (Groeniger); IDF1357-1364 (Illinois Meter); CCPF2018-2019 (C.I. Thornburg); CCPF1896 (E.J. Prescott). After McWane implemented the Exclusive Dealing Policy, Distributors withdrew from Star requests for bids valued at over $10 million. IDF1395.[9]

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[8] The fact that under cross-examination Complaint Counsel's economist could not remember the specific names of deterred Distributors identified in his report does not undermine Judge Chappell's extensive findings on point. *Contra* RAB10, 19.

[9] There is no requirement for Star to be a perfect competitor, or for the Exclusive Dealing Policy to be the only reason Distributors would not deal with Star (*contra* RAB11-12, 29-30); only, as Judge Chappell found, that McWane's Policy was a "material" cause of Star's foreclosure. *E.g.*, *Gulf States Reorganization Group, Inc. v. Nicor Corp.*, 466 F.3d 961, 965 (11th Cir. 2006); *Conwood Co. v. U.S. Tobacco Co.*, 290 F.3d 768, 791 (6th Cir. 2002). Accordingly, the contention that there was a significant volume of sales that Star failed to capture for reasons unrelated to exclusive dealing does not rebut the *prima facie* case.

But for the Policy, the deterred Distributors would have offered Star sufficient sales opportunities for it to achieve economies of scale and become a more effective constraint on McWane's monopoly power. Simple arithmetic confirms the anticompetitive exclusion. Star had { } million in Domestic Fittings sales in 2010 and again in 2011, and needed an additional { } million in annual sales to justify purchasing a domestic foundry. IDF1143, 1400. The deterred Distributors accounted for at least 53 percent, or { } million, of Domestic Fittings purchases in 2010, a volume more than sufficient to provide Star's needed economies of scale. IDF378-379 (collective share of HD and Ferguson in the Fittings market exceeds 53 percent); RX-632 at 27, *in camera* (2010 McWane Domestic Fittings sales were { } million).[10]

McWane's contention that Star sold at least one Domestic Fitting to { } customers is meaningless. RAB8, 28-29; IDF1142 (count included any Distributor that purchased Fittings, regardless of amount). The Distributors testified (without contradiction) that their small and sporadic purchases of Star's Domestic Fittings did not trigger the Exclusive Dealing Policy's penalties because they fell into two limited exceptions permitted by McWane's Policy (*i.e.*,

[10] While the deterred Distributors' market shares do not represent a precise percentage of the actual sales that would have shifted to Star absent the Policy, a Government plaintiff seeking an injunction need not "confidently reconstruct ... [the] world absent the defendant's exclusionary conduct." *Microsoft*, 253 F.3d at 79. Proof of the excluded rival's win rate in the but-for world would require speculative assumptions about the magnitude of brand loyalty, switching costs, and the willingness of customers to experiment with new suppliers. *See* Wright, *Naïve Foreclosure*, 19 GEO. MASON L. REV. at 1185-86 (expressing skepticism that such an approach could "accurately predict, with an acceptable margin of error, the probability a potential entrant will succeed in head-to-head competition[,]" and concluding that this "lack of administrability" is a significant weakness relative to the traditional approach to measuring foreclosure). It is sufficient that McWane's conduct "reasonably appear[s] capable of making a significant contribution to ... maintaining monopoly power." *Areeda* ¶651c; *Microsoft*, 253 F.3d at 79. Further, once exclusionary conduct has been shown, doubts about causation are resolved against the monopolist. *Microsoft*, 253 F.3d at 79.

bundled pipe-Fitting sales, or specific Domestic Fittings McWane could not timely deliver). ID402-404. Moreover, to establish a *prima facie* case of competitive harm, the relevant inquiry is not total foreclosure, but "whether the challenged practices bar a substantial number of rivals or severely restrict the market's ambit." *Dentsply* 399 F.3d at 191; *see also Microsoft*, 253 F.3d at 68-71; *ZF Meritor* 696 F.3d at 265, 283-84 (condemning exclusive dealing that allowed customers to purchase up to 20% of requirements from rival); *Insignia Sys., Inc. v. New Am. Mktg. In-Store, Inc.*, 661 F. Supp. 2d 1039, 1064-65 (D. Minn. 2009) (finding exclusive dealing claim viable despite plaintiff having sold services to over 60 customers). As discussed above, and as Judge Chappell correctly found, the volume of commerce foreclosed to Star by McWane's Exclusive Dealing Policy was substantial.[11]

b) McWane's Exclusive Dealing Policy Prevented Star from Competing Effectively and Injured Competition

Star had no viable alternatives to the foreclosed Distributors. Entry into waterworks distribution is difficult, and neither *de novo* entrants into waterworks distribution nor distributors in adjacent markets are well-positioned to serve as alternatives to the foreclosed waterworks Distributors for an excluded rival like Star. CCPF532-542. Vertical integration into waterworks distribution is not a cost-effective alternative to access to the foreclosed Distributors. CX2537 (McCutcheon, IHT (Vol. 1) at 41-46), *in camera* ({

}); *see also* IDF402. "For a Fittings supplier, Distributors are an important link in the supply chain and access to Distributors is essential for effectively

[11] Star had no exclusive agreements; the fact that { } Distributors never purchased Domestic Fittings from McWane simply means that they were not significant market participants. Moreover, McWane implemented its Policy before Star was a full-line supplier; it was therefore impossible for Star to compete for an exclusive because Distributors potentially needed to purchase at least some Domestic Fittings from McWane. ID407.

reaching the End User." ID408 (discussing the numerous advantages Distributors offer, which results in "[v]irtually all Fittings [being] sold through Distributors").

Where, as here, access to distribution is critical to effective competition, substantial foreclosure from such distribution predictably raises a rival's costs of servicing customers and likely makes the rival a less effective competitor. This establishes a *prima facie* case of competitive harm. *Dentsply*, 399 F.3d at 188-191, 193 (foreclosing rivals from consumers' "preferred distribution channels" is *prima facie* anticompetitive); *Microsoft*, 253 F.3d at 69-71 (foreclosing rivals from "most efficient" distribution channels is *prima facie* anticompetitive); Jonathan M. Jacobson, *Exclusive Dealing, "Foreclosure," and Consumer Harm*, 70 ANTITRUST L.J. 311, 313 (2002) (substantial foreclosure from distribution tends to prevent meaningful price competition and "gives the defendant the ability (or greater ability) to raise prices over the competitive level."); Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price*, 96 YALE L.J. 209, 224-239 (2006) (discussing cases recognizing harm from raising rivals' costs).

Separate from raising competitors' costs of distribution, exclusive dealing may impair rivals' ability to compete by depriving these firms of "a share of distribution sufficient to achieve minimum efficient scale." Wright, *Naïve Foreclosure*, 19 GEO. MASON L. REV. at 1166; *LePage's, Inc. v. 3M*, 324 F.3d 141, 161 (3d Cir. 2003) (foreclosing rival suppliers from "key large volume customers" that were "essential to achieving efficiencies of scale" anticompetitive); *Dentsply*, 399 F.3d at 188-191 (condemning exclusive dealing policy that blocked access to "key" distribution, which impeded rivals from expanding to where they could pose "real threat" to defendant's monopoly power); *Microsoft*, 253 F.3d at 69-71 (condemning exclusive dealing that kept rivals below "critical level" necessary to pose threat to defendant's monopoly). As

Judge Chappell correctly found, that is precisely what happened here. ID410-411 (by foreclosing Star's access to Distributors, McWane's Policy "hindered Star's ability to compete effectively").

Star's business plan was to grow its "virtual manufacturing" operation to the point where it could purchase and profitably operate its own domestic foundry. McWane's Policy prevented Star from reaching minimum efficient scale, purchasing its own domestic foundry, and constraining McWane's monopoly prices. ID411; IDF1097-1099; CCPF1722, 1729-1732.[12] When McWane implemented its Policy, { }. Star concluded that the Policy precluded its major customers from buying its Domestic Fittings and { } IDF1381-1392, 1408, *in camera*. McWane's Policy thus thwarted Star's plans to acquire a domestic foundry, and forced Star to continue working with independent foundries, which McWane admits is less efficient -- increasing Star's costs by { }. IDF1419, *in camera*; IDF1409; RAB11, 29. This prevented Star from lowering its Domestic Fittings prices by { }. ID411; IDF1420, *in camera*.

This evidence – McWane's monopoly power, substantial foreclosure, and a resulting diminution of a significant rival's ability to compete – establishes a *prima facie* case of monopolization (and attempted monopolization). And Star was not the only victim of McWane's Exclusive Dealing Policy. The Policy also harmed competition by deterring SIP, a

[12] Thus, contrary to McWane's assertion, Judge Chappell did not find that Star's entry was "significant" or "successful." RAB8.

small Fittings importer, from entering the Domestic Fittings market. ID411, n.40; IDF1365-1380.

c) **McWane's Efficiency Justification Fails**

Because the evidence establishes a *prima facie* case of competitive injury, the burden shifts to McWane to proffer a procompetitive justification for its Exclusive Dealing Policy. *Kodak*, 504 U.S. at 483. The analysis must focus upon the benefits, if any, that consumers receive from the exclusive dealing, and not on those advantages that inure to McWane alone. *Microsoft*, 253 F.3d at 71. McWane advances a purported "free-riding defense." However, McWane's argument evinces a fundamental misunderstanding of the concept.

In some industries, exclusive dealing can remedy a *bona fide* free-riding problem. *See Ryko Mfg. Co. v. Eden Servs.*, 823 F.2d 1215, 1234 n.17 (8th Cir. 1987); Richard M. Steuer, *Exclusive Dealing in Distribution*, 69 CORNELL L. REV. 101, 127 *et seq.* (1983). For example, when a supplier invests in improving its independent distributors, exclusive dealing may prevent that supplier's investment from being appropriated by a rival supplier. Steuer, *Exclusive Dealing*, 69 CORNELL L. REV. at 127-28.

Exclusive dealing is ***not***, however, the norm in the Fittings industry. Suppliers do not typically invest in Distributors, and Distributors typically purchase and re-sell imported Fittings from multiple suppliers. IDF391-393. The industry apparently finds this arrangement to be efficient. McWane's Exclusive Dealing Policy represents a marked departure from prevailing industry practice, one not observed outside the context of monopoly maintenance. McWane's efficiency arguments should be evaluated against this backdrop.

McWane does not claim that it makes any investment in its Distributors upon which Star could free-ride. Rather, according to McWane, its Exclusive Dealing Policy was necessary to prevent customers from "cherry pick[ing] the highest-selling, fastest-moving items ... from Star,

while purchasing from McWane only the slower-moving, infrequently-needed and higher-cost 'C' and 'D' items." RAB39-40. According to McWane: "This practice could lead to the collapse of the full-line seller." RX-712A (Normann Rep. at 54).

McWane's claim that, absent exclusive dealing, it would be forced to close its domestic foundry is speculation for which there is no supporting evidence. This alone mandates rejection of the defense. *See Dentsply*, 399 F.3d at 185, 197.

McWane's argument also fails because Star's effort to compete with McWane by selling a limited line of Domestic Fittings is not free-riding. Star does not benefit from McWane's investment in manufacturing oddball Domestic Fittings. Moreover, Star's strategy of initially selling the most-commonly used Domestic Fittings is a legitimate form of competition – a business strategy suitable for a new entrant. As Judge Posner explains, "[p]iecemeal entry is the norm in most industries" because entering with a full line of products is often riskier, more difficult, and more time-consuming. Richard A. Posner, ANTITRUST LAW 251-53 (2d ed. 2001) ("The point is not that the new entrant would have to invest more capital but that it would have to embark on a riskier enterprise, that of creating not a single successful product but a whole line of such products."). A similar "cherry-picking" argument was rejected by the Supreme Court in *Kodak*: "This understanding of free-riding has no support in our case law.... [O]ne of the evils proscribed by the antitrust laws is the creation of entry barriers to potential competitors by requiring them to enter two markets simultaneously." *Kodak*, 504 U.S. at 485.

As for McWane's asserted fear that it would be driven from the market, the antitrust laws do not afford McWane an inherent right to competitive success. If McWane is an inefficient, high-cost producer, then McWane's decline and even its exit may represent the competitive market outcome. *See Union Leader Corp. v. Newspapers of New England, Inc.*, 284 F.2d 582,

584 n.4 (1st Cir. 1960) (public benefits from free competition "even though that competition be an elimination bout"). Even the risk that Star's competition would end the domestic manufacture of rare or "oddball" Fittings does not justify McWane's anticompetitive efforts to exclude Star. The free market economy, not McWane, should dictate the product mix. *See generally Freeman v. San Diego Ass'n of Realtors*, 322 F.3d 1133, 1152 (9th Cir. 2003) ("Antitrust law presumes that competitive markets offer sufficient incentives and resources for innovation....").

For these reasons, McWane's contention that its full-line strategy should be insulated from competition is "nothing less than a frontal assault on the basic policy of the Sherman Act." *Nat'l Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679, 695 (1978)..

d) Exclusion of Less Efficient Competitors is Not a Defense

McWane also contends that the exclusion by a monopolist of a less efficient rival does not harm the competitive process, and is not actionable under the antitrust laws. RAB29-32. This argument rests upon invented evidence, a misreading of the case law, and poor competition policy – a perfect storm.

First, the evidence cited by McWane (ID411) indicates that Star was a less efficient supplier than Star would be but-for McWane's Exclusive Dealing Policy. RAB29. The evidence does not establish that Star was a less efficient supplier than McWane. In fact, McWane's free-riding justification relies on the opposite assumption – that McWane is an inefficient supplier that must frustrate consumer demand for Star's product in order to remain in business.

Second, exclusive dealing law is often invoked to protect from anticompetitive tactics firms that are initially small and inefficient, but have the potential over time to become more efficient and thus constrain the defendant's exercise of monopoly power. *E.g.*, *ZF Meritor*, 696 F.3d at 281 (exclusion of "potentially equally efficient rivals" is actionable); *Dentsply*, 399 F.3d

at 191 (monopolist's exclusive dealing kept rivals' sales "below the critical level necessary for any rival to pose a real threat" to defendant).

None of the cases cited by McWane holds that a monopolist is free to use anticompetitive tactics to exclude a less efficient rival. Instead, McWane's cases hold that the defeat of a less efficient rival due to the monopolist's greater efficiency (*e.g.*, lower costs, superior quality) is permissible under Section 2. *See Cascade Health Solutions v. Peacehealth*, 515 F.3d 883, 903 (9th Cir. 2008) (injury to rival caused by above-cost bundled discount not actionable); *Concord Boat Corp v. Brunswick Corp.*, 207 F.3d 1039, 1061 (8th Cir. 2000) ("above cost discounting is not anticompetitive"); *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 235-36 (1st Cir. 1983) (same). Complaint Counsel does not dispute the proposition that the antitrust laws permit a monopolist to engage in aggressive but efficient forms of competition. But McWane's conduct was not efficient.[13]

Finally, the policy advocated by McWane – permitting a monopolist to exclude less efficient rivals through anticompetitive tactics – is contrary to the antitrust laws' consumer welfare objectives. Market entry by a less efficient rival can stimulate competition, leading to lower prices if an incumbent dominant firm is charging monopoly prices:

> For example, assume that a dominant firm has costs of $1, but is currently charging $2. The entry of a rival pricing at $1.50 could prompt a decrease in prices, even if the new entrant has costs of $1.25. Hence a distribution strategy that drives this "less efficient rival" from the market certainly could harm consumer welfare.

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[13] McWane incorrectly cites (RAB30-31) language from *Allied Orthopedic Appliances Inc. v. Tyco Health Care Group LP*, 592 F.3d 991, 996-97 (9th Cir. 2010), which was a case addressing market-share discounts. There, the Court found no exclusion because the agreements were easily terminable if competitors offered a superior product. *Id.* Here, Distributors that wanted to purchase a portion of their requirements from McWane could not do so because of the threat of being "cut off" by McWane. ID410.

Andrew I. Gavil, *Exclusionary Distribution Strategies by Dominant Firms: Striking a Better Balance*, 72 ANTITRUST L.J. 3, 59 (2004); *accord* Steven C. Salop, *Exclusionary Conduct, Effect on Consumers, and the Flawed Profit-Sacrifice Standard*, 73 ANTITRUST L.J. 311, 328 (2006) ("The fundamental problem with applying the equally efficient entrant standard ... is that the unencumbered (potential) entry of less-efficient competitors often raises consumer welfare.").

The equally efficient rival requirement is especially inappropriate when applied to a market (like Domestic Fittings) where competition is just starting to emerge. "True, the exclusion of the less efficient firm might not have harmed competition at that precise moment because the rival had yet to reach its potential, but Section 2's horizon should not be so clipped if it is to function as an adequate deterrent to strategic behavior that impairs long-run competition." Gavil, *Exclusionary Distribution*, 72 ANTITRUST L.J. at 59-60; *see also Microsoft*, 253 F.3d at 79 (monopolization law proscribes improper exclusion of "nascent competitive technologies" as well as "producers of established substitutes").

In sum, the evidence does not show that Star was less efficient than McWane, and even if Star were less efficient, this would not be a valid Section 2 defense. Indeed, the source of competitive problem here is that McWane improperly impeded Star from becoming an efficient supplier.

C. The MDA Unreasonably Restrained Competition in the Domestic Fittings Market (Count Four)

Sigma anticipated that ARRA would lead to significant growth in the Domestic Fittings market, and resolved to enter in one of two ways: either Sigma would become a "virtual manufacturer" and produce Domestic Fittings through independent U.S. foundries; or Sigma would purchase Domestic Fittings from McWane. IDF1423. Sitting on the sidelines was unacceptable to Sigma's executives. IDF1424; CCPF1573, 1622-1624. Sigma pursued both

strategies simultaneously. Initially, McWane had little interest in selling Domestic Fittings to Sigma. IDF1425-1428. But as Sigma progressed toward independent entry, McWane improved the commercial terms it offered: from terms it knew were uneconomical for Sigma, to terms sufficient to convince Sigma to abandon independent entry. IDF1435-1445 (in June, McWane estimated Sigma needed 20% discount to be viable, but offered only 5% discount); IDF1509-1516 (McWane feared increasing likelihood of Sigma entry); IDF1529 (McWane in July offered 20% discount).

Through the MDA, McWane and Sigma agreed that Sigma would abandon its independent entry strategy, and instead supply McWane's Domestic Fittings under terms that assured that Sigma would not constrain McWane's exercise of monopoly power. Thus, using the MDA, McWane extinguished a significant competitive threat to its monopoly.

Contrary to McWane's claim, the MDA was not a simple buy/sell agreement that left Sigma free to compete with McWane. Sigma's agreement to abstain from its own domestic entry is memorialized in Section 1(b) of the MDA: "McWane shall be Sigma's sole and exclusive source for Domestic Fittings." IDF1540. The MDA also assured that there would be no meaningful downstream competition between McWane and Sigma. McWane determined Sigma's costs (*i.e.*, 20% discount from McWane's published prices), and controlled Sigma's prices (*i.e.*, weighted average of no less than 98% of McWane's published prices). IDF1548-1553. The parties also agreed that McWane would likewise sell Domestic Fittings at a weighted average price of no less than 98% of its published prices. CCPF2418-2434. When McWane raised prices, Sigma was obliged to follow. IDF1554-1557. Finally, through the MDA, McWane controlled Sigma's customer base. Under Section 1(c) of the MDA, Sigma agreed that

it would not sell Domestic Fittings to U.S. Pipe or to any Distributor that violated McWane's Exclusive Dealing Policy. IDF1558-1565; CCPF2441-2448.

Contrary to McWane's assertion (RAB36), there is no evidence that Sigma ever undercut McWane's prices by varying its rebates, cash discounts, or freight terms. The MDA negotiating history shows that the agreement was understood and intended by the parties to eliminate all price competition. Sigma's Mr. Pais admitted: "with the [MDA] pricing, we are obliged to be as close to the published multiplier as possible. Our hands are not tied – but we cannot sell below because it will undermine McWane's own sales." IDF1553; *see also* CX0248-002 (during MDA negotiations, McWane told Sigma that it wanted "a partner that will support the market price").

The elements of a Section 1 violation are (1) a contract, combination, or conspiracy between two or more separate entities, that (2) unreasonably restrains competition. *Realcomp II, Ltd. v. FTC*, 635 F.3d 815, 824 (6th Cir. 2011). McWane does not contest that the MDA satisfies the concerted action requirement. *See United States v. Delta Dental*, 943 F. Supp. 172, 175 (D.R.I. 1996) ("[C]oncerted action may be amply demonstrated by an express agreement.").

The mode of analysis of the MDA's competitive effects depends in part upon whether the Commission concludes that Sigma was a potential (reasonably likely) entrant, or instead a nascent entrant (a firm whose successful entry was less clear). If Sigma is judged to be a potential entrant, then the MDA should be condemned as a *per se* unlawful (or inherently suspect) market division agreement. Alternatively, the MDA should be judged unlawful under

the full rule of reason: by agreement, a monopolist eliminated future competition with either a potential or nascent rival.[14]

1. Sigma Was a Potential Competitor

For purposes of a Section 1 claim by a Government plaintiff seeking injunctive relief, a firm is considered a potential competitor if its entry is "reasonably probable" in the absence of the relevant agreement, as evidenced by the firm's intent and ability to enter the relevant market. *See, e.g., McWane*, 2012 FTC LEXIS 155, at *55 n.18; *Yamaha Motor Co. v. FTC*, 657 F.2d 971, 977-79 (8th Cir. 1981); *Engine Specialties, Inc. v. Bombardier, Ltd.*, 605 F.2d 1, 9 (1st Cir. 1979); Fed. Trade Cmm'n & U.S. Dep't of Justice, Antitrust Guidelines for Collaborations Among Competitors, at §1.1 n.6 (2000); *see also* CCPB182-83. It is not necessary that entry be easy, risk-free, or even more likely than not. The Commission's entry analysis should be pragmatic and not mathematical. Thus, when a firm invests significant time and resources toward market entry, then abandons those efforts because of an agreement with the incumbent firm, and the incumbent anticipated the would-be rival's entry, courts find that the potential competitor standard has been satisfied. *E.g., Bombardier*, 605 F.2d at 9; *Yamaha*, 657 F.2d at 977-979; *see also FTC v. Actavis, Inc.*, 570 U.S. __, slip op. at 19-20 (June 17, 2013).[15]

The Supreme Court's *Actavis* decision does not use the term "potential competitor," but illustrates the concept at issue here. According to the complaint in that case, generic rivals were attempting to enter the market in competition with defendant Solvay's brand name drug

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[14] Because the evidence shows that Sigma is a potential competitor and/or a nascent rival, McWane's contention that the MDA is a purely vertical restraint is incorrect. *See Areeda* ¶1901b.

[15] In analyzing potential competition, McWane and Judge Chappell incorrectly rely upon Section 2 cases brought by private plaintiffs who are required, under Section 4 of the Clayton Act, to establish injury to their business in order to establish antitrust standing. ID423-424; RAB33-34.

Androgel, and Solvay paid these generic rivals to stay out of the market in order "to prevent the risk of competition." *Actavis*, slip op. at 19. Eliminating the risk of increased competition constituted "the relevant anticompetitive harm." *Id*; *see also Areeda* ¶2030b ("The law does not condone the purchase of protection from uncertain competition any more than it condones the elimination of actual competition.").

The Commission has concluded that the antitrust objective of protecting prospective and uncertain competition is not limited to the patent context:

> The uncertainty posed by patent litigation is, of course, only one of many types of uncertainty that affect whether a new product can be successfully introduced into a market. But the existence of such uncertainties cannot justify an agreement whose very purpose is to ensure against an increase in competition, by guaranteeing that the new product will not be introduced. If, for example, an incumbent entered into an agreement with a would-be market entrant in which the latter agreed to delay or forgo introduction of a new product, it would be no defense to argue that the new product *might* not have succeeded in any event.

In re Schering-Plough Corp., 136 F.T.C. 956, 995 n.62 (2003), *rev'd*, *Schering-Plough Corp. v. FTC*, 402 F.3d 1056 (11th Cir. 2005), *later abrogated by Actavis*, 570 U.S. __ (2013). The category of potential competitors includes, then, firms that "*might* not have succeeded" even absent the challenged arrangement. *Id.*

Here, Judge Chappell found, and McWane does not contest, that "the evidence amply shows that Sigma had the desire and had expressed an intent to enter the Domestic Fittings market." ID422-423; *see also* CCPF2176 (entering the Domestic Fittings market was Sigma's "#1a priority"). Further, contemporaneous evidence establishes that Sigma "had 'available feasible means' for entering the relevant market." *Yamaha*, 657 F.2d at 977 (quoting *United States v. Marine Bancorporation*, 418 U.S. 602, 639 (1974)). Until the MDA, Sigma was in fact marching towards entry. The uncontested facts show:

- In early 2009, Sigma pursued the "virtual manufacturing" option for producing Domestic Fittings whereby domestic foundries would produce Fittings for Sigma with Sigma's engineering, design, quality control, and logistical support (IDF1446; CCPF60);
- Sigma executives had experience and expertise at "virtual manufacturing" from its imported Fittings business, and had extensive experience in United States foundry work and Fittings manufacturing (IDF1447, 1451);
- Sigma created a Sigma Domestic Production (SDP) plan and assembled high-level executives and engineers responsible for investigating all aspects of Domestic Fittings production from beginning to end (IDF1447, 1450);
- Sigma spent $50,000-75,000 investigating domestic production options (IDF1449);
- Sigma identified the "critical mass" of 730 configurations to produce a full-line of Domestic Fittings, and the 450 core patterns needed to produce them (IDF1468);
- By June 2009, Sigma had detailed action plans for identifying the top Fittings, foundries, molding machines, cost modeling, testing of lost foam production technology, and visits to potential foundry partners (IDF1454);
- By June 2009, Sigma had identified the top 50 foundries for producing Domestic Fittings, placed orders for foam patterns and other production equipment, arranged foundry visits, and produced two high-quality sample or prototype Domestic Fittings (IDF1456-1458, 1461);
- Sigma visited and received attractive price quotes from foundries capable of producing castings for Domestic Fittings (IDF1459; CCPF2239-2244);
- U.S. Pipe and ACIPCO, two important OEM customers that owned foundries and had expertise casting Domestic Fittings, worked cooperatively with Sigma to help Sigma set up domestic production (IDF1462); and
- Sigma sold three of its sample Domestic Fittings for use in waterworks projects. (CCPF2252).

At trial, Sigma sought to minimize its readiness to enter the Domestic Fittings market. Even so, Sigma executives admitted under oath that but for the MDA, Sigma would have entered the Domestic Fittings market, and that by the time Sigma signed the MDA, it was ready to enter domestic production "once the switch was flipped." CCPF2265-2266; *see also* IDF1543-1546

(Sigma abandoned entry because of the MDA).[16] Sigma used the threat of imminent entry to secure better MDA terms from McWane. IDF1439-1445, 1509-1516, 1529. This evidence establishes that Sigma was a potential competitor. For example, in *Bombardier*, the court determined that the potential competitor standard was satisfied based on evidence that (i) the would-be rival had intent to enter; (ii) the would-be rival had developed prototypes and the ability to produce parts; (iii) the agreement replaced the plans to enter; and (iv) the threat of entry improved agreement terms. 605 F.2d at 10.

McWane's belief that Sigma was prepared to enter the Domestic Fittings market reinforces this point. McWane entered into the MDA to avert the competitive threat of Sigma's independent entry. ID431. In a June 29, 2009, presentation, Mr. Tatman explained that McWane would benefit more from selling Domestic Fittings to Sigma (at a discount) than from competing with it:

> If [Sigma is] truly committed to make the investment level required to be a viable competitor regardless of our actions, then producing for [Sigma] is probably of greater financial benefit to our business than having them source elsewhere.

IDF1518. Mr. Tatman effectively admitted that Sigma was a potential entrant when he explained McWane's reason for entering into the MDA to his sales force:

> [T]he reality of the situation is that in the absence of the MDA with [McWane], Sigma was going to develop their own domestic sourcing options to the extent they could.

[16] Even the September 9, 2009 report to the Sigma Board of Directors (cited by Judge Chappell, ID428) acknowledges that the impetus for abandoning independent entry was that McWane had offered an MDA with "better terms." CCPF2356-2357 (report drafted after McWane and Sigma agreed on the material terms of the MDA, as embodied in their August 24, 2009 Letter of Intent). In his investigational hearing, Sigma's President Mr. Pais admitted that Sigma would have entered the Domestic Fittings but-for the MDA: "then we certainly would have gone another - to Plan B, which is our [domestic] production." CCPF2266.

CCPF2320, 2335. McWane executives repeatedly referred to the MDA an as "insurance policy" against Sigma's likely entry into the Domestic Fittings market. IDF1530, 1579. This evidence that McWane identified Sigma as likely to enter, and sought to prevent it from doing so through the MDA, is additional strong evidence that Sigma was a potential competitor.

McWane contends that Sigma was in a "precarious" financial position in 2009, and was therefore incapable of entering the Domestic Fittings market. RAB22, 34. This argument is factually incorrect. Sigma had the financial resources to enter the Domestic Fittings market. From the launch of the Sigma Domestic Production plan, Sigma was aware of its financial resources and the costs associated with domestic production. *E.g.*, IDF1488-1498; CCPF2287 (Sigma was aware of debt covenant issues in January 2009 when it began planning domestic production); CCPF2299 (Sigma knew of the challenges involved in domestic production as early as May 2009). If lack of money were an insurmountable problem, Sigma certainly would not have wasted the significant resources it expended marching toward entry.

At trial, Mr. Pais claimed that Sigma shareholders determined at a July Board meeting that they would not provide finances for entry. IDF1501. This story is disproven by Sigma's contemporaneous documents. Just two days before the July Board meeting, Mr. Pais wrote that Sigma was "intensely pursuing our SDP [Sigma Domestic Production] plans" and "plan[ned] to present a brief outline during our BOD meeting 7/15." CCPF2308. Representatives from Frontenac (Sigma's majority shareholder) and Ares Capital (Sigma's second lien holder) attended the meeting, and draft minutes confirm that the group was updated regarding Sigma's entry plans. CCPF2309. There is no mention in the contemporaneous documents of anyone suggesting that Sigma would be unable to finance its entry. To the contrary, immediately following the July Board meeting, Frontenac executives informed Sigma's management that

Sigma's investors were prepared to invest up to $7.5 million to fund domestic entry and other strategic initiatives:

> Investors and rollover shareholders are prepared to ***invest up to $7.5m*** in equity but not to pay down debt and add to liquidity but rather ***to fund domestic sourcing*** initiative and to fund the strategic Business additions which will enhance credit quality and help Sigma grow and build equity value.

CCPF2295 (emphasis added); *see also* CCPF2294 (prior to issuance of the Complaint, Mr. Pais testified: "I believe in Sigma so I would definitely invest"). The $7.5 million that Sigma's principal shareholder offered to invest exceeded Sigma's then anticipated total entry cost. This contemporaneous and pre-litigation evidence provides "[t]he best evidence that a firm is an actual potential entrant." *In re B.A.T. Indus.*, 1984 FTC LEXIS 4, at *153-54 n.14 (Dec. 17, 1984).

Sigma's financial activity during 2009 and early 2010 confirms that Sigma could have financed domestic entry. During this period, Sigma: { } (CCPF2285, 2288, *in camera*); considered acquiring a foundry (CCPF2289); acquired { } which was approximately the cost of domestic entry (CCPF2292, 2305, *in camera*); and elevated discussions about acquiring Star, which would have been significantly more expensive than domestic entry (CCPF2293).

Judge Chappell concluded that Sigma was not a potential competitor because Sigma purportedly could not compete successfully in the Domestic Fittings market within the ARRA time period. ID428-429. The evidence does not support this conclusion.[17]

[17] Judge Chappell also found relevant that Sigma did not have any contracts with domestic foundries to produce Domestic Fittings, a factor considered under the inapplicable Clayton Act "preparedness" standard. ID427. There is no evidence, however, that such contracts are

While ARRA was one part of Sigma's motivation to enter the domestic market, Sigma also wanted to enter the Domestic market because it believed that: (1) additional growth of the Domestic market would outlast ARRA (CCPF1629-1633, 1637); and (2) it could lose imported Fittings sales if McWane leveraged its monopoly in the Domestic market (CCPF1639-1644). Sigma viewed domestic entry as a strategic imperative, not merely a short-term option, and these considerations outlasted ARRA. CCPF1629-1633 (noting rise in "domestic requests and specifications that we expect will stay with our industry for several years if not for the next 3-5 years or even longer"). In addition, although ARRA projects needed to be planned by February 2010 (IDF1032), funds continued to be dispersed – and competition for Domestic Fittings continued – throughout 2011. CCPF1649-1651.

Judge Chappell (and McWane) also incorrectly focused on the time it would take Sigma to establish a full line of Domestic Fittings in inventory, rather than the time within which Sigma would have been a market participant. Sigma planned to enter the Domestic Fittings market incrementally (CCPF2222-2223), and to ship Domestic Fittings "as they came off the line" (CCPF2228). Sigma estimated that it could begin selling any particular Domestic Fitting within four to five months of first commissioning the tooling for that Fitting. CCPF2225. Thus, even if Sigma did not begin ordering patterns for any Domestic Fittings until September 2009 (when it instead signed the MDA), Sigma could have begun shipping completed Fittings by February 2010 – prior to the expiration of ARRA. CCPF2226. Even piecemeal entry can have a significant pro-competitive effect upon a monopolized market. *See* Posner, ANTITRUST LAW at 251-53.

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necessary for entering the Domestic Fittings market. Indeed, { }
CCPF2119-2120, *in camera*.

Finally, the contention that Sigma could not have entered the Domestic Fittings market during the ARRA period is unlikely in view of Star's actual entry during that same time. IDF1094-1144; CCPF1712-1781.

2. The MDA is *Per Se* Unlawful and/or Inherently Suspect

At its core, the MDA is a market allocation agreement: Sigma, a potential competitor, abandoned its entry efforts and ceded the Domestic Fittings market to McWane; McWane compensated Sigma by permitting Sigma to serve as its distributor. *See Areeda* ¶2134d (describing "unilateral" market allocation agreements). Market allocation agreements between actual or potential competitors are treated by courts as *per se* unlawful or inherently suspect. *E.g., Nynex Corp. v. Discon, Inc.*, 525 U.S. 128, 134 (1998) (horizontal market division is unlawful *per se*); *Palmer v. BRG of Georgia, Inc.*, 498 U.S. 46 (1990) (*per curiam*) (condemning market allocation agreement between potential competitors).[18]

That Sigma acted as a distributor of McWane's Domestic Fittings after abandoning the supplier market is not a defense. The anticompetitive effects of a market allocation are not lessened – and thus truncated analysis still governs – when the exiting competitor remains in the marketplace in another capacity, such as a distributor, licensee, or supplier to its co-conspirator. Courts understand that this ongoing relationship may simply cloak the payment to exit. For example, in *Palmer*, the Supreme Court condemned a *per se* unlawful market allocation scheme where the exiting competitor remained in the marketplace as a licensor to its co-conspirator. 498

[18] In order to judge whether a challenged restraint is inherently suspect, the Commission evaluates whether the conduct bears a "'close family resemblance' to conduct that courts have previously treated with acute suspicion," or have condemned as *per se* unlawful. *In re Realcomp II*, 2007 WL 6936319, at *25. If the MDA is judged to be inherently suspect, then McWane may rebut the presumption of competitive harm by advancing a legitimate efficiency rationale. *See id.* at *17.

U.S. at 49-50; *see also Eli Lilly & Co. v. Zenith Goldline Pharms., Inc.*, 172 F. Supp. 2d 1060, 1074-76 (S.D. Ind. 2001) (by agreement, potential competitor converted to supplier); *United States v. Gen. Elec. Co.*, 1997 WL 269491, at *2 (Mar. 18, 1997) (potential competitor converted to licensee); *In re SKF Indus.*, 94 F.T.C. 6, 99 (1979) (competitor converted to supplier).[19]

3. McWane Injured Competition by Eliminating a Nascent Entrant or Potential Competitor

Should the Commission determine that truncated analysis is inappropriate, then the MDA should still be judged *prima facie* anticompetitive when viewed in the context of McWane's power in the Domestic Fittings market. This is the "traditional" mode of rule of reason analysis. "Market power and the anticompetitive nature of the restraint are sufficient to show the potential for anticompetitive effects under a rule of reason analysis, and once this showing has been made, [the respondent] must offer procompetitive justifications." *Realcomp II*, 635 F.3d at 827.

The evidence discussed in Section III.A, *supra*, establishes that McWane had monopoly power in the Domestic Fittings market. The anticompetitive nature of the restraint is established in Section III.C.2, *supra*. The evidence shows that the MDA eliminated in full the potential competition between McWane and Sigma; case law and fundamental economics establish that the elimination of potential entrant has an obvious tendency to harm competition. An agreement by which a firm with market power (McWane) induces a potential entrant (Sigma) to abandon its entry plan is *prima facie* anticompetitive under the full rule of reason. *Schering-Plough,* 136

[19] This analysis is unchanged by the Supreme Court's recent decision in *Actavis*. There, the Supreme Court cited with approval *Palmer*, which ruled that agreements between potential competitors not to compete are *per se* unlawful. *Actavis*, slip op. at 7. The Court then ruled that the rule of reason applies to reverse payment settlements because the likelihood of harm "depends upon [the payment's] size, its scale in relation to the payor's anticipated future litigation costs, its independence from other services for which it might represent payment, and the lack of any other convincing justification." *Id* at 20.

F.T.C. 956 at 970-71 (payment to exit is *prima facie* anticompetitive); *see also Areeda* ¶701d (monopolist's "acquisition of any firm that has the economic capabilities for entry and is a more-than-fanciful possible entrant is presumptively anticompetitive…").

McWane denies that Sigma was a potential competitor (substantively, the contention is that Sigma's prospects of entry were less than "reasonably probable"). Even if correct, the MDA is *prima facie* anticompetitive. The activities of a monopolist such as McWane are "examined through a special lens," and subject to a "heightened scrutiny." *Kodak*, 504 U.S. at 488 (Scalia, J., Dissenting). In the context of a monopolized market, antitrust law empowers the Government to safeguard even nascent competition. This is the teaching of *Microsoft*.

In *Microsoft*, the D.C. Circuit condemned exclusive dealing by Microsoft (a monopolist) that foreclosed distribution of Navigator and Java. 253 F.3d at 79. There was significant uncertainty as to whether those products would have developed into viable substitutes for Microsoft's operating system. Applying the rule of reason under Section 2, the D.C. Circuit held that for a monopolist, impeding nascent competition yields a cognizable anticompetitive effect. The court reasoned that, "it would be inimical to the purpose of the Sherman Act to allow monopolists free reign to squash nascent, albeit unproven, competitors at-will…." *Id.* It was sufficient that Navigator and Java "showed potential" as competitive threats. *Id.* The leading antitrust treatise endorses this more exacting liability standard when dealing with monopolists. *Areeda* ¶¶912a, 2030b ("The acquisition by an already dominant firm of a new or nascent rival can be just as anticompetitive as a merger to monopoly.").

A rule treating an agreement not to compete with a monopolist as *per se* lawful whenever the would-be rival's entry falls short of "reasonably likely" would not adequately protect consumer welfare. Such a rule would give "potential antitrust violators []an incentive simply to

identify probable competitors earlier in the product development process." *Goldline*, 172 F. Supp. 2d at 1075; *see also* Microsoft, 253 F.3d at 79; *Sunbeam TV Corp. v. Nielsen Media Research, Inc.*, 763 F. Supp. 1341, 1356 (S.D. Fla. 2011) ("Obviously, a monopolist should not be rewarded for eliminating competition in its incipiency.").

In sum, McWane's monopoly power in combination with the anticompetitive nature of the MDA establishes a *prima facie* case of competitive injury when Sigma is judged to be a potential competitor and/or a nascent competitor.

4. There is no Legitimate Efficiency Justification for the MDA

Because the MDA is *prima facie* anticompetitive, rule of reason analysis requires McWane to demonstrate – plausibly and with supporting evidence – that there is a sufficient countervailing efficiency justification. *See generally In re Realcomp II*, 2007 WL 6936319, at *27-28 (Oct. 13, 2009). McWane must show that a market in which McWane and Sigma distribute the same Domestic Fittings at prices determined by McWane is somehow superior to a market in which Sigma distributes its own Domestic Fittings in competition with McWane at prices set by competitive forces. McWane advances two efficiency defenses: (1) that the MDA secured greater sales for McWane's foundry, which had excess capacity; and (2) that the MDA provided Distributors with a choice of suppliers for McWane-branded Domestic Fittings.

As a preliminary matter, both of McWane's proffered efficiency justifications are *post-hoc* justifications deserving no weight. *See North Carolina State Bd. of Dental Examiners v. FTC*, 2013 U.S. App. LEXIS 11006, at *35 n.12 (4th Cir. May 31, 2013) (rejecting purported efficiency claims where there is "lack of contemporaneous evidence" that the claimed efficiency "motivated" adoption of the challenged restraint); *Image Tech. Servs. v. Eastman Kodak Co.*, 125 F.3d 1195, 1219 (9th Cir. 1997) (court may disregard justification for challenged conduct when

"evidence suggests that the proffered business justification played no part in the decision to act"). As previously discussed, contemporaneous evidence demonstrates that McWane entered into the MDA only because it was more profitable than competing with an independent Sigma. ID431, 1527 (viewing MDA as a "choice of evils" between having Sigma enter independently versus sharing margin with Sigma on sales that McWane would have otherwise made). The proffered efficiencies are pretextual.

As Judge Chappell correctly found, and as discussed below, McWane's efficiency claims are also non-cognizable and contrary to the greater weight of evidence.

a) Diverting Sales to McWane's Foundry Is Not a Cognizable Efficiency

Shifting Fittings sales from a foundry retained by Sigma to a foundry owned by McWane may be profitable for McWane, but it is not a cognizable justification; it does not benefit consumers or competition by reducing costs, increasing market-wide output, or improving quality. *See In re Polygram Holding*, 136 F.T.C. 310, 345-346 (2003). As *Microsoft* explained, the desire for increased sales "is not an unlawful end, but neither is it a procompetitive justification." *Microsoft*, 253 F.2d. at 71-72 (characterizing objective as "a competitively neutral goal"). Stated simply, while a monopolist may seek additional sales, it may not use anticompetitive measures to do so. To rule otherwise would undermine antitrust policy, as nearly every instance of anticompetitive exclusion could be "justified" by a defendant's desire to capture additional sales at the expense of a supplier preferred by consumers absent the restraint. *See Polygram*, 136 F.T.C. at 347 ("[T]he Supreme Court has recognized that a defendant cannot justify curbing access to a more-desired product to induce consumers to purchase larger amounts of a less-desired product.").

b) Providing Distributors a Choice of Suppliers Is Not a Defense

McWane also avers that the MDA provided Distributors with a choice of suppliers, and that some Distributors prefer to deal with Sigma. This too is not a cognizable efficiency because it fails to show the procompetitive benefits from the challenged restraint ***relative to*** the marketplace that would exist but-for that restraint. *See Polygram*, 136 F.T.C. at 347 (defendant must articulate specific link between challenged restraint and benefit to consumers). Here, the but-for world is independent entry by Sigma, or alternatively, a simple buy/sell agreement (as Sigma initially proposed) that would allow Sigma to set its own prices and secure additional sources of supply as needed. In both scenarios, Distributors would have had the option of buying Domestic Fittings from either McWane or Sigma. The MDA offers no advantage that offsets the loss of competition.

Additionally, McWane's admission that having two McWane Fittings suppliers does not increase total output indicates that this claimed efficiency is trivial at best. IDF1527; CCPF2450-2452.

Because McWane has not advanced a legitimate efficiency justification, the Commission should condemn the MDA under a truncated or full rule or reason analysis.

5. Asserted Termination of the MDA Is Not a Defense

Finally, McWane asserts that it formally "terminated" the MDA in 2010 (after McWane received notice of the FTC investigation). RAB41. McWane continued, however, to supply Domestic Fittings to Sigma (CCPF2496), and the evidence does not show whether the succeeding arrangement was free of anticompetitive restraints. In any event, the contention that an anticompetitive agreement was short-lived is not a defense. *See PolyGram*, 136 F.T.C. at 354 (condemning price-fixing agreement in effect for ten weeks).

D. McWane Conspired with Sigma to Monopolize the Domestic Fittings Market (Count Five)

Section 1(c) of the MDA required Sigma to enforce McWane's Exclusive Dealing Policy. IDF1558-1565. Judge Chappell correctly found that this agreement was an unlawful conspiracy to monopolize the Domestic Fittings market. ID437-445; IDF1509-1597. For this claim, the Commission need not determine whether Sigma was a potential entrant into the Domestic Fittings market. *Perington Wholesale, Inc. v. Burger King Corp.*, 631 F.2d 1369, 1377 (10th Cir. 1979) ("traders oriented vertically to each other can be found in violation of Section 2 by conspiring to monopolize one horizontal market intersecting the vertical arrangement").

The "essence" of a conspiracy to monopolize is "an agreement entered into with the specific intent of achieving monopoly[.]" *Northeastern Tel. Co. v. AT&T Co.*, 651 F.2d 76, 85 (2d Cir. 1981); *Williams v. 5300 Columbia Pike Corp.*, 891 F. Supp. 1169, 1175 (E.D. Va. 1995). The standard elements of a conspiracy to monopolize claim are (1) concerted action, with (2) the specific intent to monopolize, and (3) an overt act in furtherance of the conspiracy. *See Levine v. Cent. Fla. Med. Affiliates*, 72 F.3d 1538, 1556 (11th Cir. 1996); *Thompson v. Metro. Multi-List, Inc.*, 934 F.2d 1566, 1582 (11th Cir. 1991). In addition, Complaint Counsel established that together, McWane and Sigma possessed monopoly power in the Domestic Fitting Market.[20] McWane appeals only Judge Chappell's finding that McWane had the specific intent to monopolize. RAB37-38.

[20] The Courts of Appeals are divided as to whether a plaintiff is required to prove market definition and market power. *Compare Fraser v. Major League Soccer, L.L.C.*, 284 F.3d 47, 68 (1st Cir. 2002) (market definition and market power required for conspiracy to monopolize claim) *with Levine*, 72 F.3d at 1156 ("A claim for conspiracy to monopolize . . . does not require a showing of monopoly power.").

The standard for proving specific intent under a conspiracy to monopolize claim is the same as it is for attempted monopolization: the intent to exclude competition or control prices. *Am. Tobacco Co. v. United States*, 328 U.S. 781, 788-789 (1946); *Robert's Waikiki U-Drive, Inc. v. Budget Rent-A-Car Systems*, 491 F. Supp. 1199, 1223 (D. Haw. 1980). As previously discussed, McWane implemented its Exclusive Dealing Policy with the specific intent to exclude Star and to prevent Domestic Fittings prices from getting "creamed" by competition with Star. *See, supra*, Part III.B.

There is also direct evidence that McWane entered into the MDA with the intent to exclude competition and to control Domestic Fittings prices. *See Int'l Distrib. Ctrs., Inc. v. Walsh Trucking Co.*, 812 F.2d 786, 794 (2d Cir. 1986). For example, in an internal McWane business document, Mr. Tatman explained to his superiors that the MDA would benefit McWane by reducing Star's ability to grow and by further stabilizing prices:

> Although not accurately quantifiable, having Sigma sell McWane branded product
>
> - Should ***reduce Star's ability to grow share***
> - Keeps additional overcapacity from being added to the industry
> - .... [and]
> - Should ***help drive some additional level of price stability***.

IDF1581 (emphasis added); *see also* IDF1580 (McWane noting that company's MDA negotiations with Sigma should take into account that Sigma would not be "willing to generate little to no incremental margin $ just to help us ***block Star***") (emphasis added). Likewise, contemporaneous notes from the meeting where McWane made the final decision to enter into the MDA reveal that McWane's objective in entering the MDA was to "drive Star out of business":

> ***LM [Mr. McCullough] want[s] to sell SIGMA to put pressure on Star. LM hopefully to drive Star out of business. Would rather have competition other than Star.***
>
> LM thinks that we should sell SIGMA as an insurance policy and to continue to put pressure on Star... LM approved Rick's recommendation page of his PowerPoint presentation on selling SIGMA.

IDF1579 (emphasis added).[21]

McWane incorrectly describes this evidence (and the related findings) as showing McWane's motivation to "beat competition." RAB37. As previously discussed at Part III.B.2, *supra*, a desire to "block[]" and to "marginalize" Star from competing in the Domestic Fittings market in the hope that it would bring stability in prices does not evince the laudable motive of wanting to out-compete one's rivals. IDF1578-1581; ID440-443; *Aspen Skiing*, 472 U.S. at 609 n.39. Accordingly, the Commission should enter judgment against McWane.

E. The Proposed Injunctive Remedy is Not Moot

McWane has failed to meet its burden of showing that injunctive relief is moot. RAB41. Even assuming, *arguendo,* that McWane ceased the challenged conduct "years ago," the "voluntary cessation of unlawful activity is not a basis for halting a law enforcement action." *In re The Coca-Cola Co.*, 117 F.T.C. 795, 909 (1994); *see also* 15 U.S.C. §45(b) (Commission can issue complaint when it has reason to believe that a firm "***has been or is*** using any unfair method of competition") (emphasis added). In addition to the possibility of a respondent resuming the illegal practices absent an order, courts recognize that the illegal conduct's effects "may tend to be perpetuated in practice unless affirmative measures are taken to eradicate them."

[21] McWane's specific intent can also be inferred from the anticompetitive effects of the Exclusive Dealing Policy, which was implemented through the MDA. *Howard Hess Dental Labs., Inc. v. Dentsply Int'l, Inc.*, 602 F.3d 237, 257 (3d Cir. 2010) ("Specific intent in the antitrust context may be inferred from a defendant's unlawful conduct.").

Rubbermaid, Inc. v. FTC, 575 F.2d 1169, 1175 (6th Cir. 1978) (affirming cease and desist order even though respondent abandoned challenged practices and did not intend to resume them).

McWane, therefore, has a "formidable burden of showing that it is absolutely clear the allegedly wrongful behavior could not reasonably be expected to recur." *Friends of the Earth, Inc. v. Laidlaw Envtl. Servs. (TOC), Inc.*, 528 U. S. 167, 190 (2000). McWane has not met that burden. McWane has never publicly withdrawn its Exclusive Dealing Policy, which still today deters Distributors from purchasing Domestic Fittings from Star. CCPF2064-2067. Although McWane terminated the MDA after it learned of the Commission's investigation, it continues to sell Domestic Fittings to Sigma. CCPF2492-2496. Thus, to the extent McWane "voluntarily" ceased its illegal conduct, such cessation is not a basis for declining to issue a cease and desist order. *See W.M.R. Watch Case Corp. v. FTC*, 343 F.2d 302, 304 (D.C. Cir. 1965) ("[T]here is no bar to enforcement merely because the conduct has ceased at least temporarily under the weight of the Commission's hand.").

McWane's reliance on *United States v. Uniroyal, Inc.*, 300 F. Supp. 84 (S.D.N.Y. 1969), is misplaced. RAB42. Here, unlike in *Uniroyal*, executives at the highest level of McWane's organization (Messrs. Page, McCullough, Walton, Tatman, and Jansen) conceived of, developed, and implemented McWane's illegal activities. IDF617-644, 1145-1192; CCPF907-929, 1823-1849. All but Mr. Walton continue to run McWane today. IDF20-41, 44-45. There is scant evidence that McWane has even *stopped* most of the challenged conduct, and McWane has not presented any evidence showing that market conditions now prevent it from resuming its illicit activities.[22]

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[22] The other cases cited by McWane are inapposite. None addresses the circumstances under which the Commission may obtain an injunction, nor suggests that there should be no relief if a

Because McWane has failed to show that it has affirmatively disavowed the challenged conduct and that such conduct could not reasonably be expected to recur, a cease and desist order is appropriate.

IV. CONCLUSION

For the reasons set forth above, the Commission should adopt Judge Chappell's relevant liability findings and enter judgment against McWane on Counts IV-VII.

Dated: July 8, 2013

Respectfully submitted,

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respondent strategically decides to stop violating the law while under investigation. *E.g.*, *Winter v. NRDC*, 555 U.S. 7, 22 (2008) (applying standard for proving irreparable injury when seeking a preliminary injunction); *Summers v. Earth Island Inst.*, 555 U.S. 488, 493 (2009) (addressing Article III standing); *Los Angeles v. Lyons*, 461 U.S. 95, 101-10 (1983) (same); *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541, 2559-60 (2011) (discussing certification of injunctive relief class); *eBay Inc. v. MercExchange, LLC*, 547 U.S. 388, 391 (2006) (holding private plaintiff seeking a permanent injunction must satisfy traditional equitable standards).

CERTIFICATE OF SERVICE

I hereby certify that on July 8, 2013, I filed the foregoing document electronically using the FTC's E-Filing System, which will send notification of such filing to:

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I also certify that I delivered via electronic mail and hand delivery a copy of the foregoing document to:

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July 8, 2013

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