UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION

COMMISSIONERS: **Edith Ramirez, Chairwoman**
Julie Brill
Maureen K. Ohlhausen
Joshua D. Wright

In the Matter of **MCWANE, INC.,** **a corporation, and** **STAR PIPE PRODUCTS, LTD.** **a limited partnership.**	**Docket No. 9351**

OPINION OF THE COMMISSION

By Chairwoman Edith Ramirez,

I. INTRODUCTION

In this decision we address alleged anticompetitive conduct by respondent McWane, Inc. in the ductile iron pipe fittings industry. Pipe fittings join together pipes and help direct the flow of pressurized water in pipeline systems. They are sold to municipal and regional water authorities and their contractors for waterworks projects, and are distributed mainly through independent wholesalers.

The U.S. market for the sale of small and medium diameter ductile iron pipe fittings (hereafter "fittings") is an oligopoly. Three firms—McWane, Star Pipe Products, Ltd., and Sigma Corporation—account for over 90% of fittings sales in the United States. McWane is the industry leader with a market share of about 45-50%; Sigma and Star are second and third, respectively, with shares of roughly 30% and 20%. IDF 355-56.

Complaint Counsel alleges that McWane engaged in unlawful collusion, information exchange, and exclusionary conduct. The first three counts of the Complaint relate to an alleged McWane-led conspiracy to raise and stabilize fittings prices in 2008. According to Complaint Counsel, McWane, Sigma, and Star conspired to curtail "project pricing," a form of discounting that is the main form of price competition in the industry. Counts 4 through 7 focus on alleged efforts by McWane in 2009 to maintain its monopoly in the market for domestically-manufactured fittings. In particular, Complaint Counsel charges that McWane entered into a Master Distribution Agreement (the "MDA") with Sigma to prevent Sigma from becoming an independent competitor in domestic fittings and imposed an exclusive dealing policy on its distributors to stop Star from becoming a viable rival. The Administrative Law Judge ("ALJ") found that Complaint Counsel failed to establish liability on Counts 1 through 3 but held McWane liable on Counts 4 through 7. Both McWane and Complaint Counsel have appealed.[1]

On *de novo* review, we affirm the ALJ and find McWane liable on Count 6 for unlawfully maintaining its monopoly in the domestic fittings market. We dismiss all of the remaining counts. Specifically, two Commissioners find that Counts 1 and 2 alleging an unlawful conspiracy and information exchange have been proven and two Commissioners do not. In the absence of a majority decision, we dismiss these counts in the public interest. We reverse the ALJ on Count 4 and conclude that Complaint Counsel failed to establish that the distribution relationship under the MDA between Sigma and McWane was unlawful. In light of our conclusions on Counts 4 and 6, we find it unnecessary to reach Count 5, alleging that McWane and Sigma conspired to monopolize the domestic fittings market through their distribution agreement, and Count 7, alleging that McWane's exclusive dealing policy constituted attempted monopolization of the domestic fittings market.

Having found liability on Count 6, we enter an order remedying McWane's exclusionary conduct and imposing certain fencing-in requirements designed to prevent the unlawful conduct from recurring.[2]

II. PROCEDURAL HISTORY

A. THE ALLEGATIONS

On January 4, 2012, the Commission issued a seven-count administrative complaint against McWane and Star after Sigma had separately entered into a consent agreement with the Commission. Later, on May 12, 2012, Star also entered into a consent agreement, and McWane remained the only respondent in the case.

[1] Of the counts dismissed by the ALJ, Complaint Counsel appealed Counts 1 and 2, but not Count 3, which alleged that McWane invited Sigma and Star to collude to fix prices. McWane appealed all four counts on which the ALJ found liability.

[2] This opinion uses the following abbreviations for citations to the record:

ID:	Initial Decision of the Administrative Law Judge
IDF:	Numbered Findings of Fact in the ALJ's Initial Decision
CX:	Complaint Counsel's Exhibit
CCAppB:	Complaint Counsel's Appeal Brief
CCAnsB:	Complaint Counsel's Answering Brief to Respondent's Appeal Brief
CCRB:	Complaint Counsel's Reply Brief
RX:	Respondent's Exhibit
Tr.:	Transcript of Trial before the ALJ
JSLF:	Joint Stipulations of Law and Fact
RAppB:	Respondent's Appeal Brief
RAnsB:	Respondent's Answering Brief to Complaint Counsel's Appeal Brief

Count 1 of the Complaint charges a violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, focusing on two rounds of price increases in the fittings market, the first in January 2008 and the second in June 2008. With respect to the January increase, the Complaint alleges that McWane devised a plan to trade its support for higher list prices in exchange for Sigma's and Star's curtailment of "project pricing"; that McWane communicated the terms of its plan to Sigma and Star; and that "Sigma and Star manifested their understanding and acceptance of McWane's offer by publicly taking steps to limit their discounting from published price levels." Complaint ¶¶ 31-32, 64. The Complaint further alleges, with respect to the June price increase, that McWane traded its support for higher prices in exchange for monthly shipment information from Sigma and Star disseminated through their industry association, the Ductile Iron Fittings Research Association ("DIFRA"). *Id*. ¶¶ 33-34.

Count 2 alleges that McWane's agreement to exchange information through DIFRA facilitated collusion and is therefore an independent violation of Section 5. In particular, the Complaint asserts that the exchange of aggregated data regarding the firms' fittings shipments, including shipment information typically no more than two months old, "enabled each of the Sellers to determine and to monitor its own market share and, indirectly, the output levels of its rivals," and "[i]n this way, . . . facilitated price coordination among the Sellers on the pricing of [fittings]." *Id*. ¶¶ 35-36.

The remaining counts relate to the domestic fittings market. McWane, as the only major supplier with domestic production capability, is alleged to be a monopolist in that market. The Complaint alleges that the February 2009 enactment of the American Recovery and Reinvestment Act of 2009 ("ARRA"), which conditioned funding on the use of domestically-produced fittings, "significantly altered the competitive dynamics of the [fittings] industry, and upset the terms of coordination" among McWane, Sigma, and Star by spurring Sigma and Star to seek to enter the domestic fittings market. *Id*. ¶¶ 3, 18, 44. Counts 4 through 7 are based on McWane's alleged efforts to exclude competitors from this market.

Count 4 charges that McWane entered into the MDA with Sigma to prevent Sigma from becoming an independent competitor in the domestic fittings market, and therefore that the MDA unreasonably restrains trade. *Id*. ¶¶ 48, 67. Count 5 alleges that McWane and Sigma entered into the MDA to monopolize the domestic fittings market and exclude their rivals. *Id*. ¶ 68. In Counts 6 and 7, the Complaint alleges that McWane adopted a restrictive and exclusive distribution policy to impede or delay the ability of Star and others to enter the domestic fittings market. *Id*. ¶¶ 57, 61. Count 6 charges McWane with monopolization, and Count 7 alleges that McWane engaged in attempted monopolization. *Id.* ¶¶ 69-70.

In its Answer, McWane denied all of the substantive allegations of the Complaint.

B. SUMMARY DECISION MOTIONS AND TRIAL

In August 2012, both parties moved for summary decision. McWane sought summary decision on all counts. Complaint Counsel sought summary decision on one episode of alleged price-fixing involving McWane and Star in the Spring of 2009. The Commission denied both motions, concluding that a trial was necessary to resolve disputed issues of fact. *In re McWane, Inc. & Star Pipe Prods., Ltd.*, Docket No. 9351, Order and Decision Denying Respondent's

Motion for Summary Decision and Complaint Counsel's Motion for Partial Summary Decision, August 9, 2012.

The evidentiary hearing before Administrative Law Judge D. Michael Chappell commenced on September 4 and concluded on November 2, 2012. Complaint Counsel called 15 fact witnesses, including executives from McWane, Star, and Sigma, and an economic expert, Dr. Laurence Schumann. McWane called one witness, economic expert Dr. Parker Normann.

C. The Initial Decision

On May 1, 2013, the ALJ issued a 464-page opinion. He dismissed the first three counts relating to the alleged price conspiracy, concluding that Complaint Counsel had failed to establish liability by a preponderance of the evidence. He explained that "Complaint Counsel's conspiracy theory is not implausible; it is indeed 'possible' that there is some truth in the story Complaint Counsel tells." ID at 351. However, he found that, "[w]hen fairly and objectively scrutinized and weighed, the evidence fails to prove that McWane conspired with Sigma and Star to raise and stabilize prices in the Fittings market." *Id.* "At best," he concluded, "the evidence shows interdependent or consciously parallel conduct, unaided by an agreement, which is not illegal." *Id*.

With respect to Count 2, the ALJ found that the agreement by McWane, Star, and Sigma to participate in the DIFRA information exchange was not an unlawful facilitating practice. He reasoned that while Complaint Counsel had shown that the fittings market was an oligopoly susceptible to tacit coordination, the nature of the information exchanged—aggregated, historic shipment volumes—was insufficiently specific and not the type of information, like pricing-related data, that can facilitate price coordination. ID at 352-62.

The ALJ ruled in favor of Complaint Counsel with respect to Counts 4 through 7. On Count 4, the ALJ found that by entering into the MDA with Sigma, McWane had unreasonably restrained trade in the domestic fittings market. The ALJ focused on the provisions of the MDA that barred Sigma from producing its own domestic fittings and required Sigma to charge prices close to those charged by McWane. He concluded that, although the evidence failed to show that Sigma was a potential competitor in the domestic fittings market, the availability of reasonable, less restrictive alternatives and the absence of any valid procompetitive justifications rendered the MDA unlawful under the rule of reason. ID at 433-37. The ALJ also determined that, through the MDA, McWane had conspired with Sigma to monopolize the domestic fittings market, as alleged in Count 5. ID at 445. As to Count 6, he found that sales requiring domestic fittings constituted a separate product market in which McWane held monopoly power. He ruled that McWane's so-called "Full Support Program" was an exclusive dealing arrangement that foreclosed Star from a substantial share of the domestic fittings market and thereby unlawfully maintained McWane's monopoly. The ALJ also found that this conduct amounted to attempted monopolization of the domestic fittings market, as alleged in Count 7. ID at 419.

On May 13, 2013, the parties filed timely notices of appeal. Complaint Counsel appeals the ALJ's ruling with respect to Counts 1 and 2, and McWane appeals his findings on Counts 4 through 7.

III. FACTUAL BACKGROUND[3]

A. THE DUCTILE IRON PIPE FITTINGS INDUSTRY

Fittings are small but essential components of pressurized water distribution and treatment systems. They are used to join pipes, valves and hydrants, and to change, direct or divide the flow of water. IDF 5, 278. Although there are several thousand unique configurations of fittings in different shapes, sizes and coatings, approximately 80% of the demand may be serviced with only about 100 commonly-used fittings. IDF 286, 306.

Fittings are commodity products produced to American Water Works Association ("AWWA") standards and can be made anywhere in the world. Any fitting that meets AWWA specifications is functionally interchangeable with other fittings made to that standard, regardless of the country of origin. IDF 322-23. Despite the commodity nature of these fittings, however, some waterworks projects are closed to bids that include fittings made outside of the United States. IDF 346. A "domestic" or "domestic-only" specification or project requires fittings manufactured in the United States because of either end-user preferences or legal procurement requirements. IDF 347-48, 519-23. Projects that do not require domestic fittings are referred to as "open specification" projects. IDF 349. Domestic fittings sold for use in projects with domestic-only specifications generally command substantially higher prices than imported fittings or domestic fittings sold for use in projects with open specifications. IDF 547, 1075-76.

A few decades ago, most fittings were manufactured in the United States, and there were a number of full-line domestic fittings manufacturers, including U.S. Pipe and Foundry Co. ("U.S. Pipe"), Griffin Pipe Products Co., and American Cast Iron Pipe Co. ("ACIPCO"), as well as McWane. IDF 462. However, in the mid-1980s, importers, including Star and Sigma, began to make significant inroads, and, by 2005, imported fittings made up the vast majority of sales. IDF 463, 465-67. Faced with competition from lower-cost and lower-priced imports, several domestic manufacturers, including U.S. Pipe, Griffin, and ACIPCO, dramatically reduced or ceased domestic fittings production. IDF 472-76. From April 2006 until Star entered the domestic fittings market in late 2009, McWane was the only significant supplier of domestic fittings. IDF 1040.

B. FITTINGS INDUSTRY SUPPLIERS

1. McWane

McWane manufactures, imports, and sells various products for the waterworks industry, including fittings, which account for about 5% of McWane's business. Its principal place of business is in Birmingham, Alabama. IDF 1-2, 13. Until November 2008 McWane produced fittings at two foundries, one in Anniston, Alabama, and the other in Tyler, Texas. IDF 15. In 2005, it also began producing fittings in China, and in 2007 it consolidated its fittings business

[3] Because there is no majority position with respect to Counts 1 and 2, the facts described herein are limited to those relevant to Counts 4 through 7.

into a single division, Tyler/Union. IDF 17. Faced with high levels of inventory and low demand, McWane closed the Tyler, Texas foundry in November 2008. IDF 18.

The key McWane employee for purposes of this case is Mr. Richard Tatman, who joined the company in May 2006 and became Vice President and General Manager in charge of Tyler/Union in 2007. IDF 20-27.

2. Sigma

Based in Cream Ridge, New Jersey, Sigma has imported and sold a range of waterworks products, including fittings, in the United States since roughly 1985. IDF 51. Sigma sells to distributors and original equipment manufacturers, making it both a competitor and supplier to McWane. IDF 59-60. Fittings are Sigma's primary product line, accounting for 40-45% of its revenues in 2008 and 2009. IDF 52. Unlike McWane, Sigma has no production facilities. It uses a "virtual manufacturing" model, providing technical know-how and quality control but relying on foundries in China, Mexico, and India for the manufacture of its fittings. IDF 57.

The Sigma employees most relevant here include Victor Pais, one of Sigma's founders and its CEO and President (IDF 64-69), and Mitchell Rona, Sigma's OEM business manager (IDF 82).

3. Star

Star also imports and sells fittings and a variety of other waterworks products. IDF 108. It was founded in 1981 and has sold fittings since approximately 1985. IDF 109. Like Sigma, fittings are Star's primary product line, accounting for about 50% of Star's total sales. IDF 111. It sources its fittings primarily from foundries in China. IDF 113. However, beginning in 2009, Star contracted with a number of U.S. foundries to produce domestic fittings in competition with McWane. IDF 112.

4. Others

There are also a number of pipe and other companies that manufacture or sell certain types and sizes of fittings as ancillary product lines, but none is a significant supplier. IDF 154-57, 161-62, 164-67, 169-73, 176-81, 186-88, 190-93, 196-99.

C. Market Structure

The fittings market is an oligopoly with three major suppliers: McWane, Star, and Sigma. Together they account for over 90% of all fittings sold in the United States. IDF 354-55, 362. During the relevant time period, McWane was the market leader with approximately [redacted]% of the market in 2008; Sigma had about [redacted]% of the market that year, and Star roughly [redacted]%. IDF 356, *in camera*. As of 2008, Sigma and Star only sold fittings manufactured abroad, primarily in China. IDF 56, 113-15. As discussed further below, in late 2009, Star began selling fittings produced by several U.S. foundries in response to the passage of ARRA. IDF 112, 1094-1113, 1127-29. By 2010, Star accounted for about [redacted]% of domestic fittings sales and by 2011 about [redacted]%. IDF 357, *in camera*.

McWane, Sigma, and Star sell fittings to wholesale waterworks distributors, which then resell them to end users, typically municipalities, regional water authorities, and contractors. IDF 363, 367, 373-74. There are two national distributors: HD Supply and Ferguson, which together account for about 60% of the overall waterworks distribution market. IDF 222, 227, 377-79. There are also a few regional distributors, as well as hundreds of local ones. IDF 236-277, 375. Most distribution business is conducted on a bid-by-bid basis, with distributors competing on the basis of service as well as price. IDF 383-84, 386-87.

D. Pricing

Fittings prices have two main components: (i) a nationwide list price, typically issued by suppliers once a year or even less frequently; and (ii) published "multipliers," which vary by region and are discounts off the list price. IDF 413, 416-19. The "published" or "standard" price for a given fitting is the list price multiplied by the applicable regional multiplier. IDF 414.

Virtually no customer buys fittings at the list price. IDF 418. At the very least, sale prices usually reflect the multiplier discount. IDF 425. Suppliers often also offer a variety of other price concessions, the most important of which are discounts variously referred to as "job prices," "special prices," or "project prices," which are discounts off the published or standard price. IDF 428, 430-33. Project prices are the primary form of price competition among suppliers, but, unlike the published list prices and multipliers, they are not transparent. IDF 435, 442.

E. Domestic fittings, the Full Support Program, and the Master Distribution Agreement

1. Expected Growth in Sales of Domestic Fittings

In February 2009, Congress passed ARRA, which allocated more than $6 billion to water infrastructure projects. JSLF ¶¶ 19-20; IDF 524. Waterworks projects funded by ARRA were required to use domestically manufactured fittings and to be "under contract or under construction" within 12 months of ARRA's enactment.[4] IDF 525-27.

Given the anticipated increase in domestic fittings demand due to ARRA funding, both Star and Sigma began exploring options to enter the market. IDF 1094, 1421. In June 2009, Star sent a letter to customers and publicly announced at an AWWA industry conference that it would offer domestic fittings starting in September 2009. IDF 1095-96. Sigma initially considered two approaches for entering the domestic fittings market—purchasing Sigma-branded fittings manufactured by McWane or producing domestic fittings by contracting with independent domestic foundries. IDF 1423. In April 2009, Sigma contacted McWane to ask that it supply Sigma with "private label" domestic fittings, advising McWane that Sigma would pursue its own domestic production if McWane did not supply it with domestic fittings. IDF 1425-26.

The possible entry of Star and Sigma into the domestic fittings market created significant concerns for McWane. Not surprisingly, McWane did not want to share domestic sales and worried that entry by Star and Sigma would threaten to undermine its domestic fittings prices. IDF 1148-49, 1151-53.

2. Development of McWane's Full Support Program

By May 2009, the Vice President and General Manager in charge of McWane's fittings business, Mr. Tatman, was developing McWane's strategic response to possible domestic entry. He noted in a May 26 "brainstorming" document that any competitor seeking to enter the domestic fittings market could face "significant blocking issues" if they lacked a full line of domestic fittings. IDF 1155. A few weeks later, in a June e-mail exchange with other McWane executives about how to deal with entry, Mr. Tatman laid out his strategic vision for protecting McWane. He wrote:

> [A]t this stage the chance for profitable cohabitation with Star owning a [piece] of the Domestic market is slim. . . . If their claims are ahead of their actual capabilities we need to make sure that they don't reach any critical market mass that will allow them to continue to invest and receive a profitable return. . . . I don't sense that Sigma is yet fully committed and they will be watching our response very closely to assess their strategy and probability of financial success.

IDF 1150.

[4] During the distribution of funds provided by ARRA, the Environmental Protection Agency granted certain waivers of the "Buy American" requirement. IDF 530-46. These included public interest waivers, cost waivers if using domestic materials resulted in an overall cost increase of more than 25%, and waivers when domestic materials were unavailable in adequate quantities. IDF 531-33.

As of late June, Mr. Tatman had developed three potential options for McWane's response to domestic entry: "Wait and See"; "Handle on a Job by Job basis"; or "Force Distribution to Pick their Horse." CX0076 at 009. He explained the advantages of the third approach: (1) "Avoids the job by job auction scenario within a particular distributor"; (2) "Potentially raises the level of supply concern among contractors"; and (3) "Forces Star/Sigma to absorb the costs associated with having a more full line before they can secure major distribution[.]" *Id.* When considering how to implement such a program, Mr. Tatman outlined a "Soft Approach" in which a "Domestic rebate would require exclusivity," and a "Hard Approach – Full Line or No Line," whereby access to McWane's domestic fittings would "require[] exclusivity for Domestic fitting items we manufacture." *Id.* at 010.

By August, McWane had determined to implement an exclusive dealing requirement for distributors. Mr. Tatman explained the plan: "To protect our domestic brands and market position we are going to adopt a distributor exclusivity program for 2010 wherein we won't provide domestic product to distributors who are not fully supporting our domestic product lines." CX0113 at 001. McWane's management emphasized to its sales staff that the "new policy" meant that "if a customer buys Star domestic . . . the customer will no longer have access to [McWane] domestic [fittings]." IDF 1179.

3. McWane Announces and Implements the "Full Support Program"

McWane announced its exclusive dealing policy, called the "Full Support Program," in a September 22, 2009 letter to distributors. IDF 1173. McWane's executives and sales force proceeded to contact customers to discuss the program, explaining it would be applied to them on a "company-wide basis"—if one branch purchased domestic fittings from Star, "all branches would be cut off." IDF 1180-82. There were only two exceptions permitting the purchase of another company's domestic fittings: where McWane products were not readily available or where the customer bought domestic fittings and accessories along with another manufacturer's ductile iron pipe. IDF 1173.

The message was received, and nearly all customers believed they would lose rebates or be cut off from purchasing McWane's domestic fittings if any branch bought domestic fittings from Star. IDF 1184-85, 1188-89, 1191-92, 1300. As a consequence, unless an exception applied, major distributors purchased only from McWane. *See* IDF 1231-51, 1259-64, 1299-1304, 1334-40, 1313-18, 1353-58, 1364.

McWane's enforcement of the Full Support Program was consistent with what it had described to customers. Distributor Hajoca Corporation provides one example. Because Hajoca's branches operated independently, Hajoca asked McWane to modify the Full Support Program so that not all Hajoca branches would be penalized if one branch bought from Star. McWane refused. IDF 1197-1202. Later, when Hajoca's Tulsa branch purchased Star domestic fittings, McWane cut off sales of its domestic fittings to all Hajoca branches, including branches that had complied with the program. IDF 1206-13. As a result, Hajoca was unable to place any new domestic fittings orders with McWane between December 4, 2009, and April 13, 2010

(IDF 1219), and McWane withheld its rebates for the fourth quarter of 2009 (IDF 1224-27, 1230).[5]

4. Impact of McWane's Exclusive Dealing Policy on Star

Following McWane's announcement of the Full Support Program, Star saw a dramatic reduction in the number of requests for quotes. IDF 1381-82. Numerous distributors pulled their outstanding bid requests from Star. IDF 1382. Conversations with customers led Star to believe that McWane's policy made customers less willing to risk purchasing domestic fittings from Star.[6] IDF 1382-92; Bhargava, Tr. 2960, *in camera*. Star was rebuffed by some distributors even after offering a more generous rebate than McWane. IDF 1391. Star estimated that it would have secured [redacted] in sales of domestic fittings in 2010, and potentially as much as [redacted] in 2011, but for McWane's Full Support Program. IDF 1394, *in camera*. Star's actual sales in 2010 were approximately [redacted], less than half of the sales it estimated it would have garnered in the absence of McWane's program. IDF 1396, *in camera*. Star's revenue from domestic fittings declined to [redacted] in 2011, or roughly one-third of its estimated sales in the absence of McWane's program. IDF 1397, *in camera*. [redacted] IDF 1399, *in camera*.

Despite McWane's program, distributors did make some purchases from Star. Hajoca's Tulsa branch began purchasing domestic fittings from Star soon after McWane's announcement of the Full Support Program, and by January 2010, had ordered more than [redacted] worth of Star domestic fittings. IDF 1230, *in camera*. Additionally, many distributors made purchases under the exceptions allowed by the Full Support Program. *See* IDF 1137, 1142, 1242, 1305. For example, HD Supply cancelled pending orders with Star after McWane announced its program, but retained orders for items McWane did not have available or for which a commitment had already been made before the announcement of the Full Support Program. IDF 1242. In all, Star sold to over 100 distributors from the time it entered the market through 2011. IDF 1141. Altogether, however, the sales made by Star were small compared to the overall size of the market. IDF 1396-99, 1042-43.

Star's sales levels had direct implications for its domestic fittings operations. Star had considered three possible manufacturing approaches for entering the market: building a foundry from "ground zero," buying an existing foundry, or contracting with existing domestic foundries to produce the desired fittings. IDF 1097. The cost of sourcing from independent foundries is higher because they are less specialized, which means they have less efficient equipment, run smaller batch sizes, and have higher labor costs, and because they charge a markup on each

[5] Although McWane cut off new orders, McWane allowed Hajoca branches, except Tulsa, to place orders to satisfy known commitments of existing contracts. IDF 1214.

[6] A number of distributors testified they were reluctant or unwilling to purchase domestic fittings from Star because of McWane's Full Support Program; some also identified other factors that contributed to their decisions not to purchase from Star. *See* IDF 1252-55, 1271-75, 1307, 1341-42, 1359-62.

fitting, sometimes as much as [redacted]%. IDF 1410, 1411, *in camera*, 1412-13. Star believed its sales level was insufficient to justify running its own foundry. IDF 1400-01.

In the end, because it could not expand its sales more quickly, rather than acquiring a foundry, Star contracted with six foundries to produce raw castings, which Star then shipped to its Houston facility for finishing. IDF 1409. Shipping costs alone to Star's Houston finishing facility added [redacted]% to the cost of Star's domestic fittings. IDF 1411, *in camera*. Star estimated that the cost of producing fittings at its own domestic foundry would have been [redacted]% lower than the cost of contracting with independent foundries, and that it could have reduced its domestic fittings prices by [redacted]%. IDF 1419-20, *in camera*.

5. Sigma's Efforts to Enter the Domestic Fittings Market

In April 2009, at the same time as it was developing its exclusive dealing policy, McWane was also responding to a request from Sigma that McWane supply Sigma with "private label" domestic fittings. IDF 1425, 1429. McWane's Mr. Tatman recognized that if McWane did not sell to Sigma, McWane would retain the full margin for its domestic fittings sales, but also realized that by selling to Sigma it could "eliminate the probability" that Sigma would find another domestic fittings source. IDF 1431-39, 1442.

On June 5, McWane made an initial offer to sell domestic fittings to Sigma at 5% off McWane's published prices. IDF 1443. Sigma rejected that offer because it did not allow sufficient margin to cover its operating costs. IDF 1444-45. Sigma then informed McWane that it planned to develop its own domestic fittings capability. IDF 1509-10.

While negotiating with McWane, Sigma tasked a team of executives to investigate the possibility of entering the domestic fittings market using independent foundries. IDF 1446-47. The team held planning meetings that resulted in detailed action plans. IDF 1454. When Sigma rejected McWane's June 5 offer, Sigma's president stated in an update to the Board, "We now need to go all out and implement a [domestic] plan - replicating SIGMA's 'virtual manufacturing' model working with a collection of domestic foundries who have ample idle capacity, to produce the range of Fittings, just as we do thru a collection of facilities overseas." IDF 1455. By June, Sigma's team had begun to take steps to implement a virtual model. They obtained patterns, arranged foundry site visits, placed orders for foam patterns and other equipment, and produced two large sample domestic fittings as trial runs at a foundry in Tennessee. IDF 1457-61. All told, Sigma spent between $50,000 and $75,000 investigating domestic production options. IDF 1449.

As of July 11, Sigma was still pursuing its plan to produce domestic fittings, but it was proceeding more "deliberately and thoughtfully" because it was finding the plan difficult to implement. IDF 1463. Sigma was also in a financially precarious situation and had limited access to capital. IDF 1483, 1487, 1499. At that point, Sigma had no domestic foundries, no contracts with existing domestic foundries, no core boxes, no machining facilities, and no finishing facilities or contracts for coating, painting, and lining, for domestic fittings. IDF 1465.

In September, Sigma still had very few of the patterns it would need to make domestic fittings, did not have any contracts with any pattern shops to build the necessary patterns, and did not have any contracts with any domestic foundries to produce fittings. IDF 1470-73. Ultimately, Sigma decided against producing its own domestic fittings. IDF 1545. Mr. Pais of Sigma informed the Board that "the entire project was found to be too overwhelming and cumbersome" and would have required "a sizeable Capital Expenditure." IDF 1474.

6. McWane and Sigma Enter Into the Master Distribution Agreement

In late June or early July 2009, Mr. Rona of Sigma resumed discussions with McWane. IDF 1522. On July 29, McWane offered to sell McWane-branded domestic fittings to Sigma at a 20% discount off published multipliers, but required that McWane be Sigma's sole source of domestic fittings (other than for fittings that McWane did not produce or could not ship promptly). IDF 1529; CX1805 at 002. The offer also required Sigma to agree to sell the McWane fittings only to distributors that had an exclusive supply relationship with McWane. IDF 1529.

Negotiations continued through August and September. On September 17, McWane and Sigma signed the MDA. IDF 1537. Under the agreement, Sigma agreed to act as an authorized distributor of McWane's domestic fittings on the following key terms: (1) McWane would be Sigma's sole domestic fittings source, unless certain limited exceptions applied; (2) Sigma could resell McWane's fittings at any price, but McWane could cancel the agreement if Sigma's price was less than 98% of McWane's published pricing on a weighted average basis; (3) Sigma could resell only to customers that agreed to purchase McWane domestic fittings exclusively; and (4) there would be an initial term of one year, but either party could terminate the agreement with or without cause by giving 180 days' advance written notice. CX1194 at 001-002, 007. McWane announced the MDA to customers in the same September 22, 2009 letter that announced the Full Support Program. CX0010.

Sigma's subsequent actions were consistent with the MDA. It ceased efforts to develop its own domestic manufacturing capability. IDF 1543-47. Sigma also priced domestic fittings as prescribed by the MDA and implemented McWane's exclusive dealing program. IDF 1548-53, 1566-74. Additionally, when McWane cut off the supply of domestic fittings to Hajoca, Sigma followed suit. *See* IDF 1568-70.

On February 17, 2010, McWane provided Sigma with 180 days' notice that McWane wished to terminate the MDA. IDF 1595. In all, the MDA was in effect from September 2009 to August 2010. IDF 1596.

IV. STANDARD OF REVIEW

The Commission reviews the ALJ's findings of facts and conclusions of law *de novo*, considering "such parts of the record as are cited or as may be necessary to resolve the issues presented." 16 C.F.R. § 3.54. The Commission may "exercise all the powers which it could have exercised if it had made the initial decision." *Id*. The *de novo* standard of review applies to both findings of fact and inferences drawn from those facts. *See Realcomp II, Ltd.*, No. 9320, 2009 FTC LEXIS 250 at *37 n.11 (Oct. 30, 2009), *aff'd*, *Realcomp II, Ltd. v. FTC*, 635 F.3d 815 (6th Cir. 2011).

V. MCWANE'S EXCLUSIVE DEALING POLICY AS MONOPOLY MAINTENANCE

Complaint Counsel alleges that McWane adopted an exclusionary distribution policy in order to maintain its monopoly in the domestic fittings market in violation of Section 5 of the FTC Act.[7] A claim of monopolization requires proof of "(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, 570-71 (1966). As the Supreme Court underscored in *Spectrum Sports, Inc. v. McQuillan*, "[t]he law directs itself not against conduct which is competitive, even severely so, but against conduct which unfairly tends to destroy competition itself." 506 U.S. 447, 458 (1993). Accordingly, the Commission must first determine whether McWane has monopoly power in a relevant market, and, if it does, whether McWane acted to maintain its monopoly through anticompetitive conduct. *United States v. Microsoft*, 253 F.3d 34, 79 (D.C. Cir. 2001). As discussed below, we answer both questions in the affirmative and conclude that McWane unlawfully maintained its monopoly of the domestic fittings market.

A. MONOPOLY POWER

A monopolist is defined as a firm that can "profitably raise prices substantially above the competitive level." *Microsoft*, 253 F.3d at 51. Monopoly power can be shown directly, through evidence of the defendant's control over prices or its ability to exclude competition from the market, or indirectly, by examining market structure and a firm's market share. *See Grinnell Corp.*, 384 U.S. at 571. Because direct evidence of monopoly power is often unavailable, courts have traditionally inferred it from "a firm's possession of a dominant share of a relevant market that is protected by entry barriers." *Microsoft*, 253 F.3d at 51. We start by addressing the relevant market and then turn to whether McWane has monopoly power in that market.

1. Domestic Fittings Sold for Use in Projects with Domestic-Only Specifications Are a Relevant Market

A relevant product market consists of "products that have reasonable interchangeability for the purposes for which they are produced." *United States v. E. I. duPont de Nemours & Co.*, 351 U.S. 377, 404 (1956). Courts typically evaluate the reasonable interchangeability of use and the cross elasticity of demand in assessing a potential relevant market, focusing on "the availability of products that are similar in character or use to the product in question and the degree to which buyers are willing to substitute those similar products for the product." *FTC v. Swedish Match*, 131 F. Supp. 2d 151, 157 (D.D.C. 2000).

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[7] Violations of the Sherman Act also constitute "unfair methods of competition" under Section 5 of the FTC Act. *See California Dental Ass'n v. FTC*, 526 U.S. 756, 762 & n.3 (1999); *FTC v. Motion Picture Adver. Serv. Co.*, 344 U.S. 392, 394-95 (1953). Accordingly, we rely on case law and other authority applying the Sherman Act for our analysis of the relevant claims.

We agree with the ALJ that there are two relevant product markets in this case. One is comprised of small and medium (*i.e.*, 24 inches and smaller) diameter ductile iron pipe fittings sold in the United States for use in open specification waterworks projects (the "fittings market"). *See* ID at 244, 252-53, 450. There are no reasonable substitutes for ductile iron pipe fittings. The closest substitute is made from polyvinyl chloride ("PVC"), but because PVC fittings lack the strength of ductile iron pipe fittings and thus are not suitable for high pressure applications, the two are not reasonably interchangeable. ID at 246-47. We also find that it is appropriate to group all ductile iron pipe fittings 24 inches and smaller in diameter into a single product market for the purpose of evaluating competitive effects. *See* ID at 244-46 (explaining "cluster" markets); *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 356 (1963) (finding that a cluster of products and services comprising "commercial banking" was a relevant market); *In re ProMedica Health Sys., Inc.*, 2012 FTC LEXIS 58, at *48-55, *62-72 (Mar. 28, 2012) (describing conditions that make it appropriate to delineate cluster markets). Domestically-manufactured and imported fittings are both used in open specification jobs and are therefore both included in the fittings market. This relevant market is not in dispute.

We also find there is a separate relevant market for the supply of domestically-manufactured fittings for use in waterworks projects with domestic-only specifications (the "domestic fittings market"). This is the market that McWane contests.

Product markets are sometimes defined by considering whether a hypothetical monopolist could profitably target a particular subset of customers for price increases. Where existing buyers differ significantly in their likelihood of switching to other products in response to a small but significant and nontransitory increase in price, and a hypothetical monopolist can identify and price differently to targeted buyers that cannot defeat the price increase by substituting other products, there is a "price discrimination" market. In such a case, the hypothetical monopolist would profitably impose a discriminatory price increase on sales to the targeted buyers, and those buyers would define the boundaries of the relevant market. *See* Dep't of Justice and Fed. Trade Comm'n, Horizontal Merger Guidelines § 4.1.4 (2010) ("Horizontal Merger Guidelines"); Phillip E. Areeda, Herbert Hovenkamp & John L. Solow, IIB *Antitrust Law* ¶ 534d.1, at 269 (3d ed. 2007) ("Successful price discrimination means that the disfavored geographic or product class is insulated from the favored class and, if the discrimination is of sufficient magnitude, should be counted as a separate relevant market.").

The supply of domestic fittings constitutes a price discrimination market. Certain waterworks projects require domestic-only fittings because of municipal, state, or federal law, or, sometimes, end-user preferences. IDF 347, 519; JX0001 at 002 (JSLF ¶ 13). For example, Pennsylvania and New Jersey both have "Buy American" laws governing fittings. IDF 348, 520-21. Certain federal government projects, Air Force bases, and municipalities also require domestic fittings. IDF 348, 519-23. Similarly, ARRA contained Buy American provisions requiring domestic fittings in the $6 billion worth of waterworks projects it funded. IDF 524-29. When a project requires domestic fittings, a distributor will not purchase imported fittings even though they have the same form and functionality. IDF 350, 549. Imported fittings therefore are not interchangeable with, or reasonable substitutes for, projects with domestic procurement specifications.

McWane capitalizes on this lack of interchangeability by charging higher prices for domestic fittings used in domestic-only waterworks projects. Answer ¶ 20; IDF 350-51. For instance, McWane's February 2008 price multipliers for domestic fittings sold into domestic-only specifications were substantially higher than its "blended" multipliers for domestically manufactured and imported fittings sold into open specifications, with the price differential ranging from 21.4% to 96%. IDF 1076. Indeed, due to the price differential between fittings sold into open and domestic-only specifications, McWane does not provide quotes for domestic fittings for open specification projects. IDF 548. Importantly, the price difference reflects McWane's ability to target particular customers based on project specifications, not a difference in the cost of production, which is the same for all domestically manufactured fittings.

These targeted price differences confirm that domestic fittings for use in projects with domestic-only specifications are a separate product market. Job specifications readily identify customers susceptible to discriminatory pricing and the persistence of distinct price levels shows that customers cannot use arbitrage to avoid the higher prices. *See Geneva Pharms. v. Barr Labs Inc.*, 386 F.3d 485, 496-98 (2d Cir. 2004) (finding that branded and generic versions of a drug, though "therapeutically equivalent," were in separate antitrust markets when users of the branded drug exhibited inelastic demand that was unresponsive to the lower prices of generic versions). Additionally, because customers can turn only to domestic producers in this relevant product market, the relevant geographic market is the United States. ID at 252-53.

McWane raises several arguments to dispute a domestic fittings market. None is persuasive. As an initial matter, it claims that econometric evidence is necessary to establish a product market and argues that the absence of such evidence here undermines a conclusion that a separate domestic fittings market exists. That is simply incorrect. Econometric analysis can be a valuable tool for defining a market, but it is only one of several that may be used for that purpose. Courts routinely rely on qualitative economic evidence to define relevant markets. *See, e.g.*, *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962) (recognizing that "practical indicia" such as industry or public recognition and a product's unique attributes can be used to define a relevant market); *Spirit Airlines, Inc. v. Northwest Airlines, Inc.*, 431 F.3d 917, 934-35 (6th Cir. 2005) (relying on party documents and fact and expert testimony to determine the relevant product market); *United States v. H&R Block, Inc.*, 833 F. Supp. 2d 36, 50-71 (D.D.C. 2011) (finding digital do-it-yourself tax preparation software a relevant product market based mainly on defendant's documents, price disparities, and testimony from executives); *In re Polypore Int'l, Inc.*, 2010 FTC LEXIS 97, *31 & n.19 (Dec. 13, 2010) (relying on qualitative evidence to define relevant market), *aff'd*, 686 F.3d 1208, 1217-18 (11th Cir. 2012). As one treatise explains, "[i]n a world of imperfect price and quantity data from which to analyze elasticities, qualitative evidence of buyer's willingness to substitute one good or service for another often provides the principal evidence of the boundaries of a relevant market."[8] ABA

[8] The Commission's reliance on qualitative economic evidence is also well established. *See* Horizontal Merger Guidelines § 4.1.3 (noting that, in determining relevant markets, the antitrust agencies rely on "reasonably available and reliable evidence," including business documents, customer surveys, and past behavior); U.S. Dep't of Justice and Fed. Trade Comm'n, Commentary on the Horizontal Merger Guidelines 9 (2006) ("In the vast majority of cases, the Agencies largely rely on non-econometric evidence, obtained primarily from customers and from business documents.").

Section of Antitrust Law, *Mergers and Acquisitions* 55 (3d ed. 2008). In this case, there is ample economic evidence to support domestic fittings as a relevant market.

McWane also disputes the lack of interchangeability between domestic and imported fittings. It argues that waterworks projects with legally-imposed domestic fittings requirements represent only a small fraction of all specifications, pointing to the increase in sales of imported fittings over time. But observations about the size of the domestic fittings market shed no light on the ability of customers to switch between domestic and imported fittings for domestic-only projects. As the ALJ found, "the evidence overwhelming[ly] showed [Buy American] regulations did in fact limit substitution." ID at 250.

McWane also claims that customers can "flip" specifications from domestic-only to open. The relevant testimony, however, indicates that flipping typically only occurs when domestic fittings are unavailable, rather than as the result of competition between domestic and imported fittings. *See* CX2496 at 006 (Brakefield Dep. at 18-20). In fact, the sole example in the record of flipping was an instance in which domestic fittings were unavailable to complete the job. *Id.* Moreover, while sales of imported fittings may have increased, the share of domestic-only specifications has remained largely unchanged in recent years. *Compare* IDF 1026 (in 2003, Buy American provisions applied to 10%-20% of fittings shipped), *with* IDF 1029 (prior to the passage of ARRA in 2009, projects with domestic-only specifications accounted for 15%-20% of sales). This suggests that any growth in import sales likely came from the greater use of imports in open-specification jobs and not from a decline in domestic-only projects.

Finally, McWane argues that the Environmental Protection Agency's grant of waivers permitting the use of imported fittings on ARRA-funded projects—and Complaint Counsel's expert's failure to account for such waivers—precludes a finding that a domestic fittings market exists. But EPA-granted waivers were limited, and in any event had no impact on domestic-only requirements imposed by other federal, state, or municipal laws. IDF 531-33, 537. Notably, neither McWane nor Star sold any imported fittings for use in any ARRA-funded projects. IDF 538, 540. McWane even advised distributors that the cost-based exception to ARRA requirements was unlikely to apply to fittings sales. IDF 534. Sigma representatives testified that the quantities of imported fittings used on ARRA-funded waterworks projects were "few." IDF 539. Other suppliers, as well as distributors, also indicated they were unaware of any instances in which imported fittings were used for ARRA-funded projects. IDF 541-43, 544-46. Accordingly, McWane's protest that the potential for waivers offsets ARRA's Buy American requirements is unavailing.

2. McWane Possesses Monopoly Power in the Domestic Fittings Market

Having established that domestic fittings are a relevant market, we now consider whether McWane possessed monopoly power in that market. Both direct and indirect evidence show that it did.

We begin by looking at market structure. From late 2006 until late 2009 when Star entered the domestic fittings market, McWane was the only domestic manufacturer of fittings. IDF 476, 1040. McWane's share continued to be more than [redacted]% in 2010 and [redacted]% in 2011, after Star had entered the market. IDF 1042-43, *in camera*. These market shares far exceed the levels that courts typically require to support a *prima facie* showing of monopoly power. *See United States v. Dentsply Int'l, Inc.*, 399 F.3d 181, 188 (3d Cir. 2005) (holding that market share between 75% and 80% of sales is "more than adequate to establish a *prima facie* case of [monopoly] power"); *Colo. Interstate Gas Co. v. Natural Gas Pipeline Co. of Am.*, 885 F.2d 683, 694 n.18 (10th Cir. 1989) (noting that to establish "monopoly power, lower courts generally require a minimum market share of between 70% and 80%"). Enduring high market-share figures provide particularly strong evidence of monopoly power, especially in a mature and stable industry such as this one. *See ZF Meritor LLC v. Eaton Corp.*, 696 F.3d 254, 285 (3d Cir. 2012) (recognizing competitors' "paltry penetration" in the market "over the years" as a sign of market power).

Moreover, there are substantial barriers to entry in the domestic fittings market. ID at 375-77; IDF 1050. A *de novo* entrant would need to build its own foundry or develop a supply chain of foundries to produce fittings, develop or purchase hundreds of patterns or moldings necessary to make a full line of fittings, have its products tested and certified to conform to AWWA standards and get on "approved" lists for engineers and municipalities, and develop a sales force and relationships with distributors. IDF 1044-48. As a result, a *de novo* entrant seeking to enter the fittings market would need approximately three to five years to do so. IDF 1049.

Even existing suppliers of imported fittings face significant barriers to enter the domestic fittings market. Although equipped with an existing sales team and relationships with customers, to enter this market a supplier of imported fittings would still need to build its own foundry or arrange for existing foundries to manufacture its fittings, obtain patterns for the 100-200 fittings necessary to enter with at least a partial line, and have its domestically-manufactured products tested and certified. IDF 1044-47, 1051-55, 1119-26, 1130-32. Additionally, as discussed more fully below, McWane's exclusive dealing policy raised a barrier to entry for even current suppliers of imported fittings, particularly those without a full line of fittings. *See Dentsply*, 399 F.3d at 189-90 (recognizing that the defendant's exclusionary conduct was a barrier to entry).

The record reflects the significance of these barriers. Although Star was able to and did enter the market, two other suppliers of imported fittings investigated entry, but were deterred from making the attempt. After considering the availability of domestic foundries, patterns, and other equipment, as well as its weak financial condition, Sigma concluded that it could not overcome the complexity of entering the domestic fittings market. Similarly, although Serampore Industries Private ("SIP"), a small seller of imported fittings, possessed the financial capability of entering, the challenges to entering the market, including the unavailability of a single foundry capable of supplying its full needs, the high cost of developing patterns and drilling and machining capabilities, and McWane's exclusive dealing program, led SIP not to attempt it. IDF 1366, 1368, 1373, 1375-79.

McWane argues Star's entry proves that barriers to entry are low and contradicts a finding of monopoly power. But, as the Ninth Circuit has noted, "[t]he fact that entry has occurred does not necessarily preclude the existence of 'significant' entry barriers." *Rebel Oil Co. v. Atlantic Richfield Co.*, 51 F.3d 1421, 1440 (9th Cir. 1995). "If the output or capacity of the new entrant is insufficient to take significant business away from the predator, they are unlikely to represent a challenge to the predator's market power." *Id.*; *accord Allen-Myland v. Int'l Bus. Mach. Corp.*, 33 F.3d 194, 210 (3d Cir. 1994) (rejecting district court's inference that existence of competitors demonstrated ease of entry that would disprove market power); *Reazin v. Blue Cross & Blue Shield of Kansas, Inc.*, 899 F.2d 951, 971-72 (10th Cir. 1990) (upholding a finding of monopoly power because "no other entrant remotely approached [defendant's] domination of the market").

The evidence here demonstrates that Star's entry did not displace McWane's monopoly position in the domestic fittings market. Star's market share remained below [redacted]% in 2010 and 2011. IDF 1042-43, *in camera*. Moreover, Star's presence in the market failed to constrain McWane's pricing for domestic fittings. CX2199; IDF 1073-74, 1083, 1091-92. McWane's customers testified that, after the 2009 enactment of the ARRA, prices for domestic fittings increased and McWane refused to negotiate prices. IDF 1073. Even after Star's first domestic fittings sales in September 2009, McWane continued to sell its domestic fittings into domestic-only specifications at prices that earned significantly higher gross profits than for non-domestic fittings, which faced greater competition. IDF 1091. McWane also announced a price increase for domestic fittings in December 2009 that it applied in January 2010 (IDF 1083), which allowed McWane to earn even higher gross profits for domestic fittings in 2010 than in the prior year (IDF 1091-92).

Even the testimony of McWane's own expert, Dr. Normann, demonstrates that Star did not have a disciplining effect on McWane. He concluded that Star's presence in the domestic fittings market in several states did not produce lower prices. IDF 1090. Despite McWane's protests to the contrary, these facts establish its ability to control prices in the domestic fittings market and provides direct evidence of McWane's monopoly power.

B. EXCLUSIONARY CONDUCT

The next question is whether the challenged conduct—McWane's Full Support Program—was an unlawful exclusive dealing policy that enabled McWane to maintain its monopoly power in the domestic fittings market. "Unlawful maintenance of a monopoly is demonstrated by proof that a defendant has engaged in anti-competitive conduct that reasonably appears to be a significant contribution to maintaining monopoly power." *Dentsply*, 399 F.3d at 187; *Microsoft*, 253 F.3d at 79.

Distinguishing between exclusionary conduct and vigorous competition is not always easy. *Microsoft*, 253 F.3d at 58. Exclusive dealing arrangements are common and often procompetitive. *See Race Tires Am., Inc. v. Hoosier Racing Tire Corp.*, 614 F.3d 57, 76 (3d Cir. 2010) ("[I]n many circumstances, [exclusive dealing] may be highly efficient—to assure supply, price stability, outlets, investment, best efforts or the like—and pose no competitive threat at all."); *Stop & Shop Supermarket Co. v. Blue Cross & Blue Shield of R.I.*, 373 F.3d 57, 65 (1st Cir. 2004) (exclusive dealing agreements "can achieve legitimate economic benefits (reduced cost, stable long-term supply, predictable prices)"). For instance, exclusive dealing can, among other things, align distributor and manufacturer incentives and thus prevent free-rider problems, or lead a distributor to promote the product of its exclusive supplier more effectively, thereby increasing interbrand competition. *See Ryko Mfg. Co. v. Eden Servs.*, 823 F.2d 1215, 1234 n.17 (8th Cir. 1987); *Roland Mach. Co. v. Dresser Indus., Inc.*, 749 F.2d 380, 395 (7th Cir. 1984); *see* *also* Jonathan M. Jacobson, *Exclusive Dealing, Foreclosure & Consumer Harm*, 70 Antitrust L.J. 311, 357-58 (2002); Benjamin Klein & Kevin Murphy, *Exclusive Dealing Intensifies Competition for Distribution*, 75 Antitrust L.J. 433, 465-66 (2008). It can also result in lower prices because suppliers may be willing to reduce prices in exchange for higher sales volume. *See Stop & Shop Supermarket*, 373 F.3d at 62. Indeed, "competition to be an exclusive supplier may constitute 'a vital form of rivalry, and often the most powerful one, which the antitrust laws encourage rather than suppress.'" *Race Tires Am.*, 614 F.3d at 76 (quoting *Menasha Corp. v. News Am. Marketing In–Store, Inc.*, 354 F.3d 661, 663 (7th Cir. 2004)).

Despite these and other potential benefits, exclusive dealing can harm competition under certain circumstances. *See Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 45 (1984) (O'Connor, J., concurring) ("Exclusive dealing can have adverse economic consequences by allowing one supplier of goods or services unreasonably to deprive other suppliers of a market for their goods . . . ."); Jacobson, 70 Antitrust L.J. at 328 (explaining that courts have manifested concern when exclusive dealing has been used to foster market power). Exclusive dealing can be particularly troubling when imposed by a monopolist. *ZF Meritor*, 696 F.3d at 271; *Dentsply*, 399 F.3d at 187 ("Behavior that otherwise might comply with antitrust law may be impermissibly exclusionary when practiced by a monopolist.").

Most pertinent here, exclusive dealing can be harmful when it enables a firm to acquire or maintain monopoly power by impairing the ability of rivals to grow into effective competitors that might erode the firm's dominant position. *See Microsoft*, 253 F.3d at 70-71; *Interface Grp., Inc. v. Mass. Port Auth.*, 816 F.2d 9, 11 (1st Cir. 1987); *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227 (1st Cir. 1983). The dominant firm's exclusive dealing arrangements may prevent new firms from achieving the scale necessary for them to become efficient competitors. *See* Dennis W. Carlton, *A General Analysis of Exclusionary Conduct and Refusal to Deal*, 68 Antitrust L.J. 659, 663, 655 n.15 (2001) (explaining that exclusive dealing may be harmful when it deprives rivals "of the necessary scale to achieve efficiencies, even though, absent the exclusivity," more than one firm "would . . . be large enough to achieve efficiency"). When a monopolist can impede potential rivals from becoming effective competitors, it can maintain monopoly prices and thereby harm consumers. *See* Herbert Hovenkamp, XI *Antitrust Law* ¶ 1802c, at 76-77 (3d ed. 2011); Richard A. Posner, *Antitrust Law* 229 (2d ed. 2001) (noting that exclusive dealing may "increase the scale necessary for new entry, and . . . increase the time required for entry and hence the opportunity for monopoly pricing").

As one leading commentator has summarized, the preconditions for competitive harm are: (i) exclusive dealing or similar arrangements covering a significant portion of distribution; (ii) entry barriers or equivalent impediments making it difficult for rivals or potential rivals to obtain efficient distribution; and (iii) resulting prolongation of the dominant firm's ability to earn monopoly profits in the downstream market. *See* Hovenkamp, XI *Antitrust Law* ¶ 1802b, at 74-76. Exclusive dealing can be anticompetitive, therefore, if it facilitates the exercise of market power by either impairing a rival's ability to achieve the scale necessary to become efficient, or if it makes a rival less efficient by depriving it of "efficient access to the downstream market." *Id.*; Dennis W. Carlton & Ken Heyer, *Appropriate Antitrust Policy Towards Single-Firm Conduct: Extraction vs. Extension*, 22 Antitrust 50, 53 (2008).

We evaluate McWane's Full Support Program using this accepted theory of competitive harm. In assessing McWane's exclusive dealing arrangement, we examine both the anticompetitive and procompetitive effects of the conduct to determine whether, in light of McWane's monopoly power, its use of exclusive dealing prevented rivals from meaningfully competing and had a substantial anticompetitive effect on competition. This approach is consistent with recent court precedent on exclusive dealing. *See ZF Meritor*, 696 F.3d at 271-72; *Dentsply*, 399 F.3d at 187; *Microsoft*, 253 F.3d at 58-59. As discussed below, we conclude that McWane's Full Support Program was an unlawful exclusive dealing policy that contributed significantly to the maintenance of McWane's monopoly power in the domestic fittings market.

1. McWane's "Full Support Program" Is an Exclusive Dealing Policy

"An exclusive dealing arrangement is an agreement in which a buyer agrees to purchase certain goods or services only from a particular seller for a certain period of time." *ZF Meritor*, 696 F.3d at 270. McWane's Full Support Program is an exclusive dealing policy by its terms, operation, and intent. McWane designed and implemented the program to deny Star and other potential competitors access to distributors and thereby impede their effective entry into the domestic fittings market in order to maintain its monopoly.

McWane's strategy and aim is clear from its internal business documents. Despite the fact that about 80% of demand can be met with 100 or fewer commonly used sizes and configurations of fittings, referred to as "A or B" fittings, distributors need access to a full line of domestic fittings to meet all of their customers' needs either through their own supply or with supply from others. IDF 306-08, 1252. As the only full-line supplier of domestic fittings, McWane knew very well that an exclusive dealing requirement would prevent distributors from purchasing from suppliers without full lines and took this into account when designing its Full Support Program. In a June 2009 presentation outlining options for McWane's response to Star's announced entry into the market, Mr. Tatman proposed a strategy to "Force Distribution to Pick their Horse." The proposal included a "Hard Approach – Full Line or No Line" and explained that the advantages of such a strategy included "[p]otentially rais[ing] the level of supply concern among contractors" and "Forc[ing] Star/Sigma to absorb the costs associated with having a more full line before they can secure major distribution." CX0076 at 009-010; *see also* CX0329 at 001 (advocating Full Line or No Line as preferred approach and best option against Star).

Later, while preparing for the rollout of the Full Support Program, McWane's National Sales Manager, Mr. Jansen, led an internal conference call with McWane's sales force during which he explained the new policy: "What are we going to do if a customer buys Star domestic? We are not going to sell them our domestic . . . . Once they use Star, they can't EVER buy domestic from us." IDF 1179. Mr. Tatman similarly noted in an e-mail that "we won't provide domestic product to distributors who are not fully supporting our domestic product lines." CX0113 at 001.

Following Star's first sales of domestic fittings, McWane publicly announced the program on September 22, 2009, in a letter to distributors:

> [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 fittings and accessories or shipment of their domestic fittings and accessory orders of Tyler Union or Clow Water products for up to 12 weeks.

CX0010. Despite the soft language of "may" and "or," McWane made sure distributors received the message that they would no longer be able to buy domestic fittings from McWane if they purchased domestic fittings from Star. *See* IDF 1180 (finding that McWane informed customers that if one branch of a distributor purchased domestic fittings from Star, all branches would be cut off). The only exceptions to this exclusivity policy were in situations where McWane domestic fittings were either unavailable within normal time frames, or purchased from a competitor along with pipe.[9] IDF 1173.

As McWane intended, most distributors interpreted the announced policy as a threat that McWane would terminate their ability to purchase any of McWane's domestic fittings if they purchased any domestic fittings from Star. *See* IDF 1184 (distributor Hajoca believed it would lose its rebates or be cut off from purchasing from McWane), 1187 (Groeniger viewed the policy as a threat that if it purchased domestic fittings from Star, McWane would not sell it any domestic fittings), 1188 (Illinois Meter believed it had been threatened with loss of access to McWane's domestic fittings if it bought from Star), 1190 (E.J. Prescott believed "If you bought one [domestic] fitting [from Star] in one of our 26 places, we're out, simple. . . . [McWane] said it's all or nothing."), 1192 (CI Thornburg interpreted the letter as a threat); IDF 1300 (U.S. Pipe was told that if it purchased from Star, "don't come back to McWane"); *but cf.* Thees, Tr. 3109-11 (Ferguson believed there may have been room to negotiate the Full Support Program's requirements and that its status as a large buyer would offer protection; ultimately, however, Ferguson chose not to purchase domestic fittings from Star unless McWane did not have the domestic fittings available (IDF 1262)). McWane acknowledged in an internal presentation that the message had been received by distributors: "Although the words 'may' and 'or' were specifically used, the market has interpreted the communication in the more hard line 'will' sense. . . . Access to McWane or Sigma requires distributors to exclusively support McWane where products are available within normal lead times. Violations will result in: Loss of access, loss of accrued rebates." IDF 1183.

And McWane's threat to terminate distributors who did not comply with its Full Support Program was not hollow. When Hajoca's Tulsa branch purchased Star domestic fittings,

[9] To the extent that McWane's rebates were part of the policy, McWane's threat to terminate any rebates previously offered if a distributor purchased from Star served only to further advance the exclusive dealing requirement of the program. As a result, because McWane's program was plainly more than a rebate policy, the arguments McWane raises about above-cost pricing are inapposite. Our principal concern is with McWane's threats to terminate its supply to distributors who purchased rival domestic fittings.

McWane cut off domestic fitting sales to all Hajoca branches, including those that had not purchased from Star. IDF 1208-13 (McWane refused to supply Hajoca's Lansdale branch even after Hajoca offered to pay higher prices). In an e-mail to customers of Hajoca's Lansdale, Pennsylvania branch, McWane stated, "We don't like the situation either but feel we can't support someone who is helping our competition build a line against us." IDF 1207. Consistent with McWane's policy, and in fact for a period longer than the 12 weeks specified in McWane's September 2009 letter, Hajoca was unable to place new domestic fittings orders with McWane. IDF 1219. McWane also withheld Hajoca's rebates for the fourth quarter of 2009. IDF 1224-27. It was only in April 2010, after the FTC commenced its investigation, that McWane and Hajoca negotiated an agreement allowing Hajoca to resume buying domestic fittings from McWane. Even under that agreement, however, Hajoca's Tulsa branch continued to be precluded from accessing McWane domestic fittings. IDF 1220-23.

In sum, the Full Support Program effectively required distributors to purchase domestic fittings only from McWane, under a real threat of losing access to McWane's full line of domestic fittings. Accordingly, we find that McWane's Full Support Program was an exclusive dealing policy.

2. McWane's Full Support Program Foreclosed Star's Access to Distributors for Domestic Fittings and Harmed Competition

A finding of exclusive dealing alone is insufficient to establish liability. There must be evidence that competition, not merely a competitor, has been harmed. *Dentsply*, 399 F.3d at 187. The conduct, in other words, "must harm the competitive *process* and thereby harm consumers." *Microsoft*, 253 F.3d at 58. Accordingly, the central question is whether McWane's exclusive dealing policy raised "the cost of obtaining efficient distribution" for its rivals and thereby impaired "the competitive effectiveness" of its rivals with "resulting harm to competition." Carlton, 68 Antitrust L.J. at 665 n.15. Importantly, to be unlawful, the conduct need not have foreclosed all competition from the market; rather, it must have impeded a substantial number of rivals or severely restricted the scope of the market. *Dentsply*, 399 F.3d at 191.

With few exceptions, McWane's program forced its distributors to carry McWane domestic fittings exclusively. McWane thus deprived its rivals, mainly Star, of distribution sufficient to achieve efficient scale, thereby raising costs and slowing or preventing effective entry. The result harmed competition by increasing barriers to entry and allowing McWane to maintain its monopoly position, which prevented meaningful price competition and deprived consumers of the ability to choose among the products, terms of sale, and services of varying suppliers of domestic fittings.

a. Foreclosure of Access to Distributors

A domestic fittings entrant is unable to compete effectively without access to distributors. The benefits that distributors provide to fittings suppliers include offering better sales coverage (IDF 400, 402-03, 408-09); more local influence and knowledge of projects in their market area (IDF 400, 408-09, 412); carrying local inventory (IDF 400, 402-06); aggregating small orders and shipments to capitalize on scale efficiencies (IDF 405); and carrying credit risk (IDF 400, 402, 407, 411). For a fittings supplier to replicate these distributor functions would impose an "astronomical" cost on the supplier that would be prohibitively expensive. IDF 402. The benefits accruing from distributors make them the preferred and most efficient sales channel for domestic fittings manufacturers. Not surprisingly, McWane views distributors as "critical to [its] success," as does Star. IDF 401-02. No evidence supports the existence of viable alternate distribution channels, including direct sales to end users. IDF 381. Indeed, virtually all fittings sales are made through distributors. JSLF ¶ 14, IDF 367 (99% of McWane's sales of fittings are through distributors), IDF 373-74 (similarly, Sigma and Star sell almost all of their fittings to distributors).

McWane's Full Support Program foreclosed Star and other potential entrants from accessing a substantial share of distributors. Following announcement of the program, the country's two largest waterworks distributors, HD Supply, with a roughly 28% to 35% share of distribution (IDF 378), and Ferguson, with about 25% of distribution (IDF 379), prohibited their branches from purchasing domestic fittings from Star unless the purchases fell into one of the exceptions specified in the Full Support Program. One day after learning about the program, HD Supply's management sent a memo to its district, branch, and operations managers describing McWane's policy and stating that "we need to adhere to this mandate and purchase all of our American made fittings through Union-Tyler [McWane] or Sigma . . . [to] ensure that we have a full line of product . . . as well as continued compliance with the Federal [ARRA Buy American] requirements." IDF 1238-41. HD Supply even cancelled pending orders for domestic fittings it had with Star. IDF 1242. Although a Ferguson executive testified that his company "was planning on purchasing all its needs from McWane" regardless of the Full Support Program because Star lacked a complete line of domestic fittings (Thees, Tr. 3109; *see also* IDF 1266, 1272), the record suggests that the Full Support Program nonetheless cost Star some Ferguson business. A Ferguson Vice President called district managers after McWane's policy was announced to ensure that it did not buy from Star, and at least one job Ferguson initially awarded to Star was cancelled. IDF 1260-61, 1263.

Similarly, when WinWholesale, the nation's third-largest waterworks distributor, received notice of the Full Support Program, it listed Star's vendor status internally as "Not Approved," which barred its local companies from buying from Star under any circumstances without board approval. IDF 236, 1331-32, 1334-37. WinWholesale, however, did allow local companies to make purchases from Star that fell within the exceptions allowed by the Full Support Program, and, as a result, some WinWholesale local companies made a handful of purchases from Star. *See* IDF 1338, 1343.

Other large distributors likewise refused to purchase from Star because of the Full Support Program, sometimes even though Star offered lower prices. For instance, despite a commitment from Star to offer lower prices than McWane, U.S. Pipe instructed its purchasing manager not to purchase domestic fittings from Star unless McWane could not provide the needed size. IDF 1295, 1299, 1301-02. As a result, except for minor purchases falling within the exceptions to McWane's exclusive dealing policy, U.S. Pipe did not purchase domestic fittings from Star until September 2010. IDF 1309-11. Similarly, Star offered TDG distributors a more generous rebate program on domestic fittings than McWane, but Star believed they likewise rejected Star's offer because of the Full Support Program. IDF 1391. Groeniger, which had given Star business on two sizeable domestic-only projects prior to McWane's announcement of the Full Support Program, was reluctant to make further purchases of domestic fittings from Star because it needed access to McWane's domestic fittings and feared retaliation. IDF 1313-18; IDF 1329-30 (testifying that, but for McWane's policy, Groeniger would have given Star 50% of its domestic fittings business in 2010). The Full Support Program also deterred Illinois Meter from purchasing domestic fittings from Star because of the need to have access to McWane's full line. Sheley, Tr. 3413, 3417-18; IDF 1357-58, 1362-64.[10]

In the face of this substantial evidence, McWane argues its program could not have foreclosed access to distributors because it did not require distributors to commit to purchasing McWane's fittings exclusively for a lengthy period of time. McWane's argument ignores the reality of a marketplace where distributors need access to a full line of domestic fittings to service their customers. "An express exclusivity requirement . . . is not necessary, because we look past the terms of the contract to ascertain the relationship between the parties and the effect of the agreement 'in the real world.' Thus, *de facto* exclusive dealing claims are cognizable under the antitrust laws." *ZF Meritor*, 696 F.3d at 270; *Minnesota Mining & Mfg.*, 35 F. Supp. 2d. 1138, 1144 (D. Minn. 1999) (holding that the proper focus of an exclusive dealing arrangement is not its duration, but its "practical effect"). Even arrangements that are terminable at will can be anticompetitive. *Dentsply*, 399 F.3d at 194 (noting that "in spite of the legal ease with which the relationship can be terminated," affected dealers may "have a strong economic incentive to continue carrying [the supplier's product]").

In fact, McWane's Full Support Program required exclusive dealing for as long as McWane desired. The overwhelming evidence shows the practical effect of McWane's program was to make it economically infeasible for distributors to drop McWane's full line of domestic fittings and switch to Star. This reality made McWane's exclusive dealing program as effective and enduring as a long-term contract. *See Lorain Journal Co. v. United States*, 342 U.S. 143, 149-50 (1951) (holding that unilateral conduct of indefinite duration by a monopolist with a "practically indispensable" service "forced numerous [customers] to refrain from" dealing with a rival).

McWane also disputes the connection between its Full Support Program and Star's lagging sales, pointing to other concerns distributors had about Star's supply of domestic fittings. But the Full Support Program need not have been the sole reason for distributors' reluctance to purchase domestic fittings from Star. The relevant question is whether McWane's policy contributed significantly to that result. *See Microsoft*, 253 F.3d at 78-80; *Conwood Co. v. U.S. Tobacco Co.*, 290 F.3d 768, 791 (6th Cir. 2002) (explaining that defendant's conduct "need not

[10] Complaint Counsel estimates that McWane's policy foreclosed approximately [redacted]% of distribution, emphasizing that this is a far higher percentage than what courts have typically viewed as creating a potential competitive problem. CCAnsB at 17 (citing, *inter alia*, IDF 357, *in camera*); *Microsoft*, 253 F.3d at 70 (noting that a monopolist's use of exclusive contracts may in certain circumstances "give rise to a § 2 violation even though the contracts foreclose less than the roughly 40% to 50% share usually required in order to establish a § 1 violation"); Hovenkamp, XI *Antitrust Law* ¶ 1821c.1, at 191 (foreclosure above 50% is "routinely condemned"). We need not adopt Complaint Counsel's estimate, however, to conclude that foreclosure here was both substantial and problematic. As the *Dentsply* court concluded, "the reality . . . is that the firm that ties up the key dealers rules the market." 399 F.3d at 190.

be the sole proximate cause" of lost sales that caused injury). The evidence amply shows that the Full Support Program substantially contributed to distributors' "reluctance to purchase from Star." ID at 410; *see also ZF Meritor*, 696 F.3d at 266, 285-86 (focusing on foreclosure created by exclusive dealing despite acknowledging that plaintiff could have competed more effectively).

b. Adverse Impact on Competition

McWane's exclusive dealing program created a strong economic incentive for distributors to reject Star's products, artificially diminishing Star's competitive prospects in the domestic fittings market. Beginning in Spring 2009, Star considered purchasing its own domestic foundry. IDF 1402. By September or October, it had identified a specific foundry and entered into negotiations to purchase it. IDF 1404. Star estimated it would cost [redacted] to acquire the facility and had the financial ability to make the purchase. IDF 1405-06, *in camera*. However, McWane's announcement of its exclusive dealing policy in September and its impact on Star's sales prompted Star to rethink its strategy of acquiring a domestic foundry. IDF 1407-08.

Before McWane's September announcement, Star had received requests for quotes for domestic fittings worth approximately $10 million. IDF 1395. As discussed above, almost immediately following the announcement, distributors, including HD Supply, Ferguson, and WinWholesale, withdrew their requests for quotes or orders and informed Star they were no longer interested in purchasing domestic fittings from Star. IDF 1381-82. Based in part on the withdrawn quotes, Star estimated it would have had [redacted] in sales of domestic fittings in 2010, rising to [redacted] in 2011, if McWane had not implemented the Full Support Program. IDF 1394-95, *in camera*. At trial, Star testified that more refined estimates showed that it needed between [redacted] of domestic fittings sales to justify purchasing its own foundry. IDF 1400, *in camera*; Bhargava, Tr. 2962-63, *in camera*. Star's actual sales of domestic fittings, [redacted] in 2010, were insufficient for Star to justify operating a foundry of its own. IDF 1396, *in camera*, 1401.

Consequently, rather than acquiring its own foundry, Star contracted with six foundries to produce raw castings, which Star then shipped to its Houston facility for finishing. This route was more costly and less efficient than a foundry owned and operated by Star would have been because using independent foundries means less specialized and efficient equipment; smaller batch sizes; additional logistical costs associated with inventory, finishing, and freight; less control over inventory levels; less ability to expedite orders; and inefficiencies resulting from dealing with multiple foundries. IDF 1409-10. Independent foundries also have higher labor costs and add their own markup. IDF 1412-13. Shipping costs alone from the foundries to Houston for finishing added an additional [redacted]% to the cost of Star's domestic fittings. IDF 1411, *in camera*. Star estimated that the cost of producing domestic fittings at its own foundry would have been [redacted]% lower than the cost of contracting with independent foundries, and that it could have reduced its domestic fittings prices by [redacted]%. IDF 1419-20, *in camera*. Moreover, because some customers were reluctant to rely on a supplier without its own foundry, IDF 1254, 1272, by denying Star the scale necessary to operate its own foundry, McWane further cemented its monopoly.

McWane anticipated and intended this result.[11] Mr. Tatman could not have been more clear: "We need to make sure that they don't reach any critical mass that will allow them to continue to invest and receive a profitable return." CX0074 at 001; s*ee also* IDF 1155 (quoting CX0067 at 002) (in a "brainstorming document," "Mr. Tatman observed that 'any competitor' seeking to enter the domestic fittings market could face 'significant blocking issues' if they are not a 'full line' domestic supplier"); CX0076 at 009 (explaining that a "Force Distribution to Pick their Horse" strategic response to entry would "Force[] Star/Sigma to absorb the costs associated with having a more full line before they can secure major distribution"). Impairing its rivals' ability to threaten McWane's monopoly was the Full Support Program's core objective.

And Star was not the only firm affected by McWane's exclusive dealing policy. Fittings importer SIP also evaluated whether to enter the domestic fittings market in 2009. IDF 1365-80. SIP believed that because of McWane's policy, it would have difficulty acquiring distributor customers if it entered with less than a full line. IDF 1377. Although McWane's Full Support Program was not the only reason SIP decided not to enter, it was a significant reason. IDF 1380 ("That was the straw that broke the camel's back.") (quoting CX2522, *in camera* (Agarwal, Dep. at 67-68)).

In his dissent, Commissioner Wright asks us to apply a new, heightened standard of proof for exclusive dealing cases and concludes under that standard that Complaint Counsel failed to prove McWane's exclusive dealing policy harmed competition.[12] Although Commissioner Wright assumes that McWane is a monopolist for his analysis and agrees with the majority decision in various respects, including that "[t]here is ample record evidence demonstrating that the Full Support Program harmed McWane's rival Star," he claims "Complaint Counsel fails totally to establish, as it must under the antitrust laws, that McWane's conduct harmed *competition*."[13] Dissent at 4-5. We respectfully disagree. In our view, the evidence that McWane's exclusive dealing policy significantly impaired the access of McWane's only rival, Star, to the main channel of distribution, thereby increasing its costs and keeping it below the critical level necessary to pose a real competitive threat, is plainly sufficient to meet the standard of harm to competition set forth in the prevailing case law.

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[11] While our aim is to ascertain the effect of McWane's exclusive dealing policy, evidence of McWane's intent is relevant "to the extent it helps us understand the likely effect of [McWane's] conduct." *Microsoft*, 253 F.3d at 59; *Chicago Bd. of Trade v. United States*, 246 U.S. 231, 238 (1918) ("knowledge of intent may help the court interpret facts and predict consequences").

[12] Although harm to competition is certainly necessary for a claim of monopolization, Commissioner Wright would apply a standard of evidentiary proof for this element that is far beyond that called for by applicable Section 2 law. *See generally ZF Meritor*, 696 F.3d at 286; *Dentsply*, 399 F.3d at 191; *Microsoft*, 253 F.3d at 70-71. For instance, he insists that Complaint Counsel was required to calculate the specific level of sales Star lost as result of the Full Support Program. Tellingly, Commissioner Wright offers no legal support for this heightened standard.

[13] We note that while the aim of the antitrust laws is to protect competition, not competitors, there *is* harm to competition when a monopolist's only rival is precluded from becoming an effective competitor. *See Spirit Airlines*, 431 F.3d at 951 ("[I]n a concentrated market with very high barriers to entry, competition will not exist without competitors.").

Moreover, there are significant factual oversights in his analysis even applying his proposed heightened standard. For instance, Commissioner Wright argues there is no evidence supporting Complaint Counsel's contention that Star needed its own foundry to compete effectively in the market. But the evidence shows that costs decline substantially when a market participant is able to operate its own foundry.[14] By preventing Star from securing enough sales volume to support its own foundry, McWane's exclusive dealing program increased Star's costs and denied it the ability to compete effectively. We also disagree with Commissioner Wright's assertion that the notion that Star was operating below "minimum efficient scale" "strains credulity" when one takes into account Star's entry and growth in the market. Dissent at 32. Complaint Counsel argues persuasively that McWane was charging a monopoly price, which means that even a less efficient firm could enter and grow market share. The key question is whether the exclusionary conduct kept rivals from developing into real competitive threats; here we find that it did. *See Dentsply*, 399 F.3d at 190-91 (finding competitive harm when defendant's excluded rivals failed to achieve "the critical level necessary for any rival to pose a real [competitive] threat"); *Microsoft*, 253 F.3d at 70-71 (stating that defendant's exclusionary conduct kept [competitor's product] "below the critical level necessary for [competitor's product] or any other rival to pose a real threat to Microsoft's monopoly").

Commissioner Wright also argues that our foreclosure analysis is "defective" on the ground that "[i]t makes little sense to conclude that Star was foreclosed from McWane's sales to distributors that would have taken place with or without the Full Support Program." Dissent at 38. He insists that to prevail, Complaint Counsel was required to show that but for the Full Support Program, a significant volume of sales would have actually shifted to Star. Commissioner Wright appears to assume, however, that the sales a monopolist like McWane has tied up with its distributors are not contestable and that a second meaningful alternative in the market will have no impact on price or other forms of competition, regardless of which supplier customers may ultimately choose. This assumption overlooks record evidence that McWane's main customers immediately sought an alternative when given the option, placing millions of dollars' worth of requests for proposal with Star in the few months after it announced entry and before McWane imposed the Full Support Program.

In addition, contrary to Commissioner Wright's assertion, there is evidence that McWane's exclusionary conduct had an impact on price. McWane itself recognized that if Star entered, prices in the domestic market would likely fall just like in the imported market. IDF 1148-49, 1151-53. McWane understood it had a choice—it could try to maintain its dominant market share either by lowering prices to compete against Star (CX0465 at 004 (noting that McWane could maintain its "near 100% share" by dropping prices)), or it could adopt an exclusive dealing policy that would prevent its rival from achieving the scale necessary to

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[14] Commissioner Wright points to Sigma's virtual manufacturing model as evidence that owning a foundry is not essential to achieving efficiencies. Dissent at 31-32. However, this comparison is inapt. We are concerned with the effect of McWane's conduct on Star's ability to do business in the market for domestically-manufactured fittings. The fact that Sigma uses a virtual manufacturing model for its imported fittings business sheds little light on that question.

become a more significant competitor (CX0067 at 002 (noting that rivals without a full domestic line would be susceptible to "significant blocking issues")). By adopting the program, McWane was able to ensure that prices and gross profits for domestic fittings remained high. In fact, following Star's entry, McWane's financials reveal that, while its production costs for domestic fittings remained flat for 2009 and 2010, McWane raised domestic fittings prices and increased its gross profits during that same time. IDF 1091-93, *in camera*. Moreover, McWane was able to impose those higher prices for domestic fittings in both states where it had a 100% market share and those where it faced direct competition from Star. IDF 1090.

In short, Commissioner Wright fails to adequately consider that foreclosure delaying a rival's effectiveness and growth in the market results in consumer harm and that there is considerable evidence to support a reasonable inference that the Full Support Program had that very result.

By foreclosing Star's access to distributors, McWane's exclusive dealing program increased Star's costs and denied it the ability to compete effectively. Courts have not hesitated to find antitrust liability when exclusive dealing contributes significantly to maintaining a monopoly through such effects. *See Dentsply*, 399 F.3d at 190-91 (finding competitive harm when defendant's excluded rivals failed to achieve "the critical level necessary for any rival to pose a real [competitive] threat"); *Microsoft*, 253 F.3d at 70-71 (stating that defendant's exclusionary conduct kept [competitor's product] "below the critical level necessary for [competitor's product] or any other rival to pose a real threat to Microsoft's monopoly"); *cf. ZF Meritor*, 696 F.3d at 289 (finding antitrust injury when the defendant's conduct denied rivals the market share they needed to "remain viable").

McWane's exclusive dealing policy also had another adverse impact on competition: it denied its customers the ability to make a meaningful choice regarding domestic fittings suppliers that the evidence shows many of them sought. *See ZF Meritor*, 696 F.3d at 285 (noting that a monopolist may cause harm to competition when it "use[s] its power to break the competitive mechanism and deprive customers of the ability to make a meaningful choice"); *Dentsply*, 399 F.3d at 194 (holding that the defendant's exclusive dealing policy had the anticompetitive effect of limiting the choice of products available to end users); *see also Race Tires*, 614 F.3d at 77-78 (recognizing the important role "coercion" plays in the Section 2 context). Although fittings are commodity products, there is evidence of competition among suppliers for service and other terms. *See* IDF 1584 (noting that some distributors preferred Sigma over McWane because of certain servicing benefits, including faster delivery); IDF 1586 (ACIPCO preferred Sigma over McWane because Sigma offered additional specialty services, such as coatings, linings, and tapes); IDF 1588 (Groeniger preferred buying from Sigma because it preferred Sigma's service to that offered by McWane and Star). As the Third Circuit noted in *Dentsply*, "[w]hile the [customers] might prefer to sell the [products] of multiple manufacturers, if faced with an all or nothing choice they may accede to the dominant firm's wish for exclusive dealing." 399 F.3d at 194 (internal quotations omitted).

Distributor decisions to reject Star following implementation of the Full Support Program, sometimes even when Star offered lower prices, show that McWane's policy and position as a supplier of necessary products effectively eliminated distributors' choices regarding their source of domestic fittings supply and prevented them from using Star to extract better prices or services from McWane. IDF 1395 (finding that, after announcement of the Full Support Program, Star lost $10 million in request for quotes from, among others, HD Supply, Ferguson, Mainline, WinWater, and other customers); IDF 1295, 1299, 1301-02 (finding that U.S. Pipe rejected Star despite Star's offer of lower prices than McWane). The absence of exclusivity in the more competitive imported fittings market highlights the coercive element of McWane's policy. *See* IDF 392 (noting that distributors typically purchase imported fittings from at least two different suppliers).

c. McWane's Rebuttal

McWane disagrees that its policy impaired Star's ability to compete in the domestic fittings market. It contends first that Star's sales to 130 distributors enabling Star to obtain [redacted]% market share in 2010 and more than [redacted]% market share in 2011 demonstrate successful entry into the domestic fittings market, thereby precluding a finding of liability as a matter of law. IDF 357, *in camera*. We rejected this same argument when we denied McWane motion for summary decision. Under Section 2, "it is not necessary that all competition be removed from the market. The test 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; *accord ZF Meritor*, 696 F.3d at 265, 283-84 (exclusive dealing violated Section 2 even though monopolist allowed customers to purchase up to 20% of product from rival). Moreover, growth and market share alone is not the relevant benchmark. The appropriate comparison is growth that would have occurred absent the Full Support Program. Here, as we have discussed, McWane's exclusive dealing policy ensured that Star's sales remained limited and enabled McWane to maintain its monopoly position. As we noted previously, even McWane's expert agreed that Star's entry did not affect McWane's prices for domestic fittings. IDF 1090. Indeed, soon after Star entered the market, McWane announced and implemented price increases for domestic fittings. IDF 1083.

Further, McWane's repeated claim that Star sold to 130 distributors is meaningless without context or a showing as to the size of Star's sales. As the ALJ explained, "[i]n counting the number of customers to whom Star sold domestic fittings, Respondent's expert, Dr. Normann, counted each Distributor that may have purchased only a single Domestic Fitting from Star, or whose purchases fell into one of the limited exceptions to McWane's Full Support Program. IDF 1142. The number of customers, without more information on the nature and extent of their purchases, is not entitled to substantial weight." ID at 409. Here, the record shows that distributors primarily bought domestic fittings from Star under the exceptions to the Full Support Program, *i.e.*, when McWane was unable to offer specific fittings in timely fashion or as part of a bundled order, even when they would not otherwise purchase from Star for fear of losing access to McWane's domestic fittings. *See* IDF 1237, 1242, 1257 (HD Supply); 1299, 1305, 1309 (U.S. Pipe); 1328-29 (Groeniger).

McWane also argues that, even if Star was excluded, there was no harm to competition because "the ALJ found that Star's reliance on jobber foundries made it a less efficient, higher cost supplier, and thus that McWane's domestic fittings prices were lower[.]" RAppB at 29. We disagree. McWane's argument conveniently overlooks the role its exclusive dealing policy played in limiting Star's sales and the resulting impact the policy had on Star's scale of operations and reliance on third-party "jobber" foundries. As discussed at length above, McWane designed its exclusive dealing policy precisely to slow its rivals' growth. *See* CX0076 at 009 (noting that the program "[f]orces Star/Sigma to absorb the costs associated with having a more full line before they can secure major distribution"). And there is ample evidence that McWane's program was effective in denying Star access to customers and thus impeding its ability to compete effectively.

Moreover, McWane is incorrect to the extent it suggests it is immune from liability merely because Star was a less efficient competitor. The fundamental concern with monopoly maintenance is that dominant firms may adopt policies that prevent the development of effective competition. As the D.C. Circuit held in *Microsoft*, it is "inimical to the purpose of the Sherman Act to allow monopolists free reign to squash" emerging competitors before they have the opportunity to become capable rivals that could effectively challenge the monopolist. *Microsoft*, 253 F.3d at 79; *see also* Andrew I. Gavil, *Exclusionary Distribution Strategies by Dominant Firms: Striking a Better Balance*, 72 Antitrust L.J. 3, 59-60 (2004) (while "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, . . . 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").

3. McWane's Procompetitive Justifications for the Full Support Program

Complaint Counsel has demonstrated harm to competition here, shifting the burden to McWane to show that the challenged conduct "promotes a sufficiently pro-competitive objective." *Dentsply*, 399 F.3d at 196. Cognizable justifications are typically those that reduce cost, increase output or improve product quality, service, or innovation. *See FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447, 459 (procompetitive justifications include "creation of efficiencies in the operation of a market or the provision of goods and services"); *Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc.*, 441 U.S. 1, 19-20 (1979) (courts should consider whether the challenged practice is likely to "increase economic efficiency and render markets more, rather than less, competitive") (internal quotations omitted); *Data Gen. Corp. v. Grumman Sys. Support Corp.*, 36 F.3d 1147-1183 (1st Cir. 1994) ("In general, a business justification is valid if it relates directly or indirectly to consumer welfare.").

McWane offers two justifications for its conduct. It argues first that it engaged in exclusive dealing to preserve sales in order to generate sufficient volume to operate its last domestic foundry. While preserving sales volume to continue to operate a foundry may have been a significant business objective, it is not a cognizable procompetitive justification for antitrust purposes. *See Microsoft Corp.*, 253 F.3d at 71-72 (explaining that the desire to increase sales "is not an unlawful end, but neither is it a procompetitive justification"). As the ALJ recognized, McWane's sales goal provides benefits for McWane, but "Respondent has proffered no explanation as to how its Full Support Program benefits consumers." ID at 415.

Significantly, the measures that McWane took to preserve its sales volume were not the type of steps, such as a price reduction, that typically promote consumer welfare by increasing overall market output. Indeed, McWane considered the impact of lowering its domestic fittings pricing "to defend [its] near 100% share position," but ultimately determined that lowering pricing would hurt margins. CX0465 at 004. Instead, the sales gained for production by McWane's exclusive-dealing arrangement were sales taken from Star by virtue of the increased costs imposed by the Full Support Program. That is, McWane's sales did not result from lower prices, improved service or quality, or other consumer benefits; instead, McWane's sales stemmed from anticompetitive reductions in Star's output. Sales so gained are not cognizable as procompetitive justifications. *See* Horizontal Merger Guidelines § 10 ("Cognizable efficiencies . . . do not arise from anticompetitive reductions in output or service."); c*f. NCAA v. Bd. of Regents*, 468 U.S. 85, 116-17 (1984) (holding that a defendant could not justify curbing access to a more-desired product to induce consumers to purchase larger amounts of a less-desired product); *In re Polygram Holding, Inc.*, 136 F.T.C. 310, 345-46 (2003) ("[C]ognizability . . . allows the deciding tribunal to reject proffered justifications that, as a matter of law, are incompatible with the goal of antitrust law to further competition."), *aff'd*, 416 F.3d 29 (D.C. Cir. 2005).

Furthermore, contemporaneous evidence belies McWane's contention that its exclusive dealing policies were motivated by a desire to gain volume in order to preserve operations at McWane's domestic foundry. Although that justification shows up in testimony from McWane witnesses, McWane's contemporaneous planning documents from 2009 demonstrate that the objectives were almost exclusively to maintain domestic prices and profitability, deny Star critical mass, and prevent Star from becoming an effective competitor. *See* IDF 1149 (quoting CX0074 at 001) ("Whether we end up with Star as a complete or incomplete domestic supplier my chief concern is that the domestic market gets creamed from a pricing standpoint just like the non-domestic market has been driven down in the past."), 1151 (citing CX 0102 at 002 (2010 budget describing "biggest risk factor" as the "[e]rosion of domestic pricing if Star emerges as a legitimate competitor")), 1158 (citing CX0076 at 009) (explaining that a disadvantage of not adopting exclusive dealing was that it would allow Star to "drive profitability out of our business"), 1150 (quoting CX0074 at 001) ("I agree that at this stage the chance for profitable cohabitation with Star owning a [piece] of the Domestic market is slim . . . we need to make sure that they don't reach any critical market mass that will allow them to continue to invest and receive a profitable return.").

McWane also argues that the Full Support Program prevents customers from cherry-picking the highest selling items from Star and persuades them to support McWane's full line of domestic fittings. Here too McWane fails to identify the benefit to consumers.[15]

In support of McWane's claim, its expert, Dr. Normann, explains that a full-line manufacturer incurs the costs of producing all fitting types and is able to bear these costs because it captures the benefit of scale economies arising from production of the most common fittings. According to Dr. Normann, a manufacturer that produces only the common fittings could avoid the cost of producing a full line and consequently could sell the common fittings at lower prices.

[15] Although preventing dealer or competitor free riding on manufacturer-supplied investments is commonly proffered as a procompetitive justification for exclusive dealing, there is no showing that is the case here. Indeed, the absence of evidence of exclusive dealing arrangements for sales of imported fittings belies such an argument.

If distributors were able to source from multiple manufacturers, he reasons, they would buy the common fittings from the limited supplier (at lower prices) and turn to the full-line supplier for less common products only, which could lead to the collapse of the full-line seller. *See* RX712A at 056.

This argument is unpersuasive. If a limited supplier undersells a full-line supplier for more common products, there is no reason in principle why the full-line supplier could not compete for that business by lowering its price for those products and increasing its price for the less common products. McWane offers no reason why supply would not be forthcoming to meet demand at a higher price, and we cannot conclude that consumers are necessarily worse off because less common fittings are sold for higher prices, when simultaneously, more common fittings are sold at lower prices. Even if selective entry by the full-line supplier's rivals led to the collapse of the full-line seller, that itself would not constitute a harm to the market (as opposed to harm to a single firm). Courts have long rejected claims that "because of the special characteristics of a particular industry, monopolistic arrangements will better promote trade and commerce than competition," *Nat'l Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679, 689 (1978), concluding instead that "[t]he Sherman Act reflects a legislative judgment that ultimately competition" will produce the best results. *Id*. at 695-96 (also noting that "the Rule of Reason does not support a defense based on the assumption that competition itself is unreasonable"). McWane's claim is not consonant with this core judgment of the Sherman Act, and it is inconsistent with the basic objectives of Section 2.[16]

VI. THE MASTER DISTRIBUTION AGREEMENT AS A RESTRAINT OF TRADE

We now turn to the charge that McWane and Sigma unreasonably restrained trade in the domestic fittings market in violation of Section 5 of the FTC Act by entering into the MDA. According to Complaint Counsel, McWane saw that Sigma was preparing to enter the domestic fittings market and sought to eliminate the risk of competition by inducing Sigma to become an exclusive distributor of McWane's domestic fittings.

Complaint Counsel's claim, based on Section 1 of the Sherman Act, requires that there be a contract, combination, or conspiracy among two or more entities that unreasonably restrains trade. *Realcomp II, Ltd. v. FTC*, 635 F.3d 815, 824 (6th Cir. 2011). Here, there is no question that there was an agreement. The dispute is over the agreement's lawfulness. Complaint Counsel asserts two theories of liability. Their main contention is that, without the MDA, Sigma would have entered the market independently and competed against McWane. In Complaint Counsel's view, the MDA amounted to an agreement that Sigma would cede the domestic fittings market to McWane. Complaint ¶¶ 47-55, 67. Complaint Counsel argues in the

[16] As noted above, the Commission dismisses Count 7 of the Complaint, alleging attempted monopolization based on McWane's exclusive dealing requirements. In view of our conclusion that McWane unlawfully monopolized the domestic fittings market through the same conduct, it is unnecessary to ask whether McWane attempted to monopolize the market. Accordingly, we do not reach this issue, and do not adopt the ALJ's analysis. *See Spectrum Sports*, 506 U.S. at 451-53, 460-61.

alternative that the MDA was an unreasonable vertical restraint of trade. We find there is no violation under either theory.

A. THE MDA WAS NOT A MARKET ALLOCATION AGREEMENT

Under Section 1 of the Sherman Act, an agreement among competitors to allocate markets is *per se* illegal. *See Palmer v. BRG of Georgia, Inc.*, 498 U.S. 46, 49 (1990) (*per curiam*); *United States v. Topco Assocs*., 405 U.S. 596, 608-09 (1972). Likewise, naked agreements "not to compete among potential competitors are also illegal *per se*." *Transource Int'l, Inc. v. Trinity Indus.*, 725 F.2d 274, 280 (5th Cir. 1984); *see also Engine Specialties, Inc. v. Bombardier, Ltd.*, 605 F.2d 1, 9-11 (1st Cir. 1979) (finding a market allocation agreement between potential competitors *per se* unlawful). Complaint Counsel's Section 1 theory is premised on Sigma being a potential competitor in the domestic fittings market. Accordingly, we must first determine if, but for the MDA, Sigma was sufficiently likely to enter the domestic fittings market to be considered a potential competitor of McWane.

In evaluating this question, we look to whether Sigma had "the necessary desire, intent, and capability to enter the market." *Bombardier*, 605 F.2d at 9. The ultimate issue is whether Sigma's entry was reasonably probable in the absence of the MDA. *See* Fed. Trade Comm'n & Dep't of Justice, Antitrust Guidelines for Collaborations Among Competitors § 1.1 n.6 (2000) ("A firm is treated as a potential competitor if there is evidence that entry by that firm is reasonably probable in the absence of the relevant agreement.") ("Competitor Collaboration Guidelines"); *cf. Yamaha Motor Co. v. FTC*, 657 F.2d 971, 977 (8th Cir. 1981) (evaluating, in a Clayton Act Section 7 case, whether, absent the joint venture, the merging party "probably" would have entered). We agree with the ALJ that Sigma's entry was not reasonably probable.

As explained above, Sigma began investigating two potential avenues for entry into the domestic fittings market following the passage of the ARRA in February 2009: (1) purchasing domestic fittings from McWane; and (2) producing domestic fittings by contracting with independent domestic foundries (a "virtual manufacturing" model). Rona, Tr. 1630; Pais, Tr. 1752; IDF 1423-24. In April, Sigma approached McWane about obtaining private label fittings but was dissatisfied with McWane's initial offer, which was insufficient to cover Sigma's operating costs. IDF 1425, 1443-45. After rejecting McWane's first offer, Sigma President and CEO Mr. Pais wrote: "We now need to go all out and implement a SDP [Sigma Domestic Production] plan – replicating SIGMA's 'virtual manufacturing' model . . . just as we do thru a collection of facilities overseas." IDF 1455. Before long, however, Sigma approached McWane to resume discussions about a possible distribution arrangement. IDF 1522. Ultimately, Sigma decided to forgo independent entry and chose instead to purchase domestic fittings from McWane pursuant to the MDA.

Complaint Counsel points to troubling evidence showing that McWane believed Sigma was likely to enter the domestic fittings market independently, and that McWane entered the MDA in order to eliminate that possibility. For example, an internal McWane memorandum, dated May 26, 2009, concludes that McWane's decision to sell domestic fittings to Sigma "probably comes down to . . . [h]ow legitimate of a risk is there with a competitor successfully introducing a Domestic product line?" CX0067 at 002, 004. In addition, Mr. Tatman and Mr. McCullough referred to the MDA as an "insurance policy" against potential Sigma entry.

CX2353 at 004; CX1184 at 001. The evidence also indicates that McWane believed selling domestic fittings to Sigma would "help drive some additional level of price stability." CX 0465 at 002, 010. Yet other evidence shows that McWane harbored doubts as to Sigma's capabilities. For example, McWane's Vice President and General Manager, Mr. Tatman, sent an internal email to both of his bosses, Mr. McCullough and Mr. Walton, on August 18, 2009, explaining that he was "leaning towards not throwing too much [money]" at what he referred to as an "insurance policy" against Sigma's entry, noting that he is "not picking up any strong sense that they have a strong alternate path at this point that they'd be willing to invest significant $ into." CX1184 at 001; Tatman, Tr. 771-72, 783-85.

In fact, Sigma did take various preliminary steps to explore the viability of its virtual manufacturing plan. This included assembling a team of executives responsible for evaluating entry. The team considered domestic foundries' costs and capabilities, as well as the time it would take for Sigma to start production. IDF 1447. They investigated all aspects of the necessary processing steps and concluded that Sigma would need to offer approximately 730 different types of domestic fittings in order to be an effective competitor. IDF 1468.

As described by Mr. Pais, however, the plan never went beyond "the early stages." Pais, Tr. 1761-62. As of mid-2009, Sigma had "[n]o contracts with any foundries," only a couple of patterns borrowed from Sigma's Mexico supplier, no core boxes, no machining facilities, and no contract to complete the coating, painting, or lining. Pais, Tr. 2173-74. All of these are essential prerequisites for the production of fittings. IDF 1046-47. In August, Sigma informed its customer, U.S. Pipe, that Sigma had "not made any concrete plans to either invest in all the required tooling or not invest at all." IDF 1467. By the end of the summer, Sigma had a domestic foundry produce a couple of sample fittings, but the foundry was not prepared to do the machining, painting, or cement lining. Pais, Tr. 1803; IDF 1461, 1465. As of September, Sigma only had a small number of the needed patterns, and it did not have contracts with any pattern shops or domestic foundries. IDF 1470-72; Rona, Tr. 1672, 1674-76.

As a whole, Sigma's actions relating to the virtual manufacturing plan were merely exploratory and preliminary and certainly not those of a "reasonably probable" entrant. It invested no more than $50,000 to $75,000 toward the effort, a nominal sum when compared to Sigma's estimate that it would need $5 to $10 million to enter the domestic fittings market. IDF 1449, 1479-80.

Importantly, Sigma found itself facing significant financial challenges just as it was pursuing the idea of entering the domestic fittings market. Sigma's financial resources had been greatly strained by the economic downturn in 2008. At the end of 2008, Sigma had suffered a loss of [redacted], had only [redacted] in cash, and was over [redacted] in debt. IDF 1482, 1490-91, *in camera*; Pais, Tr. 2190, *in camera*. Sigma began 2009 with a large portion of its debt unsecured and subject to high interest rates, and it remained in a financially "precarious" position throughout the year. IDF 1483, 1489, 1493-94; ID at 426. In May 2009, Sigma's internal midterm review revealed that Sigma's financial situation was "bleak." IDF 1484; CX0214 at 002; Pais, Tr. 2163-64. By June, after the outlook continued to worsen, conditions reached a point where Mr. Pais presented Sigma's Board of Directors with an "SOS" plan to save Sigma. IDF 1496. With sales down [redacted], and despite laying off employees and making substantial cuts, Sigma ended 2009 breaching some of its bank covenants. IDF 1485, *in camera*, 1486-88.

Not surprisingly given Sigma's financial condition, its lenders imposed very low capital spending limits on the company in 2009. IDF 1499. During Sigma's July 2009 Board meeting, the Frontenac Group, a private equity firm with a 60 percent ownership interest in Sigma, opined that Sigma did not have the capability to invest in domestic fittings and declared that Frontenac would not finance Sigma's domestic production plan. IDF 1500-01. Against this backdrop, Sigma's ability to make an investment of $5 to $10 million to enter the domestic fittings market independently seems questionable at best.

Complaint Counsel nonetheless argues that all of this is outweighed by an e-mail from Walter Florence of Frontenac to Mr. Pais and other Sigma executives on July 27, twelve days after the July Board meeting, outlining proposals for various upcoming banking group meetings. In the context of discussing how Sigma could best pitch ideas to potential lenders, the e-mail states: "Investors and rollover shareholders are prepared to invest up to $7.5m in equity . . . 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." CX0099 at 007. According to Complaint Counsel, this e-mail demonstrates that Sigma would have been able to obtain financial backing to expand into domestic fittings.

We find the cited statement much more ambiguous, particularly when considered in light of the position taken by Frontenac at the Board meeting less than two weeks prior and the other substantial evidence of Sigma's financial struggles. Indeed, Mr. Pais's July 28 response to Mr. Florence is in line with all of the other evidence of Sigma's difficult financial situation. In his reply, Mr. Pais revealed a "setback" that the company had "just unearthed last evening, with a significant *unfavorable* variation in [Sigma's] EBITDA projections – of as much as even $2M – from the CORE business for 09 and possibly 2010, as compared to those projections presented @ the BOD meeting in Boston." CX0099 at 004 (emphasis in the original). As described by Mr. Pais, "heading into this bank meeting, [Sigma was] actually in an even worse position than [initially] believed." Pais, Tr. 2181.

In sum, the evidence shows that Sigma took only the most preliminary acts to enter the market on its own and that it lacked the financial means necessary to get its virtual manufacturing underway. By September 2009, Sigma's President and CEO recognized that it could not overcome the complexity of entering the domestic fittings market. Pais, Tr. 1801-04. Finding "no other option" for serving the domestic fittings market, Sigma turned to McWane. Pais, Tr. 1800-01. Accordingly, we do not find there was a reasonable probability that Sigma would have been McWane's competitor in the domestic fittings market.[17] *See Transource Int'l*,

[17] Citing *Microsoft*, Complaint Counsel contends that, even if Sigma does not qualify as a potential competitor, the actions taken by McWane to eliminate the possibility of competition from a "nascent" entrant should nevertheless serve as *prima facie* evidence of anticompetitive conduct. *See Microsoft*, 253 F.3d at 79. In appropriate cases we will condemn anticompetitive activity, whether in the form of unreasonable restraints of trade or monopolization, that targets potential competition, as set forth in the Competitor Collaboration Guidelines at § 1.1 n.6 (2000), *Transource Int'l*, 725 F.2d at 280, and

725 F.2d at 280 (finding that Transource lacked the financial ability to enter the market and had previous failures in manufacturing for a similar line of business); *Conergy AG v. MEMC Elec. Materials, Inc.*, 651 F. Supp. 2d 51, 57-58 (S.D.N.Y. 2009) (considering, on a motion to dismiss, plaintiff's background and experience in the industry, its affirmative acts to enter, its financial capabilities, and the contracts in place). It therefore follows that the MDA is not an unlawful horizontal agreement.

B. THE MDA WAS NOT AN UNREASONABLE VERTICAL RESTRAINT OF TRADE

Having concluded that Sigma was not a potential competitor of McWane, we now consider whether certain provisions in the MDA amounted to an unreasonable vertical restraint under the rule of reason. *See Leegin Creative Leather Prods. v. PSKS, Inc.*, 551 U.S. 877, 898 (2007) (holding that vertical restraints are analyzed under the rule of reason); *Transource Int'l*, 725 F.2d at 280 (analyzing the alleged restraint under the rule of reason after concluding that the relationship between the two firms was vertical rather than horizontal). Courts typically accord less scrutiny to vertical restraints than to horizontal restraints. *See Leegin*, 551 U.S. at 888 (noting that recent precedent recognizes the difference in economic effect between horizontal and vertical agreements); *Arizona v. Maricopa County Med. Soc'y*, 457 U.S. 332, 348 n.18 (1982) (noting that "horizontal restraints are generally less defensible than vertical restraints"). In assessing the lawfulness of a vertical restraint, we look to the "the restraint's history, nature, and effect," recognizing that a manufacturer with market power might use the restraint to facilitate collusion with its competitors or exclude new entrants or smaller rivals. *See Leegin*, 551 U.S. at 885-86, 893-94.

Complaint Counsel challenges three aspects of the MDA: (1) the fact that the MDA anointed McWane as Sigma's sole source of domestic supply and precluded Sigma from producing its own domestic fittings; (2) that it prescribed the minimum price at which Sigma could sell domestic fittings in competition with McWane; and (3) that it required Sigma to adhere to McWane's Full Support Program.

The ALJ centered his rule of reason analysis and finding of liability on the MDA's sole source and pricing provisions. He found that these terms were unnecessary for McWane to sell domestic fittings to Sigma and concluded that the availability of reasonable, less restrictive alternatives and the absence of procompetitive justifications rendered the MDA an unreasonable restraint of trade. ID at 433. We disagree with the ALJ's reasoning.

To the extent that the Initial Decision purports to find a violation because the terms were unnecessary or because McWane could have structured the MDA less restrictively, the analysis is flawed. The rule of reason first requires a basis for finding conduct anticompetitive. Only after there has been such a finding do courts consider whether there are less restrictive alternatives. *See Care Heating & Cooling, Inc. v. Am. Standard, Inc.*, 427 F.3d 1008, 1012 (6th Cir. 2005) (explaining that, under Section 1 rule of reason burden-shifting analysis, plaintiff

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and *Bombardier*, 605 F.2d at 9-11, or nascent competition, as set forth in *Microsoft*, 253 F.3d at 53-54, 79. We find the facts here to be distinguishable from the nascent competition at issue in *Microsoft.*

bears the initial burden of showing the challenged restraint caused anticompetitive harm; the burden then shifts back to defendant to provide procompetitive justifications for the conduct, which, if met, allows plaintiff to provide evidence that any legitimate objectives can be achieved in a less restrictive manner); *Tanaka v. Univ. of S. Cal.*, 252 F.3d 1059, 1063 (9th Cir. 2001) (same); *see also* Hovenkamp, XI *Antitrust Law* ¶ 1913c, at 376 ("[A] showing of possible less restrictive alternatives is part of the 'burden shifting' procedure that goes on in a rule of reason case and is required only if the preceding inquiries warrant it . . . . That is, the availability of a purported less restrictive alternative does not make a challenged practice effectively illegal per se.").

The initial question, therefore, is whether the MDA, in place less than a year, caused anticompetitive harm. We begin with the sole source requirement, which prohibited Sigma from producing its own domestic fittings and barred Sigma from purchasing from Star. In light of our finding that Sigma was not a probable entrant in the domestic fittings market, we conclude that the prohibition against Sigma producing domestic fittings was unlikely to have had an anticompetitive effect.

We reach the same conclusion with respect to the MDA's pricing provisions. Although McWane had monopoly power in the domestic fittings market, Sigma was only one of many McWane distributors and it had a limited market presence in that market. IDF 1597. Indeed, there is no evidence in the record that the price restraint placed on Sigma had or was likely to have market-wide effects.

Finally, the MDA also prohibited Sigma from selling McWane's domestic fittings to any customers who bought from Star. To the extent there was any anticompetitive consequence resulting from this provision, we have already condemned McWane's conduct in connection with the Full Support Program in our discussion of Count 6, and there is no evidence that this provision materially added to the adverse competitive effects of the Full Support Program.

We therefore conclude that Complaint Counsel failed to establish that the MDA had or was likely to have anticompetitive effects in the domestic fittings market, apart from those already condemned. Accordingly, we reverse the ALJ's holding of liability on Count 4.[18]

VII. THE ALLEGED AGREEMENT TO CURTAIL PROJECT PRICING

Complaint Counsel alleges a conspiracy, initiated by McWane, to stabilize and raise fittings prices through two allegedly unlawful agreements. According to Complaint Counsel, in

[18] We also dismiss Count 5, which alleges that by enlisting the assistance of Sigma in enforcing McWane's exclusive dealing program against Star, McWane and Sigma conspired to monopolize the domestic fittings market. We find this count subsumed by our resolution of Counts 4 and 6. *See* Phillip E. Areeda & Herbert Hovenkamp, IIIB *Antitrust Law* ¶ 809, at 463-67 (3d ed. 2008) (noting the redundancy between a claim of conspiracy to monopolize and Section 1 claim); s*ee also Int'l Distrib. Centers v. Walsh Trucking Co.*, 812 F.2d 786, 795-96 (2d Cir. 1987) (holding that establishing a conspiracy to monopolize claim requires largely the same proof as an unreasonable restraint of trade claim under Section 1).

early 2008 McWane agreed with Star and Sigma to curtail project pricing, the major form of discounting in the industry, and later to raise its list prices in return for participation by Star and Sigma in the DIFRA information exchange.

On appeal, Complaint Counsel focuses on the first of the claimed agreements—the agreement to curtail project pricing. They point to a variety of circumstantial evidence from which they infer a price conspiracy, orchestrated by McWane through price signaling and other communications with Sigma and Star, designed to curtail project pricing and stabilize prices. Complaint Counsel contends the ALJ erred in a number of important respects, including that he: "failed to make reasonable inferences . . . and instead demanded direct proof of an agreement before any inference could be made," CCRB at 2; "improperly ignored evidence that Sigma and Star participated in the price-fixing conspiracy," CCAppB at 9; and failed to evaluate the evidence as a whole," instead "dissect[ing] each piece of the evidentiary puzzle, asking whether it alone made collusion more likely than not." *Id*. at 11.

McWane defends the ALJ's conclusion that "'[t]he totality of the evidence, given due weight and viewed as a whole, fails to demonstrate that [it], together with Sigma and Star, had an agreement'" or "'engaged in parallel conduct by curtailing Project Pricing'" and thus was "not consistent with the alleged conspiracy.'" RAnsB at 3 (quoting ID at 317-18, 350). In particular, McWane argues there were numerous project pricing episodes in 2008. Distinguishing between an unlawful agreement and independent action or conscious parallelism is often difficult, especially in contexts involving oligopolists. *See, e.g.*, *In re Flat Glass Antitrust Litig.*, 385 F.3d 350, 356-61 (3d Cir. 2009).

The Commission has not reached a majority as to liability on Count 1. Chairwoman Ramirez and Commissioner Brill find, by a preponderance of the evidence, that McWane, Sigma, and Star engaged in concerted action in violation of the law. Commissioners Ohlhausen and Wright, on the other hand, find the evidence insufficient to establish a conspiracy. In the absence of a majority decision, we dismiss Count 1 in the public interest.[19]

VIII. THE DIFRA INFORMATION EXCHANGE

Finally, Complaint Counsel also alleges that McWane conspired with Star and Sigma to exchange competitively sensitive sales information through DIFRA. They argue that this information enabled each of them "to determine and to monitor its own market share and, indirectly, the output levels of its rivals," thereby facilitating price collusion in a market already susceptible to pricing coordination, with no countervailing procompetitive justification. Complaint ¶¶ 35-36.

On appeal, Complaint Counsel points to evidence indicating that McWane, Sigma, and Star expected the DIFRA information exchange to allow them to better detect cheating and to

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[19] Where no majority decision is reached on a claim or cause of action, the Commission may exercise its discretion to dismiss it. *See In re Ticor Title Ins. Co.*, 112 F.T.C. 344, 442 n.13 (1989); *In re Am. Cyanamid*, 72 F.T.C. 623, 690 (1967).

stabilize prices and argues that the ALJ erred by "requiring direct evidence of actual price effects and ignoring evidence that the principal tendency of DIFRA was to facilitate collusion." CCAppB at 44. Specifically, Complaint Counsel argues that "the DIFRA exchange allowed each participant to monitor its own market share, and to deduce from monthly changes in that share, its rivals' relative price levels." *Id*. at 45. Emphasizing that the information exchanged was historical, aggregated data, McWane defends the ALJ's determination that "the evidence fails to prove that the DIFRA tons-shipped data reporting system has the nature and tendency to facilitate price coordination." ID at 362.

The Commission has not reached a majority as to liability on Count 2. Chairwoman Ramirez and Commissioner Brill find, by a preponderance of the evidence, that the DIFRA information exchange constituted an unlawful facilitating practice under a rule of reason analysis. Commissioners Ohlhausen and Wright, on the other hand, find the evidence insufficient to establish a violation of the rule of reason. Lacking a majority position, we dismiss Count 2 in the public interest.

IX. REMEDY

The Commission has considerable discretion in fashioning an appropriate remedial order, so long as the relief bears a reasonable relationship to the act or practice found unlawful. *See FTC v. Ruberoid Co*, 343 U.S. 470, 473 (1952); *Rubbermaid, Inc. v. FTC*, 575 F.2d 1169, 1174 (6th Cir. 1978). Having determined that McWane sought to maintain its monopoly power in the domestic fittings market through an unlawful exclusive dealing policy, we issue the attached order, which prohibits McWane from requiring exclusivity from its customers.

McWane objects to the remedy as moot, arguing that its exclusive dealing policy ended over two years ago and that the ALJ did not find any ongoing impact or threat of recurrence. In particular, McWane asserts that it modified its Full Support Program by January 2010, eliminating the provision stating that distributors risked losing shipments for up to 12 weeks if they did not support the program. It also notes that ARRA, which provided the initial impetus for the policy, is no longer in force. Under these circumstances, McWane argues, injunctive relief is unwarranted. We disagree.

First, it is well-established that the Commission may issue a cease and desist order even when a respondent no longer engages in the illegal conduct if there is sufficient danger of recurrence. *See W.M.R. Watch Case Corp. v. FTC*, 343 F.2d 302, 304 (D.C. Cir. 1965); *see also In re The Coca-Cola Co.*, 117 F.T.C. 795, 1994 FTC LEXIS 327, at *199 (1994) ("Voluntary cessation of unlawful activity is not a basis for halting a law enforcement action."). Thus, even assuming that McWane's Full Support Program ended over two years ago, that in itself does not bar a remedial order in this case.

More importantly, we are not persuaded that McWane has in fact ended its exclusive dealing policy. McWane has not publicly withdrawn the policy or notified distributors of any changes. *See* Tatman, Tr. 707-09 (asserting that the program was modified in January 2010, but that he never sent a letter to his customers to that effect). Whatever McWane may have decided internally, it failed to communicate a withdrawal of its policy to its distributors, and there is testimony from distributors who regard the exclusive dealing requirement as still in effect. *See*

Thees, Tr. 3118 (Ferguson) (testifying that as far as he is aware, McWane never rescinded the policy or indicated that it was no longer in force); Morton, Tr. 2908-09, 2911 (U.S. Pipe) (testifying that no one from McWane communicated that the policy had been withdrawn or revised); Pitts, Tr. 3364-65 (Hajoca) (testifying that as far as he is aware, McWane never withdrew its policy); Sheley, Tr. 3419 (Illinois Meter) (stating that, as a result of McWane's policy, Illinois Meter still does not purchase domestic fittings from Star); Webb, Tr. 2770 (HD Supply) (testifying that an exclusive dealing policy remains in place). As the court explained in *Rubbermaid*, "The crucial question . . . is to what degree one can be certain that the same or related practices will not recur." 575 F.2d at 1172. Here, the record contains no public communication of a withdrawal and reflects distributor concern that the exclusive dealing policy has continued, which poses an even greater danger than a risk of recurrence.

Third, the fact that ARRA is no longer in effect is irrelevant. *See Rubbermaid*, 575 F.2d at 1171-73 (rejecting defendant's mootness claim based on repeal of legislation and discontinuance of the practice at issue). While ARRA may have provided the initial impetus for Star's entry into the domestic fittings market, other "Buy American" laws and buyer preferences remain, and McWane continues to have monopoly power in that market. Executives at the highest level of McWane's organization developed and implemented an exclusive dealing policy to maintain monopoly prices, and all but one of those executives remain at McWane. *See* IDF 20-38, 1145-92. Without an order, there is no reason to believe that McWane would not again attempt to protect its monopoly power in the domestic fittings market with exclusive dealing or other arrangements that have similar effects. *See Rubbermaid*, 575 F.2d at 1172 ("The Commission may be properly concerned not only with the open and formal implementation of agreements exactly like those entered into in the past, but also with the possibility that past unlawful conduct will be perpetuated in some more subtle form in the future.")

Finally, McWane argues that injunctive relief is only appropriate where the plaintiff shows there is an imminent threat of injury that is concrete and specific. The authority McWane relies on for this proposition, however, is inapposite. It speaks to Article III standing requirements and standards for injunctive relief in cases brought by private plaintiffs, rather than to the Commission's remedial authority in exercise of its statutory law enforcement responsibilities.[20]

It is McWane that has the "formidable burden of showing that it is absolutely clear [its] allegedly wrongful behavior could not reasonably be expected to recur." *Friends of the Earth v. Laidlaw Envtl. Servs., Inc.*, 528 U.S. 167, 190 (1999); *accord Rubbermaid*, 575 F.2d at 1173 ("A company bears a heavy burden in showing that past conduct will not be repeated."). As the ALJ correctly concluded, "Respondent has not met that burden here." ID at 447.

[20] In *Winter v. NRDC*, 555 U.S. 7, 22 (2008), for instance, the Court clarified that a private party seeking a preliminary injunction must show the likelihood of irreparable injury rather than just the possibility. Similarly, in *Summers v. Earth Island Inst.*, 555 U.S. 488, 493 (2009), and *Los Angeles v. Lyons*, 461 U.S. 95, 101-10 (1983), the Court addressed the requirements for Article III standing and equitable relief applicable to private plaintiffs. These cases do not apply to the Commission.

Accordingly, we issue the attached cease and desist order to address McWane's exclusionary conduct. The order prohibits McWane from: (1) implementing or enforcing any condition, policy, or practice requiring exclusivity with a customer; (2) implementing or enforcing any retroactive rebate program that would effectively demand exclusivity; (3) "[d]iscriminating against, penalizing or otherwise retaliating" against any customer that purchases a competitor's domestic fittings or that "otherwise refuses to enter into or continue any condition [or] agreement" requiring exclusivity; and (4) "enforcing any condition, requirement, policy, agreement, contract or understanding that is inconsistent with the terms of [the] Order." Order, ¶¶ II.A.-D. The order is designed to bring an end to McWane's unlawful conduct, rectify its past violation, and ensure it does not recur. It is necessary and appropriate to remedy McWane's past and continuing competitive harm.

X. CONCLUSION

For the foregoing reasons, the Commission concludes that McWane violated Section 5 of the FTC Act, 15 U.S.C. § 45, by adopting an unlawful exclusive dealing policy to maintain its monopoly power in the domestic fittings market. Consequently, we issue a Final Order to remedy McWane's violation and prevent its recurrence.

Date of Decision: January 30, 2014