PUBLIC REDACTED VERSION

No. 14-11363

IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

MCWANE, INC.,
Petitioner,

v.

FEDERAL TRADE COMMISSION,
Respondent.

ON PETITION FOR REVIEW OF AN ORDER
OF THE FEDERAL TRADE COMMISSION
(FTC DOCKET NO. 9351)

BRIEF OF THE FEDERAL TRADE COMMISSION

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AUGUST 29, 2014

Eleventh Circuit Rule 26.1 Certificate of Interested Persons

Pursuant to 11th Cir. R. 26.1-2, Respondent Federal Trade Commission ("FTC") certifies that the following persons or entities are known to have an interest in the outcome of this appeal:

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STATEMENT REGARDING ORAL ARGUMENT

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ISSUE PRESENTED FOR REVIEW

Whether substantial evidence supported the FTC's adjudicatory ruling that an incumbent monopolist used an exclusivity mandate to impede market entry and expansion by its sole competitor, unlawfully maintaining its monopoly.

STATEMENT OF THE CASE

In mid-2009, McWane was the only supplier in the market for domestically manufactured ductile iron pipe fittings. Like many monopolists, it charged high prices with large profit margins. Star Pipe Products then announced it would enter the market. McWane responded not by competing more vigorously, but by threatening to cut off any customer that dealt with Star, with only limited exceptions. McWane knew its customers would be reluctant to move all their business to a new entrant and could not risk losing access to McWane's full line of fittings, including those that Star could not yet produce. McWane's strategy worked. It reduced Star's sales opportunities, raised its costs, and deprived it of the scale necessary to operate efficiently and compete effectively with McWane. Star therefore remained a fringe supplier of domestic fittings, and McWane faced no need to lower its monopoly prices.

McWane's internal documents described this exclusivity mandate for what it was: an anticompetitive strategy to preserve McWane's monopoly profits by impeding new competition. As the architect of McWane's strategy explained:

> "[w]hether 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";
>
> "we need to make sure that they [Star] don't reach any critical market mass that w[ould] allow them to continue to invest and receive a profitable return"; and

> McWane's exclusivity mandate thus “f[o]rce[d]” Star “to absorb the costs associated with having a more full line before they can secure major distribution.”

Comm'n 8-9, 31 (internal quotation marks omitted).[1]

As those documents and the rest of the trial record confirm, “the domestic market”—the market for domestically manufactured fittings—is the relevant market and is separate from “the non-domestic market.” They also confirm that McWane maintained its monopoly not by competing on the merits, but by raising Star's costs and keeping it from “reach[ing] any critical market mass that will allow [it] to continue to invest and receive a profitable return.” And McWane did not even compete for exclusivity. It offered customers no new discounts or other procompetitive inducements; it simply mandated exclusivity as a unilateral condition on continued access to its full line of fittings. That mandate was all stick and no carrot. It inflicted competitive harm with no procompetitive benefits.

After a two-month trial, an ALJ found McWane liable for unlawful monopoly maintenance under Section 5 of the FTC Act, 15 U.S.C. § 45. The Commission affirmed in the decision now under review.

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[1] “Comm'n __” identifies pages in the Commission's opinion. “ALJ pp. __” identifies page numbers in the opinion

A. Statement of Facts

1. The Domestic Pipe Fittings Market

Ductile iron pipe fittings connect the pipes in large-scale water distribution systems to valves, hydrants, or other pipes, and split, join, and direct water flow.[2] Comm'n 5; ALJ ¶¶ 5, 278. They come in a range of sizes, configurations, and finishes. ALJ ¶¶ 286-88. About 100 fitting varieties can fulfill most project needs, but a full line includes many less-commonly used pieces that are nonetheless essential in some projects. ALJ ¶¶ 306-08.

The typical fittings end users are municipal and other governmental water authorities and their contractors. ALJ ¶ 509. McWane and other manufacturers almost never sell fittings directly to end users. Instead, they sell them to middleman distributors, who in turn sell them to end users. ALJ ¶¶ 367, 373-74, 508. Distributors maintain relationships with end users by providing services that manufacturers cannot replicate. ALJ ¶¶ 410-412. Because manufacturers cannot sell directly to end users, and there is no viable alternative sales channel, access to distributors is critical to manufacturers' business success. Comm'n 22-23, ALJ ¶¶ 381, 400-402.

A waterworks project typically begins when a water authority issues a "specification" of the pipes, fittings, and other products required for the project.

[2] In this brief, "fittings" refers to small- and medium-diameter (24 inches and under) ductile iron pipe fittings.

ALJ ¶¶ 332-33. Competing contractors solicit bids for the specified products from distributors, who in turn seek quotes from manufacturers like McWane. ALJ ¶¶ 333, 368. Most end users issue "open specifications," which permit the use of products manufactured anywhere in the world. Other end users issue "domestic-only specifications" that require the use of U.S.-made products. Since 2003, such domestic-only projects have accounted for approximately 15%-20% of all U.S. fittings sales. ALJ ¶¶ 517-19, 1029-31; *see* Comm'n 16.

Domestic-only specifications often, but not always, arise from "Buy American" legal obligations. For example, Pennsylvania and New Jersey law requires the use of domestic materials in public projects. Comm'n 14; ALJ ¶¶ 520-21. So do Air Force bases, certain federal programs, and various municipalities. Comm'n 14; ALJ ¶¶ 522-23. The demand for American-made fittings increased when Congress enacted the American Recovery and Reinvestment Act of 2009 ("ARRA"), Pub. L. No. 111-5, 123 Stat. 115. As part of its larger stimulus package, ARRA provided more than $6 billion to fund water infrastructure products, conditioned on the use of U.S.-made products. Comm'n 7-8; ALJ ¶¶ 524-29. Because waivers of the Buy-American requirement were rarely granted, "neither McWane nor Star sold any imported fittings for use in any ARRA-funded projects." Comm'n 8 n.4, 16; *see also* ALJ p. 249; ALJ ¶¶ 527, 531-34, 537-46.

Given these end-user requirements, distributors "will not purchase" imported fittings for specifications that require domestic fittings, "[r]egardless of price." ALJ ¶ 549; *accord* Comm'n 14. That is so even though domestic and imported fittings are functionally indistinguishable and imported fittings are much less expensive. ALJ ¶¶ 323, 547. In short, although domestic and imported fittings are physically identical, they are not economic substitutes for projects with domestic-only specifications. Comm'n 14; ALJ p. 249.

The manufacture of ductile iron pipe fittings is a highly concentrated industry. Three companies supply nearly all the fittings (domestically manufactured or imported) used in U.S. waterworks projects. ALJ ¶ 355. McWane, by far the largest of the three, manufactures fittings both in the United States and in China and accounts for nearly half of total fittings sales. ALJ ¶¶ 15-16. Fittings are "about 5% of McWane's overall business," which includes pipe and other iron products. ALJ ¶¶ 12-15. Fittings are the primary product line of Sigma Corporation and Star, each of which supplies about a quarter of the fittings used in all U.S. waterworks projects (including open and domestic-only specifications). ALJ ¶¶ 13, 356.

During the relevant period, McWane owned the only U.S. foundry devoted to fittings production, and until 2009, both Star and Sigma sold only imported fittings. Thus, until 2009, McWane was the sole supplier of fittings for projects

with domestic-only specifications. Comm'n 5; ALJ ¶ 1040. Because it faced no competition for such projects, McWane charged high prices and enjoyed large profit margins. ALJ ¶¶ 547, 1075, 1091. McWane's prices for fittings in domestic-only projects were { } higher than its prices for physically identical fittings sold for projects with open specifications. ALJ ¶ 1076 & RX410. The price difference did not simply reflect the higher costs of domestic manufacturing—McWane's profit margins were also substantially greater for domestic fittings. ALJ ¶ 1091. Moreover, McWane maintained and increased its monopoly-level prices after Star entered the domestic-only market. *See* Comm'n 18.

2. Star's Entry Prompts McWane's Exclusivity Mandate

In the wake of the 2009 stimulus legislation, Star decided to enter the market for supplying U.S.-made fittings to domestic-only projects. Comm'n 7-8; ALJ ¶¶ 1094, 1421. It proceeded on two tracks. First, Star investigated building its own U.S. foundry or buying one and adapting it to manufacture fittings. ALJ ¶ 1097. Second, Star jump-started its market entry by immediately contracting with six third-party "jobber" foundries located in the United States, which produced raw fittings to Star's specifications and sent them to Star's Houston facility for finishing. ALJ ¶¶ 1098-1118. As McWane concedes, this outsourcing arrangement was much less operationally efficient in the long run than owning a foundry tailored to fittings production. *See id.*; Comm'n 10-11; McWane Br. 2,

29, 52-53. But because stimulus-related procurement had begun, Star proceeded with this plan in the short term while investigating options for acquiring its own foundry.[3]

Star entered the market in the second half of 2009 with the ability to sell the most commonly used domestic fittings and a plan to expand its offerings over time. ALJ ¶¶ 1120, 1130-31. Because Star's initial domestic product line was limited, most major distributors were willing to give Star some of their domestic fittings business, but few could do without McWane's fuller line. ALJ pp. 390-97. Some were also "reluctant to rely on a supplier without its own foundry." Comm'n 25.

McWane recognized that effective competition from Star would lead to lower prices and narrower margins. In its words, McWane's "chief concern" was that such competition would cause "the domestic market," (the market for U.S.-

"legitimate competitor" in the domestic-only market, McWane would "take a hit for decades" because "our distributors will continually pressure us to 'do something' (lower prices)," and the company would "always see downward [pricing] pressure in the future." ALJ ¶¶ 1151-52 (quoting CX0102, CX2192 (hyphens omitted)).

McWane also knew that a new competitor would face, in its words, "significant blocking issues" if, like Star, it could not immediately supply a "full line" of domestic fittings. ALJ ¶ 1155 (quoting CX0067 at 2). As Richard Tatman, the head of McWane's fittings business, explained: "we need to make sure that they don't reach a critical market mass that will allow them to continue to invest and receive a profitable return." ALJ ¶ 1150 (quoting CX0074 at 1).

To that end, McWane imposed the exclusivity mandate at issue here, which was originally described as a "full line or no line" approach, ALJ ¶ 1157 (quoting CX0076 at 1), and ultimately became known as the Full Support Program. McWane formally announced this new policy in a letter to its distributors on September 22, 2009. Unless distributors "fully support McWane branded products for their domestic fitting and accessory requirements," McWane declared, they "may forgo participation in any unpaid rebates [they had accrued] for domestic

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"nondomestic-fittings market" means the market for fittings (now mostly imports) for open-specification projects.

fittings and accessories or shipment of their domestic fitting and accessory order of [McWane] products for up to 12 weeks." ALJ ¶ 1173 (quoting CX0010) (emphasis added). The policy provided only two narrow exceptions; the only material one here concerned circumstances where McWane products were not readily available (*e.g.*, out of stock).[5] McWane offered no additional discounts, rebates, or other consideration in exchange. ALJ p. 407. The mandate was simply a new condition on continued access to McWane's products and previously-accrued rebates.

McWane made sure distributors understood "that they would no longer be able to buy domestic fittings from McWane if they purchased domestic fittings from Star." Comm'n 21 (citing ALJ ¶ 1180). For example, McWane's national sales manager explained the new policy to his sales force as follows:

> "What are we going to do if a customer [*i.e.*, a distributor] buys Star domestic? We are not going to sell them our domestic …. This means the customer will no longer have access to our domestic."
>
> "Once [distributors] use Star, they can't EVER buy domestic from us …."
>
> "For [distributors] with multiple branches … if one branch uses Star, every branch is cut off."

[5] McWane provided a separate exception where customers bought domestic fittings and accessories in a package with another manufacturer's ductile iron pipe. ALJ ¶ 1173. Except in limited resale contexts, that exception did not apply to Star because Star did not manufacture pipe. *See* ALJ ¶¶ 110, 1325.

ALJ ¶ 1179 (quoting CX0710 at 1-2). The national sales manager exhorted: "Make sure you are discussing our stance with all customers, every day." *Id.*

This message was highly effective. Mr. Tatman recognized that "[a]lthough the words 'may' and 'or' were specifically used [in the September 22 letter], the market has interpreted the communication in the more hard line 'will' sense. … Access to McWane … requires distributors to exclusively support McWane where products are available within normal lead times." ALJ ¶ 1183 (quoting CX0119 at 2, 4). He concluded: "[v]iolations will result in" not only "loss of accrued

McWane's exclusivity mandate not only deprived Star of access to efficient distribution channels, but also—as McWane intended and expected—kept Star from "reach[ing] any critical market mass that w[ould] allow [it] to continue to invest and receive a profitable return." ALJ ¶ 1150 (quoting CX0074 at 1). In mid-2009, Star believed it might promptly achieve the scale to justify the large fixed costs of procuring its own fittings foundry. *See* ALJ ¶¶ 1097, 1402-04. Because McWane had not yet announced its exclusivity policy, this was a reasonable expectation. Given its presence in the nondomestic-fittings market, Star had preexisting relationships with distributors, *id.* ¶ 1052, and it already had early orders and quote requests in hand for sales of U.S.-made fittings, *id.* ¶ 1395. By early fall, Star had also identified one foundry as a serious candidate for acquisition and specialization. ALJ ¶ 1404. As Star understood, this major capital at w[ould] allowspecialicientnotlarge mas.

(discussing relevant figures). In short, once McWane issued its all-or-nothing mandate to distributors, "Star was not able to generate a sufficient volume of sales of Domestic Fittings to realize cost efficiencies or justify operating a foundry of its own." ALJ ¶ 1401; *see also* Comm'n 10-11, 27; CX02260-A at 78 & 61 n.177.

Star did sell *some* domestically manufactured fittings, albeit on a smaller and less efficient scale. First, it sold fittings to Hajoca, the distributor that McWane cut off as a warning to the rest. Second, Star met the limited demand of other distributors for fittings that McWane could not readily supply and thus fell within that narrow exception to its exclusivity mandate. Comm'n 10; ALJ ¶¶ 1137, 1142, 1242, 1305. Third, Star sold small quantities—as little as a single fitting—to various small distributors with such limited demand for domestic fittings that they needed no relationship with McWa

investigation in early 2010 tempered McWane's enforcement of its exclusivity requirement. *See* ALJ ¶¶ 1220, 1311.

B. Procedural History

On January 4, 2012, the Commission issued a seven-count administrative complaint charging McWane with violating Section 5 of the FTC Act. Section 5 prohibits "unfair methods of competition" and encompasses, *inter alia*, practices that violate Section 2 of the Sherman Act, 15 U.S.C. § 2; *see* Comm'n 13 n.7 (incorporating Section 2 analysis). Count six—the only count on appeal—charged that McWane's exclusivity mandate constituted unlawful monopoly maintenance. Compl. ¶ 69.[7]

After the Commission denied motions for summary judgment by McWane and FTC complaint counsel, the ALJ conducted a two-month trial.[8] On May 1, 2013, he issued his 464-page decision. He found that the market for domestic

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[7] After splitting evenly on the merits, the Commission dismissed the first two counts, which alleged an earlier (2008) conspiracy among McWane, Sigma, and Star to stabilize prices in the nondomestic fittings market. Count three, related to the same conspiracy allegations, was dismissed by the ALJ without appeal. The Commission dismissed counts four and five (reversing the ALJ), which alleged

fittings is the relevant market, that McWane has monopoly power in that market, and that McWane's exclusivity mandate—its Full Support Program—was anticompetitive and unlawful.

The Commission affirmed. Like the ALJ, it found that the relevant market is the supply of domestically manufactured fittings, and that McWane had monopoly power. It explained that domestic-only specifications often arise from municipal, state, and federal laws and policies, and that, given end-user requirements, distributors will not purchase imported fittings for domestic-only projects. Imported fittings are thus not "reasonable substitutes for[] projects with domestic procurement specifications." Comm'n 14. The Commission further found that McWane's share of the domestic-only market "far exceed[ed] the levels that courts typically require to support a *prima facie* showing of monopoly power" and that there are "substantial barriers to entry[.]" Comm'n 16-17. The Commission also found direct evidence of McWane's monopoly power in the higher prices and greater profit margins that McWane enjoyed in the market for domestic fittings than in the more competitive nondomestic-fittings market. Comm'n 17-18.

The Commission next ruled that McWane's exclusivity mandate unlawfully maintained its monopoly. While acknow

exclusive dealing to "impair[]

majority. He agreed that McWane's Full Support Program was an "exclusive dealing arrangement" and rejected McWane's contrary arguments. Dissent 28 n.38; *see also id.* at 12. And he concluded that there was "ample record evidence" that the "[p]rogram harmed McWane's rival Star." *Id.* at 4. But he nonetheless found that complaint counsel had fallen short in proving harm to competition. *See* Section II.C.4, *infra*.

STANDARD OF REVIEW

This Court "review[s] issues of law de novo," but "the FTC's findings of fact and economic conclusions" are reviewed "under the substantial evidence standard," which requires only "such relevant evidence as a reasonable mind might accept as adequate to support a conclusion." *Schering-Plough Corp. v. FTC*, 402 F.3d 1056, 1062-63 (11th Cir. 2005) (internal quotation marks omitted); *see* 15 U.S.C. § 45(c). That standard "requires more than a scintilla, but … less than a preponderance of the evidence." *Florida Gas Transmission Co. v. FERC*, 604 F.3d 636, 645 (D.C. Cir. 2010) (internal quotation marks omitted). It is thus not the Court's task to "make its own appraisal of the testimony, picking and choosing for itselfTw (This Court d)]TJ 1o47 n mTc -.0.iy8

"This standard applies regardless whether the FTC agrees with the ALJ." Schering-Plough, 402 F.3d at 1062. As McWane observes, this Court has stated that it will "examine the FTC's findings more closely where they differ from those of the ALJ." Id.; see Br. 26. But the Commission agreed with the ALJ on the critical facts relevant to this appeal and affirmed the ALJ's finding of liability for monopoly maintenance.

SUMMARY OF ARGUMENT

McWane's exclusionary strategy satisfies both elements of unlawful monopoly maintenance. First, McWane exercised monopolcsupp(McWanintenance. Figy

anticompetitive if, “through something other than competition on the merits, [it] has the effect of significantly reducing usage of rivals’ products and hence protecting the ... monopoly.” *Microsoft*, 253 F.3d at 65. Here, McWane responded to Star’s entry not with “competition on the merits,” but by raising Star’s costs and making it a less efficient competitor. Because of McWane’s strategy, Star never achieved the scale economies it needed to justify a foundry acquisition and thereby lower its marginal costs. McWane’s exclusivity mandate thus kept Star from effectively competing with McWane and enabled McWane to continue charging monopoly prices. This is textbook anticompetitive conduct. It is irrelevant that

mandate harmed competition by keeping McWane's only rival from disciplining its monopoly prices. In these circumstances, harm to a monopolist's sole competitor is harm to competition.

McWane also demonstrates no procompe

Finally, well-established antitrust precedent undermines McWane's argument that complaint counsel should have been required to prove in greater detail exactly how Star would have developed in the absence of McWane's anticompetitive conduct. In *Microsoft*, the en banc D.C. Circuit unanimously adopted the position of the leading antitrust treatise and concluded that, "as to § 2 liability in an equitable enforcement action," the government need not "present direct proof that a defendant's continued monopoly power is precisely attributable to its anticompetitive conduct." 253 F.3d at 79. Instead, the government need only show that the monopolist's conduct "reasonably appear[s] capable of making a significant contribution to maintaining monopoly power." *Id.* (internal quotation marks and ellipsis omitted). Complaint counsel easily satisfied that standard.

ARGUMENT

The offense of "monopolization" under Section 2 of the Sherman Act has two elements: "(1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power" through anticompetitive means. *Morris Commc'ns Corp. v. PGA Tour, Inc.*, 364 F.3d 1288, 1293-94 (11th Cir. 2004) (quoting *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71, 86 S.Ct. 1698 (1966)). Both elements are satisfied here. Throughout the applicable period, McWane monopolized the domestic-only market and charged monopoly prices. After Star announced its entry, McWane preserved its monopoly not by reducing

prices or providing better service, but by unilaterally imposing an exclusivity mandate calculated to raise Star's cost structure and keep it from disciplining McWane's prices. And so McWane ended just as it started, with a monopoly, charging monopoly prices. Section 2 of the Sherman Act was enacted to ban precisely such conduct.

I. McWane Has Monopoly Power In The Relevant Market

McWane launched its exclusivity requirement when Star announced that it would enter the market for U.S.-made fittings used in domestic-specifications projects. McWane's senior leadership expressed concerns that "the chance for profitable cohabitation with Star owning a [piece] of the Domestic market is slim," ALJ ¶ 1150 (quoting CX0074 at 1) (emphasis added), and that Star's entry would lead "the domestic market [to] get[] creamed from a pricing standpoint just like the non-domestic market has been driven down in the past," ALJ ¶ 1149 (quoting CX0074 at 1) (emphasis added).

Court] review[s] for clear error, *Polypore Int'l, Inc. v. FTC*, 686 F.3d 1208, 1217 (11th Cir. 2012), and the Commission's market definition here easily passes

market." IIB Phillip E. Areeda, Herbert Hovenkamp, & John Solow, *Antitrust Law* ¶572b at 430 (3d ed. 2007).[9]

McWane contends (Br. 35) that there "was ample evidence" in the record that customers "flip" their demand from domestic to imported fittings in response to pricing pressures. That is incorrect. As the Commission found, flipping is exceedingly rare, and typically "occurs when domestic fittings are unavailable, rather than as the result of competition between domestic and imported fittings." Comm'n 16. That fact alone is dispositive. Markets are defined principally by the sensitivity of customers to modest price variations ("cross-elasticity of demand"). *See, e.g.*, *FTC v. Whole Foods Market, Inc.*, 548 F.3d 1028, 1038 (D.C. Cir. 2008); *U.S. Anchor Mfg. v. Rule Indus.*, 7 F.3d 986 (11th Cir. 1993). They are *not* defined by whether customers can be forced to buy product X if product Y is completely unavailable. Here, the Commission and ALJ found that distributors are insensitive

[9] When a substantial group of customers can be identified, segregated, and charged monopoly prices for a significant period, sales to that group constitute a relevant market. *See* IIB Areeda & Hovenkamp, *Antitrust Law* ¶534d.1, at 269-70. The federal enforcement agencies term this a "price discrimination" market. *See* Comm'n 14; DOJ & FTC, *Horizontal Merger Guidelines* §4.1.4 (2010); *see also In re Polypore Int'l*, 2010 WL 9933413 at *14-15 (FTC Dec. 13, 2010), *aff'd*, 686 F.3d 1208, 1217-18. Here, projects with domestic-only specifications can be targeted for higher pricing, and a hypothetical monopolist could raise prices by reducing its output because imported fittings cannot satisfy domestic-only specifications. *See generally FTC v. Whole Foods Market, Inc.*, 548 F.3d 1028, 1038 (D.C. Cir. 2008) (discussing the "hypothetical monopolist" construct for market-definition purposes).

to price variations because they simply will not buy imports for projects with domestic-only specifications when domestic fittings are available, "[r]egardless of price." *E.g.*, ALJ ¶¶ 547-50. That fact confirms the existence of a distinct domestic-only market.

McWane's appeal to history (Br. 10-12) cannot support its contrary argument. A few decades ago, nearly all fittings for U.S. waterworks projects were manufactured in the United States. Comm'n 5; ALJ ¶ 462. Less expensive imported fittings were introduced in the 1980s. Since the early 2000s, however, the percentage of waterworks projects with domestic-only specifications has held fairly steady in the range of 15%-20% (measured by sales volume). *See* Comm'n 16.[10] Again, that market reality reflects the entrenched demand for American-made waterworks products. *See* ALJ ¶¶ 1029-1031. Distributors and suppliers must take that demand as they find it. ALJ ¶¶ 547-50.

McWane also asserts that domestic fittings are "a small minority" of all fittings sales and that imported fittings "dominate" domestic fittings. Br. 32, 34. But that observation shows only that the nondomestic-fittings market is larger than the separate domestic-only market. Comm'n 16. That a given market is bigger

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[10] McWane asserts that the share of domestically manufactured fittings as a percentage of fittings sold overall continued falling in the early 2000s. Br. 11. But "any growth in import sales likely came from the greater use of imports on open-specification jobs and not from a decline in domestic-only projects." Comm'n 16 (emphasis added).

than another does not somehow make them the same market. Neither does the fact that domestic and imported fittings are physically identical. *See U.S. Anchor*, 7 F.3d at 995-96 (finding separate markets for "virtually identical," "functionally interchangeable" anchors).

Any remaining question would be resolved by the uncontradicted pricing and profitability evidence. McWane charged {   } more for domestic-specification projects than for open-specifications projects, even though the fittings supplied were functionally indistinguishable. ALJ ¶ 1076 & RX410. McWane's profits were also much higher in the domestic-only market. *See* Section I.B, *infra*. McWane can charge higher prices (and earn greater profits) for domestically manufactured fittings only because certain identifiable customers demand American-made products instead of imports and will pay significantly more for them. As discussed, McWane's internal documents also confirm that its senior executives understood the obvious: that "the domestic market" is separate from "the non-domestic market" and is subject to much less price competition. ALJ ¶ 1149 (quoting Tatman).

Finally, McWane argues that the Commission's market-definition analysis was insufficiently rigorous because it did not rest on expert econometric analysis. Br. 32-33. Given the overwhelming record evidence, the Commission needed no detailed econometric analysis to draw the economic conclusion that cross-elasticity

conclusion follows once the relevant market is identified as the supply of fittings for domestic-only projects.

Monopoly power is “the power to raise prices to supra-competitive levels” or “to exclude competition in the relevant market either by restricting entry of new competitors or by driving existing competitors out of the market.” *U.S. Anchor*, 7 F.3d at 994 (internal quotation marks omitted). Where, as here, there is direct evidence that a firm has profitably raised prices above competitive levels, “the existence of monopoly power is clear.” *Microsoft*, 253 F.3d at 51. Because cases with “direct proof” of the exercise of market power are rare, “courts more typically examine market structure in search of circumstantial evidence of monopoly power.” *Id.* Consequently, “[t]he principal measure of actual monopoly power is market share.” *U.S. Anchor*, 7 F.3d at 999.

Here, both direct and indirect evidence confirm McWane’s monopoly power. First, McWane had 100% of the domestic-only market for more than three years before Star’s first sales in 2009, and its share never fell below { } during any relevant period. Comm’n 16. This is a monopoly by any standard. *See, e.g.*, *Dentsply*, 399 F.3d at 188 (market share between 75% and 80% is “more than adequate to establish a prima facie case” of monopoly power); *Grinnell*, 384 U.S. at 571 (87% share); *American Tobacco Co. v. United States*, 328 U.S. 781, 797-98, 66 S.Ct. 1125 (1946) (over two-thirds share). McWane’s market share is also

protected by substantial barriers to entry—another reliable indication of monopoly power. See, e.g., *Microsoft*, 253 F.3d at 54-55. As the Commission found, new competitors face numerous hurdles to entering this capital-intensive market. Comm'n 17 (citing ALJ pp. 375-77; ALJ ¶¶ 1044-55, 1119-26, 1130-32); *see also* Section II.A, *infra* (refuting McWane's argument that Star's entry was easy or successful).

Second, direct evidence shows that McWane exercised monopoly power by controlling prices. Again, McWane commanded much higher prices on fittings for projects with domestic-only specifications than on fittings for projects with open specifications. Comm'n 18; ALJ ¶¶ 1075-76, 1091. Indeed, during the relevant period, McWane *increased* prices on domestic fittings and refused to negotiate prices. Comm'n 18; *see also* n.14, *infra*. And as McWane's expert conceded, Star's entry failed to constrain McWane's pricing. ALJ ¶ 1090; *see* Comm'n 18.

Third, McWane's profit margins similarly reflect its monopoly power. Although domestic fittings cost more to produce than foreign ones, ALJ ¶ 1080, McWane also earned higher profits on them. For example, in 2009, McWane reported gross profits of { } on fittings for open-specifications projects, while its profits on fittings for domestic-only projects were { }, a { } differential. ALJ ¶ 1091. The next year, after Star's entry into the domestic-only

market, McWane's gross profits in that market rose to { }, more than

{ } the new, lower profit margin for nondomestic fittings, { }. *Id.*

Fourth, McWane further manifested its monopoly power by exploiting its dominance to "restrict[] entry of new competitors." *U.S. Anchor*, 7 F.3d at 994 (internal quotation marks omitted). As discussed below, McWane did not respond to Star's entry by offering customers be

A monopolist's conduct is anticompetitive if, "through something other than competition on the merits, [it] has the effect of significantly reducing usage of rivals' products and hence protecting [the] ... monopoly." *Microsoft*, 253 F.3d at 65. In particular, as the leading antitrust treatise summarizes, a monopolist's conduct threatens harm to competition if it involves "(a) exclusive dealing or similar arrangements covering a significant portion of [distribution]; (b) entry barriers or equivalent impediments making it difficult for rivals or potential rivals … to obtain efficient access to [distribution]; and (c) resulting prolongation of the dominant firm's ability to earn monopoly profits[.]" XI Areeda & Hovenkamp, *Antitrust Law* ¶1802b at 75-76 (footnote omitted); *see also* Comm'n 19 (citing additional authorities). These formulations exactly describe McWane's conduct.

A. McWane Used Exclusivity To Impede Competition

When Star announced its imminent entry in mid-2009, McWane understood that, in its words, "any competitor" seeking to enter the domestic-only market would confront "significant blocking issues" if it could not initially produce a "full line" of fittings. ALJ ¶ 1155 (quoting CX0067 at 2). McWane thus searched for a way to force Star "to absorb the costs associated with having a more full line before they can secure major distribution." ALJ ¶ 1162 (quoting CX0076 at 9). McWane wished 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." ALJ ¶ 1150 (quoting CX0074 at 1).

The result was the exclusivity mandate at issue here. McWane required distributors, with narrow exceptions, to buy *all* of their domestic fittings from McWane as a condition for buying *any* domestic fittings from McWane. If distributors balked, McWane would deny them access to less common fittings that were initially available only from McWane. This was a highly effective threat. If McWane cut any distributor off from its full line of fittings, it would imperil the distributor's ability to meet its own customers' needs, and the end-user customers could take the entirety of their business to rival distributors, with "devastating" consequences for the cut-off distributor. *See* ALJ ¶ 366. This fear led many distributors to accede to McWane's exclusivity demand. ALJ ¶¶ 1203, 1235, 1252, 1301, 1316, 1358, 1393.

McWane implausibly mischaracterizes this exclusivity mandate as a mere "rebate program," *e.g.*, Br. 27, as though it related only to the *prices* at which McWane would sell its goods rather than

CX0119 at 2, 4 (McWane document) (emphasis added). As Mr. Tatman emphasized: "To protect our domestic brands and market position … we won't provide domestic product to distributors who are not fully supporting our domestic product lines." ALJ ¶ 1167 (quoting CX0113). And McWane's national sales manager likewise told his sales force to warn distributors "every day" that "[o]nce they use Star, they can't EVER buy domestic from us[.]" ALJ ¶ 1179 (quoting CX0710 at 1-2). In sum, as the ALJ found, "the Full Support Program is not a mere rebate from which Distributors can walk away at any time, as argued by [McWane]"; instead, "overwhelmingly, Distributors viewed [it] as an all-or-nothing exclusive dealing arrangement and acted

disobedience—all major distributors fell in line and generally bought from Star

pp. 400, 411. Star thus continued using a less efficient manufacturing process that imposed higher logistical costs, relied on jobber foundries, entailed middleman markups, and gave Star less control over inventory and production. In short, McWane's exclusivity mandate raised Star's costs and made it less capable of profitably underselling McWane in the domestic-only market. Comm'n 28.[16]

McWane objects that the harm it did to Star is somehow irrelevant because "[t]the antitrust laws are intended to protect competition, not competitors[.]" Br. 48 (quoting *Levine*, 72 F.3d at 1551). But it makes no sense to invoke that distinction on these facts: "[I]n a concentrated market with very high barriers to entry, competition will not exist without competitors," *Spirit Airlines, Inc. v. Northwest Airlines, Inc.*, 431 F.3d 917, 951 (6th Cir. 2005), and Star was McWane's only potential rival. McWane's exclusivity mandate kept Star from achieving the efficiency and scale it needed to discipline McWane's monopoly prices, so McWane went on charging those prices, with accompanying injury to consumers. That is classic harm to competition: McWane "denie[d] consumers the benefit of the pressure to lower prices that would likely accompany [the

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[16] McWane contends that the ALJ "f[ou]nd that Star had the resources to purchase a foundry … but simply made a business decision not to make an investment that could have improved its efficiency." Br. 58 (citing ALJ ¶ 1406) (emphasis omitted). That is a mischaracterization. The ALJ found only that "Star had the financial reserves and borrowing ability" to obtain a foundry, ALJ ¶ 1406, not that it would have made business sense to do so after McWane's exclusivity mandate undermined Star's cost justification for that major capital investment.

excluded firm] becoming a viable competitor." Gulf States Reorganization Group, Inc. v. Nucor Corp., 466 F.3d 961, 967-68 (11th Cir. 2006).[17]

McWane also repeatedly suggests that its exclusivity mandate was ineffective and widely ignored. The Commission's contrary factual findings are correct and, in any event, subject to the deferential substantial-evidence standard. See Polypore, 686 F.3d at 1213, 1217. McWane cannot meet the burden imposed by that standard.

First, McWane misrepresents that the "ALJ found" that "McWane had little or no ability to dictate terms to the Distributors, who held significant market power

inputs, as "a Chihuahua barking at [a] Rottweiler." ALJ ¶ 1178. This self-serving characterization was also implausible. When McWane issued its exclusivity mandate, it was the sole supplier of the full line of fittings for domestic-only specifications, including otherwise unavailable fittings, and these distributors could disregard that mandate only at their peril—which is why they generally acquiesced. *See generally Dentsply*, 399 F.3d at 195-96 (monopolist supplier can induce even large multi-product distributors to cooperate in excluding monopolist's rivals).[18]

McWane also claims that "dozens and dozens of McWane's customers did in fact purchase domestic fittings from Star," in supposed disobedience to McWane's exclusivity demand. Br. 21. That mischaracterizes the record: those customer purchases were a byproduct of McWane's limited exception for fittings that McWane did not have in stock. The marginal sales that Star made under that exception were substantially smaller than the sales Star otherwise could have made absent McWane's exclusivity mandate. *See* Comm'n 22-24, 29. Again, Star's relationship with HD Supply—which accounted for nearly one-third of fittings

[18] McWane implies that the ALJ found that "the FTC's own expert failed to identify a *single* distributor … who wanted to purchase Star domestic Fittings but could not because of McWane's rebate policy." Br. 44-45 (citing ALJ ¶ 375). The ALJ made no such finding and, to the contrary, indicated that numerous distributors likely would have given Star more business but for McWane's exclusivity mandate. *See* Statement of Facts, Section A.2, *supra* (citing findings).

distribution—illustrates that effect. Star had { } of HD Supply's business for nondomestic fittings, but less than { } of its business for domestic fittings. ALJ ¶ 1258.

Finally, contrary to McWane's repeated suggestion (Br. 4, 27, 43), Star had no exclusive agreements with any distributor. The fact that some distributors who bought in small volumes from Star never purchased domestic fittings from McWane suggests only that those distributors were insignificant market participants with negligible demand for domestically manufactured fittings.

B. McWane Demonstrates No Procompetitive Justification

Once the government "demonstrate[s] harm to competition, the burden falls upon [the defendant] to defend its exclusive dealing … by providing a pro-competitive justification[.]" *Microsoft*, 253 F.3d at 71. McWane demonstrates no such justification.

Although McWane devotes an entire section of its brief to the supposed "[p]rocompetitive [e]ffects" of its exclusivity mandate (Br. 54), its argument on that point is simply illogical. McWane argues that (1) it was more efficient than Star because it owned a foundry, whereas Star made a "business decision" not to buy one; (2) Star's resulting higher cost structure kept it from competing on the basis of price; (3) "[c]ompetition is not injured by the 'exclusion' of a less

"customers could continue to benefit from the lower prices offered by the most efficient domestic foundry" (*i.e.*, McWane's). Br. 54-55, 58.

This argument ignores McWane's role in depriving Star of the scale needed

by increasing Star's costs and reducing its efficiency. Comm'n 30-31. That is the antithesis of pro-competitive conduct, and it is not a cognizable efficiency justification.

could not compete for that business by lowering its price for those products and increasing its price for the less common products," and "McWane offers no reason why … consumers are necessarily worse off" under that outcome. Comm'n 32. McWane still offers no reason. Indeed, it does not even address, let alone challenge, the Commission's reasoning on this point.[19]

Finally, McWane intimates that effective competition by even one rival would imperil McWane's efforts to "keep [its] foundry open (and its workforce employed)." Br. 55. Even if this were a pro-competitive justification, which it is not, *see* Comm'n 32, it lacks any factual foundation. McWane cites no record evidence that its foundry was in danger of closing. And McWane's internal planning documents likewise voiced no concern that successful entry by Star would force McWane to close its foundry. Instead, the documents simply warned that, if Star "stay[s] in the business,

and anticompetitive measures to eliminate such downward pressure are the key evil that the antitrust laws target.[20]

C. McWane's Legal Arguments Co

1. Monopolists Are Subject To Stricter Limits On Exclusivity Than Non-Monopolists

In both *Microsoft* and *Dentsply*, the courts condemned exclusive-dealing strategies by monopolists even though, in each case, the strategy marginalized the monopolist's rivals rather than excluding them altogether. *See Microsoft*, 253 F.3d at 64; *Dentsply*, 399 F.3d at 191. As the courts explained, exclusive dealing has a "significant effect in preserving [a] monopoly" if it keeps competitors "below the critical level necessary ... to pose a real threat" to the monopoly. *Microsoft*, 253 F.3d at 71. Similarly, exclusive dealing can harm competition by "slow[ing] the rival's expansion by requiring it to ... rely

dealing generally presents limited potential for harm in competitive markets because "the loss of a single rival or constraints on its expansion may have little impact if there is sufficient continued competition by other rivals that prevents the excluding firm from gaining the power to raise or maintain supra-competitive prices."[22]

In contrast, exclusivity requirements trigger special antitrust concerns in monopoly markets where a monopolist imposes them to hobble new16.8798 .62239iJ -23

procompetitive—can take on exclusionary connotations when practiced by a monopolist.”). The

bypass existing distribution channels). Here, distributors are essential; manufacturers cannot effectively sell directly to end users. Comm'n 22-23.

In short, McWane violated the antitrust laws not simply because it engaged in exclusive dealing, and not simply beca

monopolist with a "practically indispensable" service "forced numerous [customers] to refrain from" dealing with a rival).

Indeed, McWane's unilateral threat to deprive any errant distributor of access to its products was more

other than by ceasing to do business with McWane—the very sanction that McWane used to enforce the program. Thereafter, the distributor could not do business with McWane again unless, implausibly, it stopped buying domestically manufactured fittings from any other source—*i.e.*, stopped buying them altogether—for another "12 weeks." ALJ ¶ 1173. As McWane's national sales manager aptly remarked, when instructing his sales force how to describe this policy to distributors, "[o]nce [distributors] use Star, they can't EVER buy domestic from us[.]" ALJ ¶ 1179 (quoting CX0710 at 1-2). In short, the Commission reasonably concluded that "the practical effect of [McWane's mandate] was to make it economically infeasible for distributors to drop McWane's full line of domestic fittings and switch to Star." Comm'n 24. That finding was correct, and it easily withstands substantial-evidence review.

Finally, contrary to its suggestion (Br. 40), McWane never placed any time horizon on its exclusivity mandate (let alone "four months"), and it never withdrew that mandate. Indeed, some distributors testified that they believed it was still in effect at the time of trial. Comm'n 39-40. McWane does appear to have begun enforcing that mandate less rigidly in early 2010, once it learned that the Commission had begun this investigation. *See* ALJ p. 405; ALJ ¶¶ 1220, 1311. But McWane cannot plausibly cite the promptness of that antitrust intervention as a basis for claiming that its exclusive-dealing mandate was short-term in nature.

McWane required exclusivity and thereby impeded competition "for as long as McWane desired." Comm'n 24. It warrants an antitrust remedy no less today because prompt antitrust intervention mitigated some of the intended harm.

3. A Monopolist Can Be Liable For Impeding A New Entrant's Growth Even If The Entrant Makes Some Sales

In a similar vein, McWane suggests that it could not possibly have violated the antitrust laws because Star managed to win some business after starting from a market share of zero in mid-2009. Br. 42. As Microsoft and Dentsply make clear, however, a monopolist's anticompetitive exclusion of a new rival violates Section 2 even if the rival is not "completely bl

that the dominant firm imposes on the smaller rival's growth." *Dentsply*, 399 F.3d at 191 (quoting XI Areeda & Hovenkamp, *Antitrust Law* ¶ 1802c, at 76); *see also* Salop, Pozen & Seward at 13 (courts properly find liability where "the entrant remains viable but with limited output").[23]

McWane's reliance on Star's ability to "double" its

(though by no means all) thereafter concluded that, "given the announced FTC investigation," the "risk" of rigid enforcement of the exclusivity mandate was "significantly less." ALJ ¶ 1311 (quoting distributor). Against that backdrop, the fact that Star's domestic-fittings share rose from { } in 2010 to { } in 2011, *see* ALJ ¶¶ 356-57, is more reasonably viewed as evidence that early antitrust intervention mitigated the full anticompetitive force of McWane's exclusivity mandate than as evidence that the mandate was ineffectual as originally implemented. *Cf. United States v. General Dynamics Corp.*, 415 U.S. 486, 504-05, 94 S. Ct. 1186 (1974) (actions taken to improve antitrust defendant's litigating position have "extremely limited" probative value).

4. Antitrust Law Does Not Require The Government To Prove How New Competitors Would Have Developed Absent Anticompetitive Conduct

As discussed in Section II.A, the Commission found strong evidence that McWane's industry-wide exclusivity mandate worked just as McWane expected: it kept Star from "reach[ing] any critical market mass that w[ould] allow them to continue to invest and receive a profitable return." ALJ ¶ 1150 (quoting CX0074 at 1); *see* Comm'n 22-29. The Commission's resolution of that evidentiary

a t 1) ;

> competitive actions. . . . [N]either plaintiffs nor the court can confidently reconstruct a product's hypothetical . . . development in a world absent the defendant's exclusionary conduct. To some degree, 'the defendant is made to suffer the uncertain consequences of its own undesirable conduct.'"

Id.

documents). That strategy succeeded. The ensuing harm to competition was no "daisy chain of unsupported inferences," as McWane suggests (Br. 49); it was the explicitly intended consequence of McWane's strategy. See *Microsoft*, 253 F.3d at 59 ("'knowledge of intent may help the court to interpret facts and to predict consequences'") (quoting *Chicago Bd. of Trade v. United States*, 246 U.S. 231, 238, 38 S.Ct. 242 (1918)). In short, McWane's conduct qualifies as "anticompetitive conduct that 'reasonably appear[s] capable of making a significant contribution to maintaining monopoly power.'" *Microsoft*, 253 F.3d at 79 (quoting III Areeda & Hovenkamp, *Antitrust Law* ¶651c, at 78).

Microsoft's holding likewise refutes the chief argument raised in the dissent

Counsel's case." *Id.* at 31-32. But that position would impose on complaint counsel a burden that, as the *Microsoft* court held, no antitrust plaintiff need bear: the burden to "reconstruct the hypothetical marketplace absent a defendant's anticompetitive conduct." *Microsoft*, 253 F.3d at 79.

Moreover, even if complaint counsel were required to shoulder that burden, the Commission majority properly concluded that the relevant question would be whether, absent McWane's exclusionary conduct, Star could have more effectively disciplined McWane's monopoly prices—not whether Star would have achieved MES in particular. Comm'n 27-28. The dissent's focus on MES in this context has elicited criticism from, among others, Professor Steven Salop, who originated the analytical framework on which the dissent relied. *Cf.* Dissent 10-12, 34 n.41, 38 n.45 (relying extensively on Prof. Salop's "raising rivals' costs" framework). As Professor Salop explains in a recent article, a new entrant in a monopolistic market can promote consumer welfare by disciplining the monopolist's prices even if the entrant has not reached MES, and a monopolist's measures to raise the entrant's costs can reduce price competition and harm consumer welfare whether or not the entrant has reached or would otherwise reach MES. *See* Salop, Pozen & Seward at 28-31. The majority's conclusion in this case thus "follows the modern approach to exclusive dealing with respect to both the economics and the law," whereas the dissent's proposed "limitations on the economic theories of exclusion

are not supported by modern economic analysis and [would] serve only to weaken antitrust enforcement.” *Id.* at 3, 23.

In any event, this Court need not reach that abstract economic dispute. First, the MES dispute would arise only if complaint counsel had to prove exactly what efficiencies the entrant would have achieved but for the monopolist’s conduct. *Microsoft* confirms that complaint counsel bears no such burden. Second, McWane itself preserves no argument on appeal concerning MES; indeed, the term “minimum efficient scale” appears nowhere in McWane’s brief. For that matter, McWane’s brief affirmatively rejects the dissent’s MES logic. As discussed, McWane repeatedly asserts that Star’s decision “to contract fittings from six

effectively." Br. 53-54. McWane notes that Star and Sigma "successfully grew their import fittings businesses" through a "virtual manufacturing" model "without owning a foundry anywhere *in the world*[.]" Br. 54 (emphasis added). But that argument makes no sense, as the Commission found. Comm'n 27 n.14. Import fittings are made in various foundries abroad and benefit from the efficiencies of low-cost, high-volume production. *See* ALJ ¶ 1077. Star and Sigma share in those efficiencies when they import such fittings. But an entrant cannot efficiently compete with McWane for *domestic* fittings production until it dispenses with inefficient reliance on generic U.S. "jobber" foundries and, like McWane, obtains the scale needed to cost-justify acquisition of a U.S.-based dedicated fittings foundry. Comm'n 27 n.14. McWane does not address, let alone challenge, the Commission's factual conclusion on that point.

In sum, McWane's exclusivity mandate qualifies as "anticompetitive conduct that 'reasonably appear[ed] capable of making a significant contribution to maintaining monopoly power.'" *Microsoft*, 253 F.3d at 79. That is more than sufficient to support the Commission's liability finding and injunctive relief.

CONCLUSION

The petition for review should be denied.

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CERTIFICATE OF COMPLIANCE

I, Theodore (Jack) Metzler, certify that the foregoing complies with the type-volume limitation of Federal Rule of Appellate Procedure 32(a)(7)(B) in that it contains 13,913 words.

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