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UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION

COMMISSIONERS: **Jon Leibowitz, Chairman**
J. Thomas Rosch
Edith Ramirez
Julie Brill

In the Matter of	**Docket No. 9350**
GRACO INC. **a corporation,**	
ILLINOIS TOOL WORKS INC. **a corporation, and**	
ITW FINISHING LLC **a limited liability company.**	

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act, and by virtue of the authority vested in it by the Act, the Federal Trade Commission, having reason to believe that Respondents Graco Inc. ("Graco"), Illinois Tool Works Inc., and ITW Finishing LLC ("ITW") having entered into an agreement pursuant to which Graco will acquire the assets of ITW, in violation of Section 5 of the FTC Act, 15 U.S.C. § 45, and which if consummated may substantially lessen competition in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18 and Section 5 of the FTC Act, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint pursuant to Section 5(b) of the FTC Act, 15 U.S.C. § 45(b), and Section 11(b) of the Clayton Act, 15 U.S.C. § 21(b), stating its charges as follows:

I.

NATURE OF THE CASE

1. Graco's proposed acquisition of ITW, its largest and most significant competitor, threatens to harm competition for certain industrial liquid finishing equipment in North America and lead to higher prices for North American distributors and end users already struggling in today's economic environment. Finishing is the application by end-user customers of coatings,

such as paint or varnish, to all kinds of metal, plastic, or wood products that they manufacture. Describing the deal, Graco's president told his Board of Directors that the ITW finishing companies were "[d]irect competitors to our IPD [Industrial Products Division] Finishing business in every region of the world."

2. Graco and ITW are the two dominant manufacturers of liquid finishing equipment for industrial use in North America. The acquisition would combine Graco's "#1 market position" with its leading competitor and eliminate the close competition ITW now poses to Graco's liquid finishing business. As described in the 2010 U.S. Department of Justice and Federal Trade Commission Horizontal Merger Guidelines ("Merger Guidelines"), the loss of this close direct competition is likely in and of itself to lead to anticompetitive effects. After the acquisition, Graco will no longer need to effectively discount on sales to distributors to compete with ITW and will have less incentive to develop new and better products. Because competition for sales to distributors will be lessened, end use industrial manufacturers may pay higher prices for industrial liquid finishing equipment.

3. Post-acquisition, Graco will control well over half of the sales of all liquid finishing equipment for industrial use in North America. According to the parties' internal documents, Graco and ITW are the dominant suppliers of certain industrial liquid finishing equipment in North America. Exel is a distant third.

4. Under the relevant case law and the Merger Guidelines, the extraordinarily high post-acquisition concentration levels render the acquisition presumptively unlawful in relevant markets within the product categories of pumps, spray guns, and proportioners for industrial use, in which Graco and ITW compete for the sale of industrial liquid finishing equipment to distributors (value-added resellers) for resale.

5. Evidence from the parties, distributors (value-added resellers), and other industry participants confirms this strong presumption of illegality. Because Exel and other niche manufacturers lack Graco's and ITW's installed base, brand acceptance, and access to quality North American distribution which can furnish some users with service and replacement parts, no existing competitors can or would constrain Graco post-acquisition from imposing price increases on industrial liquid finishing equipment. As one industrial end user commented to ITW, "[i]f you can't beat them buy them, huh . . . Not sure how that [acquisition] gets approved. Graco would essentially have a monopoly on spray finishing."

6. Effective expansion or entry into the manufacture and sale in each industrial liquid finishing equipment market in North America is unlikely in response to an anticompetitive price increase, due to significant barriers to entry. In a recent presentation prepared for its Board of Directors, Graco identified entry barriers, including "Breadth of product line, Large installed base, Well developed [distributor] channel, Market leadership position with strong brand recognition, Manufacturing capital investment, [and] Product design capability." Graco admits that "[t]he upshot of the existence of these entry barriers is the absence of any significant new competitors in the last 20 years." Repositioning or expansion by existing smaller competitors is unlikely without access to capable local distributors to sell and service finishing

equipment for industrial end users. Indeed, Graco believes its strength in distribution alone "makes it extremely difficult for competitors to enter/violate the channel[s]." Respondents have advanced no credible, cognizable efficiencies to justify the acquisition, especially given the extremely high post-acquisition concentration and the loss of close competition between Graco and ITW. Indeed, Graco's stated plan is to operate the two liquid finishing equipment businesses as separate standalone operations, only now under the common control of a single firm.

II.

RESPONDENTS

7. Graco Inc. is a for-profit corporation, existing and doing business under and by virtue of the laws of the state of Minnesota, with its office and principal place of business located at 88 11th Avenue Northeast, Minneapolis, Minnesota 55413. Graco manufactures and sells liquid finishing equipment throughout North America and the world.

8. Illinois Tool Works Inc. is a for-profit corporation, existing and doing business under and by virtue of the laws of the state of Delaware, with its office and principal place of business located at 3600 West Lake Avenue, Glenview, Illinois 60026. Illinois Tool Works wholly owns ITW Finishing LLC.

9. ITW Finishing LLC is a for-profit limited liability company, existing and doing business under and by virtue of the laws of the state of Delaware, with its office and principal place of business located at 3600 West Lake Avenue, Glenview, Illinois 60026. ITW manufactures and sells liquid finishing equipment throughout North America and the world.

III.

JURISDICTION

10. Respondents, and each of their relevant operating subsidiaries and parent entities are, and at all relevant times have been, engaged in activities in or affecting "commerce" as defined in Section 4 of the FTC Act, 15 U.S.C. § 44, and Section 1 of the Clayton Act, 15 U.S.C. § 12.

11. The acquisition constitutes an acquisition subject to Section 7 of the Clayton Act, 15 U.S.C. § 18.

IV.

THE ACQUISITION

12. Pursuant to an Asset Purchase Agreement dated April 14, 2011, Graco proposes to acquire certain assets and equity interests from Illinois Tool Works and ITW for $650 million. The transaction would create an entity with annual sales exceeding $1 billion. Respondents Graco and ITW have combined North American liquid finishing equipment sales exceeding $100 million.

V.

INDUSTRY STRUCTURE AND ANTICOMPETITIVE EFFECTS

13. Industrial manufacturers, the end users of the products at issue, use liquid finishing equipment to apply paint and other coatings to all kinds of finished goods, including automobiles, office furniture, and home appliances. Almost every surface requires a finish, whether for aesthetic value, surface protection, or other features. These characteristics are often the very things that make a customer choose one product over another. Applying a consistent finish is a critical part of the manufacturing process, because any disruption in the finishing process could impede the entire manufacturing process. Manufacturers require reliable, proven finishing equipment and local service, whenever a problem arises, day or night.

14. Graco and ITW manufacture and sell liquid finishing equipment for use in industrial settings. This equipment includes pumps, applicators (spray guns), plural component equipment (proportioners), and related equipment used in industrial paint systems. The equipment is durable, with a significant follow-on parts and service business associated with each system or component sale. Pumps, spray guns, proportioners, and the spare parts associated with these components account for the vast majority of the North American industrial liquid finishing equipment sales of both firms. Respondents sell these products throughout North America.

15. Liquid finishing equipment manufacturers, including Graco and ITW, predominantly sell their products to independent, highly-specialized distributors, who purchase the vast majority of liquid finishing equipment for resale. Distributors provide a total liquid finishing solution—a value-added bundle of goods and services to meet each end user's needs, which can include system design, engineering, installation, product training, equipment customization, maintenance, and repair. The initial sale of equipment typically results in additional business for the distributor in selling spare and replacement parts and accessories. Aftermarket sales often comprise the majority of a distributor's business. The aftermarket business most typically involves Graco and ITW parts because they have the largest installed bases of equipment.

16. Access to quality distributors appears to be the most cost-effective way to channel the local pull-through demand for the industrial liquid finishing equipment that is the subject of

this complaint. As previously stated, all industrial liquid finishing equipment manufacturers sell predominantly through distributors. Graco itself sells all of its industrial liquid finishing equipment to distributors. ITW sells the vast majority of its industrial liquid finishing equipment to distributors.

17. Graco and ITW compete directly with each other on price and product innovation. Graco and ITW compete on price by (among other things) offering reduced prices to their distributors (and, through them to industrial end users) in the form of volume discounts, payment of commissions to distributors for "switching" an end user, and other promotions on the sale of their equipment. Graco and ITW also compete on innovation, often developing new products to match close offerings of the other firm.

18. Graco and ITW are the largest suppliers of pumps, spray guns, and proportioners, and are close or the closest competitors in each category of products that are the subject of this complaint. When Graco and ITW win a competitive sale, they displace each other's products more often than anyone else's. To grow share in a mature industry, a manufacturer must displace competitive product. As Graco's president testified, "a mature market doesn't mean that it's an easy market or that it's a sleepy market. . . . [Y]ou're out there every day slugging it out for a pot that's not growing very fast."

19. Post-acquisition, distributors and industrial manufacturers will have no recourse to curb the loss of this competition. Graco's president acknowledges that Graco already enjoys power over its distributors and industrial end users: "Number one is that you've got lots of end users out there. Oh, by the way, those end users like Graco. And oh, by the way, if they already have Graco and they know Graco, the switching costs are significant for them to switch away from Graco. So . . . not only do you have thousands of end users, you have hundreds of distributors. And for a manufacturer, that's a nice spot to be. . . . The ideal place to be, the sweet spot, for having the buyer power be low is to have lots of customers and lots of distributors."

20. Other firms will not grow or expand to replace the loss of this competition, especially for installed base sales. Without a network of well-financed, capable distributors who can quickly furnish service and replacement parts to end users, firms cannot expect to penetrate these markets significantly. Fringe competitors lack the installed base to attract significant local distribution. Moreover, without a large installed base, new entrants will be unable to find adequate distribution. After the acquisition, most of the top North American distributors would not switch from Graco to carry or promote fringe competitors or new entrants. Distributors depend heavily on Graco and ITW for their business, fear retaliation from Graco if they carry other brands, and believe that their end users would be disinclined to embrace unfamiliar brands lacking long-term marketplace reliability and manufacturer credibility. The acquisition will exacerbate the already substantial barriers to entry presented by the limited pool of quality distributors with a substantial percentage of installed base sales opportunities, generally unavailable to less-established brands of industrial liquid finishing equipment.

21. Graco's large installed base in end user plants makes it extremely difficult for competitors to expand their market presence. Only ITW has managed to retain significant and growing market presence, often at Graco's expense.

22. ITW recognizes that Graco "[c]arries too big a stick" with ITW's largest distributors, and that ITW needed to "[l]oosen Graco's headlock on distribution." Post-acquisition, Graco's distributors will not risk their Graco volume discounts, promotional programs, and their Graco component and aftermarket sales by promoting other manufacturers' products. Graco will be able to realize even greater percentage price increases over cost increases than they do today.

23. Graco and ITW have the largest installed base of equipment sold to end users and the largest share of distributor sales and distributor loyalty. Graco and ITW have an advantage over other industrial liquid finishing equipment manufacturers when "slugging it out" to attract and maintain distributors to push end user sales.

24. The transaction would eliminate both price and non-price competition between Graco and ITW for distributors and end users and enhance the merged entity's market power.

VI.

RELEVANT PRODUCT MARKETS

25. From this evidence of anticompetitive effects, it can be inferred that certain of the products discussed below satisfy the hypothetical monopolist test used to identify relevant markets. Respondents' documents track their sales by the following categories of equipment.

26. The relevant product markets that would be affected by the transaction are no broader than the manufacture and sale of:

a. liquid finishing pumps for industrial use,
b. liquid finishing applicators (spray guns) for industrial use,
c. liquid finishing plural component equipment (proportioners) for industrial use,
d. circulation pumps for paint systems used in automotive assembly plants, and
e. industrial liquid finishing equipment for resale.

A.

Liquid Finishing Pumps for Industrial Use

27. Industrial liquid finishing pumps are specialized equipment used to transfer, distribute, or circulate paints and finishing liquids at a regulated pressure, flow rate, and temperature. A liquid finishing system requires one or more pumps, depending on the scale of the finishing operation. Liquid finishing pumps encompass a variety of technologies (e.g., piston, centrifugal, double diaphragm, and rotary lobe), powered by different means (i.e., electric, hydraulic, and pneumatic), and operating at different pressures and flow rates. Brand reputation, a loyal installed base of end users, and the importance of quality distribution that can quickly service and/or replace those pumps are the key competitive dynamics for all industrial liquid finishing pumps.

B.

Liquid Finishing Spray Guns for Industrial Use

28. Industrial liquid finishing spray guns are specialized equipment used to apply paint and other liquid coatings to a surface. Spray guns encompass a range of designs, such as airless guns, air-assisted airless guns, and manual electrostatic guns, and several relevant product markets may exist within the overall spray gun market. Although end users' demands are varied and specific, and a gun appropriate for one use will not always substitute for a spray gun used in a different process, brand reputation, a loyal installed base of end users, and the importance of quality distribution that can quickly service and/or replace those applicators are the key common competitive dynamics for all industrial liquid finishing spray guns.

C.

Liquid Finishing Proportioners for Industrial Use

29. Plural-component equipment (proportioners) mix paint with catalysts and other liquids in ratios before application to a product. Proportioners can handle multiple colors and catalysts and offer some flexibility in configuration. Some proportioners can make rapid, multiple color changes, with real-time information and touch screen displays. Brand reputation, a loyal installed base of end users, and the importance of quality distribution that can quickly service and/or replace those proportioners are the key competitive dynamics for all industrial liquid finishing proportioners.

D.

Circulation Pumps for Paint Systems in Automotive Assembly Plants

30. Paint circulation pumps used in automotive paint circulation systems are specialized equipment designed to circulate automotive paint and other liquid finishes to various points along an assembly line. Auto manufacturers are highly sensitive to finish quality and production costs. Automakers and automotive suppliers consider electric piston circulation pumps superior to other pump technologies in reliability and efficiency. Automakers generally preapprove liquid finishing equipment manufacturers' pumps for use in automotive assembly plants; this approval can take two years or longer.

E.

Industrial Liquid Finishing Equipment for Resale

31. Manufacturers of liquid finishing equipment for industrial use rely predominantly on independent distributors to purchase equipment for resale with a variety of value-added services and equipment that end users demand. End users require immediate turnaround on service, sales, engineering, and support. Manufacturers best supply these services, especially to their installed base, throughout North America using local distribution. Industrial liquid finishing equipment manufacturers compete to provide the broadest set of products at the lowest delivered price, with prompt equipment delivery and service to resellers.

VII.

GEOGRAPHIC MARKET

32. A relevant geographic market in which to analyze the effects of the proposed acquisition is North America because of the high entry hurdles and entry barriers presented by the parties' large installed bases and the end use customers' need for immediate service and/or repair or replacement of liquid finishing equipment. Distributors are largely bound to source liquid finishing equipment in North America in order to be able to provide the service and support their end users require. Only industrial liquid finishing equipment manufacturers with a large installed base and sales staff in North America can profitably support this network of distribution. The importance of the installed base and local distribution means that overseas manufacturers with limited sales in North America lack the economic incentive or ability to expand their North American sales.

VIII.

PRESUMPTIVE ILLEGALITY OF THE ACQUISITION

33. Because no countervailing benefits exist, the acquisition will eliminate both price and non-price competition between Graco and ITW and increase the merged entity's market power, making it illegal.

34. The acquisition's effect on concentration renders it presumptively illegal. Graco and ITW are the two most significant competitors providing pumps, spray guns, and proportioners for industrial use in North America. Other manufacturers are fringe competitors with small North American sales and lack the ability to reposition or expand in a manner sufficient to ameliorate the anticompetitive effects of the transaction.

35. Graco and ITW are the only providers currently supplying circulation pumps for use in automotive paint circulation systems, making this acquisition a de facto merger to monopoly for new sales in this market.

36. Graco and ITW are the only providers effectively able to compete for the most capable distributors because of their broad liquid finishing equipment lines, large installed bases, and strong reputations for quality with end users. Other competitors with small North American sales, for the reasons previously stated, lack the economic incentive or ability to reposition or expand in a manner sufficient to ameliorate the reduced price competition resulting from the transaction.

37. Each relevant product market is already highly concentrated, and the proposed acquisition would further increase concentration to presumptively anticompetitive levels under the relevant case law and the Merger Guidelines.

IX.

ENTRY AND REPOSITIONING BARRIERS AND LACK OF EFFICIENCIES

38. Substantial and effective entry, repositioning, or fringe firm growth sufficient to deter or counteract the anticompetitive effects of the proposed acquisition is unlikely. This is because of the high entry hurdles and barriers that need to be overcome, which include, but are not limited to, the substantial time and expense to develop and market a sufficiently extensive product line to satisfy diverse end users' needs, establish marketplace credibility, build an installed base of end users, and develop an adequate distribution network.

39. The most significant entry hurdles and barriers are reputation, installed base, and, connected to this, finding adequate distribution that can supply prompt service and/or repair or replace the equipment of the installed base. These factors present significant obstacles to expansion or repositioning by existing fringe competitors, as well as de novo entry.

40. Graco acknowledges there has been no significant new entry in 20 years. The difficult entry hurdles and barriers to entry have enabled Graco to raise prices annually and to realize increased profits. ITW is the most significant constraint on Graco's ability to raise prices even further, a constraint that will be eliminated by this transaction.

41. Extraordinary efficiencies specific to the transaction are necessary to justify the acquisition in light of high concentration and high potential to harm competition. Graco has no significant plans to integrate the ITW business or products with Graco. Any manufacturing synergies are unlikely for at least five years.

X.

VIOLATIONS

COUNT I – ILLEGAL AGREEMENT

42. The allegations of Paragraphs 1 through 41 are incorporated by reference as though fully set forth.

43. The acquisition agreement constitutes an unfair method of competition in violation of Section 5 of the FTC Act, as amended, 15 U.S.C. § 45.

COUNT II – ILLEGAL ACQUISITION

44. The allegations of Paragraphs 1 through 41 are incorporated by reference as though fully set forth.

45. The acquisition, if consummated, may substantially lessen competition in the relevant markets in violation of Section 7 of the Clayton Act, as amended, 15.U.S.C. § 18, and is an unfair method of competition in violation of Section 5 of the FTC Act, as amended, 15 U.S.C. § 45.

NOTICE

Notice is hereby given to the Respondents that the fifteenth day of May 2012, at 10:00 a.m. is hereby fixed as the time, and Federal Trade Commission offices, 600 Pennsylvania Avenue, N.W., Room 532, Washington, D.C. 20580, as the place when and where an evidentiary hearing will be had before an Administrative Law Judge of the Federal Trade Commission, on the charges set forth in this complaint, at which time and place you will have the right under the Federal Trade Commission Act and the Clayton Act to appear and show cause why an order should not be entered requiring you to cease and desist from the violations of law charged in the complaint.

You are notified that the opportunity is afforded you to file with the Commission an answer to this complaint on or before the fourteenth (14th) day after service of it upon you. An answer in which the allegations of the complaint are contested shall contain a concise statement of the facts constituting each ground of defense; and specific admission, denial, or explanation of each fact alleged in the complaint or, if you are without knowledge thereof, a statement to that effect. Allegations of the complaint not thus answered shall be deemed to have been admitted.

If you elect not to contest the allegations of fact set forth in the complaint, the answer shall consist of a statement that you admit all of the material facts to be true. Such an answer shall constitute a waiver of hearings as to the facts alleged in the complaint and, together with the complaint, will provide a record basis on which the Commission shall issue a final decision containing appropriate findings and conclusions and a final order disposing of the proceeding. In such answer, you may, however, reserve the right to submit proposed findings and conclusions under Rule 3.46 of the Commission's Rules of Practice for Adjudicative Proceedings.

Failure to file an answer within the time above provided shall be deemed to constitute a waiver of your right to appear and to contest the allegations of the complaint and shall authorize the Commission, without further notice to you, to find the facts to be as alleged in the complaint and to enter a final decision containing appropriate findings and conclusions, and a final order disposing of the proceeding.

The Administrative Law Judge shall hold a prehearing scheduling conference not later than ten (10) days after the answer is filed by the Respondents. Unless otherwise directed by the Administrative Law Judge, the scheduling conference and further proceedings will take place at the Federal Trade Commission, 600 Pennsylvania Avenue, N.W., Room 532, Washington, D.C. 20580. Rule 3.21(a) requires a meeting of the parties' counsel as early as practicable before the pre-hearing scheduling conference (but in any event no later than five (5) days after the answer is filed by the Respondents). Rule 3.31(b) obligates counsel for each party, within five (5) days of receiving the Respondents' answer, to make certain initial disclosures without awaiting a discovery request.

NOTICE OF CONTEMPLATED RELIEF

Should the Commission conclude from the record developed in any adjudicative proceedings in this matter that the Acquisition challenged in this proceeding violates Section 7 of the Clayton Act, as amended, the Commission may order such relief against Respondents as is supported by the record and is necessary and appropriate, including, but not limited to:

1. If the Acquisition is consummated, divestiture or reconstitution of all associated and necessary assets, in a manner that restores two or more distinct and separate, viable and independent businesses in the relevant markets, with the ability to offer such products and services as Graco and ITW were offering and planning to offer prior to the acquisition.

2. A prohibition against any transaction between Graco and ITW that combines their businesses in the relevant markets, except as may be approved by the Commission.

3. A requirement that, for a period of time, Graco and ITW provide prior notice to the Commission of acquisitions, mergers, consolidations, or any other combinations of their businesses in the relevant markets with any other company operating in the relevant markets.

4. A requirement to file periodic compliance reports with the Commission.

5. Any other relief appropriate to correct or remedy the anticompetitive effects of the transaction or to ensure the creation of one or more viable, competitive independent entities to compete in the relevant markets.

IN WITNESS WHEREOF, the Federal Trade Commission has caused this complaint to be signed by its Secretary and its official seal to be hereto affixed, at Washington, D.C., this fifteenth day of December 2011.

By the Commission.

Donald S. Clark
Secretary

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