CLIENT ALERT

FTC Sues Distributor for Invitation to Collude with Dual Distribution Manufacturer

Aug.12.2016

In what the Federal Trade Commission has described as the first case of its kind, the Commission announced a complaint and proposed consent agreement alleging a national distributor of ductile iron pipe and fittings violated the FTC Act by inviting its supplying dual distribution manufacturer to collude on pricing. "Dual distribution" refers to a manufacturer using more than one distribution channel at a time to reach end customers. A dual distribution manufacturer typically sells directly to consumers as well as through intermediaries. That means that, instead of a purely vertical relationship, the manufacturer and distributor are also horizontal competitors for some purposes and need to be aware of the competitive consequences flowing from that hybrid situation.

According to the FTC, after the defendant distributor, Fortiline, LCC, had ceased to serve as a distributor for the dual distributing manufacturer, it complained to the manufacturer about its lower pricing in North Carolina and most of Virginia. At that time, the manufacturer was engaged in direct sales to customers in competition with Fortiline, which was distributing the products of a competing manufacturer. On two occasions in 2010, Fortiline allegedly complained to the dual distribution manufacturer that its lower direct pricing was undercutting its competitor's prices and was below market. "In substance," according to the FTC, Fortiline was asking the manufacturer to discontinue its discounted pricing and submit the same higher bids to contractors.

The FTC alleges these two offers by Fortiline constituted "invitations to collude" that were "inherently suspect" and violated Section 5 of the FTC Act. In the antitrust context, an "invitation to collude" means a specific and direct offer to a competitor to agree on price, production, or other terms of competition. In the FTC's view, the legal analysis is not altered by the fact that Fortiline and the manufacturer were "competitors in some transactions and collaborators in others." In this instance, because the invitation to collude was "across the board," *i.e.*, it did not differentiate between Fortiline's sales of the manufacturer's products and those of its rival's, it was a restriction on interbrand competition. The Commission also noted that the restraint did not appear to have any procompetitive justification, as might be the case had it been confined to intrabrand competition: Fortiline's sales of the manufacturer's products.

Although recognizing the potential procompetitive benefits of "price-related communications between a manufacturer and its distributor," the FTC's challenge appears to have been triggered by its concern for the restraint's "across the board" scope, which included the sale of products from other manufacturers. Because the Fortiline invitations extended to interbrand competition, not just protected intrabrand distribution, the FTC concluded that their intrabrand relationship, *i.e.* Fortiline's distribution of the invitee manufacturers' products, and associated procompetitive coordination, did not "immunize" the otherwise anticompetitive invitation to collude.

The application of Section 5 of the FTC Act to interbrand invitations to collude is not controversial. However, in practice manufacturers and distributors in a dual distribution relationship may find it difficult to separate sensitive communications about intrabrand issues (usually low risk) from communications about interbrand competition (often higher risk). Commissioner Ohlhausen issued a brief dissenting statement highlighting this issue. While she agreed that a vertical relationship in other

markets did not make it lawful for a firm to invite its competitor to collude, in her view "whether the communications arose in a vertical or horizontal context is ambiguous…." She concluded, therefore, that imposing liability "in such equivocal factual circumstances may chill procompetitive vertical conduct in markets with dual distribution."

The FTC's proposed relief further highlights these practical limitations. Fortiline would be barred from participating in price setting decisions with any competitor—but still may engage in conduct necessary for the procompetitive benefits of its lawful distribution relationship. Of course, as noted by the dissent, distinguishing vertical and horizontal conduct in practice presents a complicated factual determination.

Ultimately this uncertainty may make compliance more costly. Dual distribution manufacturers and their distributors may be well served to expand training and to undertake efforts to more explicitly separate business operations, but must balance heightened compliance efforts against their associated costs. The facts in Fortiline may, however, be unusual and unlikely to arise often. According to the FTC, prior to the alleged conduct, Fortiline had terminated its relationship with the manufacturer and thus was principally concerned with the effect of its direct pricing on Fortline's future sales of its rival's products in the affected areas. The evidence of its communications, which occurred in face-to-face meetings, a follow-up email, and at a trade association meeting appeared to be explicit and left little room for a procompetitive interpretation tied to its relationship with the manufacturer. These aspects of the complaint also suggest the need for vigilant compliance counseling.

The proposed consent agreement is subject to public comment through September 8, 2016.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.

Ryan C. Tisch
Partner – Washington, D.C.
Phone: +1 202.624.2674
Email: rtisch@crowell.com

Andrew I. Gavil
Senior Of Counsel – Washington, D.C.
Phone: +1 202.628.2823
Email: agavil@crowell.com

Lisa Kimmel, Ph.D.
Senior Counsel – Washington, D.C.
Phone: +1 202.624.2749
Email: lkimmel@crowell.com

Robert B. McNary
Counsel – Los Angeles
Phone: +1 213.443.5590
Email: rmcnary@crowell.com