

# FTC SCRUTINIZES DUAL DISTRIBUTOR COMMUNICATIONS

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A dual distribution relationship does not protect against Section 5 liability for an invitation to collude.

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For the first time, the Federal Trade Commission (FTC) has charged a company with violating Section 5 of the FTC Act for an alleged invitation to collude with a company that served as both a competitor and a supplier. Invitations to collude are solicitations by one competitor to another to coordinate on price, output, or other terms of competition. The FTC treats an invitation to collude as a violation of Section 5 of the FTC Act even when (a) the respondent does not possess market power, (b) the invitee did not accept the invitation, and (c) there is no evidence of competitive harm. Previously, the FTC had only sought liability for invitations to collude against entities that were horizontal competitors.

This FTC enforcement action is a reminder to companies that engage in dual distribution that communications that may be appropriate in an ordinary supply relationship may be problematic when a supplier also acts as a competitor and the communications could affect interbrand competition. Although the FTC has not

sought monetary remedies for invitations to collude, these cases have resulted in some follow-on private damages actions alleging that the invitation to collude was actually accepted and seeking treble damages.

On August 15, the FTC published a Notice in the *Federal Register* regarding the administrative enforcement action it has taken in *In the Matter of Fortiline, LLC*, File No. 151-0000. In this matter, the FTC alleges that Respondent Fortiline illegally invited a competitor to raise and fix prices. Fortiline is a distributor of ductile iron pipe, fittings, and accessories. The target of the solicitation, called “Manufacturer A” in the Complaint, manufactures ductile iron pipe and distributes it in competition with Fortiline in some states, and also engages Fortiline to distribute ductile iron pipe on its behalf in other states. Thus, Manufacturer A has a dual distribution relationship with Fortiline, because it is both vertically related to Fortiline through its distribution arrangements, and horizontally related to Fortiline as a competing distributor of Manufacturer A’s ductile iron pipe. Fortiline also distributes ductile iron pipe for another manufacturer, “Manufacturer B.” In late 2009, Fortiline terminated its distribution arrangement with Manufacturer A in the area relevant to the Complaint and began to distribute ductile iron pipe for Manufacturer B in that relevant area. Fortiline continued to distribute ductile iron pipe for Manufacturer A in other geographic areas in the United States.<sup>[1]</sup> Thereafter, to compete against Fortiline (and indirectly, Manufacturer B), and to encourage customers to purchase ductile iron pipe directly from it, Manufacturer A offered lower prices to customers in that relevant area. In response, Fortiline and other ductile iron pipe distributors reduced their prices to customers in that area as well.

According to the FTC’s Complaint, on two occasions in 2010, the Respondent invited Manufacturer A to collude on ductile iron pipe pricing. In February, Fortiline complained to Manufacturer A that it was selling ductile iron pipe at prices that were too low, and conveyed its preference that Manufacturer A and Fortiline both increase their prices, stating in an email that Manufacturer A’s reduced pricing was “irrational behavior . . . . With this approach we will be at a .22 [multiplier] soon instead of a needed .42.” Later that year, in October, the Complaint alleges that Fortiline complained to Manufacturer A about Manufacturer A’s .31 multiplier price, which was “20% below market.” The FTC highlights that these communications about prices between Fortiline and Manufacturer A were not limited to the products that Fortiline distributed for Manufacturer A, but pertained “across the board” to all ductile iron pipe that Manufacturer A manufactured and sold and to ductile iron pipe that Manufacturer B manufactured and that Fortiline distributed in the relevant area.

Recognizing the need for legitimate communications between distributors and manufacturers, the FTC Decision and Order states that “any conduct that is (1)

reasonably related to a lawful manufacturer-distributor relationship . . . ; and (2) reasonably necessary to achieve the procompetitive benefits of such a manufacturer-distributor relationship” shall not violate the Order. The Order also allows Respondent to engage the following specific activities, which other dual distributors should be able to rely on:

- “communicate with a Manufacturer regarding Respondent’s desire to receive prices or rates (including rebates and discounts) at least as favorable as those granted by that Manufacturer to a Competitor;”
- “request, negotiate, or enter into an agreement with a Manufacturer under which Respondent shall be that Manufacturer’s exclusive or quasi-exclusive distributor;”
- “request or enter into an agreement with a Manufacturer under which Respondent distributes that Manufacturer’s ductile iron pipe to a [customer] previously or potentially served by that Manufacturer;” or
- “negotiate with a Competitor regarding the terms of an agreement, or to enter into an agreement, if that negotiation or agreement relates exclusively to the terms under which Respondent either will buy ductile iron pipe from that Competitor, or will sell ductile iron pipe to that Competitor.”

The FTC will accept public comments on the proposed consent agreement until September 8, 2016.

Consistent with Commissioner Maureen Ohlhausen’s dissent in connection with the Section 5 policy statement that the FTC issued just one year ago (see our LawFlash, [FTC Spells Out Principles on When It Will Exercise Its Standalone Authority Under Section 5](#)), she also opposed the *Fortiline* Consent Order and issued a dissent. Commissioner Ohlhausen explains that “the evidence regarding whether Fortiline made an invitation to collude and whether the communications arose in a vertical or horizontal context is ambiguous.” She states further that “imposing liability in such equivocal factual circumstances may chill procompetitive vertical conduct in markets with dual distribution.”

As Commissioner Ohlhausen aptly notes, dual distributors may find it challenging to navigate the fine line between communications that the FTC views as invitations to collude according to *Fortiline*, and conduct that would reflect procompetitive communications regarding market information and insights between manufacturers and their distributors. Dual distributors should examine their information-sharing protocols and practices, especially those that pertain to pricing. Existing antitrust compliance training and materials should also be revisited to ensure that they are consistent with this new authority.

## Contacts

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[1] In certain limited circumstances, where Fortiline had already submitted bids to customers in the relevant area specifying Manufacturer A as the source of ductile iron pipe, Fortiline continued to distribute Manufacturer A pipe to those customers after it terminated its distribution arrangement with Manufacturer A.