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Murky Waters: The FTC Dives into Exclusionary Supply Contracts

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Although most supply agreements are a benign business reality, when favorable terms negotiated with a supplier foreclose the buyer's rivals from competing, the antitrust waters can get murky, and buyers, especially those with market power, risk government investigations and private litigation.

In a recent enforcement action, the Federal Trade Commission (FTC) on November 21 entered into a consent order with Pool Corporation, Inc. (Pool Corp.) that required the company to remove any provisions in its agreements with pool supply manufacturers that could prevent new entrants from gaining a foothold in the pool supply distribution market. Two days later, a pool dealer echoed the FTC complaint in a new class action suit against Pool Corp. alleging monopolization and seeking treble damages.

The FTC Complaint: Pool Corp. Finds Itself in the Deep End

In its complaint, the FTC alleged that, as the largest wholesale distributor of pool supplies and the only distributor with a nationwide distribution network, Pool Corp. had substantial leverage in its relationships with manufacturers of pool supplies. The FTC concluded that Pool Corp.'s market share exceeded 80% in some areas and that Pool Corp. accounted for 30% to 50% of most pool supply manufacturers' sales, making it by far their largest customer. The result, the FTC alleged, was substantial market power (the power to exclude competition).

The FTC alleged that Pool Corp. abused its market power by using the clout derived from this market power to prevent its suppliers from selling pool supplies to distributors that were trying to enter the market. Pool Corp.'s strategy was successful with most manufacturers, including the three manufacturers that sell the most complete lines of pool supplies. According to the FTC's complaint, a distributor cannot succeed without supply from at least one of the large manufacturers. But Pool Corp. made that impossible by locking up those suppliers through contract provisions and threats not to do business with suppliers that sold to new entrants. The FTC said that Pool Corp.'s tactics were unusually effective in drowning competition because wholesale distribution is the primary channel through which dealers buy pool supplies. The result, the FTC claimed, was higher prices for dealers and consumers.

The FTC Consent Order

Under the Consent Order, Pool Corp. agreed that it will not:

1. Condition purchases or inclusion in preferred vendor programs on manufacturers agreeing not to sell to competing distributors
2. Exert pressure on manufacturers to limit or prevent their sales to competing distributors
3. Otherwise discriminate against a manufacturer for selling to a competing distributor.

The Class Action Complaint

Following close on the heels of the FTC consent decree, a pool supply retailer that claims to have paid inflated prices as a result of the conduct described in the FTC's complaint filed a lawsuit on behalf of a putative class of pool supply stores seeking treble damages. The class action complaint closely tracks the FTC complaint.

The class action complaint highlights the largely unavoidable consequence of any government antitrust investigation—a follow-on private lawsuit seeking treble damages. Even if Pool Corp. emerges victorious, it will face the expense and risk of litigation.

Pool Rules: Lessons for Buyers with Market Power

There is a fine line between leveraging buying power to obtain favorable terms from a supplier and using that same market clout to exclude rivals. Companies facing such issues, especially those with substantial market shares, would be well advised to seek the advice of experienced antitrust counsel to ensure that the line is not crossed—potentially resulting in unwelcome attention from antitrust regulators and the plaintiffs' bar.

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