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ROUNDTABLE ON BUYING POWER

-- Note by the United States --

This note is submitted by the United States Delegate to the Committee on Competition Law and Policy FOR DISCUSSION at its forthcoming meeting on 29-30 October 1998.

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1. In its background paper, the Secretariat proposes alternative definitions of "buyer power" which share certain core elements -- the retail buyer(s) has certain attributes that enable it to receive special concessions from its supplier(s) that are not justified by any procompetitive efficiencies and have a significant adverse affect on competition. In the most recent decision in the United States dealing with the issue of buyer power, Toys "R" Us, [1] the Federal Trade Commission employed concepts similar to those core elements employed by the Secretariat. As discussed in depth below, the Commission found that Toys "R" Us, through its size and other attributes, secured agreements from its suppliers to disadvantage a retail rival to the detriment of consumers.

2. Only one antitrust statute, -- section 2 of the Clayton Act as amended by the Robinson- Patman Act -- has an express provision for buyer liability. However, the other federal antitrust laws apply equally to conduct by buyers and sellers that violate their broad prohibitions. The U.S. antitrust enforcement agencies -- the Federal Trade Commission and the Department of Justice -- bring appropriate enforcement actions against any person, buyer or seller, who exercises market power in a manner that injures competition.

3. Although buyer power has been an issue in the United States since the beginning of the century,[2] only recently has the increasing concentration on the retail side gained attention rivaling that received by its more prominent counterpart -- seller power. Given the increasing consolidation in the retail sector in the United States, however, one can expect continuing interest in the consumer welfare implications associated with buyer power.

4. As discussed below, an antitrust analysis involving allegations of anticompetitive conduct by a buyer will focus on many of the same issues that inform an analysis of seller conduct. For instance, issues relating to "characterization" may be at the forefront; that is, is the conduct subject to the *per se* rule or a more elaborate rule of reason analysis. Although this inquiry will focus, in the first instance, on whether the conduct is joint conduct, or unilateral, as with conduct by seller, the courts are increasingly rejecting a strict *per se* test for cases involving buyers. Where a rule of reason analysis is judged to be appropriate, it will not be unlike a case involving sellers: that is, issues relating to market definition, market power, proffered efficiency defenses, and anticompetitive effects may be significant issues. All of these issues were important to the Commission's decision in Toys "R" Us.

5. This paper focuses on the legal principles underlying the Toys "R" Us case. It also reviews the buyer-induced price discrimination provisions of the Robinson Patman Act. Prior to discussing the Toys "R" Us case in detail, the paper discusses a number of cases where the courts found that a buyer's conduct, whether joint or unilateral, was not subject to *per se* condemnation, but required a more searching inquiry into the purpose and effect of the conduct. These cases involve joint purchasing arrangements and non-price vertical restraints, which, under U.S. law, are judged under a rule of reason because they hold the potential to increase consumer welfare. The next section lays out the Toys "R" Us decision, explaining why the Toys "R" Us conduct was sufficiently different from these prior cases as to be unlawful under both the *per se* unlawful and a rule of reason analysis. Finally, we discuss U.S. law as it relates to buyer induced price discrimination.[3]

I. Joint Buyer Conduct - Cooperative Buying Groups

6. In Northwest Wholesale Stationers v. Pacific Stationery & Printing Co., the plaintiff complained that his expulsion from a buying cooperative constituted a *per se* violation of the antitrust laws as a joint refusal to deal by the cooperative members.[4] Rather than finding that engaging in a wholesale purchasing cooperative is "characteristically likely to result in predominantly anticompetitive effects," the Supreme

Court found that joint purchasing arrangements often allow the participants to achieve efficiencies that can have procompetitive effects, including lower prices for consumers.[5] As a result, the Court concluded that the conduct should be analyzed under the rule of reason.

7. Joint purchasing agreements in which price is collectively set have been found lawful when the participants, individually and collectively, lack market power, and the buying group is necessary to achieve genuine economies of scale both in the purchasing and warehousing of supplies and in providing access to stocks of goods that might otherwise not be attainable by the members acting separately.[6] This approach mirrors the analysis found on the seller side, where the Court has been reluctant to attach a per se label to potentially procompetitive conduct.[7] Examples of lawful joint purchasing agreements at the retail level include small grocers purchasing foodstuffs in bulk, greeting card buyers using a buying corporation, and a nonprofit organization formed by a trade association of footwear retailers to negotiate transportation services for goods shipped to foreign countries.[8]

8. On the other hand, a joint purchasing arrangement will be found unlawful if it is a sham, designed not to achieve any efficiencies but simply to cloak a price-fixing or other cartel activity.[9] As discussed below, the Supreme Court's discussion in Northwest Wholesale Stationers of when it is appropriate to apply the *per se* rule played a prominent role in the Commission's recent Toys "R" Us decision.

II. Complaints Regarding a Competing Discounter

9. Unilateral buyer conduct, even more so than joint conduct, is likely to judged under a rule of reason analysis. Thus, while an agreement between a buyer and seller on prices or price levels (so-called resale price maintenance agreements) is illegal *per se*, the recurring fact pattern in which a manufacturer terminates a price cutting distributor after merely receiving complaints from one or more competing full price retailers is not subject to automatic condemnation.[10]

10. Some courts and scholars have recognized the danger when a dominant retailer coerces a single manufacturer.[11] Nonetheless, because of the difficulty of sorting out legitimate dealer complaints about free riding from those in which a powerful dealer is simply acting to restrain competition, the mere presence of a powerful buyer does not alter the analysis used in dealer termination cases where the defendant is the solely the manufacturer. In other words, in the absence of proof of concerted action and some further agreement on price or price levels, complaints, coercion, or threats by a retailer -- even one that might be characterized as a "power buyer" -- followed by a supplier's termination of a price-cutting retailer are insufficient to constitute *per se* unlawful resale price maintenance. The heightened standard explicit in a rule of reason analysis is necessary to ensure that an increase in interbrand competition that improves consumer welfare is not defeated simply because a large buyer is involved.

11. Although most vertical price fixing suits are brought only against the supplier, in several recent cases brought by terminated discount retailers, the defendants were both the supplier and large department stores with greater purchasing volume than the plaintiff retailer. For example, in Burlington Coat Factory Warehouse Corp. v. Esprit De Corp and Federated Department Stores,[12] Burlington, a discounter with over 30 outlets in several states, claimed that Federated Department Stores, Inc., one of the largest full-price retailing organizations in the United States, conspired with Esprit, a manufacturer of a high-price clothing line, to fix resale prices in violation of Section 1 of the Sherman Act. Burlington also claimed that pursuant to this conspiracy Esprit discontinued sales to Burlington in violation of their contract. Esprit sold its clothing to both retailers, with Federated "being by far the larger purchaser." On one

occasion Esprit refused to fill Burlington's most recent orders and informed Burlington that it would no longer sell to it. One month earlier, the chairman of Federated had made a speech on off-price retailing at a meeting attended by representatives of some 600 major retailers and garment makers in which he said that discounters were free-riding off the marketing efforts of full-price retailers and that Federated intended to stop dealing with manufacturers who sold current-season fashions to discounters. Burlington claimed this speech was the cause of Esprit's subsequent refusal to do further business with it. Esprit denied this claim, asserting that it had no knowledge of the speech and that Burlington's termination was based on its retail marketing requirements.

12. The trial court dismissed Burlington's antitrust claim and the Court of Appeals affirmed the dismissal, holding that there was no direct or circumstantial evidence of an illegal agreement as required under the Supreme Court's decision in the Monsanto case.[13] Quoting from that decision, the court stated the plaintiff must produce "evidence that tends to exclude the possibility that the manufacturer and non-terminated distributors were acting independently."[14] The court pointed out that the case was inherently weak because there was no evidence that Esprit and Federated ever discussed Burlington's discounting. In addition, because a direct complaint by Federated to Esprit about Burlington's discount would not be sufficient to make out a prima facie case under Monsanto,[15] the speech by Federated's Chairman, which was couched in generalities, was clearly inadequate to prove a conspiracy between Federated and Esprit, even if Esprit knew its contents.

13. Likewise, in Garment District, Inc., v. Belk Stores Services, Inc.,[16] the court found the evidence of price fixing insufficient to meet the evidentiary standards of the Monsanto case. The plaintiff was the only consistent discounter of Jantzen clothing in a particular locality. The defendants were, Matthews-Belk Company, a member of the Belk department store chain, Belk Stores Services, Inc., which provided purchasing assistance for the Belk chain, and Jantzen, a manufacturer of sportswear. The Belk chain had over 400 stores in the southeastern United States, about 200 of which sold Jantzen clothing at the manufacturer's suggested retail price. Soon after Garment District opened, Belk pressured Jantzen to stop supplying the store by threatening Jantzen with the loss of all of Belk's business. Jantzen was not allowed to attend Belk's annual trade show. In addition, Matthews-Belk placed its Jantzen clothing in its budget basement and sold it at discount prices. Belk's officers also met with representatives of Jantzen and complained of their sales to discounters, naming Garment District. After these meetings, Jantzen terminated its dealings with Garment District on the grounds it did not present a suitable image for a Jantzen retailer. However, based on other evidence in the case, the court found that the reason for the termination was the pressure exerted by Belk.

14. Nonetheless, the court ruled in favor of the defendant, holding that retailer complaints to a supplier, even those that rise to the level of threats, are insufficient to prove that the manufacturer and distributor acted in concert to set or maintain prices. Of particular interest is the court's specific rejection of the plaintiff's argument for distinguishing Monsanto on the ground that this case involved coordinated pressure by Belk which threatened Jantzen with the loss of business of 200 Belk stores whereas Monsanto involved complaints by small, independent dealers.[17]

III. Exclusionary Conduct - Toys "R" Us

15. Some conduct by large buyers has more definite anticompetitive effects. The FTC decision in its administrative proceeding against Toys "R" Us, the largest retailer of toys in the United States and worldwide, is the most significant case in point.[18] The case concerns alleged exclusionary conduct by a

dominant buyer of toys. The Commission issued its administrative complaint against Toys "R" Us in May 1996. The Administrative Law Judge upheld the charges in a September, 1997 initial decision, which Toys "R" Us appealed to the Commission.

16. On October 14, 1998, the Commission issued its final decision upholding the charges that Toys "R" Us had violated Section 5 of the FTC Act by using its dominant position as the leading retailer of toys in the United States to organize a campaign to suppress price competition from warehouse clubs, which represented an innovative and growing class of discount competitors. The Commission found that, as alleged in the complaint, Toys "R" Us entered into vertical agreements with, and orchestrated horizontal agreements among, toy manufacturers to stop selling to warehouse clubs the same toys sold to Toys "R" Us in order to prevent consumers from making direct price comparisons of club prices and Toys "R" Us prices. The goal was to reduce the effectiveness of clubs as competitors and thereby to prevent Toys "R" Us's prices to consumers from falling. The Commission found that the Toys "R" Us campaign succeeded, as a result of which competition was restrained. Toys "R" Us' principal defense is that it provided valuable services to consumers that the clubs did not provide, and that it was only by saving on those services that the clubs could unfairly underprice Toys "R" Us. The Commission found this "free-rider defense" to be unsubstantiated by the evidence. The following summarizes the key findings and legal analysis in the Commission's final decision.

Commission Findings of Fact

17. Toys "R" Us rose to its current position as the largest toy retailer in the United States in part by offering a larger selection of toys than any other retailer at the lowest prices. The company buys about 30% or more of the large, traditional toy companies' total output and is usually their most important customer. Toy manufacturers would have great difficulty replacing Toys "R" Us.

18. Warehouse club stores are a relatively new type of retailer in the US and a growing outlet, as the number of other toy chain outlets has shrunk. The first warehouse club was founded in 1976 and by 1992 the warehouse club chains operated about 600 individual club stores. Because of a variety of cost savings techniques, the clubs are able to sell brand name merchandise at lower profit margins than even major discount retailers in the United States. Warehouse clubs' prices were substantially below those of Toys "R" Us. The Commission found that Toys "R" Us' average retail margins are close to 30% above cost, whereas the clubs sell at mark-ups as low as 9%. By the late 1980's the clubs had become increasingly important toy retailers and could select and purchase from the toy manufacturers' full array of products.

19. Beginning in 1989, Toys "R" Us became concerned that warehouse clubs presented a threat to its low-price reputation and to its profits. Contemporary estimates predicted that clubs would continue to grow at an accelerated rate. Toys "R" Us had already lowered its prices to meet lower-priced competition from Wal-Mart and other regional and national discount chains, but the clubs' marketing strategy threatened to bring prices even lower. In 1989 and 1990, Toys "R" Us sought to eliminate the competitive threat from the clubs and began discussions with some of its suppliers about denying or restricting the club's supply of certain key toy products. Initially it made general representations about not buying from manufacturers that sold to clubs. After a prolonged and extensive period of negotiations between Toys "R" Us and toy manufacturers, Toys "R" Us formulated and announced its club policy calling for suppliers to sell to the clubs only highly differentiated products (either unique, individual products or more expensive "combo" packages of two or more toys) that were not offered to any other outlet, including Toys "R" Us and offer first to Toys "R" Us all specials and exclusives to be sold to the clubs.

20. Toys "R" Us did not just announce its policy but also met with each of its suppliers, seeking and receiving from at least ten toy manufacturers explicit oral commitments that they understood the policy and agreed to go along. The Commission found "an abundance of evidence of promises, negotiations, compromises and cooperative conduct with respect to the development, adoption and enforcement of the club policy."[19] For example, some suppliers presented proposed club products to Toys "R" Us for its preview and clearance and otherwise negotiated with Toys "R" Us about the appearance or content of club offerings. Toys "R" Us also engaged in extended negotiations with some reluctant suppliers to gain compliance with the club policy. In some instances, when breaches were detected, Toys "R" Us and the offending toy firm worked out a remedy to compensate Toys "R" Us and encourage future compliance or otherwise reached new points of agreement.

21. Toys "R" Us worked for over a year to convince the large toy manufacturers to discriminate against the clubs by selling to them on less favorable terms and conditions. The biggest obstacle Toys "R" Us had to overcome was the major toy manufacturers' reluctance to give up sales to this new, fast-growing, and profitable distribution channel, and their concern that they would lose market share if their rival competitors continued to sell to the clubs. Manufacturers indicated they would adhere to club sales restrictions only if their significant competitors did so. To ensure broad-based compliance by toy manufacturers, Toys "R" Us systematically brokered a horizontal agreement -- essentially an agreement to boycott the clubs -- among at least seven toy manufacturers by relaying assurances from one manufacturer to another that each would go along with the agreement to restrict club sales if the others did so.

22. Toys "R" Us was the communications hub and initiator of the boycott strategy. Toys "R" Us also requested and passed on complaints about breaches of the boycott agreement from one supplier to another.

23. By the end of 1993, Mattel, Hasbro and other major toy manufacturers had stopped selling to warehouse clubs any identical products that they sold to Toys "R" Us. The Commission found that, as a result of these agreements, competition was substantially restrained in the following respects: 1) the no-identical products policy prevented consumers from making informed price comparisons; 2) the special "combo" pack policy raised the average price of toys available at the clubs; 3) the pattern of rapid growth of toys sales at the clubs was halted and reversed and individual clubs' toys business was hobbled and 4) most significantly, competition from the clubs that would have driven Toys "R" Us to lower its prices was stifled..

24. The Commission also found no evidence of "free-riding" by the clubs, as asserted by Toys "R" Us as a justification for its conduct. The evidence showed that manufacturers compensate Toys "R" Us for advertising toys, warehousing and stocking toys made early in year, and stocking a broad line of each manufacturer's toys. There also was no evidence that club competition threatened to drive these Toys "R" Us "services" out of the market or otherwise harm consumers. Moreover, the Commission found no evidence that Toys "R" Us was concerned about "free-riding" when it developed its club policy.

Commission's Discussion of Law

25. The Commission found that Toys "R" Us entered into unlawful vertical agreements with at least ten manufacturers. It held that the doctrine of United States v. Colgate & Co., 250 U.S. 300 (1919) and its progeny that protects unilateral conduct from antitrust liability does not apply since Toys "R" Us overstepped the bounds of Colgate repeatedly and in several ways. As stated in the decision, "[w]e do not see how extended negotiations to change distribution policies, requests for and the granting of assurances of compliance, splitting the cost of a discount [Toys "R" Us] offered to meet a competitor's low price or

presenting products for preview and agreed upon clearance by [Toys "R" Us] can in any way be understood as unilateral decision by the toy manufacturers."[20] The Commission concluded that Toys "R" Us' conduct and the toy suppliers' responses evidence agreements under the standard of Monsanto Co. v. Spray -Rite Serv. Corp., 465 U.S. 752 (1984) and other recent case law.

26. The Commission next concluded that Toys "R" Us organized and enforced a horizontal agreement based on the standards of proof set out in United States v. Parke, Davis & Co., 362 U.S. 29 (1960), Interstate Circuit, Inc. v. United States, 306 U.S. 208 (1939) and Ambook Enters. V. Time, Inc., 612 F.2d 604 (2d Cir. 1979) and also organized a horizontal agreement to enforce the club boycott, acting as a clearinghouse of information on noncompliance and the enforcement arm of the boycott, which is similar to that held illegal in United States v. General Motors Corp., 384 U.S. 127 (1966). In addition, following the general principles used to evaluate allegations of a hub-and-spoke conspiracy, the Commission found that Toys "R" Us' suppliers entered into an agreement: "Each manufacturer was told of the nature and the goal of [Toys "R" Us'] plan and each knew others were involved. They adopted [Toys "R" Us'] anticompetitve purpose by joining the boycott and by developing special club packs that would not force [Toys "R" Us] to lower its retail toy prices to meet lower prices."[21]

27. The Commission then determined that the agreements constituted a per se illegal group boycott, applying the approach set forth in Northwest Wholesale Stationers v. Pacific Stationery & Printing Co., 472 U.S. 284 (1985). In Northwest Wholesale Stationers , the Supreme Court found that per se illegal boycotts often display certain factors: 1) the purpose of the group boycott agreement is anticompetitive, in that it was designed to disadvantage competitors of one of the participants; 2) the firms involved were dominant in their markets; 3) the boycott cut off access to products and relationships needed for the boycotted firms to compete effectively; and 4) lastly, the practice was not justified by plausible arguments that it enhanced overall efficiency. The Commission concluded from the evidence in this case that each of the factors is present. The Commission underscored the lack of any plausible business justification for the group's behavior: "Looked at from the point of view of consumers, they got nothing at all out of the boycott organized by [Toys "R" Us]. Rather they were denied an opportunity to buy toys at low prices from outlets that many were coming to prefer."[22] While the Commission found market power, it held that a per se violation would be found even in the absence of such a finding, citing FTC v. Indiana Fed'n of Dentists, 476 U.S. 447 (1986) in which the Supreme Court concluded that evidence of actual detrimental effects can obviate the need for an inquiry into market power, which is but a surrogate for detrimental effects.

28. The evidence of Toys "R" Us' market dominance is worth highlighting in light of the focus of this round table. As a first step, the Commission explained that on the buyer side, the relevant geographic market was national, while on the retail side it was local.[23] The Commission then found that barriers to entry into toy retailing on a national scale are high.[24]

29. Having defined the relevant markets, the Commission's found that Toys "R" Us enjoys extraordinarily high market shares in the relevant markets when compared with other retail sectors.[25] In addition to market share evidence, the Commission found that for the various reasons discussed below, Toys "R" Us was viewed as irreplaceable by the toy company executives.[26]

30. The Commission discussed Toys "R" Us's unique role in toy retailing. For instance, Toys "R" Us purchases such a great share of all toys and of each toy manufacturer's output that no other retailer could make up for lost sales volume should Toys "R" Us decided to terminate its relationship with the supplier. In addition, Toys "R" Us maintains a uniquely broad inventory, and no other discount retailer carries nearly as many toys. It also is the only large buyer of some of its suppliers' older or low volume

toy products , which significantly affect the manufacturer's overall profitability. The company is by far the largest retailer operating in overseas markets, which is an important ingredient in its influence over manufacturers. Without Toys "R" Us' support, many toy manufacturers will not pay for an effective marketing campaign because they believe that they cannot attain the necessary volume of sales if products are not sold by Toys "R" Us.

31. Toys "R" Us' status as a multi-brand retailer was also an important factor in the Commission's analysis. In accord with an analysis put forth by the late antitrust scholar Professor Phillip Areeda, the Commission found that Toys "R" Us' ability as a very large multi- brand retailer to play, or threaten to play, favorites among suppliers amplified its own market power and is of great importance in understanding its success in organizing a boycott. As the Commission explained:

> With multi-brand dealers, a rejected or disfavored product's shelf space will be given to that product's closest substitute with little (if any) loss to dealer. As a result, the manufacturing firm suffers a significant loss of sales and may lose even more in relative terms because its competitors will prosper as a result. Thus, a multi-brand dealer can shift from one product to another without incurring any cost, but manufacturers more often find it expensive to replace their large distributors.[27]

32. The Commission also examined the group boycott under a full rule of reason analysis and found that the boycott was illegal under this standard. "There was no business justification for a boycott that had a pronounced anticompetitive effect. The single justification offered -- the prevention of free-riding -- was a <u>post</u> <u>hoc</u> rationalization for a policy with an anticompetitive purpose and effect."[28]

33. The Commission further found that standing alone, even without the evidence of the horizontal agreement among many toy manufacturers, each agreement in the series of vertical agreements that Toys "R" Us induced or coerced from a number of toy manufacturers violated Section 1 of the Sherman Act under a full rule of reason. The Commission emphasized that Toys "R" Us gained agreements from key manufacturers accounting for roughly 40% of U.S. toy sales, and that this foreclosure effectively negated the clubs' ability to force Toys "R" Us to lower its prices. The clubs, even with their small market share, were not (as Toys "R" Us argued) "too small to matter" to the competitive process: "A policy that selectively eliminates effective competitors (or the ones most threatening to incumbent firms) harms the competitive process even though individual firms are the targets.[29] In summary, the collection of separate vertical agreements had profound anticompetitive effect; the collection of parties entering into these separate agreements had substantial market power; and there was no plausible business justification or efficiency.

34. Having found that Toys "R" Us violated the antitrust laws, the Commission adopted the proposed cease and desist order that the Administrative Law Judge issued in connection with his initial decision. The final order prohibits Toys "R" Us from:

- attempting or continuing any agreement or understanding with a supplier to restrict the supplier's sales to any discounter;
- urging or pressuring a supplier to restrict its sales to any toy discounter;
- requiring or encouraging any supplier to furnish information about any other supplier's sales or shipments to any discounter;

- facilitating or attempting to facilitate agreements among suppliers related to limiting the suppliers' sales to any retailer(s) by, among other things, transmitting or conveying omplaints, intentions, plans, or actions, or other similar information from one supplier o another supplier relating to sales to such retailer(s); and

- for five years, announcing or communicating that Toys "R" Us will discontinue purchasing products from any supplier because the supplier sells to any toy discounter,or refusing to purchase from a supplier because that supplier dealt with any toy discounter.

35. Commissioner Swindle concurred in the majority's determination that Toys "R" Us entered into a series of anticompetitive vertical agreements with various toy manufacturers but dissented from the majority's conclusion that the company orchestrated a horizontal boycott. He found that the plausibility and strength of the evidence of the vertical theory undercut the finding of a horizontal conspiracy.

(A Commission decision may be appealed to a Circuit Court of Appeals, and, ultimately, to the Supreme Court.)

IV. Discriminatory concessions in favor of large buyers

36. Another area of concern involving power buyers is the extraction of price or nonprice concessions from suppliers that are not available to their competitors. As discussed below, such conduct may be unlawful under the Robinson-Patman Act or Section 5 of the Federal Trade Commission Act.

a. The Robinson-Patman Act

37. In 1936, section 2 of the Clayton Act -- the first U.S. statute that expressly prohibits certain forms of price discrimination -- was amended by the Robinson-Patman Act. Congress took this step based on its concern that the growth of retail food and drug chains threatened the continued existence of independent retail and wholesale establishments. Congress believed that "power buyers," such as large retailers, could use their market power to extract price concessions from manufacturers and other sellers that were unavailable to their smaller competitors. As the Commission has stated:

38. [t]he major legislative purpose behind the Robinson-Patman Act was to provide some measure of protection to small independent retailers and their independent suppliers from what was thought to be unfair competition from vertically integrated, multi-location chain tores. [30]

39. Although the origins of the Robinson-Patman Act thus are rooted in concerns about buyer power, its prohibitions are nevertheless constrained by the more general prohibitions of the U.S. antitrust laws. Indeed, the Supreme Court has held on several occasions that the Act must be interpreted consistently with the broader policies of the antitrust laws. In Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., the Court stated that the "Act condemns price discrimination only to the extent that it threatens to injure competition. . . .Congress did not intend to outlaw price differences that result from or further the forces of competition."[31] Liability falls principally on the seller for granting such concessions; only one provision imposes liability on the buyer.

40. Although enactment of the statute arose primarily from concerns about buyer power, most of the Act's provisions focus on establishing seller liability for certain types of price and nonprice discrimination; only one provision imposes liability on the buyer. In particular, section 2(a) of the Act,

15 U.S.C. 13 (a), prohibits a seller from discriminating in price between two or more competing buyers in the sale of commodities of like grade and quality where the effect of the discrimination may be to I) substantially lessen competition or tend to create a monopoly in any line or commerce, or (ii) to injure, destroy; or prevent competition with any person who grants or knowingly receives the benefit of the discrimination, or with customers of either of them.

41. The key issues in determining liability under this section are the type and extent of injury to competition that can satisfy the Act's requirements. Two types of injury are commonly alleged: a) "primary line", where the injury is to competition between the seller granting the discriminatory discount and other sellers; and b) "secondary line", where the injury is to competition between the favored customer of the seller who receives the discriminatory lower price and the seller's disfavored customers. Secondary line injury is more pertinent to this round table. Secondary line injury can be established either directly by evidence of displaced sales,[32] or by inference through proof of a substantial price discrimination between competing purchasers over time.[33] The latter inference can be rebutted by showing that the two purchasers did not compete, for example, at the same level of distribution or in the same geographic market,[34] or by evidence breaking the causal connection between the price differential and the lost sales or profits.[35]

42. The Act provides three statutory defenses -- "cost justification," "meeting competition," and "changing conditions." The cost justification defense arises out of the provision in Section 2 (a) that allows for price differentials based on "differences in cost of manufacture, sale or delivery resulting from differing methods or quantities" in which the commodities are "sold or delivered." Section 2 (a) also allows price differences due to "changing conditions affecting the market for or marketability of the goods concerned," such as deterioration of perishable goods, obsolescence of seasonal goods, or distress sales under court process.[36] Section 2(b) permits price differences that represent a good faith effort to meet the competition of one or more other firms.

43. Sections 2(c), (d) and (e) are aimed at ensuring that firms do not circumvent the direct proscriptions of the Act by granting discriminatory discounts indirectly, through the provision of brokerage, advertising, and promotional allowances, or services. Section 2(c), 15 U.S.C. 13(c), prohibits sellers from paying to or receiving from a buyer certain commissions, brokerage fees, or other compensation or any allowance or discount in lieu thereof except for services rendered in connection with the sale or purchase of goods. Sections 2 (d) and (e), 15 U.S.C. 13 (d), (e), prohibit sellers from granting advertising or promotional allowances or services unless the same allowances or services are available to all competing customers or purchasers on proportionally equal terms.

44. Section 2(f), the so-called "buyer provision" of the Act, prohibits any person engaged in commerce from knowingly inducing or receiving a price discrimination that is prohibited by Section 2(a). Section 2 (f) does not expressly mention power buyers and does it categorize the recipients of illegal price discrimination by size. However, as noted above, the legislative history makes clear that this Section is directed primarily against buyers, such as chain stores, who use their purchasing power to extract price concessions from their suppliers. Viewed in the context of U.S. antitrust enforcement policy today, Section 2(f) is aimed at preventing market inefficiency and ultimate harm to consumers that may result when, for example, an inefficient buyer with large market share is able extract discounts that are not cost justified..

45. To establish buyer liability under Section 2(f), the evidence must show that the buyer knew or should have known that the discrimination it induced or received was an illegal discrimination. Buyer liability is entirely derivative of seller liability under Section 2 (a), and the defenses and injury to

competition requirements of Section 2 (a) apply to Section 2(f) as well. In Great Atlantic & Pacific Tea Co. v. FTC, the Supreme Court held that a "buyer cannot be liable if a prima facie case could not be made against a seller or if the seller has an affirmative defense." [37] The A&P case involved the efforts of a major grocery chain to obtain cost savings in the purchase of milk for its Chicago area stores by selling milk under its private label instead of a brand name. A&P first obtained a bid from its long term supplier, Borden, then received a lower cost bid from a competitor of Borden. A&P contacted Borden, telling them their bid was too high and suggesting a certain dollar range for improving Borden's bid. Borden then submitted a lower second bid which A&P accepted. Reversing the FTC finding of a Section 2(f) violation, the Supreme Court explained that "a buyer who has done no more than accept the lower of two prices competitively offered does not violate § 2(f) provided the seller has a meeting-competition defense."[38] The Court found that because Borden's granting of the discriminatory price was justified under the "meeting competition" defense, A&P's solicitation of a lower price was not prohibited by the statute.

46. Section 2 (f) applies only to price discrimination; it does not prohibit buyers from inducing or receiving nonprice discrimination --that is, allowances or services that would be unlawful for a seller to provide under Sections 2(d) or 2(e), and there is no private right of action against buyers for either type of conduct. However, the FTC has ruled that buyer inducement or receipt of unlawful allowances or services is an unfair method of competition prohibited by Section 5 of the Federal Trade Commission Act ("FTC Act"). For example, in Grand Union Co. v. FTC,[39] the operator of a large chain of grocery stores entered into a contract with an advertiser by which it obtained indirect payments from a number of suppliers that were not made available to its competitors. After first establishing in another proceeding that the suppliers' payments violated Section 2(d), the FTC charged that the buyer's receipt of these payments violated Section 5 of the FTC Act. The Court of Appeals agreed, finding that the Act's failure to hold buyers liable for discriminatory receipt of promotional or advertising allowances was an oversight, and that the conduct was plainly within the spirit of "unfair methods of competition" because the underlying conduct was already prohibited by Section 2(d) of the Act. The Commission's approach has been endorsed by several Courts of Appeal.[40]

47. In order to prove that a buyer knew or should have known of the illegality of the price discrimination at issue, a plaintiff (governmental or private) may introduce evidence of the buyer's expertise and "trade experience" from which its knowledge of an unlawful price discrimination can be inferred.[41] The sufficiency of this evidence is often a contentious issue in cases under Section 2(f) and Section 5. In the FTC's case against American Motors Specialties, Co.,[42] jobbers had formed group buying organizations for the express purpose of obtaining volume discounts from suppliers. However, these organizations were often only bookkeeping devices that combined the purchases of members but performed no distribution functions. The group members knew that they purchased in the same quantities and were served by the same sales methods as their competitors but still received substantial discounts through their buying organizations. The FTC and the courts found this type of trade experience to be sufficient evidence to establish the requisite buyer knowledge of illegality. In Boise Cascade Corp., the Commission found that the largest distributor of office products in the U.S. knowingly received discriminatory wholesale discounts based on evidence that it knew that its purchase price was lower than the other prices in published price lists.[43] Other examples of trade experience evidence sufficient to prove buyers' illicit knowledge include protests by sellers and pressuring by a buyer to obtain regularly recurring special allowances or price reductions.[44]

48. The Commission and the courts have ruled that the plaintiff has the burden of proving other elements of the violation, such as that the buyer knew or should have known that the price differential was not cost justified and that this burden can be met by inferences rather than evidence of the exact costs.[45]

The Commission also has taken the position that once the plaintiff establishes a prima facie buyer liability case, the plaintiff does not have to prove also the absence of meeting competition and changing conditions defenses,[46] but the courts have divided on this issue.[47]

b. The Robinson-Patman Act and Slotting Allowances

49. The term "slotting allowance" typically refers to one-time payments that manufacturers make to a retailer for initial access to a retailer's shelves; these payments often, but not always, are associated with the introduction of new products. Less commonly, the term encompasses repeated payments to retailers for stocking established products, or for providing preferential shelf space. In about 1984, grocery retailers in the United States began requiring slotting allowances, and the practice has become increasingly widespread; drug stores recently adopted the practice.

50. The payment of slotting allowances has been controversial since its inception. There are conflicting views among businesses, economists and lawyers as to their effects of these allowances on competition.[48] At the supplier level, manufacturers, especially small companies, claim that they cannot afford to pay the allowances and are denied retail outlets for their products because they do not pay allowances. Another complaint is that large suppliers use the payments to exclude competitors and to raise barriers to entry. At the retail level, small retailers who do not receive the allowances complain that these payments are a guise for otherwise unlawful price discounts or promotional allowances, allowing larger retailers to circumvent the Robinson- Patman Act. Others, however, offer procompetitive rationales for slotting allowances, such as that they lower the net price for the retailer and can facilitate price competition among manufacturers. In addition, where shelf space is scarce, the payments may be one way of auctioning a scare resource to its highest and best use. They may also compensate retailers for the costs of bringing a new product into inventory and the risk that the product may not be successful. Indeed, to the extent that the payments communicate a manufacturer's willingness to share such costs and risk, the slotting allowance can promote efficiency by providing valuable information to the retailer about the manufacturer's confidence in the product's likely success.

51. There are no Commission or federal court decisions ruling directly on the legality of slotting allowances. It could be argued that the use of slotting allowances could violate the Robinson-Patman Act.[49] If the payment is for access to the store itself, slotting allowances arguably may constitute a discriminatory discount on the price of the product covered by the prohibitions in Sections 2 (a) and 2(f), discussed above. As noted above, unlawful price discrimination requires competitive injury. This may be shown at the level of the seller's disfavored customers who compete with the seller's favored customer(s). -- "secondary line" injury.[50] The cost justification, changing conditions, and meeting competition defenses also would be relevant to determining liability.

52. If the payment is for preferential shelf space, the payment may constitute a discriminatory promotional allowance, provided that an express connection between the payment of these allowances and the resale of particular products can be established. In the FTC Guides for Advertising Allowances, the Commission states that the "discriminatory purchase of display or shelf space, whether directly or by means of so-called allowances," may violate the Robinson Patman Act[51] and Section 5 of the FTC Act.[52]

NOTES

1. kt. No. 9278 (Final Decision and Order, October 13, 1998).

2. wift & Co. v. United States, 196 U.S. 375 (1905) (agreement among meat packers to refuse to bid against each other for the purchase of livestock held illegal under Section 1 of the Sherman Act).

3. The Secretariat has advised that this round table will not address simple monopsony or oligopsony power. In addition, we understand that the round table will not cover horizontal restraints, such as horizontal price-fixing and group boycott, since these topics have been addressed in other round tables.

4. 472 U.S. 284 (1985)

5. Id. at 295 ("arrangement permits the participating retailers to achieve economies of scale in both the purchase and warehousing of wholesale supplies, and also ensures ready access to a stock of goods that might otherwise be unavailable on short notice. The cost savings and order-filling guarantees enable smaller retailers to reduce prices and maintain their retail stock so as to compete more effectively with larger retailers").

6. See, e.g., id. at 286-87 ("The cooperative arrangement thus permits the participating retailers to achieve economies of scale in purchasing and warehousing that would otherwise be unavailable to them.")

7. See, e.g., Broadcast Music, Inc. v. Columbia Broadcasting System, Inc., 441 U.S. 1 (1979); National Collegiate Athletic Ass'n. v. Board of Regents of University of Oklahoma, 468 U.S. 85 (1984).

8. U.S. Department of Justice, Business Review Letter to FRA Shipper's Ass'n, 6 Trade Reg. Rep (CCH) ¶ 44,021 (Summary 88-7); Central Retailer-Owned Groceries, Inc. v. FTC, 319 F.2d 410 (7th Cir. 1963); Associated Greeting Card Distributors, 50 F.T.C. 631 (1954).

9. See, e.g., Timken Roller Bearing v. United States, 341 U.S. 593 (1951); Massachusetts Board of Registration in Optometry, 110 F.T.C. 549 (1988); Council of Fashion Designers of America, 120 F.T.C. 817 (1995).

10. Monsanto Co. v. Spray-Rite Co., 465 U.S. 752 (1984).

11. See, e.g., Lomar Wholesale Grocery, Inc. v. Dieter's Gourmet Foods, Inc., 824 F.2d 582, 594 (8th Cir. 1987), cert. denied, 484 U.S. 1010 (1988); VII Areeda, Antitrust Law ¶ 1453c at 144-45.

12. 769 F.2d 919 (2d Cir. 1985).

13. Monsanto, 465 U.S. 752. In a later case decided after the lower federal court cases discussed above, the Supreme Court further increased the plaintiff's burden of proof of what constitutes an agreement by requiring an express or implied agreement on the price or price levels to be charged. See Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717 (1988).

14. Id. at 764.

15. "Permitting an agreement to be inferred merely from the existence of complaints, or even from the fact that termination came about ?in response to' complaints, could deter or penalize perfectly legitimate conduct." Id. at 763.

16. 799 F.2d 905 (4th Cir. 1986).

17. Id. at 909.

18. In the Matter of Toys "R" Us, Inc., Dkt. No. 9278 (Final Decision and Order, October 13, 1998) ("Final Decision").

19. Final Decision at 22.

20. Id. at 50.

21. Id. at 60.

22. Id. at 82.

23. Id. at 68.

24. Id. at 69.

25. Id. at 70.

26. Id. Although Toys "R" Us accounts for approximately 20 percent of sales on a national basis, in local markets, Toys "R" Us often accounts for over 35 percent of sales. This is because Toys "R" Us does not do business in every local market where toys are sold. Id. at 74- 75.

27. Id. at 71. See 8 P. Areeda, Antitrust Law ¶ 1648C, at 535.

28. Id. at 87.

29. Id. at 84.

30. Boise Cascade Corp., 107 F.T.C. 76,210 (1986), rev'd and remanded on other grounds, F. 2d 1127 (D.C. Cir. 1988), on remand, 113 F.T.C. 956 (1990), appeal dismissed pursuant to stipulation.

31. 509 U.S. 209, 220 (1993).

32. Falls City Industries v. Vanco Beverage, Inc., 460 U.S. 428, 435 (1983); Chroma Lighting v. GTE Products Corp., 111 F.3d 653, 654 (9th Cir. 1997), cert. denied, 118 S.Ct. 357 (1997)..

33. Texaco, Inc. v. Hasbrouck, 496 U.S. 543, 559 (1990).

34. See, e.g., Anaren Microwave, Inc. v. Loral Corp, 49 F.3d 62, 63 (2d Cir. 1995).

35. Falls City Industries, 460 U.S. at 435.

36. See, e.g., Comcoa, Inc. v. NEC Telephones, Inc., 931 F.2d 655 (10th Cir. 1991).

37. 440 U.S. 69, 76 (1979).

38. Id. at 81.

39. 57 F.T.C. 382 (1960), modified, 300 F. 2d 92 (2d Cir. 1962), cert. denied, 372 U.S. 910 (1963).

40. See, e.g., Alterman Foods, Inc. v. FTC, 497 F.2d 993 (5th Cir. 1994); Fred Meyer, Inc. v. FTC, 359 F.2d 351 (9th Cir. 1966), rev'd in part on other grounds and remanded, 390 U.S. 341 (1968).

41. See Automatic Canteen Co. of America v. FTC, 346 U.S. 61 (1953), which was the first Supreme Court case to consider § 2 (f). In a recent case, Walker v. Hallmark Cards, Inc., 1997-2 Trade Cas. (CCH)¶ 71,999 (M.D. Fla. 1997), the court granted summary judgment in part because the plaintiff failed to produce evidence that the buyer knew, or should have known, that its competitors were not receiving similar terms and incentives.

42. 55 F.T.C. 1430 (1959), aff'd, 278 F.2d 225, cert. denied, 364 U.S. 884 (1960).

43. 107 F.T.C. 76.

44. See, e.g., Giant Food Inc. v. FTC, 307 F.2d 184, 187 (D.C. Cir. 1962), cert. denied, 372 U.S. 910 (1963); Fred Meyer, 359 F.2d at 363.

45. See, e.g., Fred Meyer, 359 F.2d at 364; Suburban Propane Gas Corp., 73 F.T.C. 1269 (1968).

46. See, e.g., Boise Cascade, 107 F.T.C. at 217; American Motor Specialties Co., 55 F.T.C. at 1446-47 (dictum).

47. Compare Mid-South Distributors v. FTC, 287 F.2d 512 (5th Cir.), cert. denied, 368 U.S. 838 (1961) with Thurman Industries v. Pay ?N Pak Stores, 709 F. Supp. 985, 995-96 (W.D. Wash.), modified on other grounds, 1987-2 Trade Cas. (CCH) ¶ 67,676 (W.D. Wash. 1987), aff'd, 875 F.2d 1369 (9th Cir. 1989).

48. See, e.g., Cannon & Bloom, Are Slotting Allowances Legal Under the Antitrust Laws?, 10 J. Public Policy and Marketing 167 (Spring 1991); Kelly, The Antitrust Analysis of Grocery Slotting Allowances: The Procompetitive Case, 10 J. Public Policy and Marketing 187 (Spring 1991).

49. Slotting allowances may also violate other antitrust statutes in ways not pertinent to the topic of this round table. First, rival suppliers or retailers might collude to allocate available shelf space or fix the amount of such payments in violation of Section 1 of the Sherman Act or Section 5 of the FTC Act. Second, suppliers or retailers might use their direct or indirect control of slotting allowances and access to shelf space to monopolize or attempt to monopolize a relevant product or geographic market in violation of Section 2 of the Sherman Act and Section 5 of the FTC Act. Third, slotting allowances may be provided in connection with an unlawful exclusive dealing arrangement that creates or maintains market power in violation of Section 3 of the Clayton Act and Section 5 of the FTC Act.

50. Injury at the manufacturer level -- "primary line" injury-- again is outside of the parameters of this round table because it involves elimination of competition at the manufacturing level.

51. Liability is imposed only on the seller for violations of Section 2(d) of the Act, as noted above.

52. 16 C.F.R. 240.9, n. 1.