

IN THE MATTER OF

TOYS "R" US, INC.

FINAL ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF
SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket 9278. Complaint, May 22, 1996—Final Order, Oct 13, 1998

This final order prohibits, among other things, the nation's largest toy retailer from continuing, entering into, or attempting to enter into, vertical agreements with its suppliers to limit the supply of, or refuse to sell, toys to a toy discounter. The order also prohibits Toys "R" Us from facilitating, or attempting to facilitate, an agreement between or among its suppliers relating to the sale of toys to any retailer, and from urging or coercing suppliers to restrict sales to any toy discounter.

Participants

For the Commission: *L. Barry Costilo, Richard Dagen, Patrick Roach, Sarah Allen, James Frost, Michael Antalics, William Baer, Richard Ludwick, David Glasner, and Jonathan Baker.*

For the respondent: *Michael Tumolo, in-house counsel, Paramus, N.J., Michael Feldberg, Schulte, Roth & Zabel, New York, N.Y. and Irving Scher, Weil, Gotshal & Manges, New York, N.Y.*

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act, and by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that Toys "R" Us, Inc., a corporation (sometimes referred to as "TRU" or "respondent"), has violated the provisions of said 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, stating its charges as follows:

PARAGRAPH 1. Respondent Toys "R" Us, Inc. ("TRU") is a corporation organized, existing, and doing business under and by virtue of the laws of Delaware, with its principal office and place of business at 461 From Road, Paramus, New Jersey.

PAR. 2. TRU is the largest toy retailer in the United States. It has approximately 600 stores located throughout the United States and 300 stores in foreign countries, which sell toys, infant supplies and

equipment, juvenile sporting goods and related items ("products"). In 1995 its total sales were approximately \$9.4 billion.

PAR. 3. TRU's acts and practices, including the acts and practices alleged herein, are in or affect commerce as "commerce" is defined in the Federal Trade Commission Act.

PAR. 4. TRU's importance as a provider of distribution to manufacturers of toys and related products has given it the ability to exercise market power over those manufacturers, and TRU has exercised this power.

PAR. 5. Warehouse clubs ("clubs") charge a membership fee and retail a broad variety of products, including toys and other products sold by TRU. The clubs operate on lower margins than TRU or other national chain discounters. During the late 1980's and early 1990's, club sales were growing at a much faster rate than other retailers. During that period, the toy manufacturers wanted to increase their sales to this relatively new channel of distribution because of the growth potential of the clubs and the manufacturers' desire to have additional outlets for their merchandise. Before TRU engaged in the conduct described in paragraphs seven through nine below, the clubs generally were able to buy popular individual toys from open stock (*i.e.*, any toys sold by the manufacturer without restriction) from most of the major manufacturers, which they generally sold at lower prices than TRU and other retailers. The clubs needed the option to buy the same toys from the manufacturers that TRU and the other major retailers were carrying in order to compete effectively.

PAR. 6. TRU has cultivated the image with the public as a toy discounter that has everyday low prices. However, it does not have the lowest retail prices among national toy retailers, and it generally does not lead prices down. In the early 1990's the clubs' low prices were putting competitive pressure on TRU. TRU feared that consumers would draw unfavorable and embarrassing comparisons between the clubs' prices and its prices, and that its image for everyday low prices could be eroded.

PAR. 7. Beginning at least as early as 1989, TRU used its power to gain agreements or understandings with various suppliers relating to toy sales to the clubs. These agreements or understandings included the following:

- (a) The suppliers agreed not to sell to the clubs the same individual toys that TRU carried;

(b) In the event a supplier wanted to sell to the clubs some toys carried by TRU, TRU and the suppliers agreed upon toy products that could be sold to the clubs. These generally were "club specials" consisting of combination packs of two or more different items, or other product that was differentiated from regular open stock items. The items in the club specials could not be readily price-compared to products sold by TRU, the club specials generally cost more to produce, and the club specials raised the clubs' prices to consumers; and

(c) The suppliers agreed to advise TRU in advance of the specific products, including club specials, that the suppliers wanted to sell to the clubs. If after reviewing the products TRU determined that they did not pose a competitive conflict with the products sold by TRU, the supplier could sell the product to the clubs.

PAR. 8. Some major manufacturers were reluctant to give up their sales of individual toys to the clubs so long as their competitors were selling them to the clubs. To secure the agreements or understandings alleged in paragraph seven, TRU facilitated understandings among competing manufacturers to achieve substantial unity of action among them relating to their dealings with the clubs.

PAR. 9. TRU sought, received, and negotiated agreements or understandings with manufacturers with respect to the toys they would not sell to the clubs. TRU policed the manufacturers' sales and repeatedly brought any infractions to their attention. When it deemed necessary, TRU enforced its policy by taking product off its shelves or not buying product that manufacturers had sold to the clubs.

PAR. 10. By 1994 and continuing to the present, most of the major U.S. toy manufacturers had stopped selling popular individual toys to the club channel of distribution that were carried by TRU.

PAR. 11. The purpose and effect of the agreements and understandings described in paragraphs seven through ten was to restrain competition among toy retailers and among toy manufacturers.

PAR. 12. By engaging in the acts or practices described in paragraphs four through eleven of this complaint, TRU has unreasonably restrained competition in the following ways, among others:

(a) Retail price competition has been restrained, and toy prices to consumers are higher than they would have been absent TRU's conduct;

(b) Competition among toy manufacturers, including competition with respect to their distributional practices and their dealings with TRU's competitors, has been restrained;

(c) The clubs' costs were increased, which impeded the growth of a new method of toy distribution in its incipiency; and

(d) Information that would enable consumers to make informed price comparisons has been suppressed.

PAR. 13. The acts or practices of TRU alleged herein were and are to the prejudice and injury of the public. The acts or practices constitute unfair methods of competition in or affecting commerce in violation of Section 5 of the Federal Trade Commission Act. These acts or practices are continuing and will continue, or may recur, in the absence of the relief requested.

Commissioner Azcuenaga and Commissioner Starek dissenting.

INITIAL DECISION *

BY JAMES P. TIMONY, ADMINISTRATIVE LAW JUDGE

SEPTEMBER 25, 1997

INTRODUCTION

The Commission's complaint of May 22, 1996, charges respondent Toys "R" Us, Inc. with unfair methods of competition in violation of the Federal Trade Commission Act, alleging as follows:

- The low toy prices of the warehouse clubs put competitive pressure on TRU, compromising TRU's image for everyday low prices.
- Being the largest toy retailer in the United States, TRU used its power to gain agreements with various suppliers to limit toy sales to the club.
- Suppliers agreed not to sell to the clubs the same toys that TRU carried. TRU and the suppliers agreed upon specially packaged toy products that could be sold to the clubs. These "club specials" consisted of packs of two or more items.

* Note: [] indicates information has been redacted.

- The suppliers agreed to get TRU's approval in advance of items they wanted to sell to the clubs. The sellers could sell the product. TRU facilitated understandings among competing manufacturers to achieve substantial unity of action among them relating to their dealings with the clubs.
- TRU policed the manufacturers' sales and infractions and enforced its policy. By 1994, most of the major U.S. toy manufacturers stopped selling to the clubs the toys carried by TRU.
- TRU unreasonably restrained competition among toy manufacturers and retailers. Toy prices to consumers are higher. The clubs' costs increased, impeding the growth of a new method of toy distribution in its incipiency. Information to enable consumers to make price comparisons was suppressed.

Respondent denied the principal allegations of the complaint. Respondent's motion for summary decision was denied on February 27, 1997. The hearing in this matter began on March 5, 1997. Complaint counsel called 25 witnesses including two expert witnesses and the respondent called 18 witnesses including three expert witnesses.

Respondent subpoenaed Gary L. Roberts, Associate Director for Antitrust in the Commission's Bureau of Economics, asserting that his uncle was the chief executive officer of Wal-Mart, and that Mr. Roberts' parents had received a substantial gift from his uncle. I granted a *motion in limine* for failure to allege facts indicating conflict of interest and to avoid interference with the deliberative process of the Commission. (RX-885.)

Complaint counsel's economic expert, F. M. Scherer, submitted rebuttal evidence on June 25, 1997. Closing arguments were on July 1, 1997 and September 5, 1997, closing a trial of 43 trial days and over 9500 pages of trial transcript; about 2600 exhibits were admitted (CX-1 through CX-1830; RX-1 through RX-915).

FINDINGS

RETAIL SALE OF TOYS IN THE UNITED STATES

A. Respondent

1. Toys "R" Us, Inc. ("TRU") is a corporation organized, and doing business under the laws of Delaware, with its principal office at 461 From Road, Paramus, New Jersey.

2. TRU is the world's largest toy retailer, operating over 650 toy stores in the U.S. and 300 in twenty other countries. (TRU Answer to Complaint ¶ 2.) TRU had revenues of \$9.4 billion in 1995 and \$10 billion in 1996. (TRU Answer to Complaint ¶ 2.)¹

3. TRU is a "category killer" chain -- a specialized retailer offering an array of merchandise in a particular category, sold at discount. (Scherer (CX-1822-C) ¶ 6.) TRU stores offer children's toys, games, bicycles, and electronic video games -- 16,000 "SKUs" in the early 1990's.² (Goddu 30:6574/10 - 6575/17.). TRU's stores are typically 45,000 square feet in major markets. (Goddu 30:6973/11-12.) TRU operates self-service where customers find products. (Goldstein 36:8242/18 - 8243/1.)

B. Toy Industry

1. Retail sale of toys

4. Traditional "mom and pop" stores "were challenged by department stores, which were challenged by mail-order houses, chain stores, supermarkets, hypermarkets, and more recently, "category killers" like TRU. Price-cutting by chain stores was the target during the 1930's of the Fair Trade laws and the Robinson-Patman Act. (Scherer CX-1822-B-C.) Between the end of World War II and the late 1980's, there were major innovations in retail toy distribution. Television ads "pull" toys making self service retailing feasible. The repeal in 1974 of the Miller-Tydings Act supporting state resale price maintenance laws facilitated discounting of toys at retail. With consumers' increased mobility, discount chains proliferated. They began stocking nationally advertised toys at discount prices. Toys "R" Us was one of the first specialized "category killer" retailers. (Scherer CX-1822-C.)

5. During the early 1990's, some other major toy supermarket chains (Lionel Leisure and Child World) went out of business. (CX-503-A.) By the 1990's, TRU's principal competition came from

¹ References to the record use the following abbreviations:

F. (Findings of Fact), CX (Commission Exhibit), RX (Respondent's Exhibit); References to trial transcript are made using witness name, volume, page and lines. References to exhibits include prefix, number and page. References to investigational hearing or deposition transcripts included as exhibits include witness name and the designation "IH" or "Dep.", exhibit number, and transcript page and lines. In camera portions of the record are in italics/brackets.

² A "SKU" (stock-keeping unit) is a product in an inventory control system.

national, mass-market general merchandise discount chains like Wal-Mart, Target and K-Mart. (Goddu 30:6517/7-10.) []

6. []

7. [] TRU carries toys year-round, but the fourth quarter exceeds their sales for all three prior quarters combined. (CX-1616.) []

8. [] TRU recently reduced its SKUs to 11,000, three times as many SKUs as its next closest competitor. (RX-621 at 27; Goddu 30:6574/22-25; Walters, 28:6068/21 - 6069/7.)

2. Toy manufacturing

9. The top four manufacturers of toys in the U.S. market are Mattel, Hasbro, Tyco and Little Tikes. In 1994, for the total U.S. toy market, Mattel had 18%, Hasbro had 17 %, Tyco had 3.2% and Little Tikes had 2.8%. (CX-1669-C; CX-1230-J.)

10. [] Hasbro sells Mr. Potato Head, G.I. Joe, Monopoly, Tinker Toys, Lincoln Logs, Play-Doh, and toys based on motion pictures such as Star Wars and Jurassic Park. (Verrecchia 7:1412/14-16, 1548/1-13, 1336/13.) Tyco sells the Magnadoodle, radio control cars, and matchbox cars. (Grey 14:2986/5-9.) Little Tikes sells large blown plastic toys. (Schmitt 11:2275/12-23; DePersia 10:2133/11-18; CX-1230-J.)

11. In recent years, there are fewer toy manufacturers. The three largest toy manufacturers acquired a dozen smaller competitors. In 1993, Mattel acquired Fisher-Price, Inc., a \$1.2 billion transaction. (Cohen, 35:7926/7-8.) In 1994, Hasbro acquired the game division of Western Publishing, adding "Pictionary" to its collection of other board games such as Monopoly. (Wilson, 26:5784/24-5785/2.) Recently, Mattel has merged with Tyco. (Grey 14:2985/16-22.)

12. The market for toys is highly differentiated -- a plastic sandbox is an imperfect substitute for a Hot Wheels car. (Carlton (RX-877) at 9.) Competition among toy manufacturers is most direct between those firms whose products are substitutes such as firms which produce large molded plastic toys. (Murdough 27:5884/16 - 5886/15.) Television ads "drive" demand for toys. (CX-773-J.)

13. Because of the seasonal demand for toys and the desire of toy manufacturers to operate their plants year-round, manufacturers induce retailers to ease the burden of warehousing. These incentives include "dating" terms (deferring the date by which the retailer must

make payment), allowances for placing orders and taking shipment of goods early, and warehousing. (Okun 13:2829/24 - 2838/1.)

C. Warehouse Clubs

1. Growth

14. Warehouse clubs are low-frills, low-cost, low-price retailers, undercutting other firms in both price and service. (Ingene 41: 9039/25 - 9040/8.) The first modern warehouse club was the original "Price Club" opened by Sol Price in a converted airport hangar in San Diego in 1976. (Buzzell (RX-894) at 8 n.2; CX-178-C). []

15. Warehouse clubs do not sell to the general public but to members who pay an annual fee to shop at the warehouse club. (Sinegal 2:147/24-148/17; Zarkin 21:4784/1-2.) Warehouse clubs offer prices below those available in other retail channels. (Sinegal 2:149/11 - 150/1; Zarkin 21:4801/17 - 4802/19.)

16. Warehouse clubs operate at profit margins lower than other channels. Their gross margin -- the difference between the selling price and cost of merchandise -- averages about 9-12%. (Sinegal 2:150/2-12; Zarkin 21:4803/15-4804/1; Buzzell (RX-894) at 18; RX-741.) This is lower than for other channels like discount drugstores, 20 % (Buzzell (RX-894) at 18; RX-741); grocery stores, 20-25% (Sinegal 2:150/19-20; Buzzell (RX-894) at 18; RX-741); mass merchandisers, 25% (Zarkin 21:4804/4-8; Buzzell (RX-894) at 18; RX-741); and department stores, 45-50% (Sinegal 2:150/18-19; Zarkin 21:4804/8-9).

17. The main warehouse clubs in 1992 were Sam's Club (a division of Wal-Mart, 256 stores, Pace (a division of Kmart, 115 stores), Price Club (based in San Diego, 94 stores), Costco (based in Redmond, Washington, 100 stores), and BJ's Wholesale (based in Natick, Massachusetts, 39 stores). [] After consolidations, by early 1997 the main warehouse clubs were Price/Costco (renamed Costco) (with 1996 sales of about \$20 billion). Sam's (also \$20 billion in 1996 sales), and BJ's (with \$3 billion in 1996 sales). (Sinegal 2:145/5-147/10; Zarkin 21:4785/15 - 4786/22.)

18. Warehouse clubs sell to small business customers and to individual consumer members. (Buzzell (RX-894) at 8-9.) []

19. Warehouse clubs' sales consists of food and grocery products, (Sinegal 2:207/25-208/11; Zarkin 21:4789/22-24), (grocery about 60% of sales at Costco and BJ's), and electronics, appliances, jewelry,

cameras, video and audio recordings, books, hardware, housewares, sporting goods, automotive, tires, office supplies, health and beauty aides, apparel, seasonal goods and others. (Sinegal 2:147/13-21; Zarkin 21:4789/11-15.) With non-food products, warehouse clubs compete with other warehouse club chains, discounters such as Wal-Mart and Kmart and specialized "category killer" retailers such as Toys "R" Us, Sports Authority, and Circuit City. (Zarkin 21:3787/8-20.)

20. Warehouse clubs keep down prices by reducing operating costs and increasing the rate of inventory turnover. Warehouse clubs reduce capital costs for storing goods in inventory; a warehouse club selling merchandise to club members before payment is due to the vendor does not bear the capital costs of carrying that merchandise. (Sinegal 2:159/7-160/7; Zarkin 21:4807/17-4808/13; Buzzell (RX-894) at 18.) []

21. Warehouse club buildings are large buildings (100,000 square feet or more) using industrial lighting and plain steel shelving, located in areas where land acquisition or lease costs are low. (Buzzell (RX-894) at 13; Ingene 41:9045/15 - 9046/2; Sinegal 2:156/23 - 157/6.) Warehouse clubs are staffed with few employees. Checkout lanes have a single employee operating the cash register and scanner, and customers pack their own purchases. (Zarkin 21:4806/24 - 4807/16; Buzzell (RX-894) at 14-15.)

22. The clubs purchase merchandise from suppliers packed on pallets and marked with computerized codes that can be read by the scanners at checkout lanes. (Sinegal 2:157/13-21; Zarkin 21:4806/11-4807/3, 4809/9-15.) Goods are shipped by vendors to centralized distribution centers to reduce freight costs and typically are dispatched the same day to individual warehouse clubs. (Zarkin 21:4809/16 - 4810/8.) Merchandise is delivered directly to the sales floor, displayed on the pallets on which it was shipped, or stored in tall steel shelving. (Sinegal 2:157/12-21; Zarkin 21:4809/24-4810/6.) This lessens costs of labor, inventorying, unpacking, marking and displaying goods. (Sinegal 2:157/22 - 159/6.)

23. Maximizing inventory turnover affects products offered by the warehouse clubs. Warehouse clubs carry the most popular branded items that are most likely to generate the high inventory turnover. (Zarkin 21:4797/4-7; Sinegal 2:153/1-17,161/8 -162/21; Buzzell (RX-894) at 10-12.) Warehouse clubs carry 4000 "SKUs" (Zarkin

21:4808/14-19; Sinegal 2:151/19-23), compared to about 22,000 SKUs at a supermarket or 80,000 SKUs at a Wal-Mart. (Zarkin 21:4808/22-25; Buzzell (RX-894) at 11.) The smaller assortment of products simplifies inventory and ordering. (Sinegal 2:161/23 - 162/17.)

24. Name-brand merchandise is important to the clubs. (Zarkin 21:4797/15-16.) Members are more likely to be aware of the prevailing price for the item in other outlets and recognize the low price in the club as a value. (Zarkin 21:4797/17-22.) About 70-80% of club items are branded products. (Buzzell 38:8381/12-13; RX-433; Zarkin 21:4829/23 - 4830/11; Sinegal 2:153/1-17.)

25. Some manufacturers have restricted the availability to warehouse clubs of name-brand products (Sinegal 2:230/17 - 237/18), typically brands that manufacturers choose not to distribute in any discount or mass merchant channel, not merely warehouse clubs. (Buzzell 38:8377/20 - 8406/25; Zarkin 21:4829/23 - 4830/11; Ojendyk 18:4035/8 - 4038/13, 4290/11 - 4298/14; Hilson, 20:4542/6-4543/4.)

26. Warehouse clubs frequently change the mix of non-food products offered. Warehouse clubs create a "treasure hunt" atmosphere that will persuade members to take advantage of bargains that may not be available the next time the member comes to shop at the club. (Zarkin 21:4788/18 - 4791/14; Sinegal 2:151/4 - 152/13.) This assists the clubs by developing its reputation and membership by word-of-mouth spread by their members. (Zarkin 21:4798/2-17.)

27. Warehouse clubs often stock packages containing multiple items or larger quantities of the product, to encourage members to make larger purchases and increase inventory turnover. (Zarkin 21:4799/9-24; Sinegal 2:166/25 - 167/23; Buzzell (RX-894) at 17.) This technique is best suited for products that are highly consumable. (Zarkin 21:4800/10 - 4801/8; Sinegal 2:167/24 - 168/14.)

28. The clubs advertise by direct mailings to members, newsletters listings products currently for sale in the clubs. (Sinegal 2:160/19 - 161/7; Zarkin 21:4825/11 - 4826/4.) The clubs make few expenditures for advertising in mass media. (Zarkin 21:4824/24 - 4825/9; Sinegal 2:160/8-21.)

29. Members pay annual fees of about \$30-35 to shop at a warehouse club. (Sinegal 2:165/12-16; Zarkin 21:4820/18-24.) Clubs require association with a business or employment group (Sinegal

2:148/5-15), or permit any member of the public to join at a higher fee. (Zarkin 21:4821/3-6.) The gross income provided by membership fees for Costco and BJ's has exceeded the net income of those clubs. (Sinegal 2:163/17-24; Zarkin 21:4824/1-22.)

30. The requirement of the membership fee provides a financial incentive to shop at the club consistently and in larger quantities in order to realize the greatest value from their investment in the fee, achieving greater inventory turnover. (Zarkin 21: 4821/5 - 4822/19.) The fee also ensures that club members have resources to spend. Club members are more likely to be homeowners and long-time residents, with higher income and larger households than the general population. (Sinegal 2:171/19 - 172/21; Zarkin 21:4822/20 - 4823/13.) Warehouse clubs costs for bad checks and loss of inventory are lower than other forms of retailing. (Sinegal 2:156/13-22, 172/7-174/9.)

2. Toy sales

31. Toys are well-suited to the "treasure hunt" approach of the warehouse clubs. (Zarkin 21:4828/1-16.) Warehouse clubs sell toys at their average merchandise margins. [] Halverson 3:355/22-25 (Pace, 10-14% including freight); Hilson 20:4436/1-3 (BJ's, 10%).)

32. Warehouse clubs carry fewer toys and periodically change the mix of toys that they carry; they carry more toys during the holiday season. Pace had about 50 toys during January to September and about 125 items in the Christmas season from October to December. (Halverson 3:484/24 - 485/4.) Costco had about 100 toy items in the Christmas season and 15 at other times with the total number of toy items carried during a year about 400. (Moen 4:615/5 - 616/20.) BJ's (including juvenile furniture items) had about 150 toy items during the holiday season and 50 items in January, with the total in the year of 300. (Hilson 20:4417/23-4419/11.) Sam's Club had about 60 toy items during the fall and about 45 items at other times. (Jette, 5:996/2 - 997/22.)

33. Warehouse club toy buyers attend the annual New York Toy Fair in February and other industry shows. (Hilson 20:4424/10 - 4426/16; Jette, 5:1007/5-13.) Warehouse club toy orders for the holiday season are typically placed during March, April, and May presentations by manufacturers at Toy Fair. (Hilson 20:4424/10 - 4426/16; Moen, 4:611/2 - 613/14; Halverson 3:349/7-11; Jette, 5:1006/12 - 1007/4.) Shipments of products for sale during the

holiday season begin to arrive at the warehouse clubs in August or September. (Hilson 20:4419/2-11; Moen 4:622/3-5.)

34. Up to the early 1990's, warehouse clubs purchased regular line products of toy manufacturers. (Halverson 3:357/3-20; Moen 4:606/8-22.) Warehouse clubs also worked with toy manufacturers to develop specially-packaged products increasing the price and value of an item offered for sale to warehouse club members. Warehouse clubs purchased "combo" packs of ten or twenty Matchbox or Hot Wheels toy cars that could be priced for sale to club members in the \$10 - 15 dollar range (Moen 4:606/23 - 608/8; Halverson 3:358/2-22). []

35. Costco's toy buyer preferred open line products to combo packs because combo packs could make it difficult to compare prices in other retailers. (Moen 4:608/9-22; Hilson 20: 4573/15 - 4575/7.) Up to 1991 about 15-20% of Pace's toy selection was combo packs. (Halverson 3:358/19 - 359/21.) About half of the toy items offered by Sam's were regular line products rather than combo packs. (Jette 5:1001/18 - 1002/13.)

36. In deciding whether products are likely to be good sellers, the warehouse club toy buyers rely on their own assessments of products characteristics, the strength of the product brand and on information concerning such things as planned manufacturer advertising in support of the products. (Halverson 3:352/4 - 353/18; Hilson 20:4581/4 - 4582/13; Jette 5:1003/12 - 1004/16.) Warehouse club toy buyers typically do not make product selections based on other retailers' advertising plans or sales experience. (Hilson 20:4582/14-21; Halverson 3:354/5-19; Jette 5:1004/17-23.)

37. Many toys carried by warehouse clubs are not best-sellers. Complaint counsel's marketing expert showed that in 1991 of 310 toy items carried by warehouse clubs that year, 11% were among the 100 top-selling toys industry-wide, and 27 % were among the top 500. (CX-1827; Ingene 41:9078/20 - 9079/20.) In 1991 the warehouse clubs were not successful in "cherry-picking" only the best-selling toy items for their product lines.

AGREEMENTS

A. Warehouse Clubs as an Innovation

38. [] During the 1980's, warehouse clubs were selling mainly to business customers. But then they began to encourage private consumers to become members. (Zarkin 21:4791/24 - 4792/10.) []

Using selective procurement of merchandise, sales from pallets rather than shelves, wide aisles to facilitate easy pallet movement, and avoiding low-priced items, the clubs operated at retail margins lower than those of TRU and the discounters. The margin between retail sales revenues (excluding fees) and merchandise procurement costs for Price Costco ranged from 9.1 - 9.4% in fiscal years 1992 to 1995. (RX-342 at 8; Sinegal 2:150/2-12.) At Pace, the average mark-up was 10 - 14 %. (Halverson 3:355/22-25.) [] Sinegal, the president of Price Costco, testified, "Almost invariably our presence in the community is going to have a tendency to drive prices down." (Sinegal 2:200/10-12.)

39. [] According to a May 1989 analysis by Goldman Sachs in the TRU files (CX-1632):

We continue to regard the warehouse club industry's prospects as quite bright *** Price Company's skills as a merchant and an operator are unsurpassed *** we also believe that the combination of value and merchandise excitement offered by warehouse clubs is simply being discovered by more and more shoppers *** We continue to believe that this retailing revolution has much further to go, and the tilt to retail simply means that warehouse clubs are becoming an increasingly important competitive factor for traditional retailers in nearly every merchandise category.

40. The clubs' lower prices threatened TRU's reputation as a toy discounter. (Goldstein 36:8110/2-10.) []

41. Toys "R" Us initiated a price image program in February 1991. This program lowered prices on some high profile, volume products. (CX-1038-E.)

42. TRU knew that consumers form opinions of a store's relative prices based on highly visible items. (Scherer 22:5006/21 - 5008/7; Carlton 32:7075/1-11.) TRU designates these toys as "Price Image" or "Price Sensitive" items. (Goddu 30:6543/23 - 6544/13.) TRU priced these items at lower margins than other products to enhance TRU's price image. (CX-1024; Goddu 30:6544/18-19.) These items bring customers into the TRU stores where they will also buy other, high profit margin toys. (Goldstein 36:8135/4.) TRU had sales of \$500 million of these items in 1995. (CX-1826.)

43. []

44. []

45. TRU price charts track competition in geographic areas. (Goddu 30:6555/19 - 6558/5.) These areas match newspaper circulation areas (known as an ADI or Area of Dominant Influence).

(Goddu 30:6556/12-23.) Price-sensitive items are priced based on the competition in an ADI. (Goddu 30:6554/6 - 6559/7; 31:6790/22 - 6796/23.) In setting prices, TRU considers national discounters (Target, Kmart and Wal-Mart) and some regional retailers. (Goddu 30:6527/11-19.)

46. Senior TRU executives discussed the warehouse clubs since 1989. (Goddu 30:6613/8-10.) The architects of the response to club competition at TRU were Goddu, Lazarus, Nakasone and Goldstein. (Goddu 31:6826/3-6.)

47. []

48. TRU shopped warehouse clubs in 1989. (Goddu 30:6746/3-9; CX-1545-B.) TRU learned that Price Club, Costco, BJ's and Pace carried 120-240 toy SKUs competing with TRU. (CX-1545-B.) []

49. TRU knew that the clubs had lower costs and thinner margins. (CX-1042-43; CX-1036-I.) TRU felt its costs were the lowest in retailing, other than the warehouse clubs. TRU's U.S. expense rate to sales is 17%. The expense ratio at the clubs is 9%. (Sinegal 2:162/22-163/9.)

50. []

51. TRU executives believed that the clubs were in the same class as Wal-Mart as a competitive threat. [] Spencer, 9:1844/19 - 1845/1.)

52. TRU feared that the clubs' prices could damage its price image and cause it to lower prices. (Goddu 31:6798/24 - 6807/8; [] TRU worried that the clubs were forcing down prices at other retailers the same way that Wal-Mart had. (Goddu 30:6615/20-6618/2; 31:6818/11-6819/7; CX-1576-B.) []

53. TRU feared that the clubs would erode TRU's profits and price image. "We were concerned that, in the eyes of the customer, they would be recognized as being a price leader." (Goddu 30:6616/11-12; []

54. []

55. TRU watched warehouse clubs competing near TRU stores. In 1992, TRU created a list of TRU stores that competed within a five-mile radius of warehouse clubs. (CX-912-A.) This document was circulated to Lazarus, Goddu, Goldstein, Nakasone, and Reinebach. (CX-912-A.)

56. []

57. []

B. TRU and the Warehouse Clubs

1. Toy manufacturers

58. TRU began to discuss the clubs with its suppliers, Mattel, Fisher-Price, and Playskool in 1989-1991. (CX-529; Cohen 35:7937/7-24, 7938/6-13; Spencer 9:1847/18 - 1851/11.) TRU said it might stop buying from manufacturers that sold to the clubs. (Spencer 9:1850/3-18.) TRU's top officials contacted Mattel and "threatened to 'review' their support of those manufacturers that overly supported the warehouse clubs." (CX-529.)

59. TRU's first written policy relating to sales by manufacturers to warehouse clubs was in late 1990 or early 1991. (CX-957, Goddu 30:6628/10-23.) This early approach was complicated and was abandoned by TRU. (Goddu 30:6629/16-25.)

60. Prior to and at Toy Fair 1992, TRU informed the manufacturers of its warehouse club policy (CX-1681):

Warehouse Clubs - TRU Position

- No new or promoted product unless entire line is carried.
- All specials and exclusives to be sold to the clubs should be shown first to TRU to see if TRU wants the item.
- Old and basic product should be in special packs.
- Clearance/Closeouts are OK providing TRU is given first opportunity to buy this product.
- No discussion about prices.

This document, drafted by Goddu, is dated January 29, 1992. (CX-955; Goddu 30:6631/11 - 6638/8, 31:6826/11 - 6829/22; CX-1793.)

61. The TRU theme at Toy Fair 1992 was the clubs. (Spencer 9:1863 - 1864; Verrecchia 7:1503 []

62. []

63. [] To avoid the future meetings, TRU sought the commitments up front.

64. [] A May 1991 LEGO market report gave the toy manufacturer's view of the clubs:

Warehouse clubs are the ultimate extensions of low margin, low cost, high turn philosophy. In fact, clubs may be the most important new format development in retailing in the past century. Retail sales should approach 28 billion in 1991, which is a four fold increase over the past four years. . . . There will be over 500 warehouse clubs in the U.S. by the end of the year generating about 55 million each in sales. No single market is saturated yet. . . .

(CX-487-B; CX-523 (Mattel) ("retail business is rapidly swinging to the clubs"); CX-506-B ("they sell large volumes of product to a certain type of consumer who chooses to shop there rather than elsewhere"); CX-698-B (Fisher-Price) (the opportunity for growth is phenomenal); CX-573-H (from 1988 to 1992, clubs fastest growing retail segment); CX-78 (Hasbro) ("Clubs are one of the fastest growing segments of the entire retail business"); CX-526.)

65. TRU also had to alleviate the manufacturers' fears of losing business to rivals who did sell to the clubs. (Scherer (CX-1822) at ¶¶ 32-53.)

2. Ceasing sales to the clubs

66. Manufacturers were reluctant to restrict sales to the warehouse clubs. []

67. []

68. The manufacturers did not want to give up sales and they were also concerned that their competitors would gain share at their expense. "[I]t was obvious it was an economic thing as far as they were concerned. If the competitor's products was there, they wanted to be there too." [] The manufacturers did not want their competitors to sell to the clubs if they could not. (Lazarus 24:5443/9-10; [])

69. The competition between the manufacturers with respect to the clubs -- the interbrand competition -- was intense. The manufacturers told TRU that they were in the clubs because their competitors were there. This information was transmitted between the manufacturers by TRU.

70. Mattel, Hasbro, Tyco, Little Tikes, Fisher-Price and others all wanted to know how competitors were reacting to TRU. The manufacturers wanted assurances from TRU that their competitors were subject to the same rule. (DePersia 10:2149/15 - 2151/4; Goddu 30/6679/20 - 6680/13.) They informed TRU that they wanted a level playing field to avoid being placed at a competitive disadvantage. (Goldstein 36:8157/23 - 8158/4.)

71. The president of Hasbro's Playskool division testified that he wanted a level playing field, which included not wanting competitors to have access to volume that Hasbro could not have. He did not want to be at a competitive disadvantage. (Owen 6:1131/3-18.) []

72. Verrecchia believed that the agreements would not hold, and that Hasbro would be able to sell to the clubs again. (Inano

16:3335/15-20.) Verrecchia established club shops to determine whether Mattel or other competitors were selling regular line product to the clubs. These shops began after the restrictions. (Verrecchia 7:1365/18-1366/1, 1368/3-9; 1373/16-20; CX-46 - CX-63; CX-71.)

73. Prior to the TRU conduct, Hasbro knew that its competitors were selling regular product to the clubs. [] He asked Hasbro personnel to be "very aggressive" in determining what Mattel and other competitors were selling to the clubs. (Verrecchia 7:1489/13-23.) []

74. Hasbro complained the most frequently about competitor product in the clubs. [] 30:6701/13-18; CX-336.) [] Fisher-Price and others also complained when regular line product from their competitors was found in the clubs. [] Weinberg 34:7628/15-34:7629/1; CX-811; Shiffman 10:2017-7-18; 2018/3-16, 2021/24 - 2022/7, 2026/3-6.) And when Mattel heard rumors that Hasbro and Tyco might be selling regular line to the clubs, the president of Mattel's Boy Division instructed that the clubs be shopped and the information sent to TRU. (CX-626-B.)

75. The manufacturers told TRU that they did not want to be prevented from selling regular line product to the clubs without assurances that their competitors were similarly excluded. Goddu found it "frustrating" that vendors were always talking about what their competition was doing. (Goddu 31:6877/11-13.)

76. The manufacturers did not want to be selling to the clubs when none of their competitors were. (Inano 16:3451/13 - 16; Moen 4:648/24 - 649/4, 651/17 - 23.) []

3. Coordinated response

77. TRU tried to obtain a coordinated response from manufacturers by assuring them that TRU was applying its policy to each of its competitors and by telling each of the major manufacturers that its competitors were only selling to the clubs because the other was. TRU explained that the policy applied to everybody. (Goldstein 36:8157/23 - 8158/4.) Lazarus told manufacturers that TRU was talking to each manufacturer about its club policy, so that they would know there was going to be a level playing field. (Lazarus 24:5440/5 - 10, 5442/14 - 16.)

78. TRU told vendors that it would administer the TRU policy "in a fair and equitable manner across all vendors." TRU did this

"because it was of concern to the vendors that whatever we did with them, the same kind of merchandising approach was applied to their competition." (Goddu 30:6679/20 - 6680/4, 31:6871/11 - 6878/1, 6880/7 - 6883/3.)

79. []

80. The manufacturers required assurance that their competitors would go along; they were aware that TRU was communicating its policy to the other manufacturers and that without unanimity, regular line product sales to the clubs would recommence.

4. Manufacturers

81. In an October 1991 meeting between high officials of Mattel and TRU, Mattel CEO, John Amerman, told TRU CEO, Charles Lazarus, that Mattel "[W]ould not sell the clubs the same items we were selling them. This was based on the fact that competition would do the same." (CX-532-A.)

82. []

83. Goddu understood each of the major manufacturers when they said that they were only selling to the clubs because their competition was selling to the clubs. and that they would get out of the clubs if their competition got out.

5. *Quid Pro Quo*

84. During conversations with manufacturers, TRU did not merely announce that it would refuse to deal with manufacturers selling to the clubs, or inform manufacturers that all manufacturers would be treated equally. Instead, TRU communicated the *quid pro quo* (i.e., I'll stop if they stop) from manufacturer to manufacturer. (Goddu, IH (CX-1658) at 276-80.)

6. TRU's orchestration of combination

85. TRU used the acquiescence of certain manufacturers in order to obtain the acquiescence of others. After Mattel agreed not to sell to the clubs the same products "based on the fact that competition does the same" (CX-532), TRU told Hasbro that Mattel had agreed. (Verrecchia 7:1393/5-14, 23-25, 1394/1-4; Owen 6:1128/5 - 1129/25, 1132/6 - 1135/9; Inano 16:3333/12 - 3335/7.)

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86. TRU informed Hasbro that the club special pack only approach would probably also fly with other manufacturers. (Owen, 6:1136/20-1141/14.) []

87. Before committing not to sell certain products to the clubs, Little Tikes asked TRU what its main competitor in the clubs (Today's Kids) was going to do. Goddu informed Little Tikes that Today's Kids "was going to start doing less business with the warehouse clubs," whereupon Little Tikes committed to restrict its sales. (DePersia 10:2147/7-14, 2147/18-24, 2150/3-12, 2150/25-2151/4.) []

88. TRU attempted to gain agreement from Sega and Nintendo to not sell any products to the clubs.³ []

89. TRU's Goddu explained how he dealt with Sega and Nintendo []

90. Lazarus and Goddu told Sega that TRU had convinced Nintendo to stop selling product to the clubs as part of TRU's effort to convince Sega to do the same. (CX-1776; Kalinske 12:2490/7-25, 2491/24 - 2492/2.) TRU argued that Sega should stop selling because TRU had convinced Nintendo to stop. (Kalinske 12:2515/12 - 2516/2.) Hasbro's Milton Bradley division president wrote on August 13, 1992, that TRU's Goddu told him what Hasbro's competitor, Mattel, was doing regarding the clubs (CX-1612):⁴

In a conversation I had with Roger Goddu yesterday, I thought it was interesting to note that he claims to have had a conversation with Mattel executives, including Amerman, on Tuesday concerning the warehouse clubs and Mattel's fear that this whole issue will end up in the courts.

He further went on to explain that their fear wasn't based on the issue of a manufacturer's right to pick and choose the customers they want to sell, but rather, they were concerned that the case could lead to questions concerning the discounts and favorable treatment that one customer may receive relative to another. In essence, Mattel's major concern is that a court case could lead to exposure of the terms and discounts that they give to Toys "R" Us.

91. []

92. []

93. On August 10, 1992, TRU circulated internal Hasbro memoranda detailing the extent to which Hasbro's competitors,

³ []

⁴ This discussion refers to the memorandum summarizing the results of TRU's contacts with various manufacturers. (CX-913-A-F.)

including Mattel, were restricting (or not restricting) sales to the clubs. (CX-1633; Goddu 30:6689/13 - 6690/10.) []

94. TRU promised to "take care of it" after Fisher-Price representatives complained about a TV-promoted Playskool product they found in Price Club. (Chase 8:1666/4 - 1667/1.) After Tiger complained about finding a competitor's product in the clubs, a Tiger representative testified that Goddu told him: "because this was a new company and they hadn't, you know, explained their policy with regard to club sales to the people at Yes Entertainment, basically, it was you know, kind of like what we told them, don't do it again or God knows what." (Shiffman 10:2027/10-14.)

95. The transmission of the complaints between the manufacturers allowed TRU to monitor compliance with the agreements and assured the manufacturers that their competitors were complying.

96. By these communications, TRU facilitated horizontal agreement among the manufacturers.⁵

97. The manufacturers did not want to be placed at a competitive disadvantage against their rivals. (Scherer (CX-1822) ¶ ¶ 41-50; Owen, 6:1130/15 - 1134/18; DePersia. 10:2146/10-25; Lazarus, 24:5441/17 - 5442/16.)

98. TRU policed the agreements with the manufacturers. It regularly conducted "shops" of the warehouse clubs to determine which manufacturers were selling product to the clubs. (Goddu 30:6746/3-9; CX-1545 through CX-1565.) [] TRU's policing was aided by manufacturers who reported to TRU when they found their competitors' products in the clubs, including Mattel, Hasbro, Fisher-Price, Nintendo, Sega, Western Publishing, and Little Tikes. (Goldstein 36:8157/2-22, 36:8230/12 - 8242/10.)

99. [] These contacts were made at the request of Charles Lazarus. (24:5437/18-22.) Zablow of Mattel wrote on September 12, 1991, that Bob Weinberg of TRU "visited Costco on the West Coast. He called to comment that he felt that there was an 'inordinate' amount of Mattel infant product being sold in this store vs. product of other vendors." (CX-529.) Weinberg of TRU called Today's Kids about two products he saw in a warehouse club. Weinberg told Today's Kids that it needed "to do something to the item or the packaging." (CX-857.)

⁵ When a manufacturer complained about sales to the clubs, these communications related to the most immediate competitors. []

100. In the spring of 1992, Goddu and his staff investigated products found in the clubs during a club shop (CX-926 - CX-927); the results were reported in a memo from Goddu to TRU's Lazarus in June 1992. (CX-913; Goddu, 30:6748/2-6754/13.) TRU discussed this with manufacturers during 1992 and 1993. (Goddu. 31:6863/19 - 6864/4.)

101. TRU's threats resulted in manufacturers' communicating back to TRU their commitment not to sell certain toys to the clubs. [] This memo was sent to TRU's then-CEO, Charles Lazarus:

| MFG. | DESCRIPTION | COMMENTS |
|--------------------------|---|---|
| Hasbro | Puppy Surprise | Shipped early. No more will be shipped to warehouses. |
| Binney & Smith | {various} | Per Brent Blaine, understood our concern. Going forward they will offer special packs only for '93. Commitments already made for '92. |
| Mattel | Barbie Dream House | Sold LY mdse. Will not sell again. |
| Huffy Sports | Graphite Ultra Pak | Per Dave Allen, VP Sales, they admit their mistake. Effective immediately only special Backboards will be sold to clubs... |
| Playtime, (Div. of Tyco) | Super Saturator | Per Howard Abrams, SVP Sales, pleaded ignorance. He's now aware and other than some prior commitments, they will only sell club "special" item or items we don't carry. |
| Today's Kids | Activity Rocker Little Golfer All Star Baseball | Per Jim Stephens, they needed the business, but fully understand our position. They will sell special items going forward. |
| Tyco | 123 Firehouse Blocks Deluxe Set Magnadoodle DB Nursery/Playground | Per Ken Shumaker, these are goods shipped last year - prior to their new "no ship" policy on current goods we carry. |
| Century Fisher-Price | Elite Car Seat Nursery Monitor | Vendor will stop shipping BJ's. They have agreed to stop selling this item to the clubs. |
| Safety 1 st | Swivel Bath Seat | They have agreed to stop selling the clubs this item. |

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| | | |
|-----------------------------------|------------------|--|
| Playskool Baby (a Hasbro Div.) | Nighttime Feeder | We have reached a corporate agreement on the sale of this item to the club stores. |
| Kransco | Swim Sweater | Will not be selling like items to them next year. Will change graphics/packaging to differentiate item in future. |
| Morey Boogie | Sting Ray Board | Admitted they screwed up - will not happen again. Will continue to sell them but in a "completely" different packaging and graphics on the boards. |
| Nintendo | Asst. | "Not getting it from Nintendo" per Randy. They will "look into." |
| Sega | Asst. | Will continue to sell as long as Nintendo is in Warehouse Clubs. |

102. TRU became dissatisfied with the manufacturers' efforts not to sell hot or promoted products to the clubs. TRU concluded that commitments relating to hot product were too difficult to interpret. (Goddu 30:6639/6 - 6645/2.)

103. TRU changed and simplified its policy during late '92 or early '93. TRU told manufacturers it would not buy any product sold to warehouse clubs. (Goddu 30:6645/5-9; 31:6846/22 - 6848/9; 31:6861/22 - 6862/22.)

104. There was some testimony that TRU stated they were simply "reserving the right not to buy" products they found in the clubs, but the weight of the evidence is that TRU told manufacturers that TRU would not buy products that did not comply with the TRU policy. [] (CX-809 (Tiger) (TRU won't buy, period end of story); CX-1521 (Little Tikes) ("make it clear that TRU will not carry identical products as the warehouse clubs"); CX-532 (Mattel) (TRU will "allocate open-to-buy based on who agreed not to support the clubs"). [] In a document drafted around Toy Fair 1993, Greg Staley from TRU's international division summarized TRU's policy as follows:

Our buying is simple - we will not carry any identical item which is sold to a Warehouse Club. If we find an item in both our assortments and those of a Club, we will discontinue carrying that item immediately; and we reserve the right to take clearance markdowns to dramatically accelerate the rate of sale on that item. In

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summary, the vendor has to make a choice as to whom he sell an item - either us or them. Discussions with our vendors should not go beyond what I have stated above.

(CX-1591; Goddu 6864-65 (confirms this was TRU policy at the time).)

105. By early 1993, Mattel, Hasbro and others ceased selling any identical product to the clubs. TRU policed these agreements by "shopping" the warehouse clubs. (Scherer 24:5403/1-2.) Manufacturers also continued to report to TRU when they saw their competitors products in the clubs. (CX-811: Shiffman 10:2017/7- 18, 2018/3-16, 2021/24-2022/7, 2026/3-6.)

7. TRU's intent

106. TRU club policy aimed at eliminating the competitive threat of the clubs. TRU tried to keep merchandise out of the clubs, or to make sure that the price of toys in the clubs was not directly comparable to TRU's price. (Goddu, 3 1:6840/20 - 6841/7.)

107. TRU tried to gain commitments from the manufacturers to sell the clubs only combo packs or differentiated product: []

108 TRU did not object to the clubs selling combination packs because (1) they prevented the customer from making a direct pricing comparison between items on TRU shelves and the clubs shelves, (2) TRU did not want the packs, and (3) consumers were less likely to want combination packs than individual items. (Lazarus 24:5430/16-23, 5430/24-5431/4, 5431/18-29, 5432/12-14, 5433/3-10; Goddu 30:6635/13-24; 31:6827/20-22; RX-813-A.)

109. TRU argues that the primary reason for the club policy was TRU's inability to obtain hot product. (Lazarus 24:5350/21 - 5351/3; Butler 5490/17-22.) The exhibits relating to perceived shortages occurred after the club policy was implemented, and those shortages were not attributed to the clubs. (Carlton 32:7227/6 - 7228/11.) []

110. Goddu testified that shortages were not the primary focus of the policy. []

111. []

C. Agreements

1. Mattel

112. Since 1993, Mattel Inc. ("Mattel") has been the nation's largest toy manufacturer. (CX-1814; Verrecchia 7:1317/25 - 1318/11.)

In 1994 its share of the U.S. toy market was 18%. (CX-1669-C.) Mattel's products include the Barbie doll line, Hot Wheels, Disney toys, pre-school toys and Nickelodeon. (Okun 13:2604/24 - 2605/4.)

113. In November 1993, Mattel acquired Fisher-Price, [] (Chase 8:1641/9-13; Cohen 35:7926/9-17; []) In 1997, Mattel acquired Tyco, then the nation's third largest toy maker whose popular toys include Magna-Doodle, Tickle Me Elmo and Sesame Street products. (Grey 14:2985/16-22, 2986/5-9, 16-18; Hilson 20:4484/23 - 4486/1; CX-1814.)

114. TRU is Mattel's largest customer. (CX-1669-D; CX-1276-D-E.) TRU bought 25% of Mattel products in 1992 and 29% in 1993. (CX-1276-E; CX-1669-D; []) In 1985, TRU accounted for 12% of Mattel sales. (CX-1669-D.)

115. In December of 1990, Mattel's CEO, John Amerman, stated to his staff: "The constriction in the number of traditional retail outlets that carry toys" was going to be a "bigger and bigger problem as time passes." (CX-523.) He mentioned the financial problems of Child World and other major customers of Mattel. (CX-523; [])

116. Amerman noted the clubs' rapid growth rate. He told his staff that he wanted to be much more aggressive in pursuing the club channel of distribution, so Mattel would not be as dependent on TRU. (CX-523; [])

117. Mattel's retail customers became increasingly concentrated. Mattel's sales to the top five toy retailers (TRU, Wal-Mart, Kmart, Target and Kay Bee) increased from 28% in 1985 to 53% by 1990 and a projected 72% in 1994 (CX-1669), with TRU and Wal-Mart accounting for almost half of Mattel's sales volume. (CX-1669-B; [])

118. [] From 1989 to 1991, Mattel's sales volume to the clubs increased by 87%. (CX-574; [] 2653/19.) Mattel's overall sales growth rate increased by 10% during this period. (CX-530-E; []) In 1989, 94% of the clubs' purchases from Mattel were from its regular product line (as compared to customized product). (CX-691; [])

119. On September 26, 1991, for a meeting called by TRU to discuss the club and other issues (CX-530-A; []), Mattel's vice president, Frederick Okun, sent a briefing memo to his boss Jill Barad (then-president of Mattel's girls division):

WAREHOUSE CLUBS

This is one of the fastest growing channels of distribution in the country. As a public company we owe it to our shareholders to maintain our business by selling this class of trade. . . . Two years ago we committed to Toys R Us that we would do our best not to sell them regular line goods. We have reached a point where we are selling them approximately 50% of our volume on a customized basis. We will continue to move in this direction and promise to increase the percentage sold on a customized basis.

(CX-530-B.) The memo recommended in connection with the upcoming meeting with TRU that Mattel "should commit" not to sell critical items to the clubs. (CX-530-B.)

120. The memo's reference to Mattel's commitment to TRU two years earlier to do its best not to sell the clubs regular line product relates to Toy Fair 1990. ([]) TRU's officials met in February 1990 with Mattel's officials and "threatened to review their support of those manufacturers that overly supported the warehouse clubs" (CX-529; []). Following Mattel's commitment to TRU in February 1990, by September 1991 Mattel's sales of regular line product to the clubs dropped from 94% in 1989 to 50% in 1990. (CX-530-B; CX-691.)

121. An April 1990 Mattel memo states that Mattel's then-president, Bob Sansone, discussed with TRU Mattel's "policy to grow the Wholesale Club business with non-competing SKUs." (CX-600-B; []) Mattel vice president Okun's response in December 1990 to John Amerman's memo (CX-523) urged Mattel to aggressively pursue the club channel of distribution. In his memo, Okun states "[w]e must acknowledge the TRU issue, but if we give [the clubs] specials we should be ok." (CX-595-B; [].)

122. In 1990, TRU and Mattel reached an agreement under which Mattel committed to TRU that it would do its best to move the clubs away from regular line product to customized product and Mattel adhered to its commitment.

123. The meeting referred to in Okun's September 6, 1991 memo was at TRU's headquarters on October 3, 1991. (CX-1763.) High level TRU and Mattel executives attended. (CX-532; []) Okun wrote a summary of that meeting the same day. ([]; CX-532.)

124. At the meeting, [] He said "regular line specials" were not the answer and that Mattel would have to choose between selling the same items to TRU and to the clubs. (CX-532-A; []) At the meeting TRU vice chairman, Michael Goldstein, said that TRU "was

going to allocate open-to-buy based on who agreed not to support the clubs." (CX-532-A).

125. In response to TRU's threats ([] Barad 35:7843/18 - 7844/1), Mattel's CEO, John Amerman, assured TRU that Mattel would not sell the same items to the clubs that it was selling to TRU. (CX-532-A; []) TRU vice president, Roger Goddu, testified that Amerman committed to TRU that Mattel would not sell any merchandise to the clubs. (Goddu 30:6663/6-22.)

126. Okun's meeting summary said that Amerman's statement not to sell the same items to the clubs that it was selling to TRU "was based on the fact that competition would do the same." (CX-532-A.)
[]

127. Mattel conditioned its agreement on its competitors also going along with TRU's club policy. (Goddu IH (CX-1658) at 276/8 - 279/21.) I find that it was not in the unilateral business interest of Mattel to enter alone into an agreement with TRU because if it was in Mattel's unilateral interest, it would have done so without regard to the positions taken by its competitors.

128. Mattel also "agreed" at the meeting to supply TRU with customer quantities and volume, even though Okun was nervous about supplying data to TRU about TRU's competition. [] I find it was against Mattel's unilateral business interests to transmit this confidential competitive information to TRU.

129. After the October 3, 1991 meeting, Barad told TRU's Roger Goddu that he should realize that Mattel could not live up to what its CEO has agreed to and added, "we need to talk." (Goddu 31:6885/17 - 6887/2; Barad 35:7891/19 - 7892/10.) Barad then called Goddu a few days later and told him [] "we'll get back, we'll work this thing out." (Goddu 31:6887/17 6888/15; Goddu IH (CX-1658) at 282/13 - 284/12.)

130. Barad testified that she also called TRU's Michael Goldstein within a few days of the October 3, 1991 meeting, in order to tell him that she knew what Amerman had said, but that Mattel could not stop selling everything to the clubs because Mattel already had outstanding commitments to them, and what Mattel really wanted to do was to sell special packs to the clubs. (Barad 35:7894/7-20; Goldstein IH (CX-1659) at 100/17-101/13; Goldstein 36:8266/25 - 8268/22.) Barad further testified that Mattel wanted to continue selling to the clubs because she thought the clubs were an important channel of

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distribution in order to grow Mattel's business. (Barad 35:7896/21 - 7897/7.) []

131. Following the October 3, 1991 meeting and Barad's follow-up phone calls to Goddu and Goldstein, Mattel committed to sell only exclusive items to the clubs. (Goddu 31:6891/13 - 6892/14.)

132. Two weeks after the October 3, 1991 meeting, a memo from Rita Rao of Mattel to Mattel's Arco division president, Bill Quinlan, stated that Arco would not be permitted to sell the clubs Mattel's current promoted products. (CX-624.) Rao also suggested showing specialized products to TRU's Peter Spencer before showing them to the clubs. If Spencer passed on buying these products, she wrote, it would then be "ok to sell to the Clubs." (CX-624.)

133. A January 22, 1992 memo from Cathy Larson, Arco's then-vice president of marketing who had just come to Arco from its parent company Mattel [] summarized a conversation she had with Okun and stated that Mattel had initially "committed" not to do "any business with the clubs" but that Mattel had been able to "negotiate to do exclusive items only so that there would be no direct competitive threat to TRU." (CX-540.)

134. The Larson memo stated that "our agreement with TRU is that all of these [club] items will be offered to them as well so we must plan for a presentation to TRU." (CX-540.) It also stated that the clubs "do not know that we will not be selling them the regular line dolls. U.S. Sales will position it to them as risky availability items." (CX-540.)

135. Mattel's Arco division operates as a letter of credit business under which its customers purchase products by paying prior to shipment from manufacturing plants located in the orient. (Leighton 15:3145/14 - 3146/3.) The reference to "U.S. Sales" in Larson's memo refers to the Mattel Toys U.S. operation. (Okun 13:2604/5-21.) Okun, Mattel's vice president for U.S. sales, and Tom Northup, the Mattel employee who sold to the clubs (Ojendyk 18:3983/2-12), received copies of this memo. (CX-540.)

136. Okun discussed with Larson TRU's meeting with Mattel where according to him, "TRU came away thinking there was an agreement." []

137. [] that the contemporaneous business documents and Mattel's actions that are consistent with these documents are entitled to more weight than Okun's explanation.

138. [] Butler told Spencer that they would review Arco merchandise to "select what merchandise could be shown to the warehouse clubs or what merchandise was not to be shown to them." (Spencer, 9:1860/3 - 1861/25.)

139. A July 21, 1992 memo to Mattel CEO Amerman from Arco's president Bill Quinlan, who also was present at Toy Fair 1992 when Arco showed its club specials to TRU's Spencer and Butler [], corroborates this account of the event: "At Toy Fair we showed Van and Peter all of our club specials. We paid particular attention to the Barbie doll/Arco accessory combinations. We offered each and every one to TRU on a 'right of first refusal' basis. They passed on every item leaving us free to sell to the Wholesale Clubs." (CX-550-A; CX-624.)

140. At Toy Fair 1992, Mattel told Costco's toy buyer Michelle Moen that some items that she wanted would not be available because they would be in short supply. (Moen 4:609/9-610/19-20.) Items are not typically in short supply at that time: some items have not even been produced yet. (Moen 4:612/9-15.)

141. During Toy Fair 1992, Pace's Halverson asked Mattel salesman Nick Snider why they were not stopping to look at certain regular line Mattel products, and Snider told Halverson that Pace could not buy those products. (Halverson 3:378/24 - 379/16.) Snider admitted to Halverson that TRU executives had pressured higher-level Mattel people not to sell key items to the clubs, in part because the clubs sold these products at a lower retail price than TRU, which hurt TRU's value image. (Halverson 3:379/15 - 381/12.)

142. At Toy Fair 1992 and on other occasions, TRU told Hasbro that Mattel and other manufacturers had agreed not to sell promoted product to the clubs. (Inano 16:3333/12 - 3335/5, 3343/17 - 22; Owen 6:1132/6 - 1135/9; Verrecchia 7:1391/22 - 1393/14, 1393/23 - 1394/4.)

143. At a meeting on February 27, 1992, TRU executives Goddu, Butler and Spencer and Mattel's Okun (CX-541) agreed to TRU's right of first refusal and Mattel's not selling certain products to the clubs. [] Mattel's written summary of the meeting describes the agreements reached (CX-541):

WAREHOUSE CLUB

- Agreed to show TRU all specials/exclusives . . . they will have first right of refusal.

