

IN THE MATTER OF
TEAC CORPORATION OF AMERICA

MODIFYING ORDER IN REGARD TO ALLEGED VIOLATION OF
THE FEDERAL TRADE COMMISSION ACT

Docket C-2752. Consent Order, Oct. 24, 1975—Modifying Order, Nov. 16, 1984

This Order grants the request of a Montebello, California supplier of high fidelity audio components to reopen the proceedings and delete Paragraph I(11) from the Commission's October 24, 1975 Consent Order, 86 F.T.C. 981, *modified*, November 25, 1983, 102 F.T.C. 1814, so as to permit the firm to prevent transshipment of its products to dealers who did not meet non-discriminatory standards of promotion, service and display. After considering company's arguments and other relevant information, the Commission concluded that the public interest warranted reopening and modifying the Order as requested. The transshipment provision had served its remedial purpose. There was no indication that the firm had engaged in resale price maintenance or breached the transshipment provision. Nor was there anything in the record to suggest a need to retain the provision as a fencing-in mechanism, or as a means of preventing anticompetitive effects from nonprice vertical restraints. Accordingly, the Commission ordered that the matter be reopened and Paragraph I(11) of the Order deleted.

ORDER REOPENING AND MODIFYING ORDER ISSUED ON OCTOBER 24, 1975

On June 6, 1984, respondent TEAC Corporation of America ("TEAC") filed its "Request to Reopen Proceedings and to Modify Consent Order" ("Request"), pursuant to Section 5(b) of the Federal Trade Commission Act, 15 U.S.C. 45(b), and Section 2.5 of the Commission's Rules of Practice. The Request asked the Commission to reopen the proceeding in Docket No. C-2752 and modify the order issued by the Commission in this case on October 24, 1975—as modified by an order issued November 25, 1983—to remove a provision that restricts TEAC's ability to limit transshipment of its products. TEAC's Request was placed on the public record for thirty days and no comments were received.

After reviewing TEAC's request and other available information, the Commission has concluded that the public interest warrants reopening and modifying the order in the manner requested by TEAC. The transshipment provision of the order [2] (Paragraph I(11)) was adopted principally as a "fencing in" restraint ancillary to the order's ban on resale price maintenance ("RPM"). TEAC has shown that it does not fix the prices at which its authorized dealers resell TEAC products, that TEAC product prices vary from dealer to dealer, and that the transshipment provision therefore has encouraged the emer-

gence of intrabrand price competition in TEAC products. Consequently, Paragraph I(11) need not be retained for that purpose.

To the extent that Paragraph I(11) was also intended to remedy alleged anticompetitive effects of vertical practices other than RPM, the Supreme Court decision in *Continental T. V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977)—issued after the original order in this matter—makes further analysis necessary. As the Court explained, non-price vertical restraints may either enhance or impede economic efficiency and consumer welfare, depending upon whether the fundamental purpose or effect of the restraints is on balance to enhance or exploit market power or instead to promote a more efficient form of distribution. It follows that devices that facilitate the imposition of non-price vertical restraints—such as transshipment restrictions—similarly may be beneficial in some situations and harmful in others. These practices are not inherently suspect or so plainly anticompetitive that they can be condemned without more extensive analysis under the rule of reason. The Commission has relied upon *Sylvania* to conclude that [3] it will only prohibit non-price vertical restraints that have “a probable adverse effect on *interbrand* competition” at either the manufacturer or the dealer level.¹

The foregoing cases establish the need to evaluate the likely consequences of non-price vertical restraints in the recording equipment industry under the rule of reason in considering TEAC's petition. Vertically imposed transshipment restrictions such as those at issue here are most likely to be used in conjunction with a program of other non-price vertical restraints that effectively limits the entities with whom the manufacturer will deal. TEAC apparently seeks authority to use transshipment restrictions to facilitate a distribution program involving only carefully selected dealers. If TEAC's petition is granted, TEAC could use transshipment restrictions to facilitate the imposition and enforcement of other non-price vertical restraints.

I.

When market power either does not exist or cannot be sustained, anticipated efficiency gains are the only rational basis for a manufacturer to impose a vertical restraint. Only procompetitive practices will survive the market test when the [4] creation or enhancement of market power is unlikely; the market does not reward inefficient distribution practices. Thus, when the exercise of market power in a

¹ *Belton Electronics Corp.*, 100 F.T.C. 68, 208 (1982). The Commission identified two different adverse effects upon interbrand competition that could satisfy this standard. First, the Commission indicated that non-price vertical restraints might in some circumstances support or increase the likelihood of collusion among competing firms. *Id.* at 206-07. Second, the Commission indicated that non-price vertical restraints might in some circumstances create or enhance the market power of one or more competing firms. *Id.* at 207.

properly defined relevant market is unlikely,² we consider non-price vertical restraints to be efficiency enhancing in purpose and effect, and therefore lawful, without further inquiry.

Market power can be exercised either by a dominant firm or through the action of competitors acting in concert. Because no firm can claim dominance in the recording equipment market (*see* pp. 6-8, *infra*), we will focus our attention on the possibility of collusive activities in this market.³ In this context, our concerns are: (1) whether the firms that use the questioned non-price vertical restraints constitute a significant competitive threat; and (2) whether such a threat is effectively constrained by the remainder of the market.

In general, the likelihood of collusion depends on the expected gains from and costs of forming and enforcing a collusive scheme. Collusion is attractive only to the extent [5] that there are potential gains from cooperation, such as when market demand is inelastic at the competitive price. As the elasticity of market demand at the competitive level increases, the potential gains from collusion decline. Collusion becomes less likely as the costs of forming or enforcing a collusive agreement increase. The likelihood of collusion is directly related to, among other things, the overall level of market concentration, the distribution and aggregate value of the market shares of the firms using the challenged practice, and the presence and significance of barriers to entry. The likelihood of collusion is inversely related to, among other things, the number of fringe firms and the diffusion of their market shares.⁴

The factors that affect the feasibility of successful collusion often can be used to conclude that it is probably not a threat to consumer welfare in a given market. For example, collusion is unlikely to be successful in an unconcentrated [6] market.⁵ Moreover, even in a somewhat concentrated market, if the firms actually using the vertical restraint at issue do not collectively possess and are not likely to secure market power, then the restraint is unlikely to facilitate the creation or maintenance of market power. In particular, non-price

² The Commission adheres to the principles of relevant market definition it adopted in 1982. *Statement of Federal Trade Commission Concerning Horizontal Mergers ("FTC Merger Statement")*, Trade Reg. Rep. (CCH) No. 546 (June 16, 1982), at 71, 84-85.

³ The imposition of vertical restraints as a result of collusive activities in the recording equipment market might arise in one of two forms. First, distributors or retailers might act in concert to coerce manufacturers to impose vertical restraints on their competitors in order to limit competition in distribution or retailing. Second, manufacturers might impose vertical restraints in concert in order to facilitate the monitoring of a collusive agreement or otherwise to enhance the exercise of collusive market power.

⁴ *E.g.*, R. Posner, *Antitrust Law: An Economic Perspective* 56-59 (1976). The Commission has recognized that other factors, in addition to those enumerated, also affect the likelihood of successful collusion. *FTC Merger Statement*, *supra* note 2, at 71, 75-80.

⁵ In the context of horizontal mergers, the Justice Department has broadly characterized markets with Herfindahl-Hirschman Indexes ("HHIs") below 1000 as "unconcentrated," and markets with HHIs equal to or above 1000 as "moderately concentrated." *Justice Department Merger Guidelines*, 49 FR 26823, 26830-31 (1984). An HHI of 1000 or less certainly indicates an unconcentrated market; however, for the purpose of analyzing non-price vertical restraints, it may also be appropriate to characterize markets with somewhat higher HHIs as unconcentrated.

vertical restraints implemented by new entrants or small established firms are unlikely to threaten consumer welfare. The absence of barriers to entry is also likely to prevent successful collusion. On the facts in this case, we need go no further than to determine that successful collusion in the recording equipment market is highly unlikely. We do not confront a market in which non-price vertical restraints may create both market power and consumer benefits, and we therefore do not need to balance positive and negative effects upon competition and consumer welfare.

II.

We commence our analysis of the TEAC request by evaluating the threat of the exercise of market power. TEAC competes in the home and professional recording equipment segments of the high fidelity audio components market. The facts pertaining to the recording equipment industry indicate that no firm has a dominant [7] position and that the chance of successful collusion is remote. TEAC's share of the home recording market fell substantially between 1974 and 1983, so that it is now only the sixth largest firm in the industry. Moreover, only one firm has more than eight percent of the home recording market. The structure of the distribution and retailing segments of the home recording equipment market is even more diffuse. Thus, existing levels of concentration in this market at the manufacturer, distributor, and retailer levels are significantly lower than the threshold level that should trigger concern with the possibility of successful collusion.

In addition, since the original order was entered, at least twenty manufacturers have entered and/or increased their participation in the high fidelity audio components market and its tape recording equipment segment, indicating the absence of significant impediments to entry. There is similarly no evidence of barriers to entry into the distribution or retailing of home recording equipment. For example, the typical TEAC dealer carries as many as seven competing lines of tape recording equipment. The professional recording segment is similarly competitive. There are at least twelve manufacturers of professional recording equipment. Moreover, professional equipment is sold to knowledgeable buyers on a bid basis by geographically dispersed dealers, making successful collusion among manufacturers even more difficult and unlikely. [8]

In summary, the low levels of concentration and the absence of barriers to entry into the manufacture, distribution, and retailing of recording equipment make the creation of market power in this industry an extremely remote possibility.

CONCLUSION

The transshipment provision in question has served its remedial purpose. There is no indication that TEAC has engaged in RPM (or has breached the transshipment provision) from October 24, 1975 to date, and nothing in the record suggests that there is a need to retain the transshipment provision as a fencing-in mechanism to ensure that TEAC does not reinstitute RPM.

The transshipment provision does not appear to be needed to prevent anticompetitive effects from non-price vertical restraints either. Because the recording equipment market and its constituent segments are unconcentrated at the manufacturer, distributor and retailer levels, and because there has been substantial entry, we conclude that neither market dominance nor successful collusion is likely. The record presented by TEAC and other information indicate that transshipment restraints imposed by TEAC would pose no threat to interbrand competition. At the same time, Paragraph I(11) imposes unnecessary costs by requiring TEAC to prospectively specify and apply qualification standards for all dealers who seek to secure TEAC products transshipped by TEAC's authorized dealers, including dealers not served directly by TEAC. We therefore conclude that an effort by TEAC to control transshipment is very unlikely to harm competition. [9]

Accordingly, *it is ordered* that this matter be, and it hereby is, reopened and that Paragraph I(11) of the order be, and it hereby is, deleted.

Commissioner Bailey voted in the negative.

IN THE MATTER OF

GROLIER, INCORPORATED, ET AL.

MODIFYING ORDER IN REGARD TO ALLEGED VIOLATION OF THE
FEDERAL TRADE COMMISSION ACT

Docket 8879. Final Order, March 9, 1982—Modifying Order, Nov. 19, 1984

This Order reopens the proceeding and modifies the 1978 Commission Order, 91 F.T.C. 315, revised December 10, 1981 and made final March 9, 1982, 99 F.T.C. 379, which required a seller of encyclopedias to cease engaging in certain unfair and deceptive trade practices in connection with the sale of its products and the recruitment of door-to-door sales personnel. Pursuant to the company's petition, the Order has been modified to closely conform with the modification granted in *Encyclopaedia Britannica, Inc., et al.*, 100 F.T.C. 500. Among other things, the Order no longer requires the firm to include in employment ads information such as the nature of the employment, the location of the company or the basis of compensation, so long as they provide such information to potential employees during the initial job interview. The company may provide information concerning income and expenses to prospective employees when an actual job offer is made. The Order no longer requires the company to disclose in advertisements and promotional material that a sales representative will contact consumers who return inquiry cards, provided the firm can demonstrate through surveys that most readers of the ads understand this implicitly. The business cards of company's sales representatives may be reduced from three-by-five to two-by three-and-a-half inches, and the respondent may follow relevant Commission guidelines when making "free" offers, and is no longer required to attach lists of prices and free products to encyclopedia contracts.

ORDER REOPENING THE PROCEEDING AND MODIFYING
CEASE AND DESIST ORDER

On October 13, 1983, respondents, Grolier, Incorporated, et al., filed a "Request to Reopen Proceedings To Modify Order and Application for Stay of the Order." ("Request") The Order became effective on October 11, 1983. On August 23, and October 4, 1984, Grolier supplemented the "Request" with a revised Appendix B, which sets out the methodology to be used by Grolier to show compliance with Paragraph II.A. of the proposed Order.

Grolier granted the Commission until November 19, 1984 to decide its "Request". The Commission previously granted Grolier's "Request for Extension of Time" for the Commission to act to allow Grolier more time to complete its surveys bearing on the disclosures required by Paragraphs II.A. and B., which are subject paragraphs of the pending "Request".

Grolier seeks Order modifications virtually identical to those the Commission made to a similar Commission Order against *Encyclo-*