

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 incipency; 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 incipency. 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.)

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 midse. 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.

Initial Decision

126 F.T.C.

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 become 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

415

Initial Decision

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

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.

- Regular line product - won't sell them hot product that we know about, i.e., Teen Talk, Totally Hair, etc. We did not agree that we would not sell them any 1992 regular line items.
- We agreed not to ship Warehouse Club items we can't supply TRU.
- Roger will talk to Charles . . . can't predict his reaction.

144. During the spring of 1992, Mattel was still taking orders from the clubs for regular line product. In March and April 1992, Costco placed with Mattel orders for the Christmas season, with deliveries to begin in early August. (Moen 4:611/2-7, 619/10-25.) In April of 1992, in response to a letter from Costco about certain products Costco wanted that Mattel was not offering to them (CX-1369), Mattel's Jill Barad informed Costco that "when we feel production capacity or availability are potential issues, we have tried to guide you away from the item." (CX-1371.)

145. Pace also placed orders with Mattel in the spring for the Christmas 1992 season (CX-1710-A-Z-33) and received written confirmation from Mattel. (Halverson 3:371/18 - 372/15, 561/6 - 563/14.) One of the items Pace ordered from Mattel was Air Pro Hockey, but Mattel tried to steer Pace to a "special" version with extra hockey sticks added, which would have made the product a poor value and the retail price non-competitive for Pace. (Halverson 3:372/12 - 374/13; CX-1633-B.) Pace buyer, Scott Halverson, complained to Mattel and Mattel shipped some of the regular line product in the spring without the added sticks. (Halverson 3:374/14-25; CX-1633-B.)

146. Pace's additional orders for Air Pro Hockey were scheduled to be delivered in July 1992. (Halverson 3:375/1-9.) However, the product did not arrive on schedule, and when Pace asked Mattel when it could expect shipment, it received no answer. (Halverson 3:375/3-9; CX-1692.)

147. In late June 1992, one of TRU's vice presidents, Robert Weinberg, complained to Mattel about finding Air Pro Hockey and two other TRU-promoted products in the clubs. (Weinberg 34:7690/20 - 7691/23, 7701/10 - 7702/3; [].) To protect its image for low prices and avoid being embarrassed with its customers, TRU marked down the prices on these products [] to meet the club prices in areas where the club stores competed with TRU stores. (Weinberg 34:7696/13 - 7698/10, 7701/10-19, 7703/20 - 7705/6; [].) TRU put a hold on payment to Mattel for these products in order "to send a message" to Mattel. (Weinberg 34:7692/11 - 16, 7699/13 - 22.) []

148. At a meeting on July 17, 1992, of TRU CEO Charles Lazarus and Mattel CEO John Amerman (CX-1772), []

149. [] I find that TRU relaying Hasbro's complaints about Mattel to Mattel, as well as Mattel's complaints about Hasbro to Hasbro, informed each manufacturer that the other one was willing to go along with TRU's club policy if its chief competitor stopped selling regular line products to the clubs and that this behavior by TRU facilitated horizontal understandings among the toy manufacturers.

150. On July 24, 1992, the president of Mattel's boys' division, David Mauer [] wrote a memo to Mattel's CEO. (CX-626.) The memo states: "Our company policy is to ship only specials to the clubs. As a general rule, the specials will not include what is likely to be hot/allocated first year merchandise. I recommend, however, that if we are in doubt about whether a special falls within the guidelines that we expose it to TRU, rather than assume it shouldn't be shipped." (CX-626-A.)

151. Mauer's memo states that the "'specials only policy' will be implemented immediately Our new policy will result in some volume loss to Mattel for the balance of the year,"⁶ and that an upcoming meeting was scheduled on August 10, 1992 between Mattel and TRU for TRU "to review the specific product that will be shipped to the clubs for the balance of the year." Mauer suggested that Mattel should ascertain what its competition was shipping to the clubs so that the matter could be raised with TRU and that the 'specials only policy' should be conveyed to the clubs at Mattel's pre-Toy Fair meeting in La Jolla, California. (CX-626.)

152. []

153. Also on August 10, 1992, TRU's Goddu sent to his CEO confidential internal Hasbro reports listing various Mattel regular line products that Hasbro found in the clubs and relating assurances by Mattel's Amerman to one of the clubs' toy buyers that Mattel would ship the club the regular line items it had ordered. (CX-1633.) On August 12th, Goddu talked to a Hasbro division president about a conversation he had with Mattel executives, including Amerman, concerning the warehouse clubs. (CX-1612.)

⁶ Mattel reported that "in 1992, Price Costco was booked in excess of \$13,000.0 million [sic] prior to Mattel's decision to sell only customized products" to the clubs, but only sold \$5.7 million. (CX-590.) This confirms both the implementation of a specials only policy in 1992, and the effect on sales to the clubs.

154. Goddu testified about ongoing conversations he had with both Mattel and Hasbro (as well as other vendors), in which he assured each that the other was selling to warehouse clubs "only because my competitor is there." (Goddu IH (CX-1658) at 276/17 - 277/25): []

155. Pace's buyer testified that around August 10th "all of our orders for Mattel dried up." (Halverson 3:414/14-20.) Mattel toys due at Pace in the beginning of August did not arrive and Mattel representatives said the goods were not available and could not be shipped. (Halverson 3:414/21 - 415/9.)

156. On July 7, 1992, Mattel informed Costco that deliveries scheduled later in July would be on time. (CX-1372-A; Moen 4:619/10-25.) When the orders were not received by August 10th or 11th, Costco's toy buyer, Michelle Moen, called Mattel's sales representative who told Moen there were some product availability issues. (CX-1372-A; Moen 4:620/1-16.)

157. At Mattel's pre-Toy Fair in La Jolla, California held on August 24, 1992, Mattel told Moen and Costco's merchandise manager, Gary Ojendyk, that except for a few items, the unshipped orders from Mattel would not be delivered because the product was unavailable. (CX-1375-A; Ojendyk 18:3989/1 - 3990/11.) These orders were for the bulk of the toys Costco ordered for the 1992 Christmas season. (CX-1375-A; Moen 4:623/19 - 624/2; Ojendyk 18:3990/1-11.)

158. Mattel tried to sell Costco products from its international line, but Costco declined these items as higher priced than the domestic products Costco already had ordered. (CX-1375-A; Moen 4:622/18 - 623/7; Fuentesvilla 18:4117/2-24; CX-626-A.) When Costco asked if it could purchase other items from Mattel's domestic line, Mattel's Okun said everything in their domestic line was in short supply and nothing was available. [] CX-1375-A; Moen 4:623/8-18; Ojendyk 18:3991/5-13, 3992/17-24.) Mattel had over 1000 regular line products in 1992, and they were not all in short supply (Barad 35:7907/25 - 7908/5; []

159. Mattel salesman Nick Snider, who attended the 1992 pre-Toy Fair meeting, called Ojendyk to apologize and told him that what Okun told Costco about product unavailability was untruthful. (Ojendyk 18:3996/5 - 3997/12; CX-1677.)

160. Mattel also told BJ's at the 1992 pre-Toy Fair that there was a shortage or every item that BJ's had ordered but had not yet received. (Hilson 20:4440/25 - 4442/4, 4443/1-8.) BJ's had placed its orders for the fall season in the spring and Mattel confirmed the orders. (CX-1330-A; Hilson 20:4443/21 - 4444/3.) But Mattel now said that BJ's would only be sold products that were reconfigured, bundle-packed or made special for the club channel of distribution. (Hilson 20:4441/21 - 4442/4.) When BJ's toy buyer, James Hilson, asked why there was a change in Mattel's policy, Mattel vice president Ramon Fuentevilla said that Mattel's senior management was being either coerced or influenced by TRU. (Hilson 20:4453/3 - 4454/1.)

161. Following the August 1992 pre-Toy Fair, Costco, BJ's and Pace sent letters to Mattel complaining about the claimed shortages and threatening litigation if the products were not supplied. (CX-1688 (Pace); CX-1330 (BJ's); CX-748 (Costco).) Mattel then notified the companies that it would supply most of the products that Mattel previously said were unavailable to the clubs. (Hilson 20:4440/25 - 4441/20; Moen 4:628/2-18; Halverson 3:419/8-22.)

162. Following the 1992 pre-Toy Fair, Mattel created a task force to study how it should deal with the clubs. (CX-553-B; Amerman 17:3693/6-13.) In its memo setting up the task force, Mattel stated that its "marketing independence was compromised in 1992 by uninvited communications from Toys "R" Us." (CX-553-A.)

163. In late December 1992, Mattel's general counsel promulgated the formal club policy recommended by the task force that Mattel will not sell the same SKUs to the clubs as it sells to traditional retail channels and will only offer differentiated product to the clubs. ([] CX-688; []) Mattel has followed this policy ever since. ([] ; Barad 35:7917/22 - 7918/16.) []

164. I find that Mattel's policy was not arrived at unilaterally, but through TRU's orchestration, with other manufacturers, including Hasbro. I also find that Mattel and TRU agreed that Mattel would submit to TRU for approval a product Mattel intended to sell to the clubs.

165. Mattel's change of policy in selling to the clubs retarded the growth of the clubs' sales of Mattel product. Mattel's sales of regular line product to the clubs dropped from \$17 million in 1991 to zero in

1993, and its sales of customized product to the clubs only increased from \$6.7 million to \$7.5 million in the same time. (CX-574.) Costco's sales of all Mattel products (both by Mattel Toys and by divisions owned by Mattel) dropped by more than half during this period (CX-1745-Z-11), even though the number of Costco stores increased (including Price Clubs) by over 40% (CX-1745-Z-10) and Costco's overall sales growth was over 25%. (CX-1745-Z-9.)

166. Based on the evidence discussed above and elsewhere in these findings, I find that Mattel, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to clubs.

2. Hasbro

167. Hasbro, Inc. ("Hasbro") is the second largest U.S. toy manufacturer with worldwide sales of \$3 billion. (Verrecchia 7:1316/16-17.) It has a 12-14% share of the traditional toy market in the United States. (Verrecchia 7:1317/5-13.) Forty percent of Hasbro's business is done outside the United States. (Verrecchia 7:1316/20-22.)

168. Hasbro's products include 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, [], 1336/13; Halverson 3:527/17-19.)⁷ Hasbro's domestic operations include its Hasbro Toy Group (Playskool Toy, Hasbro Toy, Playskool Baby, Kid Dimension, and Kenner divisions), and its game group, (Milton Bradley and Parker Brothers). (Verrecchia 7:1315/19 - 1316/13.)

169. TRU is Hasbro's largest customer. (Owen 6:1102/13-14.) Currently, TRU buys 30% of Hasbro's toy and game sales in the United States. (Owen 6:1102/5-17.) []

170. In 1991, Hasbro's Playskool division viewed the clubs as having growth potential that it wanted to exploit. (Owen 6:1105/4-7.) []

171. In the fall of 1990, TRU's CEO, Charles Lazarus, met with Hasbro's executives and told them that the clubs were a threat to TRU because of their low prices. (Spencer 9:1848/4 - 1849/22.) He said that if Hasbro continued to aggressively supply the clubs, especially Pace, that this could affect their business at TRU, although he was

⁷ []

open to the sale of multi-packs to the clubs. (Spencer 9:1850/3 - 1851/11.)

172. Playskool's president responded that his company could not stop doing business with the clubs, and that in view of the consolidation in the retail trade it was important for Playskool to have other customers than TRU. (Spencer 9:1850/23 - 1851/4.) []

173. When national toy chains Lionel Leisure and Child World went out of business in the early 1990s, TRU was the only national free standing toy chain left. (Owen 6:1158/9-23.) The demise of these toy chains made TRU more important to Hasbro. (Owen 6:1158/24 - 1159/2.)

174. If TRU stopped purchasing toys found in the clubs, there would not be enough other outlets to make up the volume. (Owen 6:1151/3-10.) TRU's support in promoting a new product is necessary for success. (Owen 6:1154/6-9.)

175. Between late 1991 and 1992, TRU's vice president, Roger Goddu, complained to Playskool's CEO, Dan Owen, that a Playskool product was in the clubs. (Owen 6:1106/5 - 1107/25.) Goddu told Owen that TRU would not carry products Hasbro sold to the clubs. (Owen 6:1108/1-5.)

176. Owen wrote a memo on January 24, 1992 to Hasbro's CEO Verrecchia stating the clubs are one of the fastest growing segments of the entire retail business, and that Playskool's cost of doing business with the clubs is lower than average and much lower than for TRU. (CX-78.) He stated that "it is very important that we achieve some major concessions if we are to dramatically change the way we approach the Warehouse Clubs [sic]." (CX-78.)

177. Just before or at Toy Fair 1992, Hasbro's then western regional sales manager, James Inano, met with Verrecchia. (Inano 16:3333/12-3334/2.) Verrecchia said that he had just come from a meeting with TRU, that TRU had met with Hasbro's competitors, including Mattel and Fisher-Price, and that they had agreed not to sell promoted products to the clubs. (Inano 16:3334/21 - 3335/5, 3343/17-22.) Verrecchia said that because Hasbro's competitors had agreed not to sell promoted product, Hasbro would go along with the agreement, that Verrecchia did not expect them to stick to this course for long, and that when someone else sold promoted product to the clubs, "the door would be open for us." (Inano 16:3335/15-20.)

178. Verrecchia had complained to TRU that it was selling knock-offs of Hasbro merchandise and "that was one of the things he hoped

to gain in return." (Inano 16:3335/21 - 3337/6.) Verrecchia told his staff that Hasbro would not sell promoted products to the clubs and that Hasbro would watch other manufacturers' sales to the clubs. (Inano 16:3338/15-21.) Hasbro would refrain from selling to the clubs until another manufacturer broke the agreement. (Inano 16:3335/15-20.)

179. Inano's testimony about the agreement of major toy manufacturers not to sell promoted products to the clubs is corroborated. Verrecchia testified that TRU told him that the other major manufacturers would go along with its policy, which Verrecchia took to mean Mattel, Fisher-Price, Little Tikes, Tyco, and maybe Lego. (Verrecchia 7:1393/5-14, 1393/23-25, 1394/2-4.) Owen understood from his discussions with Goddu that Mattel, Fisher-Price, Tyco and Little Tikes would not be selling promoted individual in-line merchandise to the clubs. (Owen 6:1132/6 - 1134/17.)

180. The effort by Hasbro to seek concessions from TRU, including knock offs, is corroborated in a Hasbro document (CX-78) [] The reference to Verrecchia wanting to monitor what was happening with respect to the other manufacturers' sales to the clubs is also corroborated. (CX-180.)

181. Inano's testimony is further corroborated by notes showing that Inano told Pace's Scott Halverson in December of 1992 (which is closer to the time of the event) that he obtained information from his company that Mattel's Amerman agreed that Mattel could no longer sell products to the clubs and that Mattel would end up selling specially configured products to the clubs. (CX-1630-A-B; Halverson 3:428/17 - 430/4.)

182. Inano's bonuses were based on his sales to the clubs. (Inano, 16:3544/22-3545/6.) Acting without Hasbro's knowledge or authority, and perhaps showing more affiliation with stockholders than his superiors, Inano tried to help the clubs by talking to the clubs and their lawyers about possible litigation. (Inano 16:3454/10 - 3462/21, 3468/14-25.) Nevertheless, Inano's testimony is corroborated by other evidence, and I rely on it.

183. TRU asked Hasbro for a response to TRU's "policy." (Goddu IH (CX-1657) at 130/20-25). TRU informed Hasbro that its competitors had agreed not to sell promoted product to the clubs. Hasbro went along.

184. During 1992 and 1993, Hasbro's Owen spoke to TRU and described his company's evolving policies relating to not selling to the clubs some of the hottest toys. (Owen 6:1114/21 - 1115/5, 6:1117/6-9.)

185. When contacted by TRU about Hasbro products found in the clubs, Hasbro explained to TRU that its Puppy Surprise product was shipped early and that Hasbro did not plan to ship any more to the clubs. (Butler 25:5535/24 - 5535/18; CX-913-B.) TRU Vice President Butler confirmed that "[T]his was during the [1992] period...when they [Hasbro] had told us that they weren't going to ship key product to the warehouse clubs." (Butler 25:5535/5-9.)

186. In regard to a TRU inquiry to Hasbro's Playskool baby division about Hasbro product found in the clubs, TRU noted "[w]e have reached a corporate agreement on the sale of this item to the club stores." (CX-913-F.) Playskool was under the impression that less important items could be sold to the clubs." (CX-913-C.)

187. Hasbro wanted to ensure that TRU's policy on sales to the clubs was being applied to its competitors so that Hasbro would not be discriminated against. (Verrecchia 7:1385/7-25, 1376/16 - 1377/12.) TRU assured Hasbro that it was talking to the major manufacturers about the clubs [], Owen 6:1128/5 - 1131/2.)

188. Hasbro did not want to be placed at a competitive disadvantage by losing club sales volume to its competitors if it complied with TRU's policy and its competitors did not. It wanted a level playing field. (Owen 6:1130/24 - 1131/18.) []

189. In May of 1992, at a toy manufacturers conference, Hasbro's CEO Allan Hassenfeld discussed with Tyco's CEO Richard Grey what each company was doing or not doing with respect to the clubs. (Grey 14:3011/12 - 3012/24.) Tyco's CEO discussed its 25-item policy with Hassenfeld. (Grey 14:3012/25 - 3013/4.)

190. Following Toy Fair 1992, Hasbro monitored its competitors' products in the clubs. (Verrecchia 7:1366/6 - 1367/7; CX-309; CX-47 - CX-50.) Verrecchia directed his staff to be "very aggressive" in determining whether Mattel and other competitors were selling to the clubs. (CX-180; []; CX-363.)

191. Hasbro complained to TRU when it discovered product from competitors like Mattel, Fisher-Price, Nintendo, Little Tikes, and Tyco that should not have been in the clubs. (Verrecchia 7:1374/13 - 1376/20; CX-336.) [] Fisher-Price complained TRU that the clubs were selling Playskool's products. (Weinberg 34:7628/15 - 7629/1.)

And Mattel, through John Amerman or Jill Barad, complained to TRU that Hasbro's products were in the clubs. []

192. []

193. TRU's CEO admitted that he sent competitors' complaints about each other to the respective competitors. (Lazarus 24:5452/12-18.) He admitted that he could have sent to Mattel Hasbro's complaints about Mattel's product being shipped to the clubs. (Lazarus 24:5451/14 - 5452/7.) []

194. At a meeting on July 17, 1992 (CX-1772) between TRU's Charles Lazarus and Mattel's John Amerman [] Later on the same day, Lazarus met with Hasbro's CEO, Allan Hassenfeld. (CX-1772; CX-1773-B; Lazarus 24:5448/13-16; CX-1174.)

195. Following the July 17th meeting with Hasbro, TRU received confidential internal Hasbro memos dated from June 30 to July 31, 1992, which reported information about Mattel's sales to the clubs as well as those of other Hasbro competitors. (CX-1633.) On August 10th, Goddu sent this information to TRU's CEO, []

196. In an August 13, 1992 memo, the president of Hasbro's Milton Bradley division referred to a conversation he had with Goddu the day before concerning a discussion Goddu had with Mattel's CEO about the clubs. (CX-1612.) Around this time, Pace's and Costco's scheduled shipments from Mattel stopped because of alleged availability problems. (Halverson 3:414/4 - 415/9 (shipments "dried up"); Moen 4:619/10 - 621/22.)

197. TRU complained to Hasbro during 1992 about Hasbro products found in the clubs, most often through high level officials, Mike Goldstein or Roger Goddu. (Verrecchia 7:1353/6-17, 1363/13-24.) If the products sold violated Hasbro's policy, Hasbro would ensure that the sales to the clubs would not be repeated. (Verrecchia 7:1364/10-15.)

198. Playskool's former president, Dan Owen, was pressured by TRU and Goddu in 1992, concerning Hasbro's dealing with the clubs. (Owen 6:1145/17 - 1146/14, 1148/12-16.) Hasbro worried that TRU could retaliate against it in subtle ways, involving end caps, shelf space and advertising. (Owen 6:1109/1-14; Verrecchia 7:1407/10 - 1408/15.) But for TRU's pressure in 1992, Playskool would have sold more or different toys to the clubs. (Owen 6:1147/8-11.) Verrecchia acknowledged that Hasbro might have sold more toys to the clubs were it not for TRU's position. (Verrecchia 7:1414/5-12.)

199. Owen's statements about unwanted pressure from TRU were confirmed by other statements from Hasbro representatives. Jeff Berman of Hasbro told Pace's Halverson that "Geoffrey" [the TRU giraffe symbol] was "putting the screws to them." (Halverson 3:391/18-22.) Jim Inano also told Pace about TRU pressure and said the source of his information was Hasbro's CEO, Al Verrecchia. (Halverson 3:388/25 - 389/12.) Inano also made statements to Costco about TRU pressure. (Moen 4:769/12-19.)

200. In August of 1992, Goddu told then Playskool sales vice president, George Miller, that if Playskool continued to ship to the clubs, TRU would continue to purchase Playskool's TV-promoted product, but "wouldn't still buy [Playskool's] basic product." (Inano 16:3376/13-20, 3377/7-9, 3378/2-10.)

201. In 1992, when TRU found Hasbro selling its toys to Price Club, TRU called Playskool's then Vice President George Miller to its offices, and "took him to the shed." (Chase 8:1673/17-23.) Miller said "I never in my life want to go through that again." (Chase 8:1673/23-24.)

202. This occurred when Fisher-Price complained to TRU that Hasbro toys were in the clubs. (Chase 8:1666/4 - 1667/1.) TRU told Fisher-Price that "TRU was going to take care of it." (Chase 8:1666/18 - 1667/1; Verrecchia 7:1353/6-17, 1363/13-24.)

203. In 1992, Playskool promulgated a list of products captioned as "Verboten" to its sales staff that could not be sold to the clubs without receiving specific authorization. (CX-127; CX-130; []

204. Some of Hasbro's claims that production shortages accounted for the clubs not getting product are specious. Inano told Costco that toys were available but that he was forbidden to sell them to Costco. (Ojendyk 18:4016/8-21.) A Hasbro memo states: "As discussed, we have no other planned business for the other warehouse clubs listed. We steered away from our regular items...due to 'capacity issues.'" (CX-132 quotes in original.)

205. Hasbro was willing to sell 15,000 One-Two-Three bikes to Costco in 1991, but only 2,000 of the bikes in 1992 when the line was no longer a new item. (Moen 4:665/18 - 668/11.)

206. In July 1992, Joseph Antonini (CEO of Pace's parent corporation, Kmart) complained to Hasbro's CEO: "Playskool has cut Pace's allocation over 75% from what was ordered and what PACE was told it would receive; and future orders are 'in doubt.'" (CX-364; CX-182.)

207. In 1992, Hasbro told Costco an item would be shipped, but it was not delivered. (Moen 4:668/24 - 669/7.) From August to September of 1992, there were erratic shipping patterns. (Moen 4:669/8-13.) Hasbro kept changing its mind whether it was going to cancel orders. (Moen 4:668/24 - 669/13, 670/22 - 671/5.) Inano informed Costco that his company was thinking about canceling orders as Mattel had done. (Moen 4:670/22 - 671/16.)

208. In 1992, Pace canceled \$1.8 million orders with Hasbro because Hasbro was "very ambiguous" and could not give Pace confirmation of delivery information on when products were going to be shipped or if they ever were going to be shipped. (Halverson 3:372/1-11, 443/22 - 444/13; CX-1633.)

209. TRU's complaints to Hasbro about product found in the clubs increased in the 1992 Christmas selling season. ([] Owen 6:1143/2 - 1144/23.)

210. Hasbro's policy of selling to the clubs evolved by Toy Fair 1993 into its present policy of only selling differentiated products to the clubs. (Owen 6:1112/13-15, 1144/20 - 1145/14; Inano 16:3428/1-4.)

211. Before Hasbro's 1993 policy became final, Hasbro told its plans to Goddu. Goddu gave his assent. (Owen 6:1136/20 - 1141/14.)

212. [] In Costco's FY 1992, Hasbro and its subsidiaries products accounted for 14.1% of Costco's sales. By Costco's FY 1996, they accounted for 2.6% of Costco's sales. (CX-1745/11.)

213. In June of 1994, Hasbro issued a written statement of only selling differentiated product to the clubs. (CX-243.) This document is dated after Hasbro received the Commission's February 7, 1994 letter requesting documents.

214. Hasbro also sent a letter to Costco in March 1994 indicating Hasbro's willingness to sell the clubs individual toys if Costco was willing to change the way it does business and promote and support Hasbro's product line to the extent of other retailers. (RX-373.)

215. Hasbro, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to the clubs.

3. Fisher-Price

216. During the early 1990's, Fisher-Price was the third largest toy manufacturer in the U.S. (Cohen 35:7926/9-17.) In 1993, Fisher-Price merged with Mattel. (Cohen 35:7926/7-8.) Fisher-Price makes

products for infants and juveniles, including pre-school toys, outdoor environmental play products and Power Wheels (battery-operated ride-ons). (Cohen 35:7928/5-12.) TRU has been Fisher-Price's largest customer since 1992, currently with 35% of its business. (Cohen 35:7926/18 - 7927/4.)

217. Fisher-Price considered the clubs to be a growth business and told its sales force to aggressively pursue club sales. (Chase 8:1646/23 - 1747/3.) [] Fisher-Price's regular line was sold to the clubs without restriction in the late 1980's. (Chase 8:1645/5-18.)

218. At a 1989 Toy Fair meeting with Fisher-Price, TRU's CEO stated that it would have to consider whether it would carry the same products being sold in clubs located near TRU's stores. (Cohen 35:7937/7-24, 7938/6-13.) In 1990 or 1991, TRU stated its policy to Fisher-Price and asked how it was going to deal with the clubs. (Cohen 35:7792/10-19; Weinberg 34:7732/8 - 7733/19; Weinberg IH (CX-1662) at 97/1-5.) [] TRU's approval of manufacturers selling special packs to the clubs was because they "avoid the customer being able to make a direct pricing comparison" between items sold by the clubs and TRU. (Goddu 30:6635/13-24.)

219. In 1990, Fisher-Price's sales staff received a list of items -- mostly new, hot or allocated product -- that they could not sell to clubs. (Chase 8:1652/14-19.) []

220. In 1990, Fisher-Price still allowed some restricted items to be sold to the clubs. (Chase 8:1652/23 - 1653/7.) Fisher-Price was still selling a broad line of opening stock items to BJ's in 1991. (Cohen 35:7942/3-9, 8005/4-18.) []

221. In 1991, Price Club's toy buyer asked Fisher-Price what he had to do to get product other than combo packs. (Chase 8:1655/10-18.) He was willing to consider buying more SKUs, taking delivery earlier, and warehousing products. (Chase 8:1655/10-25.) When Fisher-Price salesman John Chase asked Fisher-Price's regional sales manager Ken Walters how he should respond, he was told "don't tell them you can't sell because Toys 'R' Us is pressuring, just make up a reason, tell them anything, but don't tell them you can't sell them because we're not allowed to because Toys 'R' Us. [sic]." (Chase 8:1657/1-7.)

222. In September 1991, Fisher-Price's regional manager sent Chase a copy of a TRU shopping report showing products of Hasbro, Fisher-Price and Playskool found in Price Club. (Chase 8:1660/16 - 1661/5.) He told Chase that a TRU executive had sent the report to

Byron Davis, Fisher-Price's vice president for sales. (Chase 8:1660/16 - 1661/5.) The words "Byron, you promised this wouldn't happen" were written on the report. (Chase 8:1661/4-5.) After this event, Fisher-Price limited its club sales to special and combination packs. (Chase 8:1661/6-8.)

223. At Toy Fair 1992, TRU informed Hasbro that Fisher-Price and Mattel had agreed not to sell promoted product to the clubs. (Inano 16:3334/21 - 3335/5.) TRU's Goddu told Hasbro officials that Fisher-Price and other manufacturers would not be selling in-line promoted products to the clubs. (Owens 6:1132/6 - 1134/17; Verrecchia 7:1393/5 - 1394/4.)

224. Fisher-Price's meeting notes of Toy Fair 1992 state that Pace's Scott Halverson asked Fisher-Price what it would take to do business with Fisher-Price in 1992. (CX-684-A; Cohen 35:8011/9 - 8012/1.) The notes state that "[w]e were deliberately vague on our answer" and that "[w]e denied they [TRU] were the cause, but we weren't to [sic] convincing." (CX-684-A.) The notes point out that after Toy Fair 1992, Hasbro's Kenner and Playskool representatives told Fisher-Price that their company was "adamant that they would not be shipping key SKUs [sic] to the Clubs, at least not yet." (CX-684-B; Cohen 35:8015/3-23.)

225. In June of 1992, TRU contacted Fisher-Price about its nursery monitor that was found in Price Club. Fisher-Price "agreed to stop selling this item to the clubs." (CX 913-E.)

226. In November 1992, Fisher-Price's Byron Davis and John Chase were at a Price Club and saw a TV-promoted Playskool product in the club. (Chase 8:1666/4-13.) Davis told Chase he would call TRU to see if "they'll take care of it." (Chase 8:1666/14-16.) Davis then made a telephone call to TRU and later told Chase that Playskool was not "going to get away with it, that Toys 'R' Us is going to take care of it." (Chase 8:1666/18 - 1667/1.)

227. [] TRU's vice president Weinberg said that Fisher-Price complained to him about Playskool products that Fisher-Price found in the clubs. (Weinberg 34:7628/15 - 34:7629/1.) []

228. At Toy Fair 1993, Fisher-Price offered the clubs combo packs and special packs. (Chase 8:1678/3-5.) Fisher-Price added extra dishes to a toy kitchen to create a combo pack. (Chase 8:1678/9-12.) When Fisher-Price executives walked through the display, they noticed the kitchen. (Chase 8:1678/16-17.) They took the person who

was in charge of developing the item, Jamie Leder, into a back room. (Chase 8:1678/17-18.) When he came out ten minutes later, "he was white." (Chase 8:1678/19.) Chase's regional manager told Chase about a half hour later that Leder was almost fired over the incident, because the kitchen was a "sensitive item" for TRU. (Chase 8:1678/20-23.) The item was pulled from display to the clubs. (Chase 8:1678/24-25, 1680/5-6.)

229. []

230. A Fisher-Price study prepared for its 1993 annual meeting, stated the opportunity for toy growth at the clubs was "phenomenal." (CX-698-D; Cohen 35:7958/22 - 7959/4.) It refers to TRU "demanding" that the club products be differentiated from the products it carries. (CX-698-C; CX-699-A.)

231. Fisher-Price never imposed the restrictions it imposed on the clubs on any other channel of distribution. (Chase 8:1691/16-20.)

[]

232. Fisher-Price, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to the clubs.

4. Tyco Toys

233. During the 1990's, Tyco Toys was the third-largest traditional toy manufacturer in the United States, with worldwide sales of about \$750 million in 1995. (Grey 14:2986/16-18.) Tyco makes radio-controlled toys, die-cast Matchbox cars, a drawing toy called Magna-Doodle, electric racing sets, boys toys, dolls and girls toys, games, science sets, and preschool toys. (Grey 14:2986/5-9.) During the trial in this case, Tyco was acquired by Mattel, Inc. (Grey 14:2985/16-22; RX-819; Barad 35:7912/10-15.)

234. During the 1990's, TRU was the largest customer of Tyco, buying between 30 and 41.4% of Tyco's domestic United States sales from 1990 to 1994; this was two to three times the next largest customer. (CX-1272-B; Grey 14:2986/22-2989/13.)

235. Tyco began to sell toys to the warehouse clubs in the 1980's. (Gray 14:2993/13-19; CX-1420, CX-1424, CX-1263, CX-1264.) Richard Grey (Tyco's CEO between 1981 and 1995), testified that Tyco sold the warehouse clubs primarily regular-line products, although Tyco sometimes would make up a special package. (Grey 14:2993/20-2994/9.)

236. [] "At some point we asked Tyco, as we did other vendors, you know, what is your merchandising philosophy. And I believe Dick Grey said, We'll get back to you." (Goddu 30:6677/6-8.)

237. At a 1992 Toy Fair luncheon, TRU again discussed the clubs with Tyco, with Lazarus telling Tyco that it and other toy manufacturers were making a mistake selling regular line merchandise to the clubs. (Grey 14:2996/9-17, 2996/22 - 2997/9.)

238. []

239. []

240. The policy adopted by Tyco in 1992, required customers wishing to purchase products from Tyco's regular line to submit a \$20,000 minimum purchase order and order a minimum of 25 Tyco items. The policy required that the smallest quantity of any item ordered must be at least 20% of the unit count of the highest quantity ordered. The policy made exceptions for categories of customers (other than warehouse clubs) that did not typically purchase as many as 25 separate Tyco products. (CX-1418; Grey 14:3006/18 - 3009/1.)

241. The Tyco 25-item policy plainly was directed to the warehouse clubs. (CX-1418.) Prior to 1992 the warehouse clubs had not commonly purchased as many as 25 Tyco items (Grey 14:3002/12-14) and in discussing the proposed policy prior to its adoption Tyco executives "recognized that we might lose some or all of our warehouse club business." (Grey 14:3001/1-2.) The policy excepted other categories of Tyco customers who did not purchase 25 regular line items: specialty retailers, electronics customers, Disney stores and other sellers of licensed products, and customers who bought Tyco products for use as promotional premiums. (CX-1418 at ¶ 3; Grey 14:3008/9 - 3009/1, 3002/15 - 3006/3.) In effect, the policy applied only to the warehouse clubs. (Grey 14:3009/2 - 3010/15.)

242. TRU executives considered the policy adopted by Tyco a "unique" response. (Lazarus 24:5388/11-14; Goddu 30:6678/8-24, 6681/15-18.) []

243. TRU contacted Tyco after a competition shop in the spring of 1992 found several Tyco products for sale in the clubs; TRU's Goddu reported to Lazarus by memo that the products were "goods shipped last year prior to their new 'no ship' policy on current goods we [TRU] carry." (CX-913-D.) TRU's Robert Weinberg spoke with the Tyco salesman and testified that the reference to a "no ship" policy was language used by the Tyco salesman Ken Shumaker

referring to the 25-item policy. (Weinberg 34:7716/2-5.) Tyco's Grey confirmed that Tyco had a "no-ship policy" -- the 25-item policy adopted in February 1992. (Grey 14:3047/2-11.)

244. In the summer of 1992 Goddu sent to senior TRU executives internal Hasbro correspondence which characterized the Tyco policy as a "tough program . . . impossible to qualify for the SKU-conscious club." (CX-1633-D.) After learning that BJ's had placed an order for 25 Tyco products, TRU obtained from Tyco details of the items and quantities ordered and shipped, which Goddu reported by memo to senior TRU executives in September 1992. (CX-808.) Tyco provided this information to TRU without BJ's knowledge. (Hilson 20:4505/5-4507/13).

245. In May of 1992 at an industry conference Tyco's CEO Grey and Hasbro's CEO Al Hassenfeld discussed their respective companies approaches to warehouse club sales. (Grey 14:3011/12-22). Grey told Hassenfeld about Tyco's 25-item policy, and Hassenfeld told Grey there were three different approaches at the time by the three Hasbro divisions. (Grey 14:3011/22 - 3013/4.)

246. Hasbro's Jim Inano, then western regional manager of sales, testified that at a trade show in California in April or May 1992, Tyco's regional sales vice-president Joel Tasman told him that the manufacturers problems in selling to the clubs began when the head of Mattel returned from a visit to TRU saying that Mattel would no longer be selling promoted products to the clubs. (Inano 16:3345/2 - 3347/4.)

247. After Toy Fair in 1992, Price Club placed an order meeting the 25-item minimum (Grey 14:3013/12 - 3015/17); Price Club met the minimum quantity requirement by buying the products for its clubs in various areas. (CX-1633-D.)

248. BJ's placed an order for 25 Tyco items, with large quantities of some items but small quantities of others; because the order failed to comply with the minimum quantities required under the Tyco policy, BJ's was shipped some combination pack products but not the regular line Tyco products it ordered. (Hilson 40:4478/1 - 4479/9, 4506/5 - 4507/6.) Pace considered a strategy similar to the one attempted by BJ's but decided not to place an order after being told that Tyco would not ship an order that did not comply with the policy. (Halverson 3:368/1 - 369/12.)

249. Costco also decided not to place an order under the 25-item policy in 1992 because Costco believed that the minimum quantity

requirements of the policy made it impractical to place an order for as many as 25 items. (Ojendyk 18:4009/22 - 4011/5; Moen 4:646/4-648/23.) Costco's toy buyer Michelle Moen asked Tyco how the mass discounters were able to satisfy the minimum quantity requirements of the Tyco policy. Tyco salesperson Julie Edwards told her that exceptions were made to those requirements for companies like Kmart, Target and TRU. (Moen 4:648/3-20.)

250. In 1992 after its adoption of the 25-item policy Tyco did "considerably less business" with the warehouse clubs than the \$5 to 8 million it had been doing in prior years. (Grey 14:3016/11 - 3017/2; CX-1432 Z-7-Z-19.)⁸ Tyco developed for 1993 a line of specially configured products which were offered to the warehouse clubs without regard to the 25-item minimum. (Grey 14:3017/3-3018/3, 3067/16-21.) The warehouse club line was printed on a blue price list and consisted of combination packs and other products packaged specially for the warehouse clubs that were different from Tyco's regular line merchandise. (Grey 14:3017/3 - 3018/3; CX-1269.)

251. Costco's toy buyer Moen testified that in late 1992 or early 1993 Tyco's salesperson Edwards told her that TRU put pressure on Tyco to sell combination packs to the warehouse clubs because other major toy companies were doing so; when Tyco went along, this fact was used by TRU to persuade other companies to go along. The three companies mentioned by Edwards were Tyco, Mattel and Hasbro. (Moen 4:651/17 - 652/9.)

252. Tyco continues to have the 25-item policy for regular line products, and a line of differentiated warehouse club products. (Grey 14:3020/22 - 3021/1, 3057/21 - 3058/24; CX-1405.) In effect this policy is similar to that of other major manufacturers who permit warehouse clubs to purchase only differentiated products. (CX-1412-B; Grey 14:3027/22 - 3029/12.) After 1992, no club bought regular line merchandise under the 25-item policy. (Grey 14:3021/13-23.)

253. TRU contacted Tyco's Playtime division to enforce the TRU warehouse club policy. Playtime, a division of Tyco operated separately from the principal domestic toy division of Tyco, had a separate sales staff and sold toys on a letter-of-credit basis to domestic United States customers. (Grey 14:2989/14 - 2991/1.)

⁸ In September 1992 Tyco told TRU that its sales to the clubs the prior year were \$11 million and estimated that its sales in 1992 would be \$2 million or less. (CX-808-B; [])

254. In its warehouse club competition shop in April 1992, TRU discovered a Playtime product, Super Saturator, for sale in warehouse clubs. (CX-193-D.) TRU's Robert Weinberg, a divisional merchandise manager reporting to Roger Goddu, contacted Playtime's senior vice-president for sales Howard Abrams about the product, which was heavily promoted. (Weinberg IH (CX-1662) at 149/19 - 150/7; Weinberg 34:7677/14 - 7678/5; CX-1414-B.) Playtime's Abrams told Weinberg that, other than for some prior commitments, Playtime would sell the warehouse clubs only "special" items or items that TRU didn't carry. (CX-913-D; Weinberg 34:7719/7-22.)

255. []

256. [] A confirming letter received by Weinberg from Playtime shortly after the meeting stated that "Playtime will not offer any merchandise to Warehouse Clubs that is bought by Toys R Us. This will make our policy exactly the same as Tyco's." (CX-914-A.)

257. []

258. Playtime informed its warehouse club customers that they could only purchase the reconfigured Thunderstrike product. (Moen 4:655/7 - 659/4; Hilson 20:4481/18; CX-1408-A; CX-1409.) Playtime representatives told Costco buying personnel that the reason was pressure from TRU. (Moen 4:657/5-6, 658/1-3.) After Costco sent an angry letter to Tyco CEO Grey (CX-1270), Grey replied confirming that the product would be sold to Costco only in the "exclusive value-added version" (CX-1412-B); Costco canceled pending orders for \$3.8 million from several Tyco divisions. (CX-1411.) Another separate Tyco subsidiary, Tyco Preschool, reconfigured several of the products to sell to warehouse clubs to comply with a policy "to offer the Clubs customized items only." (CX-1413-A.)

259. In 1993 and later years, Tyco sold to warehouse clubs only differentiated products from the special warehouse club line. (Grey 14:3021/13-23.) By 1995, Tyco's sales to the warehouse clubs were \$8-10 million, all differentiated products. (Grey: 14/3021/24 - 3023/7.)

260. Tyco Toys, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to the clubs.

5. Little Tikes

261. The Little Tikes division of Rubbermaid Corporation makes large plastic outdoor children's toys and other juvenile products.

(Schmitt 11:2275/12-23; DePersia 10:2133/11-18.) [] TRU has been the largest customer of Little Tikes since the mid-1980's (Murdough 27:5862/20-24); in the early 1990's Little Tikes' sales to TRU were two or three times larger than to its next largest customer. (Schmitt 11:2282/7-14.)

262. Little Tikes was founded in 1970 by Thomas Murdough, who sold the company to Rubbermaid in 1984 and continued to manage the business as president and general manager of Little Tikes until leaving the company in 1989. (Murdough 27:5855/16 - 5857/2.) Under Murdough's leadership, Little Tikes focused on full-line dealers to preserve the profit margins of the retailers that distributed its products. (Murdough 27:5862/20 - 5864/7; DePersia 10:2134/21 - 2135/15.) Murdough preferred not to sell to warehouse clubs or other retailers he believed would "football" the products by selling at prices he thought were too low. (Murdough 27:5858/17 - 5859/6, 5861/4-12, 5882/13 - 5884/11; Ojendyk 18:4020/8 - 4021/8 (for a period in the late 1980's Costco carried Little Tikes items).) Murdough's strategy was motivated by the "rotational molding" process used to produce the products, which is more costly and time-consuming than the induction molding process used for other kinds of plastic products, and the bulkiness of the products which make them difficult to ship and display. (Murdough 27:5865/9 - 5867/8, 5859/12-19; DePersia 10:2134/21 - 2135/15.) Little Tikes' limited distribution strategy under Murdough differed from the strategy of the Rubbermaid organization which sought "to have products available wherever consumers wanted to purchase them." (Schmitt 11:2276/12 - 2277/3; CX-483.)

263. Murdough left Little Tikes in 1989, (Murdough 27:5856/25-5857/2, 5867/9 - 5868/21.) In 1991 Murdough founded the Step 2 Corporation, a manufacturer of rotationally-molded plastic products, including toys that compete with those made by Little Tikes. (Murdough 27:5857/12 - 5858/10, 5884/16 - 5885/4.) Step 2 has followed a distribution strategy similar to that which Murdough used at Little Tikes; Step 2 offered no products to the warehouse clubs until 1996 when it began to sell discontinued or low-demand products to the warehouse clubs. (Murdough 27:5868/22 - 5870/6, 5871/17 - 5872/12; DePersia 10:2226/6-16.)

264. Little Tikes made no sales to warehouse clubs early in 1990. (DePersia 10:2136/6-2 137/6; Ojendyk 18:4020/8-4021/8.)

265. By late 1990 or early 1991 Little Tikes began sales to the warehouse clubs, and sold to the clubs from 1991 to 1993. (DePersia 10:2137/2-11, 2138/17 - 2139/6; CX-1533-C-D.) []

266. In late 1992, Wolf Schmitt, Rubbermaid CEO, wrote "For 1993 every one of our business units has tremendous upside potential with [the club]. Are your plans firmly in place to take advantage of those opportunities?" (CX-483 (11/21/92).)

267. After Little Tikes in the fall of 1992 agreed to broaden the range of products it would sell, Costco resumed purchasing from Rubbermaid and by January 1993 placed orders for a number of Little Tikes spring 1993 products. (Ojendyk 18:4025/6-20; CX-1385.) Costco believed that Little Tikes had agreed to make eight of its ten top-selling regular line items available for purchase each season, giving Little Tikes a year-round presence in Costco clubs. (CX-1387-B; Ojendyk 18:4023/12 - 4025/2.) []

268. At Toy Fair in February 1993, TRU's Lazarus, Goddu and Sullivan met to discuss the warehouse clubs with Gary Baughman and Neal DePersia, Little Tikes president and sales vice-president, in the Little Tikes showroom in New York. (DePersia 10:2143/2 - 2144/11, 2145/4-14; Goddu 30:7613/16-25.) TRU had learned through its competition shops that Little Tikes had begun to sell its products to the clubs. (Goddu 30:6713/16 - 6714/20.) Goddu raised the warehouse clubs issue "strongly" because TRU perceived a change in Little Tikes sales activity with the warehouse clubs -- Little Tikes under Murdough had not been selling to the warehouse clubs but had begun to do so after Murdough left. (CX-509; Goddu 30:6713/23 - 6714/15.)

269. At the 1993 Toy Fair meeting TRU's Goddu told the Little Tikes executives TRU's policy that if a manufacturer was going to sell products to warehouse clubs, TRU would possibly not carry them. (DePersia 10:2144/12-22.) In response, the Little Tikes executives asked whether the TRU policy also would be applied to Today's Kids, at the time the only manufacturer of large plastic toys competitive with Little Tikes' whose products were being sold in the warehouse clubs. (DePersia 10:2146/17 - 2146/6; 2148/7-22.) The primary concern of Little Tikes was that this competitor might take away business and market share from Little Tikes. (DePersia 10:2214/23 - 2215/3.) Goddu responded that Today's Kids was not doing a lot of business with the clubs and would be getting out of the

business of selling to the warehouse clubs. (DePersia 10:2147/7-14, 2150/3-12.)

270. Goddu met with Today's Kids concerning the TRU warehouse club policy and he was told about that company's plans to discontinue sales to the warehouse club channel. (Goddu 30:6726/2-11; 6727/8-12; 6730/20 - 6732/2; 30:6738/5 - 6739/25.) []

271. At the Toy Fair meeting and on the telephone with Goddu later in February 1993, Little Tikes' president Baughman told TRU that Little Tikes was only selling discontinued products to the warehouse clubs (which was not accurate), and in the future would only sell discontinued, near-discontinued or "value pack" merchandise to the clubs. (DePersia 10:2145/15 - 2146/9, 2151/13-23; CX-1510.) Baughman assured Goddu that Little Tikes' sales to Costco were a "one shot deal" and that Little Tikes did not plan to sell regular products to Costco in the future. (CX-1510.) Baughman told Goddu that the sales to Costco were made because Costco "threatened to throw Rubbermaid out" and told Goddu that he "may need his help" in dealing with Rubbermaid management. (CX-1510; Goddu 30:6714/21 - 6715/14.)

272. In a meeting at Toy Fair and in February and March 1993, Little Tikes personnel told Costco that Costco would not have access to Little Tikes' regular product line for the fall 1993 season, but would be offered only combination packs. (Ojendyk 18:4028/22 - 4029/25; CX-1387-A; CX-1511; CX-1513.) Costco threatened again to discontinue purchasing products from all Rubbermaid divisions. (Ojendyk 18:4029/20-25; CX-1387-B.)

273. In early April 1993 senior management of TRU and Little Tikes met with Wolf Schmitt, the recently-appointed CEO of Rubbermaid. (DePersia 10:2159/9 - 2160/7; Schmitt 11:2283/24 - 2284/23, 2288/2-7; Goddu 30:6715/15-6716/9.) Before the meeting TRU provided Little Tikes with a competitor shop report showing Little Tikes products for sales in warehouse clubs at prices less than at TRU. (CX-1516-B; DePersia 10:2162/15 - 2164/10.) []

274. At the April 1993 meeting, TRU repeated that it would not carry any products carried by the clubs, asked to be informed what products were being sold by Little Tikes to the clubs, and expressed interest in purchasing value packs prepared by Little Tikes. (CX-1521 (Baughman file memo); CX-1519 (Schmitt handwritten notes);

Schmitt 11:2291/25 - 2292/13; 2297/1 - 18; DePersia 10:2172/7 - 2173/12.) []

275. Little Tikes represented that its future sales strategy for warehouse clubs would be to sell value packs and discontinued and near-discontinued items. (CX-1521; DePersia 10:2170/22 - 2171/12; Schmitt 11:2294/2-14; Goddu 31:6900/8-20; 6916/18 - 6916/6.) There was further discussion focusing on the issue of products for which Little Tikes had unabsorbed production capacity. Schmitt felt that the parties did not find common ground on that "clarification" of the Little Tikes future strategy to sell the warehouse clubs value packs and discontinued and near-discontinued items. (Schmitt 11:2305/22-23, 2296/7-10.)

276. Little Tikes' vice-president of sales DePersia believed that the April 1993 meeting resolved the issue of warehouse clubs in the eyes of Little Tikes and TRU, and that Little Tikes would only be selling discontinued, near-discontinued and value pack merchandise to the warehouse clubs. (DePersia 10:2177/13-22.) Schmitt's contemporaneous notes of the meeting use the words "Agreement" and "Understandings" in referring to the discussion of the warehouse club distribution issues. (CX-1519.) TRU's President Michael Goldstein came away from the meeting understanding that the Rubbermaid/Little Tikes executives did not intend to sell to the clubs. (Goldstein 36:8298/9-20.)

277. In mid-April 1993, about a week after the meeting at TRU headquarters, Little Tikes issued a memo to its sales force listing the only Little Tikes items that were available for sale to warehouse clubs for the fall of 1993; the list was made up of value packs, discontinued and near-discontinued items. (CX-1520; DePersia 10:2176/16 - 2177/4; 2177/23 - 2179/10.) During the balance of 1993, the sales staff of Little Tikes limited the products available to the warehouse clubs to "value packs, discontinued and near-discontinued." (Hilson 20:4494/3-9; CX-1523; DePersia 10:2179/11-2180/13, 10:2180/15-2181/3.)

278. In August 1993, because of the limitations on availability of Little Tikes products, Costco again discontinued its purchases of products from Rubbermaid Corporation. (CX-1524; CX-1522.) This action cost Rubbermaid \$15 to \$20 million in annual sales to Costco. (Schmitt 11:2342/18 - 2343/6.)

279. During 1993 and 1994 Little Tikes tried to resolve the differences with Costco by offering to sell Costco its popular items

which were late in their product life-cycles. (DePersia 10:2183/2-2184/11 (Party Kitchen); Schmitt 11:2340/16 - 2341/9 (Cozy Coupe).) Little Tikes' DePersia believed this approach was consistent with the "value packs, discontinued and near-discontinued" commitment to TRU. (DePersia 10:2184/12 - 2185/11.) These offers were not accepted by Costco and the differences between Little Tikes and Costco continued to be unresolved through early 1994. (RX-225; DePersia 10:2187/24 - 2190/2; CX-1531; Schmitt 11:2346/21 - 2350/17.)

280. In January 1995 TRU's Lazarus contacted Rubbermaid's Schmitt to meet to discuss the warehouse clubs in light of changes in senior management at Little Tikes (Baughman, the president, and DePersia, the vice-president of sales, left Little Tikes in late 1994 and early 1995). (Schmitt 11:2325/10 - 2326/1, 2327/11 - 2328/5.) TRU competition shops showed that Little Tikes had begun to sell products to the clubs that did not conform to the strategy communicated to TRU in 1993. (Goddu 31:6896/9 - 6897/9, 6898/25 - 6901/1; Goddu IH (CX-1657) at 314/5-8, 317/11-18.)

281. At a January 1995 meeting Little Tikes told TRU that none of the products sold to TRU were sold to the clubs. (CX-1535; Schmitt 2338/2 - 2339/13.) TRU's president Goldstein felt that after the 1995 meeting TRU's concerns had been resolved (Goldstein 36:8286/25 - 8287/4.) []

282. []

283. Little Tikes and its parent Rubbermaid, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to the clubs.

6. Today's Kids

284. Today's Kids manufactures plastic toys for children up to nine years old. (Stephens 27:5893/9-10.) Today's Kids is smaller than its principal competitors, Little Tikes, Fisher-Price, and Step 2. (Stephens 27:5893/20 - 5894/1.) []

285. From 1990 to 1993, Today's Kids directed its sales force to try to get as much of the warehouse club business as it could. (Stephens 27:5964/16-19.) []

286. During the early 1990's, Today's Kids sold its regular line products to the clubs without restriction. (Stephens 27:5965/25 - 5966/3, 5896/24 - 5897/1; CX-902.) In 1993, Sam's wholesale club

was Today's Kids' largest customer among the clubs with purchases of [] in regular line product. (Stephens 27:5965/19-21; []

287. In June 1992, TRU's Robert Weinberg complained to Today's Kids about an item that was found in the clubs and told Today's Kids that it needed to "do something to the item or the packaging." (CX-857.) TRU contacted Today's Kids about other products that were found in the clubs. (CX-913-D.) Today's Kid's sales vice president, James Stephens, stated that Today's Kids understood TRU's position, but needed the clubs' business. (CX-913-D.) Stephens told TRU that Today's Kids would sell "special items going forward." (CX-913-D.)

288. []

289. Thereafter, there were several meetings between TRU and Today's Kids. (Goddu 30:6733/23 - 6734/3.) TRU told Today's Kids that it did not want to carry any identical product that was sold to the clubs. (Goddu 30:6728/10-15, 6730/20 - 6732/24.) If Today's Kids was going to sell product to the clubs, TRU wanted Today's Kids to notify it about the product so that TRU would not buy it. (Butler 25:5524/6 - 5525.) Today's Kids' response was to inquire "how much would we [TRU] work with them, how much time would they have, how much more business could we do with them" if they changed their distribution "away from the warehouse club channel." (Goddu 30:6729/9-22.)

290. In 1993, Today's Kids told TRU that they changed the amount of business they were doing with the clubs for their own benefit. (Goddu 30:6738/5-22, 6739/12-14.) Today's Kids told TRU that it was going to stop selling to the clubs or to minimize what they were going to sell to them. (Butler 25:5526/7-10, 25:5551/2-7.) Today's Kids asked TRU "if we could have more time." (Goddu 30:6739/4-7; Goddu IH (CX-1657) at 167/11-14.) []

291. Today's Kids got back to TRU later in 1993 and discussed its intention of not selling to the clubs at all. []

292. Also in 1993, Little Tikes complained to Roger Goddu of TRU about Today's Kids sales to the clubs. (DePersia 10:2146/10-25.) Goddu told Little Tikes' vice president, Neil Crosby DePersia, that Today's Kids would be getting out of the business of selling to the clubs. (DePersia 10:2147/7 - 2148/6, 2150/3-12.)

293. In November of 1993, a TRU representative warned Today's Kids that it might not order a product which Today's Kids sold to the clubs even though it was selling well at TRU. (CX-891.) The

following day, she advised Today's Kids that TRU's "top echelon said don't order any more now." (CX-892.) []

294. In early February 1994, a Costco representative who met with Today's Kids stated that a change in Today's Kids' policy relating to the clubs might be made because of pressure from TRU. (Moen 4:682/11 - 684/6; CX-1678.)

295. In March 1994, following Toy Fair, Today's Kids informed the clubs that it would no longer sell any product to them. (Stephens 27:5985/5-11.) This was the first time that Today's Kids had ever decided not to sell a class of distribution. (Stephens 27:5989/22 - 5990/3.) []

296. Today's Kids witness Stephens attributed Today's Kids' decision not to do business with the clubs to the unpredictability of the clubs' purchases, the lower price points at which the clubs sold, the clubs' cherry picking, and clubs tendency to cancel orders. (Stephens 27:5927/6-24.) I did not consider this to be credible testimony. (Stephens 27:5991/23 - 5992/5; CX-893.)

297. Today's Kids, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to the clubs.

7. Tiger Electronics

298. Tiger Electronics ("Tiger") makes electronic toys, hand held games and family games. (Shiffman 10:1993/4-12.)

299. TRU was Tiger's largest customer through 1994. In 1993 TRU bought twice as much as Tiger's second largest customer. (CX-822; Shiffman 10:1998/2-4) TRU's share of Tiger's sales was between 23% and 35.4% in the years 1991-1996. (CX-822; []

300. Between 1992-1994, Tiger felt it needed to sell to TRU for Tiger to launch successfully a nationally advertised product. (Shiffman 10:2002/2-23.) The number and geographic coverage of TRU stores made it essential. []

301. Between 1991 and 1993, Tiger's club business was growing well, and it was selling its regular line product, including some of its top ten items, to the clubs. (Shiffman 10:2004/22-24, 2012/24 - 2013/8; CX-1756.) In 1991, Tiger sold \$273,000 worth of merchandise to the clubs. []

302. In June of 1993, Tiger's Shiffman spoke over the telephone with TRU's Roger Goddu, during which he first heard directly from TRU about its warehouse club policy. (Shiffman 10:2007/17 -

2008/2, 2015/23 - 2016/8.) After the phone call, Shiffman dictated a memo of his talk with Goddu. (Shiffman 10:2008/3-14: CX-809.) In this memo, Shiffman wrote: "TRU will NOT handle any item that is made available for sale through clubs. Period. End of story. It makes no difference who the club is or what the price is. If it is a new television advertised product, they will drop it immediately and will not handle it whatsoever." (CX-809.) []

303. Shiffman had asked Goddu whether TRU's policy applied to BJ's, a small club compared to the other warehouse clubs. (Shiffman 10:2013/22 - 2014/17.) Goddu's answer was that "the policy stands. If it is in a club including BJ's, it is out at TRU. Period. End of story one more time." (CX-809; Shiffman 10:2014/2-10.) Shiffman got the impression from Goddu that TRU's club policy would apply to all manufacturers in the industry. (Shiffman 10:2016/18 - 2017/1.)

304. Several months later, Shiffman wrote to TRU's Goddu in early December 1993 informing Goddu that Tiger had found one of its competitor's products in a BJ's club. (CX-811; Shiffman 10:2017/2 - 2019/12.) The club version of the competitive product merely had one additional videotape inside the box and a sticker attached to the outside of the box to differentiate it from the regular line product being sold at other retailers, including TRU. (Shiffman 10:2021/20 - 2022/7.) Shiffman felt that the package of the club version of the competitor's product was not differentiated enough from the regular line product's package and that the consumer could too easily compare the two versions of the product to comply with TRU's club policy. (Shiffman 10:2022/24 - 2023/14, 2023/25 - 2024/22.)

305. In his letter Shiffman wrote, "I understand that with regard to hot new product, television items, high profile items, etc., the only way these can be sold to the clubs is through very 'creative' packaging." (CX-811.) Shiffman indicated that, as Goddu knew, Tiger had not sold its similar product "to any club in the country," although Tiger "could have easily responded with a similar answer as this [competitive] product if we had known that it was acceptable to you." (CX-811.) Shiffman asked Goddu to let him know if that type of packaging was "satisfactorily meeting the needs and concerns of Toys R Us." (CX-811.) After sending this letter, Shiffman spoke with Goddu, who told him that although the competitive product's package did not meet TRU's club policy criteria, TRU had not yet explained its club policy to the company, but that Goddu would tell the competitor "don't do it again or God knows what." (Shiffman

10:2026/7 - 2028/13.) I find that Tiger's concern about its competitor's product being in the clubs and its statement to TRU that Tiger could "easily have responded with a similar answer" for selling its like product to the clubs if it had known that was acceptable to TRU shows that it was not in Tiger's unilateral business interests not to sell its regular line version of this product to the clubs.

306. In late January 1994, Shiffman had dinner with TRU's Goddu and after dinner, wrote an e-mail relating their conversation. (CX-814; Shiffman 10:2033/12-25.) At this dinner, Shiffman wanted more information on TRU's club policy so that he would know what products Tiger could sell to the clubs without jeopardizing its sales to TRU. (Shiffman 10:2037/4-10.) At dinner, Goddu told Shiffman that if Tiger sold the clubs a five-year-old product called Skip-It, as well as handheld games "in multipack with high price point," that would comply with TRU's club policy and would not adversely affect Tiger's sales to TRU. (CX-814; Shiffman 10:2037/1 - 2038/18, 2039/15-2040/2.) Goddu told Shiffman that he could get back to Goddu to review Tiger's club strategies with him and get approval in advance, even for individual products and packaging. (Shiffman 10:2044/21 - 2045/9; CX-814.)

307. On March 5, 1994, Tiger vice president of sales, Bernbaum, sent an e-mail to Tiger president Rissman urging Tiger to "address the club situation" since Costco wanted to purchase up to 300,000 handheld games alone, and "between their own stores and the Price Club acquisition they are going to be a huge factor." (CX-812.) Bernbaum explained that he needed an answer to give Costco since "I have to address the problem, TRU or no TRU." (CX-812.)

308. On April 6, 1994, executive vice president Shiffman, with the help of Tiger's in-house counsel, wrote and distributed a document that set out in a formal fashion Tiger's policy regarding sales to the clubs. (CX-818; Shiffman 10:2058/10 - 2059/3.)

309. After Tiger's policy went into effect, its sales to the clubs dropped from \$3.5 million in sales to the clubs in 1993 to \$31,740 in sales in 1994. (CX-822; Shiffman 10:2004/22-2005/6, 2055/22-24.) [] Tiger attempted to sell multi-packs to the clubs, but these were not successful. (Shiffman 10:2055/11-13.) I find that this also illustrates that it was not in Tiger's unilateral best interests to restrict its sales to the clubs.

310. Tiger's decision to restrict the clubs to multi-packs was not attributable to the fact that the clubs bought too few of its SKUs. (Shiffman 10:2053/3-9.) Tiger continued to sell its regular line products to drugstores, which carry an average of 4-10 Tiger products each year. (Shiffman 10:2052/14 - 2053/4.) Drugstores do not carry Tiger products year-round and like to be out of stock on Tiger items by December 25th each year. (Shiffman 10:2106/6-24.)

311. Tiger did not sell regular line products to the clubs again until 1996. (Shiffman 2057/7-12.)

312. Tiger, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to the clubs.

8. VTech Industries

313. VTech Industries makes electronic educational toys. (Walter 29:6061/22 - 6062/7.) In 1992, Toys "R" Us purchased 33% of VTech's U.S. sales. No other customer bought more than 9.6%. (CX-1305.) In 1993, VTech wanted to sell to retailers other than TRU to "reduce their dependence" on TRU. (CX-1301, CX-1318; O'Brien 12:2423/5-17.)

314. VTech sold regular line merchandise to the warehouse clubs for the 1992 Christmas season. (Walter 28:6087/21-24.) In 1993, VTech stopped selling regular line product to the clubs. (Walter 28:6087/21-24, Hilson 20:4508/6-9.) VTech "promised" TRU during the 1993 Toy Fair that they would not sell to the warehouse clubs. (CX-1318, O'Brien 12:2426/16 - 2427/18.)

315. Bill Walter, VTech's vice president of sales, testified that VTech stopped selling regular line products to the warehouse clubs for reasons unrelated to TRU. (Walter 28:6108/17 - 6109/17). He testified that clubs had excessive returns, returned product in poor condition, bought on a domestic rather than a letter of credit basis, and insisted on guaranteed sales. (Walter 28:6088/2 - 6090/2.)

316. Walter's testimony includes much post-hoc rationalization. (CX-1318; O'Brien 12:2432/1-19, 2424/10-14, 2412/1-3.) The TRU campaign motivated VTech's decision to stop selling to the clubs. (Walter 29:6190/19 - 6191/3.)

317. According to Walter, these issues were discussed orally with the clubs. (Walter 28:6189/10-19, 6190/19 - 6191/3.) This conflicts with the testimony of Jim Hilson, a toy buyer for BJ's, and a credible witness, who never heard any complaints about excessive returns

from VTech before VTech stopped selling to BJ's. (Hilson 20:4512/12-19.)

318. VTech, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to the clubs.

9. Binney & Smith

319. Binney & Smith (B&S) makes "Crayola" crayons, markers, colored pencils and similar products. (Blaine 29:6326/19 - 6327/20.) B&S competitors include Rose Art, Dixon Ticonderoga, Sanford Corporation, Amov and Battat. (Blaine 29:6340/23 - 6342/16.)

320. B&S began selling to the warehouse clubs in the 1980's. (Blaine 29:6342/17 - 6343/1.) B&S had trouble selling to the warehouse clubs because B&S regular line products had low price points. (A box of 64 Crayola crayons retails from \$1.99 to \$4.99.) (Blaine 29:6343/11 - 6344/24, 6328/6-10.)

321. B&S bundled packs of regular line merchandise for the warehouse clubs. (Blaine 29:6345/11-16.)

322. In May or June 1992, B&S' vice president of sales Brent Blaine was contacted by [] This meeting was called by TRU, after TRU found B&S products in the warehouse clubs. (Weinberg 34:7614/8 - 7617/5.)

323. At the meeting, Brent Blaine agreed to offer special packs only for 1993. (CX-913-C; Weinberg 34:7666/14 - 7667/18.)

324. After this meeting, B&S stopped selling regular-line merchandise to the warehouse clubs. (CX-913; Blaine 29:6934/2-19.) B&S makes differentiated products for drug stores and supermarkets. (Blaine 29:6461/7-25.) These other customers may also buy B&S regular line. (Blaine 29:6462/5 - 6463/17.)

325. In December 1992, Weinberg contacted Blaine and asked him to meet with him about B&S' warehouse club strategy. (Blaine 29:6418/11-19.) Blaine showed Weinberg samples of warehouse club products that B&S planned to sell to the warehouse clubs. (Blaine 29:6422/10-17.) After viewing these products, []

326. After this December meeting, Blaine wrote a letter to Weinberg summarizing their discussions on the clubs: "Our intent is to differentiate our product offering to Membership Clubs from that sold through our traditional retail trade channel. We will do this with larger sets and multi-packs that move the clubs to higher price points.

In addition, we will alter contents to present the club customer with a non-comparable value." (CX-2.)

327. BJ's purchased regular line B&S products before B&S established their warehouse club policy. (Hilson 20:4531/23 - 4543/2.) BJ's had been successfully selling a B&S product called the "Crayola Drawing Desk." (Hilson 20:4532/13-14.) However, B&S stopped offering the regular line Crayola Drawing Desk to BJ's. (Hilson 20:4532/13-25.) B&S provided BJ's with no explanation for their change in policy. (Hilson 20:4533/10-15.)

328. Binney & Smith, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to clubs.

10. Lego

329. Lego is a leading manufacturer of plastic construction toys.
[]

330. Until 1991, Lego sold to the clubs discontinued product. (CX-487-A; Hilson 20:4528/24 - 4529/8.) However, the growth of the clubs made the clubs an attractive market. (CX-487; CX-491.)

331. In the early 1990s, BJ's purchased older regular line product but sought new regular line products from Lego. The Lego salesman told BJ's that his management was influenced by TRU not to sell to the clubs. (Hilson 20:4529/18-4530/1.)

332. In December 1992, TRU informed Lego that it will "delist or not list any" Lego item that has wholesale club distribution. This policy affected several items that Lego was considering for the clubs. (CX-492.)

333. In February 1993, Lego decided to sell two items to the clubs and accept the consequences from TRU, but to change the color of two other items for the clubs and to use two combination packs for the clubs. Lego also decided to sell some discontinued product to the clubs and "to resurrect the strategy" of providing customized product for the clubs in 1994. (CX-493-A-B.) BJ's made no purchase of Lego product for several years until 1996 when it purchased some older product, some of which was about to be discontinued. (Hilson 20:4530/2-4531/1.)

334. Lego, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to the clubs.

11. Sega

335. Sega of America, Inc. ("Sega") makes home video game hardware and software. Its products include Sega Genesis, Saturn video game system and Game Gear hardware and software titles, including Sonic the Hedgehog and Joe Montana Football. (Kalinske 12:2470/20 - 2471/9.)

336. In 1990 Sega had 8-10% of United States sales of home video games, with Nintendo having almost all of the rest. (Kalinske 12:2473/13-15.) By 1994 Sega had 50% of the video game market. (Kalinske 12:2518/24 - 2519/2.) Sega's percentage of TRU's sales of video games ranged from the "high teens or low 20s." (Kalinske 12:2495/5-8.)

337. In 1990-1991 Sega sold to the clubs, which it considered to have sales growth potential. (Kalinske 12:2473/16-23, 12:2474/17-19.) In 1991, Sega sold old bundled software to Sam's. (CX-754.) Sega wanted to sell Sam's everything that it had in inventory. (Kalinske 12:2513/16 - 2514/5.)

338. [] In a fall 1991 meeting between Sega's CEO Thomas Kalinske, Charles Lazarus and top TRU executives at TRU's headquarters (Kalinske 12:2475/3-9), Lazarus expressed concern about Sega's sales to the clubs (Kalinske 12:2476/11-23), and said do not sell to them. (Kalinske 12:2540/17-20.) At the meeting, TRU asked what Sega's policy was in selling its Genesis product to the clubs. (Goddu IH (CX-1658) at 387/1 - 388/6.)

339. Kalinske said he was not selling any Genesis product to Sam's. Later, upon learning that his statement was not correct, he wrote a letter to Lazarus stating that he "could not look you in the eye" if he did not explain the following: "Frankly, we were also looking for a way to get Wal-Mart's attention. . . . The quantities of hardware are low with the software greater, but it's a one shot deal that when sold out, will not be restocked." (CX-754.) Kalinske further assured Lazarus that "Sam's Wholesale Club will have old Genesis software bundled with Hardware this Fall. . . ." (CX-754.)

340. []

341. []

342. In 1991, Sega sold Costco in-line product which it tested for Sega. (Moen 4:692/15-18.) By Christmas of 1992, Sega would only offer combo packs to Costco. (Moen 4:692/13 - 693/7). In 1992, Sega was selling BJ's its open line of merchandise, including a wide variety

of software. (Kalinske 12:2486/5-12, 12:2500/8-23; CX-769-A.) Sega's sales to BJ's were \$25 million. (Kalinske 12:2498/5-9.)

343. In late spring or early summer of 1992, TRU contacted Sega about Sega product found in the clubs. Sega said that it would sell to the clubs "as long as Nintendo is in the warehouse clubs." (CX-913-F; Goldstein IH (CX-1659) at 59/10-17) []

344. By February 1993 Sega limited its sales to BJ's to hardware packs only, as it was to the other clubs. (CX-769-A; Moen 4:692/15-693/18.) A Sega memo states "we have made a decision to package our product consistently with other manufacturers who sell to the warehouse club class of trade." (CX-769-A.) BJ's wanted to buy Sega's regular line video game software. (CX-769-A; Hilson 20:4520/19 - 4521/17.) Costco, Sam's and Pace also wanted to buy regular line product. (CX-701-B; CX-710-A; CX-716-B; CX-727 (Nintendo product); Moen 4:692/10 - 693/5 (Sega product).)

345. In April of 1993, BJ's still was selling regular line Sega merchandise. (Hilson 20:4521/6 - 4523/6; CX-678.) Charles Lazarus angrily confronted Kalinske at a Charity Ball about Sega's sales to the clubs and some other outlets TRU disfavored. Lazarus asked Kalinske "what he thought he was doing" (Lazarus 24:5393/14 - 5394/11) and implied that he had convinced Nintendo not to sell to the clubs and that Sega should follow suit. (CX-1776; Kalinske 12:2490/7-25, 2491/24 - 2492/2.)

346. Kalinske was concerned that TRU might retaliate against Sega. (CX-767-A; Kalinske 12:2494/21 - 2495/4; CX-766.) Sega decided to restrict the clubs to bundled hardware/software packs rather than cutting them off completely. (Kalinske 12:2507/7-21.) Sega concluded that TRU has more to lose than Sega since Sega supported TRU with more product and promotional monies than all its other accounts combined, and Sega felt it could replace any shortfall with other customers. (CX-767-B.)

347. Sega's position from 1993 to near the time Kalinske left Sega in 1996 was that the clubs had to buy bundled packs. (Kalinske 12:2507/7-20; CX-760-A.) In 1995, after the popularity of Sega's products had declined somewhat, Sega offered Costco in-line products if it would purchase 16 SKUs of software. However by this time Costco was not interested. (Moen 4:692/15 - 693/18.) In 1996, Sega permitted BJ's to purchase from open stock. (Hilson 20:4526/19 - 4527/8.)

348. Sega agreed with TRU to restrict its sales to the clubs to combination packs of video game hardware and software. In the face of TRU pressure not to sell to the clubs at all, Sega told TRU that it would restrict the products it sold to the clubs to bundled software and hardware packs. Sega stopped selling regular line product to BJ's even though its business with BJ's was satisfactory to Sega.

349. Sega, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to the clubs.

12. Huffy

350. []

351. []

352. []

353. []

354. []

355. [] At one point, Huffy asked TRU whether using a different name or color on a product that it sold to the clubs would differentiate it. (Butler 25:5560/5-12, 5561/6-10.) Van Butler of TRU advised that a name change would not be sufficient. (Butler 25:5561/6-10.)

356. []

357. []

358. Huffy, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to the clubs.

13. Just Toys

359. Just Toys, a maker of foam plastic toys and licensed toys, was selling toys to warehouse clubs by 1996; it sold regular line products as well as combo packs and specially configured products. (Hilson 20:4498/25 - 4500/5.) In 1993, Just Toys informed the buyer for BJ's that it would no longer sell BJ's regular-line products but only specially-configured products. A sales VP for Just Toys said that his management was being strong-armed by TRU and that Just Toys risked having its products thrown out of TRU if it continued to sell them to the warehouse clubs. (Hilson 20:4500/6-22.) Just Toys continued to follow this policy after 1993 until a management change in 1996; at the time of trial it offered its products to BJ's without restriction. (Hilson 20:4501/9-11, 4503/4-15.)

360. During 1993, Just Toys asked whether BJ's would participate in a product test, and BJ's agreed to place the item (a stretchable

plastic figure) in two of its stores in the New York area. Just Toys later informed BJ's that TRU had seen the product in BJ's stores, had decided not to carry it and had returned all of its inventory of the product to Just Toys. Without the support from TRU, Just Toys determined that it could not give the toy the promotional support it had intended. BJ's did not go forward with the item. (Hilson 20:4501/12 - 4503/3.)

361. Just Toys, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to the clubs.

14. New Bright

362. New Bright, a Hong Kong-based maker of radio controlled toys and other toys, sold both regular line and combination pack or differentiated products to warehouse clubs since the late 1980's. (Hilson 20:4515/6-22.) Just before Toy Fair in 1994, a New Bright sales representative told the toy buyer for BJ's that New Bright was "taking a vacation" from selling to the warehouse clubs. The New Bright representative said that his management had been reminded by TRU that products on the shelf at BJ's would not be purchased by TRU, and that if New Bright wanted to have its assortment expanded at TRU it would have to stop selling to BJ's. (Hilson 20:4515/23 - 4516/17.) After discontinuing sales to BJ's in 1994, New Bright resumed sales the following year and has sold to BJ's since. (Hilson 20:4517/17-23.)

363. New Bright, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to the clubs.

D. Success of the TRU Campaign

364. The TRU campaign against the warehouse clubs achieved participation by toy manufacturers, including the largest toy makers.

365. []⁹

366. In February 1994 the FTC's investigation was known by "virtually everybody in the industry." (Muris 33:7469/17-24.) After this date, some of the manufacturers who restricted their sales to warehouse clubs in cooperation with TRU began to sell to the clubs. This may have been caused by the FTC's investigation and proceeding. (Hilson 21:4776/22 - 4777/1.)

⁹ []

ANTICOMPETITIVE EFFECTS

A. Effects

367. The purpose of the agreements in this case was to restrain competition among toy retailers and among toy manufacturers. TRU intended to prevent the clubs from competing with TRU (Kalinske 12:2488/20 - 2489/3 []), to prevent toy manufacturers from competing with each other to sell products to the clubs ([] Kalinske 12:2488/20 - 2489/3, 2491/19 - 2492/6), and to prevent consumers from making direct price comparisons between products sold by TRU and products sold by the clubs. (Butler 25:5560/13-24; Goddu 30:6635/7-21.)

368. The TRU campaign had its intended effect -- the evidence shows that the campaign impeded the growth of the clubs as a emerging and innovative method of toy distribution, restrained retail price competition and caused toy prices to be higher than they would have been.

1. TRU impeded growth of the clubs

a. Growth of the warehouse clubs

369. The rise of the warehouse clubs and TRU's response is part of a recurring historical pattern in retailing -- [] (Scherer(CX-1822-B-C), Ingene 41:9039/25 - 9040/22; Okun 13:2791/15-2792/11.)

370. Ironically, when TRU was just becoming successful, established retailers thought the toy manufacturers should not sell to TRU because its prices were too low. (Kalinske 12:2516/13 -2517/5; [])

371. As a new, low cost toy retailer in Japan, TRU fought efforts by toy distributors in Japan to "pressure suppliers to not sell us or charge us higher prices. . . ." (CX-1031-G; Goldstein 36:8257/19-8258/10.)

372. []

373. Toy manufacturers recognized the clubs potential. In 1990, Mattel's chief executive officer, John Amerman, instructed his staff to be aggressive in new channels of distribution, especially the clubs. (CX-523.) In September 1991 Fred Okun of Mattel wrote, "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." (CX-530-B.) A 1992 Hasbro

memo states "[w]e have only begun to see the potential for this channel of distribution." (CX-11; CX-78.) []

374. The clubs were seeking aggressively to grow their toy business. (CX-1664; CX-373). Pace's toy department was one of the highest growth departments in the company. (Halverson 3:348/25 - 349/6.) Costco's toy sales from its FY 1991 to FY 1992 increased by 28%, compared to Costco's overall sales growth of 15%. (CX-1745-Z-9.) BJ's' purchases of toys in the early 1990's were also growing at a rapid rate. (CX-373.) Mattel's sales to the clubs increased 50% a year in both 1989 and 1990. (CX-530-E.)

375. The TRU campaign halted this growth trend and the clubs' threat to TRU's price image. []¹⁰

376. An internal TRU memo in July 1993 removed the clubs from the list of "knock-off" competitors whose presence in the vicinity of a TRU store warranted an adjustment in sales and profit expectations of the store for manager compensation -- because the clubs were thought to have "no significant knock off impact on TRU stores." (CX 1058.)

b. The clubs' ability to obtain regular line toy products

377. Before the TRU conduct at issue in this case, warehouse clubs were able to buy regular line toys from toy manufacturers. (Moen 4:606/8 - 608/11; Halverson 3:357/3; Hilson 20:4573/15 - 4575/14; 4430/4-6.) In 1989, over 90% of Costco's purchases of Mattel's toys were regular line items. (CX-691) Eighty to eighty-five percent of Pace's toys were regular line items. (Halverson 3:359/13-21.)

378. The clubs purchased combinations packs or other differentiated products from leading toy manufacturers following TRU's actions. (Hilson 20:4536/18 - 4538/22.) While the clubs wanted some combination packs (Moen 4:634/12-15; []),¹¹ they prefer to sell the same regular line product as the manufacturers sell to their retail competitors. ([] Moen 4:634/9-15; Jette 5:1001/13-17.)

¹⁰ [] In 1993 and 1994 the clubs sales volume growth slowed sharply when consolidations were occurring, but their growth rate is beginning to increase again. (Sinegal 2:154/5 - 155/15 (Costco); Zarkin 21:4785/15-23 (BJ's); Ingene 41:9042/23 - 9045/5; CX-1824; CX-1825.)

¹¹ Combination packs of hot wheel cars that each retail for less than a dollar make sense because the value is clear to the consumer who can see that the total price of the pack is less than the total of the retail price of each car. (Halverson 3:358/2 - 359/7.)

379. Parents see an individual toy promoted on TV or in a magazine and want to buy that individual toy. ([])

380. Combination packs make it difficult for consumers to compare prices of like items between the clubs and other retailers. (Butler 25:5560/13-24; Goddu 30:6635/7-21; []) Manufacturers want to prevent such price comparisons by putting together combination packs for the clubs. (Okun 14:2897/23 - 2898/8; RX-813; CX-2.)

381. []

382. The inability of the clubs to obtain regular line merchandise (CX-691; CX-447-A-E; Hilson 20:4437/5-19), caused by TRU's conduct, impeded the clubs' ability to become a more competitive force in the retail distribution of toys. TRU's conduct, which led the manufacturers to move the clubs into combination packs, made it difficult for consumers to make informed price comparisons between toys for sale in the clubs and those in other outlets such as TRU.

c. The clubs ability to obtain products from major manufacturers

383. The clubs relied on the brands of well-known toy manufacturers to attract customers to their stores. The TV-promoted products of these companies are the "lifeblood of the industry." (Goddu 23:6572/9-20; Hilson 20:4538/6-18; Halverson 3:356/19 - 357/2.)

384. In 1990 and 1991, a large part of Costco's toy purchases consisted of the products of major toy manufacturers. (Moen 4:603/24-605/9, CX-1745-Z-15.) In 1995, 64% of TRU's price image/sensitive toys were from major manufacturers and 70% of those toys were advertised on TV. (Ingene 41:9084/2 - 41:9085/1; CX-1826.)

385. The clubs' purchases of the brands of leading manufacturers dropped in 1993 after they were precluded from purchasing regular line toys from major manufacturers. ([]; CX-691 (Mattel); CX-1745-Z-15.) From FY 1993 to FY 1996, Costco's toy sales decreased by 1.6% whereas its overall sales increased by 19.5%; from Costco's FY 1991 to FY 1993 toy sales increased by 51% and Costco's sales of all products increased by 25%. (CX-1745-Z-9.) These decreases were caused at least in part by TRU's conduct and they had a negative impact on the ability of the clubs to become a competitive force in the retail distribution of toys.

386. After the clubs encountered difficulties obtaining regular in-line product from major toy manufacturers, they shifted their toy purchases to second or third-level toy manufacturers. (Hilson 20:4538/19-22; Halverson 3:434/7-23; Moen 5:893/17 - 5:894/8.)

387. These toys were generally not desirable for the clubs. (Sinegal 2:205/3-14; Hilson 20:4536/18 - 20:4537/3; Halverson 3:356/15 - 357/2.) The major manufacturers did the bulk of promotion and the lesser known brands "didn't have [the] dollars to do this type of promotion." (Halverson 3:356/19-24.) If these second and third-tier manufacturers were as desirable to the clubs' customers as the brands of major toy makers, the clubs would have carried more of these lines in the first place. (Hilson 20:4537/21 - 4538/18.)

2. Retail price competition

a. TRU's prices to consumers

388. [] TRU was concerned about the clubs impairing its image for fair and low prices. (Weinberg 34:7697/4-11; 34:7699/7-12; [].)

389. The price differentials between toys sold by the clubs and TRU were illustrated by the competition shop reports prepared for TRU and toy manufacturers, which show the products and prices for toys available in TRU stores and warehouse clubs at particular times. (CX-46 through CX-64; CX-1545, CX-1550 through CX-1563.) These reports show warehouse clubs prices well below TRU. [] (CX-54-B).

390. When Costco enters a market, its presence pushes competitors' prices down. (Sinegal 2:200/7 - 201/9.) [] To keep its image for low prices from being eroded, in 1992 TRU lowered its prices to meet the clubs' prices on Mattel toys in local areas where the clubs competed (TRU reduced its price by 19% on 47,000 units of Mattel's Air Pro Hockey). (Weinberg 34:7696/13 - 7699/12, 7704/5 - 7705/3.)

391. In 1992, there were warehouse clubs within the areas of dominant influence of 486 out of 497 TRU stores -- that is, in the same local geographic areas reached by the newspapers in which TRU advertises. (CX-1823; Ingene 41:9050/2-21.) That same year, there were 238 TRU stores within five miles of a warehouse club; and 20% of TRU's stores were within one mile of a club. (CX-912; Ingene 41:9051/12 - 9052/11.) []

392. I find that TRU would have lowered its prices had it not taken action to stifle the competitive threat posed by the clubs. If TRU, as the nation's largest toy retailer lowered its prices to meet the clubs competition, this would likely have driven prices down among all retailers. (Goddu 30:6616/19-23; Blaine 29:6372/12-20.) (Binney & Smith believed that the prices charged by the warehouse clubs would become the prevailing market price.)

b. The clubs' prices

393. By inducing the toy manufacturers to shift the clubs from regular line products to combination packs, TRU's conduct raised the clubs' retail prices. (CX-2; [] Hilson 20:4464/24 - 4465/20, 4473/11 - 4475/13; Ingene 41:9083/1-19.) After the TRU policy the club packs sold by manufacturers to the clubs were designed to avoid price comparisons that would have been unfavorable for TRU.

394. Mattel's club policy required that the retail price of the combination packs sold in the clubs be higher than the retail price of any single component item in the package carried by TRU or other retailers. (CX-688; Okun 13:2809/11 - 2810/23; Halverson 3:374/4-18; Hilson 20:4473/11 - 4475/13.)

395. Hasbro's Playskool division designed its combination packs for the clubs to ensure that the retail price of the combination pack in the clubs would not be lower than the retail price of one of the regular-line items sold alone in other outlets. (Inano 16:3384/13 - 3385/5.) Hasbro told Hilson that it would not allow a combination pack to be put together for BJ's that would retail for less than one of the items elsewhere. (Hilson 20:4464/17 - 4466/6.)

396. Hilson testified that this raised the retail prices of the Hasbro products that BJ's could sell. (Hilson 20:4466/7-16.) BJ's placed an order for a combo pack made up of an inflatable toy with a pump, where the cost of the pack to BJ's would have permitted BJ's to sell the two items to consumers at a price less than the retail price for the inflatable toy alone (without the pump) in other retailers. A Hasbro vice-president later returned the purchase order papers to Hilson, saying that "a decision came down from above" at Hasbro not to sell the combo pack to the warehouse clubs. (Hilson 20:4466/7 - 4473/2; CX-1433.)

397. Consumers who only desired to purchase a promoted individual product would tend to purchase the product in regular toy channels because of the clubs higher price points for combination packs. (CX-688; Okun 13:2811/17-22.) Consumers therefore paid more to get the individual toy they wanted -- []

398. Costco charged higher prices for regular line products that were unavailable directly from the manufacturers because Costco had to purchase through distributors whose prices were higher than those charged by manufacturers and Costco passed on part of the added cost to its members. (Ojendyk 18:3999/8 - 18:4002/1; CX-1379; Sinegal 2:309/17 - 311/7.)

3. The warehouse clubs' price competition

399. TRU's marketing expert witness, Professor Buzzell, testified that even if TRU limited the availability of some toys to the clubs, the effect on toy prices would be trivial. (RX-894 at 32.)

400. Professor Buzzell relies on a list of 70-100 toys, which TRU deems to be price image ("PI") toys. (Goddu 30:6543/23 - 6544/1, 6551/19-22.) TRU prices these high profile toys at nationwide "sharp" prices. (Goddu 30:6544/18 - 6545/23, 6653/25-6554/11.)[]

401. Professor Buzzell fails to consider competition by warehouse clubs on toys outside this group of toys. Another 130 - 150 toys are deemed by TRU to be price sensitive ("PS") toys (Goddu 30:6551/23 - 6552/1), priced on competition in local markets. (Goddu 30:6554/12 - 6555/13.) TRU prices these "PS" toys at margins of 20%. (CX-1826.) TRU's margins are 30-35 % for toys ranked lower than the top 500 - 1000 toys. (Ingene 41:9078/20 - 9080/24.)

402. Most toys carried by the clubs rank lower than the top 500 - 1000 toys, and the difference between a club 10% margin and a TRU 30-35% margin is important to consumers. (CX-1827; Ingene 41:9080/2 - 9081/16.) "The real price impact and the real image impact comes not in the top 100 toys but outside of the top 100." (Ingene 41:9086/12 - 9087/3.)

403. The clubs wanted to expand their toy business. (CX-1664 (Costco); CX-373 (BJ's); Chase 8:1655/9 - 1656/3 (Price).) The expansion of the clubs' toy departments would have placed more downward price pressure on TRU.

404. [] However, his testimony is contradicted by evidence that TRU lowered its prices to respond to the clubs' prices.

405. Concerned about the clubs' low prices, and the effect on TRU's price image and profits, TRU took steps to prevent competition from the clubs. I conclude that the clubs' pressure on TRU to lower its prices would have caused TRU to lower its prices on toys beyond the top 100 - 250 toys.

406. TRU points to RX-430, a one page Costco document entitled "Items Price Costco Would Have Bought Individually But Did Not Want In Combination Packs." The document lists 13 items in fiscal years 1996 and 1995. TRU argues this shows the minor impact of its policy.

407. Little weight will be given to this ambiguous document. TRU did not clarify its meaning by questioning Costco witnesses at the hearing. (5:884/6-21.) [sic]

408. At Toy Fair 1997 there were 60 toys displayed that Costco wanted to purchase but the manufacturers would not sell to Costco. (Moen 4:638/5-649, 641/10 - 644/9.) There were more than 13 toys that Costco wanted in FY 1995 and 1996 that manufacturers refused to sell to Costco.

409. TRU argues that Sam's warehouse club is not affected by the TRU policy because Wal-Mart, its parent, prevents Sam's from carrying the same toys as Wal-Mart. (Reinebach 39:8724/17 - 8725/3.)

410. Christopher Jette, Sam's toy buyer from 1991 to 1995 (Jette 5:992/10- 993/3) testified that Wal-Mart had no policy against Sam's carrying the same toys as Wal-Mart, despite the industry rumor of such a policy. (Jette 5:1011/20 - 1012/1, 1012/21 - 1013/6.) Sam's has carried toys that were also carried at Wal-Mart. (Jette 5:1012/2-6.)

411. TRU policy did affect Sam's toy business. Sam's relied more heavily on combination packs than the other clubs (Jette 5:998/22 - 1001/12), but half of the toys carried by Sam's were regular line toy items, many "hotter sellers." (Jette 5:1001/13-25.)

412. [] Sam's placed orders for regular line toys from Hasbro's Playskool division in 1994, but Playskool would sell to Sam's only specially configured "value packs." (CX-462; CX-461.)

B. Market Power

413. [] Other TRU executives reported TRU's share at 22-25%. (CX-1052-E (June 1989); CX-1039-E (March 18, 1992); CX-1040-A (April 2, 1992).)

414. National statistics are poor indices of market structure in retail markets. []

415. Local competition is recognized by Toys "R" Us. []

416. []¹²

417. TRU calculated its share among all toy retailers in newspaper areas of dominant influence ("ADI"). []

418. TRU's own documents state that TRU is the dominant toy retailer. (CX-1040-A ("TRU is the dominant market share leader"); CX-1039-E; CX-1042; CX-1048-A; Goldstein 36:8249/16 - 8250/11.)

419. TRU studies show that toy retailing is growing increasingly concentrated, CX-1043-L-M:

Other remaining retailers are the mass merchants such as Sears, Penneys and Wards and the catalogue showrooms. The mass merchants are losing share because they can't compete with the toy supermarkets on price and selection and can't compete with the disc on price. The catalogue stores are losing share because of their lack of selection. Other retailers include mom and pop toy stores, department stores, high priced toy shops like FAO Schwartz and convenience stores such as variety stores, drug stores and supermarkets. These retailers are losing share to the toy supermarkets and discounts because of price and to Kay-Bee because of convenience. So, just as there is consolidation in the toy industry with Hasbro, Mattel, Tyco gaining huge market shares, there is also consolidation in toy retailing

¹² RX-895 was developed specifically for this litigation.

with Toys R Us, Wal-Mart, Kmart and Kay-Bee gaining large market shares. I see this consolidation continuing with intensity in the 1990's.

420. On October 29, 1991, Mr. Goldstein, TRU's CEO, stated:

[W]e have seen the domination of category killers like Toys "R" Us, Home Depot, Circuit City, Staples and Office Club. So, what we have seen are new concepts, consolidation and huge, powerful retailers dominating the retail landscape. *** In my opinion, the companies such as Wal-Mart, Home Depot and Toys "R" Us that can continue to lower prices, gain market share and lower costs again will dominate retailing in this decade. *** Regarding category killers, consolidation is happening here also. Toys "R" Us is dominating the toy industry and is gaining market share.

(CX-1042-G-I (October 29, 1991); CX-235-A.)

421. TRU exerts its dominance as a buyer of toys. TRU also exercises market power as a seller of toys. TRU's power as a buyer and seller are related.

1. TRU's buyer power

422. TRU, the leading retailer of toys in the United States, has power as a purchaser of toys from manufacturers. (Scherer (CX-1822) ¶ 13; CX-1624-C (for 1986, largest drug chain had 3.8 % of U.S. drug industry's sales; the largest food store had 4% of food sales).)

423. Toy manufacturers would have difficulty finding alternative buyers to replace TRU. (Scherer (CX-1822) ¶ 16.)

424. TRU is the largest customer for the major traditional (non-video) toy manufacturers. (Okun (Mattel) 13:26-8/22-2609/1; Owen (Hasbro) 6:1102/13-17, 1159/1-2; CX-1272 (Tyco); DePersia (Little Tikes) 10:2256/8-10, 2257/15-16; Cohen (Fisher-Price) 35:7926/18 - 7927/4.)

425. In 1994, TRU had 29% of the sales of the top ten traditional toy manufacturers. TRU purchased 28% of Mattel's toys, 28% of Hasbro's toys, 31% of Little Tikes' toys, and 48% of Tyco's toys. TRU has 35% of Fisher-Price's sales. (Cohen 35:7927/2-4.) TRU's average market share for four years from top ten firms is [] For the seven traditional manufacturers, the average share is [] These shares were growing, indicating that manufacturers were becoming more dependent on TRU. (Scherer (CX-1822) ¶ 13 & Exh. 1; Cohen (Fisher-Price) 35:7926/18 - 7927/4.)

426. []

427. []

428. Top manufacturers account for a low percentage of TRU's sales. [] This gives TRU leverage over the manufacturers.

429. Toy retailing is local (Scherer 23:5161/3-15), and because TRU has high local market shares in metropolitan areas, this adds to TRU's buyer power. To sell in many metropolitan areas, the manufacturer must have TRU distribution. (Shiffman 10:2249/12 - 2250/6, 2001/21 - 2002/1.)

430. TRU's buyer power is magnified when compared to other toy retailers. [] Kay-Bee sells discontinued and close-out merchandise. (Verrecchia 7:1549/18-20; CX-1036-C.)

431. TRU's main competitors (Wal-Mart, Kmart, and Target) carry less than a third of the toys carried by TRU; their floor space for toys is far less than TRU's. TRU's main competitors also carry a lower percentage of the manufacturers' lines after the Christmas season. (Goddu (CX-1658) at 356-57; Goldstein 36:8242/18 - 8249/5.)

432. []

433. Manufacturers would have difficulty replacing sales if TRU did not purchase an item. (Okun 13:2813/22 - 2814/1; Owen 6:1151/3-10; Verrecchia 7:1412/19-22.) As Amerman of Mattel testified, "Toys 'R' Us is 30% of our business, so that is a very big number to put to other accounts that are already committed to what they feel is correct and would be unwilling to take more." (Amerman 17:3617/23 - 3618/16.)

434. A new toy can cost \$12 million in television and tooling costs (sunk costs). (Verrecchia 7:1409/14 - 1410/2.)

435. TRU's support is essential in the sale of a new promoted toy because its size and geographic coverage generate the sales necessary to support an effective advertising campaign. (Fuentevilla 18:3886/12-15, 3888/9-22; Owen 6:1154/20 - 1155/2; CX-773 -F-G; Shiffman 10:2001/21 - 2002/1, 2002/20-23, 2249/12 - 2250/6.)

436. Manufacturers depend on TRU for promotion. Other national chains do not advertise toys year-round or to the extent that TRU does. (Goldstein 36:8244/21 - 8245/13.)

437. TRU's refusal to purchase a new toy could cause serious financial harm to manufacturers. In 1994 a small video game company put itself up for sale after TRU dropped its line. (CX-773-G.) Major manufacturers took seriously TRU's statements that it would not carry the same toys that the manufacturers sold to the clubs. (Fuentevilla 18:3892/17-20, 3893/17-20; Amerman 17:3656/19-25; Verrecchia 7:1486/14 - 1487/12.)

438. Mattel and Hasbro need TRU's purchases, the "critical mass" is essential for continued production. If TRU did not purchase older, basic toys, manufacturers could not profitably make them. Since initial promotion and tooling cost have already been amortized, these toys profit the manufacturers. (Amerman 17:3622/18 - 3624/24, Inano 16:3378/11-23; Owen 6:1151/11 - 1152/12.)

439. TRU used this power to enforce its club policy. In 1993, Just Toys asked BJ's to test a new item (a stretchable plastic figure) in two of its stores in the New York area. After TRU saw the product in BJ's stores, it returned all of its inventory of the product to Just Toys. Without the support from TRU, Just Toys could not promote the toy and did not go forward with the item. (Hilson 20:4501/12 - 4503/3.)

440. When considering whether to reduce the number of SKUs it carries, [] (CX-1013-Z-1.)

441. Hasbro officials were concerned that if they alienated TRU by selling first-year, TV-promoted products to clubs, TRU could retaliate by reducing purchases of their basic toys on which they depend. (Inano 16:3378/11-23.)

442. Manufacturers fear TRU retaliation by not including their products in TRU's catalogues and flyers or not giving them endcaps or desirable shelf space. (Owen 6:1109/1-14.)

443. Amerman of Mattel worried about increasing toy retail concentration. Mattel's top five customers doubled their share of Mattel's sales between 1985 and 1990 to half of Mattel's sales. (CX-1699.) On December 13, 1990, Amerman wrote "The constriction in the number of traditional retail outlets that carry toys is going to become a bigger and bigger problem as time passes." (CX-523.) By 1994, Mattel's top five customers accounted for 72% of Mattel's sales. (CX-1669.) Mattel's CEO wanted to increase sales to clubs to reduce dependence on TRU. (Okun 13:2631; CX-523.)

444. []

445. A Tiger Electronics vice president of sales wrote: "I am very worried about our future business as a whole for the following reasons: *** (2) TRU dictating to Tiger and becoming even a bigger percentage of our business...." (CX-813; Shiffman 10:2003/13-16, 2029/13-21.)

446. [] and Video Tech ("VTEch") wanted to reduce dependence on TRU. ([]; CX-1301 (Video Tech).)

447. The manufacturers also depend on TRU for international sales. Half of Mattel's and Hasbro's sales are now outside the United States. TRU is the largest worldwide retailer of toys. [] (Scherer (CX-1822) at ¶16; Goldstein IH (CX-1659) at 179; Staley IH (CX-1729) at 56; CX-773-A-O; CX-235-C-D.)

448. []

449. [] In addition, the monopsony regression could not determine whether TRU exercised its buyer power by extracting agreements from the manufacturers to restrict sales to the clubs. (Carlton 32:7036/25 - 7038/9.) Finally, Professor Carlton disregarded the manufacturer testimony as to their dependence on TRU. (Carlton 32:7059/19 - 7061/20.)

450. TRU pressured Playskool in 1992 and this pressure limited Hasbro's flexibility in the marketplace. (Owen 6:1145/17-20, 1146/5-14, 1148/12.) Playskool would have sold more and different products to the clubs were it not for the TRU pressure. (Owen 6:1147/8-11.) Limits on dealing with the clubs were in Hasbro's best business interest. (Owen 6:1146/24 - 1147/7.)

451. Mattel's CEO testified that TRU's club policy caused Mattel to "lose flexibility to enhance shareholder value and do things that were in the economic best interests of Mattel." (Amerman 17:3658/10 - 3659/4.)

452. TRU recognized that manufacturer profitability depended on TRU: "The key to increased profitability in the 90's will be doing more business with Toys R Us since most of the expansion in the toy industry, at retail, will be taking place in Toys R Us stores in the U.S. and throughout the world." (CX- 1650-E.)

453. Manufacturers were faced with TRU not carrying its toys, giving them inferior shelf space, or not buying nonpromoted toys. (Scherer 23:5172/24 - 5173/9, 5177/22 -5179/2.) Because of TRU's dominant position, I find that the threat faced by the manufacturers to be credible. (Scherer 22:5022/15-25.)

454. TRU has substantial buyer power or leverage and the ability to cause severe economic harm to its suppliers.

2. TRU's power at retail

455. []

456. It is unnecessary for TRU to have the power to raise prices in order for its conduct to result in anticompetitive effects. (Carlton 32:7034/15 - 7035/25; Dennis W. Carlton and Alan S. Frankel, *The Antitrust Economics of Credit Card Networks*, 63 Antitrust L.J. 643, 654 (1995); Dennis W. Carlton and Alan S. Frankel, *The Antitrust Economics of Credit Card Networks: Reply to Evans and Schmalesee Comment*, 63 Antitrust L.J. 903, 904-05 (1995).)

457. Thus, even where a firm does not have the power to raise prices, the prevention of entry by a new, low cost efficient competitor can cause consumer harm. The question is whether TRU has the ability to prevent entry that could result in lower prices. (Carlton 32:7034/9-14; Scherer 22:5024/1-14.)

458. Even if market power as a seller were necessary, TRU has such power. (Scherer (CX-1822) ¶ 28, 22:5025/16-20.)

459. A key in determining whether TRU has the power to raise price is whether TRU's prices vary according to the degree of competition it faces. TRU concedes that its prices are highest where it has the least competition. (Goddu 31:6951/19-22, Dep. (CX-1651) at 174.)

460. []

461. Professor Carlton's reliance on industry concentration data at the national level is misplaced. []

462. []

463. []

464. TRU argues that entry into toy retailing is easy. [] This evidence shows, however, that it is difficult to enter as a significant competitor on a

national basis. [] Business documents from the manufacturers and TRU describe a consolidated industry. (CX-1043-K-M; CX-1031.) In a 1995 speech, the CEO of TRU explained the difficulties of succeeding in the toy business (CX-1031-C):

[T]o be successful in the toy business, because of the extreme seasonality, you need unique expertise in systems, logistics, warehousing, buying, human resources that takes a long time to develop and if rushed leads to disaster as we have seen in the U.S. as evidenced by Child World and Lionel which at one time did over \$1BB combined and both went bankrupt and have been liquidated and Toy City in Canada, formerly part of the #1 toy retailer in Canada, and which is now out of business.

465. I find that TRU has market power. TRU has raised barriers to entry into toy retailing by the warehouse clubs. (Scherer 22:4974/4-23.)

DEFENSES

A. Economic Defenses

466. TRU argues that its conduct was justified as an effort to protect against free-riding. Free-riding does not justify TRU's conduct in this matter. (Scherer 3:5068/1 - 5070/11.)

467. [] (Scherer (CX-1822) ¶ 57 (citing Griliches, "The Search for R&D Spillovers," 94 *Scandinavian J. Econ.* 29-47 (1992 Supp.).) Without them, economic progress would grind to a halt. Paul M. Romer, "Endogenous Technological Change," 98 *J. Pol. Econ.* no.2, part 2, p. S89.

468. []

469. TRU may provide spillover benefits for third parties, but it also takes advantage of uncompensated spillover benefits that are provided by others in the economy. TRU locates near shopping centers so as to benefit from the traffic without having to pay the higher shopping center rents. (Scherer 23:5073/9 - 5074/17.)

1. Advertising

470. TRU argues that the clubs free-ride on its advertising. In the toy industry, the manufacturer is primarily responsible for generating the demand for toys through television advertising. (Spencer 9:1866/7-10; Amerman 17:3738/8-17; Weinberg IH (CX-1662) at 48/21-25.) Consumer demand is driven primarily by the manufacturer's advertising efforts, not TRU's. (CX-773-J; CX-1053.)

471. TRU advertises price of toys for sale in TRU stores. (Spencer 9:1866/23-25.) The TRU's price image toys, with the lowest margins, are selected by manufacturer promotion, not TRU promotion. (Goddu 30:6594/6 - 6596/2.)

415

Initial Decision

472. TRU receives compensation from the manufacturer for advertising. []

473. []

474. [] TRU's senior vice-president of advertising felt that TRU received more in advertising allowances than it spent on advertising. (Spencer 9:1867/7-14.)

475. Toy manufacturers spend 8% of their total sales dollars on advertising. (CX-1624-Z-11.) This 8% for all manufacturers understates the spending for manufacturers who advertise their products, since it includes manufacturers who do not engage in any advertising. Hasbro's advertising expenditures are much higher, some divisions with advertising expenditures of 19.3% of total sales. (CX-88.)

476. []

477. Professor Scherer corrected errors in the Carlton regression and concluded [] (Scherer (CX-1831) ¶ 6-8.)

478. []

479. Professor Scherer reasonably relied on testimony from deposition testimony from buyers. (Scherer (CX-1831) ¶ 8.) []

480. Demand for toys is mostly created by manufacturer advertising, not advertising by TRU. TRU benefits from its own advertising and promotional efforts. TRU is compensated for promotional expenses that benefit the manufacturer. There is no evidence connecting the clubs to any free-riding on TRU advertising. There is no evidence that TRU advertising generates sales at warehouse club stores.

2. In-store promotion

481. TRU is like a warehouse selling toys. Like Wal-Mart, Kmart, and the clubs, TRU does not provide service in demonstrations or informed sales personnel. TRU stores are like the chain discounters and clubs in lack of personal service. []

482. TRU's Goldstein acknowledged that TRU provides "limited service" today, and even less in 1992. (Goldstein 36:8242/18--8243/1.)

483. TRU's low service is [] In a New York Times article ("Lost in Toyland," March 31, 1996, at 3, 12) (CX-807), TRU's service was described as follows:

"I don't know a single retailer about which I hear as many complaints as TRU," said Barry Bryant, an analyst at Rodman & Renshaw and the father of a 3-year old son. "You never know where anything is, and there is no one to help. . . . All of these things combine to create a uniquely unpleasant shopping experience for the parent."

The supermarket style of selling playthings has always been the TRU trademark. Shoppers squeeze through charmless, colorless aisles, and pick through rows of [toys] displayed often without care or accessibility.

Merchandise is often piled so high it is impossible to reach. . . . And if a sales clerk can be unearthed, chances are his or her job is to stock, not to serve. . . . By offering a giant selection with very low prices and plenty of inventory, TRU has been able to get away with this no-frills, service short shopping experience.

484. []

485. Because TRU sells products that require little service, TRU competes on price, as well as selection. (CX-1052.)

3. Showroom

486. TRU argues that its around-the-year stocking policy helps manufacturers identify items that are selling well, facilitating production planning, and that the warehouse clubs free-ride by observing what toys TRU is buying, thereby identifying the "hot items" (Scherer (CX-1822) ¶ 63.)

487. The warehouse clubs attend toy fairs, decide what will sell, and order merchandise near the same time as the rest of the trade. The clubs place most of their orders in the springtime (March and April) when it is still uncertain which toys would be the "hot" toys for the upcoming Christmas season. (Hilson 20:4424/10-4426/16; Moen 4:611/2 - 613/14; Halverson 3:349/7-11; Jette 5:1006/12-1007/4; CX-113; CX-748-A-B; CX-816; CX-930; CX-1265-D; CX-1385; CX-1387-A-B; CX-1664; *Okun* 13:2809/3-10, 14:2939/8-12.)

488. The clubs selecting toys to purchase cannot consider other retailers' sales or advertising of products because their purchasing decisions are made early in the season before the toys are for sale in other retailers; with older toys, sales history from prior years is not reliable because what sells from one year to the next can be totally different. The clubs rely on their own perception of the toy, and on the manufacturers' promotional plans: television advertising was key in creating demand. However, there is no way to know in advance whether a toy will sell well. (Halverson 3:351/1-2, 3:352/20 - 353/12; Hilson 20:4581/4 - 4582/10, 20:4582/14-21, 20:4585/21 - 4586/23.)

489. TRU is compensated in part for the risks it takes stocking new items by manufacturers' discounts for those that turn out to be "duds." (Scherer (CX-1822) at ¶ 63c.) TRU is compensated by the manufacturers with extended "dating" terms that allow it to delay payment until December for merchandise it received earlier in the year. (Spencer 9:1873/19-21, 1874/22-25.)

490. TRU is not a toy showroom upon which the clubs can free-ride. TRU is not a showroom such as high ticket automobile or furniture showrooms; TRU is more like a supermarket. (CX-1034-B, D; CX-1051-C; CX-1031-C.)

4. Year-round full line.

491. TRU benefits from its full-year, full-line coverage. Taking product early, TRU reduces the risk of being out-of-stock when a product becomes hot and in short supply. [] (CX-1586-B; CX-1597-A; CX-1044.)

492. By buying early and monitoring sales TRU has an advantage over other retailers in identifying what products will be "hot." (Lazarus 24:5351/18 - 5352/16, Lazarus Dep. (CX-1654) at 55-56; Verrecchia 7:1457/18-1458/3.)

493. TRU buys and takes delivery of merchandise early in the year to get the merchandise onto its shelves at the time that the consumers want the merchandise. (Scherer 22:4906/2-7.) []

494. For the toys that make TRU a "full-line" toy supermarket -- the non-promoted toys. [] (Scherer (CX-1822) ¶18; Butler 25:5569/7-14.)

495. The toy industry is seasonal. Manufacturers traditionally ship, and retailers sell, most toys during the fourth quarter. []

496. That the clubs sell a high percentage of toys in the fourth quarter is of little importance. (RX-621 at 28 (Table 7) (62-64% for clubs; 56-57% for TRU); CX-723-C.)

497. Prior to 1996, TRU carried between 15,000 and 18,000 SKUs. TRU reduced the number of SKUs by one third, to around 10,000 to 11,000 SKUs. (Goddu Dep. (CX-1651) at 218/3 - 222/5; Goddu 30:6576/1-4; 6578/6-13; Goldstein 36:8265/12 - 8266/9; CX-994.)

498. Fewer SKUs carried by TRU is not related to free riding nor does it imply a reduction in output. (Scherer 23:5063/1-12.) []

5. Compensation

499. Dating terms enable TRU to carry a full line of toys for most of the year. (CX-1012; CX-1611.)

500. TRU convinced the manufacturers to produce toys for delivery earlier in the year in return for TRU paying later. (Lazarus 24:5353; 5362 - 5363.)

501. []

502. []

503. Manufacturers also give TRU warehouse, early buy, early ship discounts or other allowances to compensate TRU for purchasing product early. (CX-1730.) When a manufacturer wants TRU to take more product earlier than planned, TRU charges the manufacturer an additional warehousing fee. (Spencer 9:1876/15-21; CX-1730; CX-548.)

504. []

505. A Mattel briefing paper preparing for a meeting with TRU stated that the extended dating and other allowances compensate TRU for taking product early (CX-686-B):

- In some respects, you are our warehouse, but be aware that we pay you for the privilege through:
 - A dating program that pays a great amount.
 - Policy allowances.
- You might not want to hear it, but it's the truth.... You are our most expensive customer.
- Other accounts accept significant quantities early and are paid less benefits, less discounts, and with no extended dating.

506. []

507. []

508. []

509. If a toy continues not to sell manufacturers provide additional allowances to TRU. []

510. []

511. TRU's standard contract contains a "Most Favored Nation Clause" whereby if a TRU competitor receives a lower price after TRU purchases the product during the same calendar year, TRU gets the benefit of the lower price. (CX-1030-F.)

512. []

513. [] If TRU advertises the product and it does not sell as expected, TRU charges the manufacturer. (Spencer 1874/2 - 1875/10.)

514. TRU is the most expensive customer for Mattel and Hasbro. (CX-686-B; CX-7-A.) []

515. []

516. []

517. TRU is or can be compensated for costs and risks it assumes by ordering a broader product line earlier in the year. TRU gains price concessions from manufacturers through direct wholesale price reductions, or better dating terms. TRU is compensated for carrying toys not carried by the clubs.

6. Benefits to TRU

518. TRU receives other benefits for taking in product early. TRU takes in product early as a trade-off for hot product later in the year. (Lazarus 24:5364.)

519. TRU receives a disproportionate share of hot products. []

7. "Hot" Toys

520. TRU places most of its orders for the Christmas season in the spring, and receives some product early in the year, and some as the year progresses. TRU, like all retailers of toys, adjusts its order as the year progresses, increasing orders for toys that are selling well, and decreasing or canceling orders for toys that are not. The clubs place their orders soon

after TRU places its orders. At the time that the clubs place their orders, neither the clubs nor the manufacturers know which toys will become hot.

8. "Free-Ride"

521. TRU accounted for 48% of the toy industry's retail advertising support from January through May of 1994, while Wal-Mart accounted for 2%. []

522. [] I find no significant difference between Wal-Mart and the clubs in terms of advertising.

523. The chain discounters have done little warehousing. They operate on a just-in-time system, like the clubs. (Okun 13:2815 - 2817/12.)

524. TRU provides a greater level of services for manufacturers than any other of the national chains, including Wal-Mart, Target and Kmart, by taking product earlier, carrying a fuller line, carrying less-popular or non-promoted toys, advertising year-round, test-marketing products, avoiding knock-off products, and promoting manufacturer brands. (Goldstein 36:8252/18 - 8259/5.)

525. If free-riding were the true rationale, one would expect to see similar restrictions on the clubs in other countries. However, no such restrictions exist in Canada. From 1990 to the present, Costco Canada has purchased regular line toys from Mattel, Hasbro, Lego, Irwin Toys (both a manufacturer and distributor, 5:942/11-12), V-Tech, Tyco, Today's Kids, Little Tikes, Binney & Smith and Playmates. (Nickel 5:922/9-16.) The Canadian arms of Mattel, Hasbro, Binney & Smith, Lego, Video Tech, Tyco and Playmates all marketed and sold independently of their parent companies. (Nickel 5:922/25 - 924/2, 967/21 - 969/24, 972/21 - 975/25, 977/7-14.)

526. TRU may have less market power in Canada than in the United States. (CX-1648-T, V (Zeller's in Canada is "about as tough a competitor in the toy business as we have in the world").) The absence of restraints in Canada supports the view that the restraints are market power driven rather than efficiency driven.

9. Overall costs and benefits

527. TRU's economic expert, Professor Carlton, did not attempt to quantify whether TRU was adequately compensated for its "showroom" functions. (Carlton 32:7021/15 - 7022/11.)

528. TRU's Thomas Reinebach created a chart for purposes of this litigation that shows his estimates of the net costs to TRU of providing services to manufacturers. I find his calculations fail to substantiate the existence of any significant free-rider problem.

529. Mr. Reinebach calculated [] This includes actual costs for advertising and markdowns, derived from TRU business documents, as

well as estimates for the costs [] Mr. Reinebach testified that the manufacturers provide allowances to TRU related to these services. [] Reinebach 40:8881/3-12.)

530. [] This equals about 1.6% of TRU's 1995 sales revenues. (Reinebach 8881/23 - 8882/9.) []

531. []

532. TRU also benefits from taking product early. Mr. Reinebach did not account for such benefits.

533. I find that whatever free-rider issues may exist are insubstantial, and outweighed by the competitive harm caused by the TRU campaign against the warehouse clubs.

B. Other Defenses

534. The respondent alleges that prior to the Commission's vote to issue the complaint in this case an unidentified Commission employee provided non-public information to the Wall Street Journal; that this leak of information influenced the vote of the Commission to issue the complaint; that the leak was a federal crime; and that the complaint should be dismissed because it was issued as a result of criminal conduct by Commission employees.

535. The evidence introduced by the respondent was a copy of a Wall Street Journal article dated May 21, 1996, concerning the investigation in this case (RX-776) and a copy of a June 4, 1996, letter from the Director of the Commission's Bureau of Competition to counsel for the respondent indicating that the respondent's allegations were being brought to the attention of the Commission's Inspector General. (RX-915.)

536. The Wall Street Journal article does not indicate that anyone at the Commission was the source of information for the story; it describes its sources as "people familiar with the situation" and specifically states that "an FTC spokeswoman declined to comment." (RX-776.) The Bureau Director's letter notes that the news article "does not demonstrate that the source or sources [for the article] included any Commission employees" and notes that the existence of the investigation had earlier been reported in the press based on information attributed to "industry executives." (RX-915 at 2.) During the course of the trial the respondent stipulated that "virtually everybody in the industry" was aware of the FTC's investigation as of February 1994. (33:7469/17-24.)

537. I find that the record evidence does not show that any Commission employee provided any person with any non-public information concerning the Commission's investigation in this case. The respondent has failed to substantiate the factual allegations in its affirmative defense.

REMEDY

538. There is no evidence that the respondent TRU has discontinued its warehouse clubs policy. The respondent asserts that its warehouse club policy is legal and justified by the needs of its business. (43:9390/2-15.)

539. Some toy manufacturers who joined in the TRU campaign against the warehouse clubs have recently relaxed their earlier restrictions on sales of products to the clubs; other toy manufacturers continue to apply the restrictive sales practices that they adopted pursuant to their concert of action with TRU. These include both Mattel and Hasbro, the two largest toy manufacturers.

540. The relief contained in the order is reasonably necessary to remedy the effects of the respondent's conduct. Each of the provisions addresses conduct that might be used by the respondent to perpetuate the restraint.

541. Among the remedial provisions is one which, for five years, would prohibit the respondent from communicating to any supplier that it may discontinue purchasing toys because the supplier sells to toy discounters. (III.E.) This provision is reasonable to "fence in" a respondent that has orchestrated an extensive concert of action with toy manufacturers to restrict toys to a competing channel of trade.

542. Executives of toy manufacturers that participated in the TRU campaign commented negatively on the foregoing provisions of the order. (Owen 6:1166/4 - 1170/6; Verrecchia 7:1446/12 - 1447/21; Wilson 26:5705 - 5707/16; Barad 35:7870/12 - 7871/13.) I find that this testimony should be given little weight. The premise of the respondent's questions to these witnesses presumed that during the 5-year "fencing in" period the respondent would be permitted to continue to refuse to deal with suppliers who sold to the clubs, but could not inform the suppliers of the reason for such a decision. (6:1166/25 - 1167/12.) The order prohibits respondent from making a purchase decision. The order does not prohibit the respondent from communicating with suppliers about issues other than the matter of the suppliers' sales to toy discounters like the clubs.

543. I find that entry of the order is necessary to cause the respondent to discontinue the challenged conduct and to dissipate the anticompetitive effects of the existing restraint. Entry of the order is in the public interest.

LEGAL ANALYSIS

In the early 1990's, TRU was the largest toy retailer in the United States. Toy manufacturers depended on TRU with its 20% of national retail toy sales. TRU's principal competition came from chain discounters Wal-Mart, Kmart and Target. An aggressive, low-margin retailer, Wal-Mart, forced lower retail toy prices.

Another new factor stirred price competition in the retail sale of toys. The warehouse clubs ("clubs"), operating at lower margins than the chain discounters, were expanding their toy operations. TRU acted to meet this competition. TRU announced to toy manufacturers that it would refuse to carry toys that the clubs carried. The question is whether TRU agreed with the manufacturers, and orchestrated agreement among them, to limit their sales of toys to the clubs.

During the late 1980's and early 1990's, toy manufacturers were losing retail outlets at the same time that the clubs were expanding their toy departments. In 1990, Mattel's chief executive officer, John Amerman, instructed his staff to be aggressive in new channels of distribution, especially the clubs. In a September 1991 Mattel document, Fred Okun, Mattel's senior vice president, wrote, "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." Other major toy manufacturers felt the same.¹³

Toy retailer concentration increased.¹⁴ The other national chain toy stores, Lionel Leisure and Child World, were in financial distress, leaving TRU difficult to replace.¹⁵ TRU accounted for 30% of the sales of major manufacturers including Mattel, Hasbro, Tyco, Little Tikes, and Fisher-Price.¹⁶

TRU viewed the clubs as a competitive threat. TRU feared that the clubs' prices could hurt the TRU price image.¹⁷ The clubs' mark-up was only 10% -- which is lower than the Wal-Mart mark-up and lower than the TRU mark-up of 30%. The difference between club prices and TRU prices was "embarrassing."¹⁸ An internal TRU analysis projected that by 1997, the warehouse clubs would have between 6 - 8 % of the U.S. Toy market.¹⁹

In 1990, TRU threatened to stop buying from Mattel if Mattel supported the clubs.²⁰ At Toy Fair 1990, Mattel gave TRU its commitment to move the clubs away from regular line product.²¹ This first agreement is a vertical agreement between TRU, the largest toy retailer, and Mattel, the largest toy manufacturer. The clubs had been buying regular line product

¹³ CX-78 (Hasbro); CX-1670 (Fisher-Price); CX-483 (Little Tikes).

¹⁴ CX-136-G; CX-523.

¹⁵ Verrecchia 7:1549/13 - 1550/1; Okun 13:2664-65; Owen 6:1159/1-2.

¹⁶ Scherer (CX-1822) at ¶ 13. Exh. 1.

¹⁷ CX-1576-B.

¹⁸ Weinberg IH (CX-1662) at 206/10-19.

¹⁹ CX-1070-C.

²⁰ CX-529; F. 120.

²¹ CX-530; F. 119.

from Mattel. After Mattel agreed to move the clubs away from regular line product, only half of Mattel's club sales were from the regular line. However, this reduction was not sufficient for TRU.

In late 1991 and early 1992, TRU told its main suppliers it did not want them to sell products to the clubs, and that it would not purchase products sold to the clubs. In response, Mattel and Hasbro both agreed not to sell hot toys to the clubs after being assured by TRU that their prime competitors would not do so.²² TRU conveyed to each major manufacturer the *quid pro quo* (this for that) offered by that manufacturer's competitors, and *vice versa*. Each would stop selling to the clubs if its competitors would.

After Mattel stated that it would go along based on competition doing the same, TRU approached Hasbro. In late 1991, TRU told Hasbro that TRU would not carry products Hasbro sold to the clubs.²³ Hasbro, like Mattel, worried about being at a competitive disadvantage. Hasbro indicated that it wanted a level playing field if it were to restrict its sales to the clubs. At a conference between Hasbro and TRU, a meeting of the minds was reached. Hasbro agreed not to sell promoted products to the clubs after it learned from TRU that Hasbro's competitors, including Fisher-Price and Mattel, had agreed not to sell.²⁴

TRU assured Hasbro that there would be a level playing field, and that Hasbro's competitors were going along.²⁵ Hasbro's CEO Alfred Verrecchia said in substance that because Hasbro's competitors had agreed not to sell promoted product, Hasbro therefore agreed to a similar restraint.²⁶

TRU found that the clubs were still carrying competing toys, and that these toys were lower priced. TRU established a more restrictive policy. TRU gained agreements from the manufacturers to sell no regular product at all to the clubs, regardless of whether it was hot. At Toy Fair in 1992, companies communicated their commitments to restrict the clubs, and TRU monitored compliance.²⁷ Manufacturers also monitored compliance.

²² CX-532-A; Goddu IH (CX-1658) at 276/1 - 277/11; 278/22-24; F. 125.

²³ Owen 6:1107/14-16, 1108/1-5.

²⁴ Inano 16:3334/21 - 3335/5, 3343/17-22. Other Hasbro officials confirmed that TRU's Goddu told them that Fisher-Price and other manufacturers would not be selling in-line promoted products to the clubs. Owen 6:1132/6 - 1134/17; Verrecchia 7:1393/5-13, 23-25, 8:1394/1-4; F. 177.

²⁵ Verrecchia 7:1393/5-14, 1393/23-25, 1394/1-4; Owen 6:1132/6 - 1134/17; F. 179.

²⁶ Inano 16:3335/15-20; F. 177.

²⁷ TRU shopped the clubs. Just after Toy Fair 1992, TRU contacted manufacturers whose products were found in the clubs. (CX-913). The TRU shopping report shows agreements between TRU and manufacturers. The document shows how TRU went far beyond Colgate, F. 101, CX-913-B, the third party entry down, refers to Hasbro's Puppy Surprise: "Shipped early. No more will be shipped to warehouses." Further down Mattel's Barbie Dream House: "Will not sell again." Under that there is an assurance from Mattel with respect to Totally Hair Ken that Mattel did not sell it to the clubs. A reference to Birney & Smith notes: "Per Brent Blaine, understood our concern. Going forward they will offer special packs only for '93." At the bottom of (CX-913-C) is a Playskool reference: "They were

Thus, the record shows that after Toy Fair conversations in February 1992, TRU contacted manufacturers to discuss the status of the agreements. These conversations show that TRU sought and received commitments. TRU sought assurances from Tyco and Fisher-Price that they would not sell to the clubs. Both Tyco and Fisher-Price worried about competitors. Both companies agreed with TRU that the clubs would be restricted.

Other manufacturers also joined. TRU agreed with Little Tikes, Tiger, Sega, Video Tech, and Today's Kids in 1993 and 1994. These agreements prevented competition between TRU and the clubs over toys that are the "lifeblood" of the industry.²⁸ The agreements involved much of the toy industry. Mattel and Hasbro accounted for 35% of national toy sales in 1994.²⁹

AGREEMENTS

A. Vertical Agreement

To meet the competition of the clubs, TRU could have announced a unilateral policy by TRU and a refusal to deal with suppliers that did not comply.³⁰ The issue is whether TRU went further, entering agreements with each manufacturer.³¹

To rely on the Colgate doctrine,³² a firm must "content itself with announcing its policy ... and [follow] this with a simple refusal to have business relations with any [persons] who disregarded that policy."³³ Having announced its policy, the firm must "rely on individual self-interest to bring about general voluntary acquiescence" with its policy.³⁴ It can not go beyond that and take the affirmative action of asking for or inducing acquiescence to its policy.

TRU first communicated to its suppliers that it would not purchase hot product carried by the clubs, and then that it would not purchase any products carried by the clubs. TRU and the manufacturers reached an

under the impression that less important items could be sold to clubs. We informed them if so, perhaps at the expense of selling us these goods."

²⁸ Goddu 23:6572/9-20.

²⁹ CX-1669-C.

³⁰ *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919); *FTC v. Raymond Bros. - Clark Co.*, 263 U.S. 565 (1924).

³¹ That the distribution policy was on advice of counsel is not relevant. *United States v. Champion Int'l Corp.*, 1979-2 Trade Cas. (CCH) ¶¶ 62,862, 78,989-991 (D. Or. 1979) ("Before their convictions under the Sherman Act, none of the defendants even knew their actions were unlawful Even their lawyers, all honorable and ethical people, believed defendants' bidding practices were lawful.")

³² *United States v. Colgate & Co.*, 250 U.S. 300 (1919).

³³ *United States v. Parke, Davis & Co.*, 362 U.S. 29, 45 (1960).

³⁴ *Id.*, at 46-47.

agreement when TRU sought acquiescence from the manufacturers. *Monsanto*, 465 U.S. 752, 766 n.9 (1983). TRU asked the manufacturers how they planned to respond, and the manufacturers gave their acquiescence.

1. Manufacturers' acquiescence

TRU monitored and communicated with its suppliers regarding compliance. TRU's Roger Goddu, the executive vice president who was responsible for TRU's club policy, informed toy manufacturers "that we had no intention of buying product that was carried by the clubs." Goddu testified that he would then ask the manufacturers what their intentions were with respect to selling to the clubs.³⁵ To avoid future meetings, TRU sought immediate commitments.³⁶ TRU contacted manufacturers whose product appeared in TRU shops of the clubs.³⁷ The pressure from TRU to gain agreements continued through 1992 and 1993.³⁸

TRU policed its program by "shopping" the clubs or by learning from manufacturers what their competitions were selling in the clubs.³⁹ When TRU learned that Mattel, Hasbro or any other manufacturer was selling new or promoted individual toys to the clubs, TRU officials would call the offending company to complain and would threaten to stop buying those products.⁴⁰ TRU's threats resulted in manufacturers agreeing not to sell certain toys to the clubs. The conversations were described in a memo prepared by Roger Goddu,⁴¹ summarizing contacts made by Goddu and his four divisional vice presidents, and sent to TRU's then CEO, Charles Lazarus. Excerpts from this memo use the language of vertical agreement. This document, and the Goddu testimony, show that TRU asked for and received acquiescence from its suppliers regarding restrictions on sales to the warehouse clubs. TRU describes how Hasbro, Mattel, Today's Kids, Huffy, Tyco and others communicated acquiescence to TRU. TRU reached vertical agreements with its suppliers.

Mattel -- Mattel "committed to Toys "R" Us that we would do our best not to sell [clubs] regular line merchandise."⁴² This agreement was reaffirmed in an October 1991 meeting in which Michael Goldstein, chief operating officer of TRU, stated that TRU was "going to allocate open-to-

³⁵ Goddu IH (CX-1657) at 130/20-25; Goddu IH (CX-1657) at 125/19-21.

³⁶ Goddu IH (CX-1657) at 209/21-23; F. 63.

³⁷ Lazarus IH (CX-1660) at 55/12-21.

³⁸ Owen 6: 1148/6-16.

³⁹ Goddu IH (CX-1657) at 128/11 - 129/5.

⁴⁰ Goddu IH (CX-1657) at 124/12 - 125/21.

⁴¹ Goddu 30:6572/20 - 6574/13; CX-913-A-F; F. 101.

⁴² CX-530-B.

buy based on who agreed not to support the clubs."⁴³ John Amerman, the CEO of Mattel said that Mattel "would not sell the clubs the same items we were selling to them," and that "this was based on the fact that competition would do the same."⁴⁴ Mattel executives later informed TRU that Mattel could not completely stop selling to the clubs, but in January 1992, a Mattel memo noted that "We've been able to negotiate to do exclusive items only [customized product for the clubs] so that there would be no direct competitive threat to TRU."⁴⁵

At a February 27, 1992 meeting with TRU, Mattel agreed not to sell the clubs "hot" product, not to ship to clubs items that Mattel could not supply to TRU,⁴⁶ and to give TRU a right of first refusal on special club packs.⁴⁷ These were the points on which TRU sought acquiescence.⁴⁸

At Toy Fair 1992 Mattel "showed [TRU's] Van [Butler] and Peter [Spencer] all of our club specials.... We offered each and every one to TRU on a 'right of first refusal' basis."⁴⁹ After Toy Fair 1992, Mattel representatives met with Roger Goddu who was "adamant that Mattel should not offer first year promoted stand alone items to the clubs. He was also comfortable with combinations of product that we were going to offer."⁵⁰ A Mattel memo dated July 1992 states that if Mattel shipped a particular product to the clubs, "arguably we are violating the spirit of our agreement."⁵¹ Mattel's sales of open stock toys to the clubs dropped from over \$10 million in 1991 to zero in 1993.⁵²

Little Tikes -- During the early 1990's, under the influence of its parent corporation Rubbermaid, Inc., Little Tikes modified its earlier strategy that had limited distribution of its large molded plastic toy products. By early 1993, Little Tikes had begun to sell its open stock products to warehouse clubs.⁵³

At a meeting with Little Tikes executives at the 1993 Toy Fair, TRU's Goddu said that if Little Tikes was going to start selling products to the

⁴³ CX-532-A; F. 124.

⁴⁴ CX-532; F. 125; F. 126.

⁴⁵ CX-540; F. 133.

⁴⁶ CX-541; F. 143.

⁴⁷ CX-541; F. 143.

⁴⁸ CX-1681.

⁴⁹ CX-550-A; F. 139.

⁵⁰ CX-550-A.

⁵¹ CX-550-B.

⁵² CX-574.

⁵³ DePersia 10:2260/10 - 2261/3; CX-1533-D; F. 268.

clubs, TRU would contemplate dropping the products.⁵⁴ Little Tikes' president told TRU that Little Tikes intended to sell warehouse clubs only low-priority, discontinued and near-discontinued products, and value-packs. He assured TRU that "we do not plan to sell regular products to Costco in the future."⁵⁵

The Little Tikes president told Goddu that not selling to Costco "will create a major problem with Rubbermaid" because Costco had threatened to discontinue buying Rubbermaid products if Little Tikes did not sell regular line products to Costco. He told Goddu "I may need [your] help."⁵⁶ At the invitation of TRU, in early April 1993, the chairman of Rubbermaid and executives from Little Tikes attended a meeting at the TRU corporate offices where the warehouse clubs were discussed. At that time, TRU was one of the largest customers of the entire Rubbermaid corporation.⁵⁷ Little Tikes sold [] as much in dollar volume to TRU than all of Rubbermaid combined sold to Price Costco.⁵⁸

During the meeting Little Tikes again acquiesced to the TRU policy: "Little Tikes sales strategy to warehouse clubs in the future will be to sell value packs, as well as discontinued and near-discontinued products."⁵⁹ The handwritten notes of Rubbermaid's chairman reflect that there was "agreement" and "understandings" on the distribution issues discussed.⁶⁰

After the April meeting, a Little Tikes' memo to the sales force listed products that could be offered for sale to warehouse clubs for the fall of 1993. The memo indicated that combination packs of Little Tikes items were the "only products that are available to the clubs at present."⁶¹ A TRU executive concluded that Little Tikes "for the most part did not have product in the clubs or anything that was first line product"⁶² until late 1994, when TRU shopping reports showed Little Tikes' first-line product being sold to the clubs.⁶³ TRU wanted a clarification of Little Tikes' club

⁵⁴ Goddu 30:6713/23 - 6714/15; CX-509; F. 269.

⁵⁵ CX-509-A; F. 271.

⁵⁶ CX-509-A; F. 271.

⁵⁷ CX-1533-C; CX-1514-C; Schmitt 11:2282/1 - 2283/5; DePersia 10:2161/20 - 2162/14.

⁵⁸ CX-1533-C; CX-514-C.

⁵⁹ CX-509-B; DePersia 10:2177/13-22; F. 275.

⁶⁰ CX-1519; F. 275.

⁶¹ CX-1520-A-C; F. 277.

⁶² Goldstein IH (CX-1659) at 110/11-14, 114/21-24.

⁶³ Goddu IH (CX-1658) at 313/6 - 314/16.

policy because Little Tikes management had changed.⁶⁴ In January 1995, at the invitation of TRU, the chairman of Rubbermaid and the new management at Little Tikes again met with senior executives of TRU.⁶⁵ The meeting reaffirmed the understandings from the April 1993 meeting concerning Little Tikes' dealings with warehouse clubs.⁶⁶

Hasbro --In early 1992, after being informed by TRU that Mattel and Fisher Price had agreed not to sell promoted product to the clubs, Hasbro committed to TRU that it would not sell new and promoted individual product to the clubs.⁶⁷ Later in 1992, the president of its Playskool division explained its policy of selling only special packs to the clubs to Roger Goddu as a "trial balloon." Mr. Goddu indicated to him that this policy was satisfactory.⁶⁸ As a result of the agreements, Hasbro sales of toys to the clubs from its Hasbro, Playskool, Playskool Baby and Kenner Divisions decreased from [] in 1991 to [] in 1993.⁶⁹

Tyco -- Tyco began selling toys to the warehouse clubs in the late 1980's. The clubs purchased individual toy products from open stock.⁷⁰ In 1991, TRU approached Tyco on the issue of Tyco's sales to the clubs. Tyco wanted to sell to the clubs because their competition did.⁷¹ TRU asked Tyco what their plans for the clubs would be.⁷² At a luncheon meeting with TRU executives during Toy Fair in 1992, Tyco unveiled their new "25 item" policy to TRU.⁷³ Under Tyco's 25 item policy, if the clubs purchased 25 SKUs, the clubs could buy regular line product.⁷⁴ However, the policy contained exceptions for Tyco customers (other than warehouse clubs) that did not typically purchase a minimum of 25 items.⁷⁵ Since the clubs could not purchase so many different products from one manufacturer because of their limited selection of toys, Tyco's plan was acceptable to TRU.⁷⁶

⁶⁴ Schmitt 11:2325/10 - 2326/1, 2327/11 - 2328/5; F. 280.

⁶⁵ Schmitt 11:2328/15-20, 2333/13-21; F. 281.

⁶⁶ Schmitt 11:2328/15-20, 2333/13-21; Goddu IH (CX-1658) at 316/11-16; F. 281.

⁶⁷ Inano 16:3335/15-20; F. 177.

⁶⁸ Owen 6:1136/20 - 1141/14.

⁶⁹ CX-448; CX-447-E; F. 212.

⁷⁰ Grey 14:2993/13-19; CX-1420; CX-1424; CX-1263-64; F. 235.

⁷¹ Goddu IH (CX-1658) at 271/23 - 272/22, 273/24 - 274/3; Goddu 30:6876/20 - 6877/13; F. 239.

⁷² Goddu 30:6677/6-8; F. 236.

⁷³ Goddu IH (CX-1675), at 177/6-8; F. 238.

⁷⁴ CX-1418; F. 240.

⁷⁵ CX-1418; CX-1667; Grey 14:3006/18 - 3009/1; F. 241.

⁷⁶ Lazarus IH (CX-1660) at 169/3 - 170/12; F. 242.

The 25 item policy was a commitment not to sell to the clubs.⁷⁷ Ken Shumaker, the Tyco sales representative to TRU, referred to it as the "no ship" policy.⁷⁸ Playtime told TRU it "will not offer any merchandise to warehouse clubs that is bought by TRU. This will make our policy exactly the same as Tycos."⁷⁹ By Toy Fair in February 1993, Tyco had a special line of products for the warehouse clubs, ignoring the 25-item minimum. Tyco's warehouse club line was similar to that of other major toy companies.⁸⁰

Tyco's subsidiary Playtime acquiesced in TRU's efforts to restrict sales of products to the warehouse clubs. In 1992, TRU contacted Playtime concerning the Super Saturator (water gun) sold to TRU and discovered by TRU for sale in warehouse club stores. The Playtime executive assured TRU that Playtime would only sell the clubs special items, or items that TRU did not carry.⁸¹

In the spring of 1993 respondent discovered another Playtime product carried by TRU (a toy gun called the "Thunderstrike" that shot foam rubber balls) was sold in the warehouse clubs.⁸² TRU met with Playtime⁸³ and received a confirming letter from Playtime which stated: "I want to apologize for misunderstanding the Toys R Us desire to merchandise their stores in a different manner than the Price Clubs. To confirm the meeting we had, Playtime will not offer any merchandise to Warehouse Clubs that is bought by Toys R Us. This will make our policy exactly the same as Tyco's."⁸⁴

A Playtime executive later presented a warehouse club version of the Thunderstrike to TRU, in a larger package and a different color with more foam balls, which would cost more to the clubs than the standard version. TRU told Playtime that the reconfigured product was acceptable.⁸⁵ By 1993, the Tyco policy was essentially identical to that of other major manufacturers: a commitment to TRU not to sell identical product to the clubs.

⁷⁷ CX-1633-D; F. 242.

⁷⁸ Weinberg 34:7715/18 - 7716/5; F. 242.

⁷⁹ CX-914; F. 256.

⁸⁰ CX-1412-B; Grey 14:3027/22 - 3029/12.

⁸¹ Weinberg 34:7719/7-22; CX-913-C; F. 254.

⁸² Weinberg IH (CX-1662) at 119/9-13; Moen 4:655/18-24; CX-1414-B; F. 255.

⁸³ Weinberg IH (CX-1662) at 169/10 - 170/4, 172/12-16; F. 256.

⁸⁴ CX-914-A.

⁸⁵ Weinberg 178, 184; F. 257.

Fisher-Price -- Before merging with Mattel in 1993, Fisher Price was the third largest toy manufacturer in the U.S.⁸⁶ Fisher-Price's regular line was sold to the clubs without restriction in the late 1980s.⁸⁷ At the 1989 Toy Fair, TRU told Fisher-Price that TRU might not carry the same products being sold in competing clubs.⁸⁸ TRU stated its policy and asked how Fisher-Price was going to deal with the clubs.⁸⁹ The answer can be inferred.

In 1991, Price Club's toy buyer asked Fisher-Price what it had to do to get product other than combo packs. Price Club would buy more SKUs, take delivery earlier, and warehouse products.⁹⁰ When Fisher-Price salesman John Chase asked his supervisor how he should respond, he was told "don't tell them you can't sell because Toys 'R' Us is pressuring, just make up a reason, tell them anything, but don't tell them you can't sell them because we're not allowed to because [of] Toys 'R' Us."⁹¹

A TRU shopping report showed products of Fisher Price found in Price Club.⁹² On the report were written the words "Byron, you promised this wouldn't happen."⁹³ This is direct evidence of agreement between Fisher-Price and TRU: a promise from Fisher Price to TRU that they would not sell certain products to the clubs.⁹⁴ After this event, Fisher-Price sold only special and combination packs to the clubs.⁹⁵

Fisher-Price was concerned with what its competitors were doing.⁹⁶ In 1992, Fisher-Price representatives saw a TV-promoted Playskool product in the Price Club.⁹⁷ The CEO of Fisher-Price telephoned TRU to see if "they'll take care of it."⁹⁸ Fisher-Price was informed by TRU that Playskool

⁸⁶ Cohen 35:7926/9-17; 35:7926/7-8; F. 216.

⁸⁷ Chase 8:1645/5-18; F. 217.

⁸⁸ Cohen 35:7937/12-21, 35:7938/6-13; F.218.

⁸⁹ Cohen 35:7792/10-19; Weinberg 34:7732/8 - 7733/19, 34:7629/1; Weinberg, CX-1662-Z-73; F. 218.

⁹⁰ Chase 8:1655/10-15; F. 221.

⁹¹ Chase 8:1657/1-7; Cohen 35:8094/25 - 8095/5; F. 221.

⁹² Chase 8:1660/16 - 1661/5; F. 222.

⁹³ Chase 8:1661/4-5; F. 222.

⁹⁴ At Toy Fair 1992, TRU informed Hasbro that Fisher-Price had agreed not to sell promoted product to the clubs. (Inano 16:3334/21 - 3335/5; Owens 6:1132/6 - 1134/17; Verrecchia 7:1393/5-14, 23-25, 8:1394/1-4.

⁹⁵ Chase 8:1661/6-8; F. 222.

⁹⁶ Goddu (CX-1658) at 328/25 - 329/2; F. 226.

⁹⁷ Chase 8:1661/6-8; F. 226.

⁹⁸ Chase 8:1666/14-16; F. 226.

wasn't "going to get away with it, that Toys "R" Us is going to take care of it." (Chase 8:1666/18 - 1667/1.)

Other manufacturers -- TRU sought and received acquiescence from Tiger, Today's Kids, Huffy, Video Tech, and Binney & Smith.⁹⁹

Tiger -- After Tiger Electronics was informed by TRU of its club policy, Tiger's president, Randy Rissman committed that Tiger would not sell any product to the clubs.¹⁰⁰ Tiger vice president Roger Shiffman asked Mr. Goddu whether it would be permissible for Tiger to sell older product and combo packs. Mr. Goddu specifically "OK'D sales of Skip It (5 yrs. old) and HHG's [hand-held games] in multi-pack with high price point."¹⁰¹ Tiger complained to TRU when it saw one of its competitor's products in the warehouse clubs.¹⁰² Mr. Goddu responded that the company (Yes, Inc.) would be punished in the future if it continued.¹⁰³

Video Tech -- Video Tech ("VTech") sold regular product to the clubs through the 1992 Christmas season.¹⁰⁴ After VTech "promised" TRU that they would not sell to the clubs.¹⁰⁵ VTech's sales of regular line product to the clubs became virtually non-existent.¹⁰⁶

Today's Kids -- At a meeting between Today's Kids and TRU, Mr. Goddu asked Today's Kids about their sales to the clubs. TRU told Today's Kids president that TRU would delay taking action against Today's Kids upon the "understanding" that Today's Kids would get back to TRU and tell TRU its plans regarding sales to the clubs.¹⁰⁷ Today's Kids got back to TRU and "said they didn't want to sell the clubs any product."¹⁰⁸

Huffy -- When TRU discovered Huffy product in the clubs identical to that carried by TRU, it complained to Huffy. Huffy responded by committing not to sell identical product to the clubs.¹⁰⁹

Binney & Smith -- After TRU called Binney & Smith to complain about finding product in the clubs, TRU reported, "Per Brent Blaine

⁹⁹ Lazarus IH (CX-1660) at 71; Goddu IH (CX-1657) at 79-80, (CX-1658) at 379-80; Weinberg IH (CX-1662) at 146-56; CX-2.

¹⁰⁰ CX-814; F. 302.

¹⁰¹ CX-814.

¹⁰² CX-811; F. 304.

¹⁰³ Shiffman 10:2026/7 - 2028/13; F. 305.

¹⁰⁴ Walter 28:6087/21-24; F. 314.

¹⁰⁵ CX-1318; F. 314.

¹⁰⁶ CX-1310; CX-1738.

¹⁰⁷ Goddu IH (CX-1657) at 167/11-14; F. 290.

¹⁰⁸ Goddu IH (CX-1657) at 168/19 - 170/12; Goddu 30:6729/9-22; F. 291.

¹⁰⁹ Goddu (CX-1658) at 380/18 - 381/6; CX-913-C; F. 354.

[director of national account sales for Binney & Smith], understood our concern. Going forward they will offer special packs only for '93."¹¹⁰

2. Advance approval

Manufacturers agreed to notify TRU in advance of toys they planned to ship to the clubs. The manufacturers would sell to the clubs only those toys about which TRU had no objection. Mattel, Tyco, Little Tikes, and Tiger gave TRU advance approval.

Mattel, at the Toy Fair 1992, provided TRU with a right of first refusal over toys being sold to the clubs.¹¹¹ Mattel agreed to ship only specials to the clubs and not hot/allocated first year product.¹¹² If Mattel shows TRU a product and TRU does not order it, Mattel would be "free" to sell it to the clubs.¹¹³

Little Tikes informed TRU of products "that we think we can sell the clubs that should not be a conflict."¹¹⁴ TRU's CEO, Michael Goldstein, testified: "That if they were going to sell anything to the clubs they would tell us about it before hand so we had the opportunity to pass on the item and not buy the particular item."¹¹⁵

3. Colgate

TRU agreed with suppliers that they would not supply toys to the clubs that were carried by TRU. Manufacturers agreed to submit products for TRU's review to ensure that these products would not cause a competitive conflict. This exceeded the limitations of the Colgate doctrine.¹¹⁶ When TRU discovered companies selling to the clubs, TRU sought and received assurance that use the language of "agreement" and "commitment." Several manufacturers agreed to allow TRU to preview their club selections. Where TRU learned that product had found its way to a club, TRU contacted the manufacturer and sought renewed acquiescence, which the manufacturers provided. This is evidence of vertical agreement, and not a Colgate announcement of a unilateral policy by TRU.

¹¹⁰ CX-913-C; CX-2; F. 101; F. 236.

¹¹¹ Leighton 15:3267/21 - 3268/6, 3269/3 - 3271/2, 3272/8-18; F. 138; F. 139.

¹¹² CX-626-A. Mattel personnel collected information on product of Mattel's competitors that was appearing in the clubs so that it could be brought to TRU's attention. CX-626-B.

¹¹³ CX-550-A.

¹¹⁴ Goddu 311-12.

¹¹⁵ *Id.*; F. 274.

¹¹⁶ *Parke Davis*, 362 U.S. at 45.

B. Horizontal Agreement

TRU orchestrated a horizontal conspiracy among its suppliers. The major manufacturers knew that TRU was contacting the other manufacturers with the same proposal and that concerted action was invited. Each also knew that unanimous action was necessary;¹¹⁷ manufacturers did not want to be singled out and put at a competitive disadvantage. The evidence shows that "compliance with the proposals involved a radical departure from the previous business practices of the industry,"¹¹⁸ which for the major toy manufacturers had been to actively pursue sales to the warehouse clubs as an innovative and rapidly growing new channel of toy distribution. Here, the manufacturers told TRU they went along with the plan because their competitors were going along with the plan. TRU informed the major manufacturers that their competitors said they were only selling to the clubs because their competitors were. TRU communicated acquiescence to their competitors, and the manufacturers participated in policing other manufacturers who violated the agreement.

1. Manufacturers' interest

Major manufacturers were reluctant to restrict sales to the warehouse clubs, being concerned with their competitor's sales to the clubs.¹¹⁹ The manufacturers felt pressure to be in the clubs because their competitors were selling to the clubs.¹²⁰ The manufacturers did not want to give up sales and were also concerned that their competitors would gain share at their expense.¹²¹ The manufacturers did not want their competitors to sell to the clubs if they could not.¹²² The competition between the manufacturers with respect to the clubs was intense. The manufacturers told TRU that they were in the clubs because their competitors were there. This information was transmitted among the manufacturers by TRU.

Mattel, Hasbro, Tyco, Little Tikes, Fisher-Price and others expressed to TRU concern with how their competitors were reacting. Manufacturers wanted assurance from TRU that their competitors were subject to the same

¹¹⁷ *Interstate Circuit v. United States*, 306 U.S. 208, 222 (1939).

¹¹⁸ *Ibid.*

¹¹⁹ Goddu IH (CX-1658) at 276; Goldstein IH (CX-1659) at 59/13-17; Lazarus (CX-1654) at 72, 181-82; F. 82.

¹²⁰ Lazarus (CX-1654) at 62; F. 83.

¹²¹ Lazarus IH (CX-1660) at 127/12-14; Goddu IH (CX-1657) at 272-73; Okun 13:2651/14-25.

¹²² Lazarus 24:5443/9-10; F. 97.

rule.¹²³ They informed TRU that they wanted a level playing field to avoid being placed at a competitive disadvantage.¹²⁴

Because of the incentives to sell to the clubs, Mr. Verrecchia, the CEO of Hasbro, believed that the agreements would not hold, and that Hasbro would be able to sell to the clubs again. (Inano 16:3335/15-20.) Mr. Verrecchia put into place a regular club shop 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, 7:1373/16-20.) Hasbro complained the most frequently about competitive product in the clubs.¹²⁵ Mattel, Fisher Price and others also complained when regular line product from their competitors was found in the clubs.¹²⁶ 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 so that the information could be brought to TRU's attention.¹²⁷ The manufacturers explained to TRU that they did not want to be prevented from selling regular line product to the clubs without assurance that their competitors were similarly excluded.¹²⁸

Manufacturers also were concerned that if they were the only one selling to the clubs, they could be easily disciplined by TRU. (Moen 4:648/24 - 649/4, 651/17-23.) TRU had a greater ability to replace a manufacturer than the manufacturer did to replace TRU.¹²⁹

2. Coordinated response

Respondent tried to obtain a coordinated response from manufactures by assuring them that they would not be placed at a competitive disadvantage because TRU was applying its policy to their competitors. Respondent told each major manufacturer that its competitors were only selling to the clubs because it was.¹³⁰ Mr. 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.¹³¹

¹²³ DePersia 10:2149/15 - 2151/4; Goddu 30:6679/20 - 6680/13; F. 87, *et seq.*

¹²⁴ Goldstein 36:8157/23 - 8158/4.

¹²⁵ Goddu IH (CX-1658) at 329/23-24; Goddu 30:6701/13-18.

¹²⁶ Goldstein IH (CX-1659) at 59/10-17, 61/17-22. Goddu IH (CX-1658) at 328/18 - 329/29; Weinberg 34:7628/15 - 34:7629/1; CX-811; Shiffman 10:2017-7-18; 2018/3-16, 2021/24 - 2022/7, 2026/3-6.

¹²⁷ CX-626-B.

¹²⁸ Goddu 31:6877/11-13.

¹²⁹ CX-486-B; CX-1141.

¹³⁰ Goldstein 36:8157/23 - 8158/4.

¹³¹ Lazarus 24:5440/5-10, 5442/14-16; Goddu 30:6679/20 - 6680/4, 31:6871/11 - 6878/1, 6880/7 - 6883/3.

The manufacturers did not act out of independent self-interest. The manufacturers did not focus on the clubs' taking advantage of others' promotion of the toys ("free-riding"); rather, they required assurances that their competitors would go along. The absence of efficiencies is demonstrated by the fact that the manufacturers feared that the restrictions would place them at a competitive disadvantage unless adopted by rivals.

TRU coordinated its policy with the manufacturers. The manufacturers all were aware that TRU was communicating its policy to everyone and that uniformity was contemplated. And everyone knew that without unanimity, regular line product sales to the clubs would recommence.¹³²

3. Manufacturers would go along

A Mattel memo on the October 1991 meeting between high officials of Mattel and TRU, shows that Mattel's CEO, John Amerman, told TRU's CEO, Charles Lazarus, that Mattel "[W]ould not sell the clubs the same items we were selling them," and that "this was based on the fact that competition would do the same."¹³³ Mr. Goddu recalled that all of the major toy companies told him that they would stop selling to the clubs if their competitors would do the same. He understood that the major manufacturers, when they said that they were only selling to the clubs because their competition was selling to the clubs, actually meant that they would get out of the clubs if their competition got out.¹³⁴

4. *Quid Pro Quo*

During conversations with manufacturers, respondent did not simply explain a Colgate policy announcing that it would refuse to deal with manufacturers selling to the clubs. Nor did it merely inform manufacturers that they would be treated equally. Instead, TRU passed the implied *quid pro quo* (they will stop if you stop) from manufacturer to manufacturer.¹³⁵ These communications by TRU ensured that the "conspirators had a unity of purpose or a common design and understanding, or a meeting of the minds." *American Tobacco Co. v. United States*, 328 U.S. 781, 809-10 (1946).

5. TRU's assurances

Respondent used the acquiescence of one manufacturer to obtain the acquiescence of another. After Mattel agreed not to sell to the clubs the same products "based on the fact that competition does the same" (CX-

¹³² *Interstate Circuit*, 306 U.S. at 222.

¹³³ CX-532-A.

¹³⁴ Goddu IH (CX-1658) at 271-72.

¹³⁵ Goddu IH (CX-1658) at 276/63 - 277/11.

532), TRU told Hasbro that Mattel had agreed.¹³⁶ Mr. Goddu indicated that he passed on assurances of compliance from one manufacturer to another: "We may have indicated to one supplier that his competitor is going to do nothing but warehouse club packs and, you know, 'you should do the same.'"¹³⁷

When TRU asked it not to sell certain products to the clubs, Little Tikes asked what its main competitor in the clubs (Today's Kids) was going to do. Mr. Goddu informed Little Tikes that Today's Kids "was going to start doing less business with the warehouse clubs."¹³⁸ Whereupon Little Tikes committed to restrict its sales.

Like each of the major manufacturers, Tyco discussed its competitors with TRU.¹³⁹ Respondent pressured Sega and Nintendo to not sell any products to the clubs.¹⁴⁰ Mr. Lazarus and Mr. 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.¹⁴¹

6. Policing the agreement

Manufacturers complained to respondent about sales by their competitors to the clubs. During July and August 1992, TRU conveyed complaints from Mattel to Hasbro and Fisher-Price and back again.¹⁴² At one meeting on July 17, 1992, TRU told Mattel that its competitors, including Hasbro, were upset about Mattel product appearing in the clubs.¹⁴³ Mattel assured TRU that it was not selling regular line product to the clubs.¹⁴⁴ Later that same day TRU met with senior executives from Hasbro.¹⁴⁵

On August 10, 1992, using internal Hasbro memos detailing the extent to which Mattel and other Hasbro competitors were selling to the clubs,¹⁴⁶

¹³⁶ 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; F. 114.

¹³⁷ Goddu IH (CX-1658) at 279.

¹³⁸ DePersia 10:2147/7-14, 2147/18-24, 2150/3-12, 2150/25 - 2151/4. Today's Kids' sales to warehouse clubs fell from \$8 million in 1993 to zero in 1994. CX-902-A.

¹³⁹ Goddu IH (CX-1658) at 271/19 - 272/13, 273/24 - 274/3.

¹⁴⁰ Moen 4:692/15 - 693/18. TRU does not account for as high a percentage of Sega or Nintendo sales as it does for sales by traditional toy manufacturers. (Scherer (CX-1822) at Exh. 1.)

¹⁴¹ CX-1776; Kalinske 12:2490/7-25, 2491/24 - 2492/2.

¹⁴² Lazarus IH (CX-1654) at 141.

¹⁴³ CX-1772; Amerman 17:3795/5-12; 3800/7 - 3802/9, 3806/24 - 3808/4; Lazarus 24:5451/4 - 5452/18.

¹⁴⁴ Amerman 17:3802/10 - 3804/14.

¹⁴⁵ CX-1772; CX-1773-B; Lazarus 24:5448/13-16.

¹⁴⁶ CX-1633; Goddu 30:6689/13 - 6690/10.

TRU met with Mattel to discuss its sales to the clubs.¹⁴⁷ The clubs found it increasingly difficult to obtain regular line product from Mattel and Hasbro.¹⁴⁸

TRU promised to "take care of it" after Fisher-Price representatives complained about Playskool product they found in Price Club.¹⁴⁹ After Tiger complained about finding a competitor's product in the clubs, Mr. Goddu told the offending manufacturer "don't do it again or God knows what."¹⁵⁰ TRU facilitated horizontal agreements among the manufacturers.¹⁵¹

7. Manufacturers contacted each other

Manufacturers discussed with each other their responses to the TRU policy. A Fisher-Price representative wrote: "After discussions with other vendors at the Lounge show, I believe the industry is backing away from the clubs. Kenner and Playskool in particular were adamant that they would not be shipping key SKUs to the Clubs, at least not yet."¹⁵² A Fisher-Price representative spoke to a Little Tikes' regional manager to find out if Little Tikes had experienced any repercussions from TRU about products it offered to the clubs.¹⁵³

Hasbro and Tyco discussed their policies relating to the clubs. In May 1992, Richard Grey, president of Tyco, discussed with Allan Hassenfeld, chairman of the board of Hasbro, how to respond to TRU. Both later adopted identical policies.¹⁵⁴

8. Summary of agreement

As a result of respondent's conduct, by 1995, the five top manufacturers of popular toys, and many other manufacturers complied with TRU's policy restricting toy sales to the clubs; the conspiracy included much of the toy manufacturing industry. The manufacturers agreed, reluctantly, to go along with the plan as long as there was a level playing field; that is, as long as

¹⁴⁷ Leighton 15:3291/2 - 3294/24.

¹⁴⁸ Halverson 3:414/14 - 415/9; Moen 4:619/10 - 621/22.

¹⁴⁹ Chase 8:1666/4 - 1667/1.

¹⁵⁰ Shiffman 10:2027/10-14.

¹⁵¹ Complaints about competitor's sales to the clubs generally related to the most immediate competitors. Hasbro, Tyco and Mattel were most interested in learning from TRU what each other's plans were. Little Tikes was concerned most with Today's Kids. Sega was most interested in Nintendo. Tiger complained about its closest competitor. Goddu IH (CX-1658) at 276/8-16 (Mattel and Hasbro); Goddu IH (CX-1657) at 228/24 - 229/15 (Sega); DePersia 10:2149/15 - 2151/4 (Little Tikes); CX-811 (Tiger).

¹⁵² CX-684-B.

¹⁵³ CX-563.

¹⁵⁴ Grey 14:3011/8 - 3013/4; F. 245; F. 259; F. 213.

their competitors also acquiesced so that they were not at a competitive disadvantage. Respondent used its buying power to organize and coordinate this understanding.

The horizontal agreement was not initiated by the manufacturers to fix prices. It involved price nonetheless. It was initiated by TRU, which was concerned that its image as a price discounter would be eroded. Pressure from TRU, and the orchestration of assurances between key manufacturers, resulted in a horizontal agreement restricting sales to the clubs.

The agreement cut off the club's supply of TV-advertised toys, and eventually stopped the sale to the clubs of any individual toy carried by TRU. Respondent permitted the manufacturers to sell specially bundled "packs" of individual toys that consumers could not readily compare to the products on TRU's shelves. The packs had to be submitted to TRU for advance approval. The horizontal agreement facilitated by TRU is *per se* illegal. *United States v. Parke, Davis & Co.*, 362 U.S. 29, 45 (1960).¹⁵⁵

The agreement here -- manufacturers changing their distribution policy to deny warehouse clubs products based on respondent's assurances that competitors would do the same -- is also a boycott.¹⁵⁶ The vertical agreements were entered into only if there was an assurance that other manufacturers would forgo that method of competition as well. Mattel and the other manufacturers entered agreements with TRU "based on the fact that competition would do the same." Under the *per se* rule the TRU conduct violates Section 5 of the FTC Act.¹⁵⁷

¹⁵⁵ In *Parke Davis*, a drug manufacturer led a horizontal agreement among its retail customers (drug stores) not to advertise prices below its suggested retail prices. The Court described the conduct of Parke Davis, as the instigator of the horizontal agreement. *id.* at 46:

First it discussed the subject with Dart Drug. When Dart indicated willingness to go along the other retailers were approached and Dart's apparent willingness to cooperate was used as the lever to gain their acquiescence in the program. Having secured those acquiescences Parke Davis returned to Dart Drug with the report of that accomplishment. Not until all this was done was the advertising suspended and sales to all the retailers resumed. In this manner Parke Davis sought assurances of compliance and got them, as well as the compliance itself. It was only by actively bringing about substantial unanimity among the competitors that Parke Davis was able to gain adherence to its policy.

¹⁵⁶ In *Klor's, Inc. v. Broadway-Hale Stores*, 359 U.S. 207 (1959), the Supreme Court held *per se* illegal a group boycott. Broadway-Hale, a retailer of appliances in Los Angeles, orchestrated an agreement with ten appliance manufacturers. The target was Klor's, a discounter located next door to Broadway-Hale. The appliance manufacturers agreed among themselves and with Broadway-Hale not to sell to Klor's or to sell only at discriminatory prices. *Id.* at 209. The Supreme Court held that "[g]roup boycotts, or concerted refusals by traders to deal with other traders, have long been held to be in the forbidden category" of conduct that is *per se* illegal. *Id.* at 212.

¹⁵⁷ Violations of Sherman Act §1 are within the scope of "unfair methods of competition" that violate Section 5 of the FTC Act. *FTC v. Motion Picture Advertising Service Co.*, 344 U.S. 392, 394-95 (1953); *Fashion Originators' Guild v. FTC*, 312 U.S. 457, 463-64 (1941). Conduct far short of the campaign orchestrated by TRU here would likely be held to violate Section 5. *FTC v. Brown Shoe Co.*, 384 U.S. 316, 321-22 (1966) (section 5 includes incipient violations of antitrust laws).

C. Proof of Agreement

Witnesses from respondent and the manufacturers denied any vertical or horizontal agreements, contending that TRU and the manufacturers all acted independently and unilaterally. "Little weight can be given to testimony which is in conflict with contemporaneous documents." *United States v. United States Gypsum Co.*, 333 U.S. 364, 396 (1948); *Adolph Coors*, 83 FTC 32, 185 (1973).

Respondent argues that the restrictions varied over time and by manufacturer, so that the requisite common design or understanding is missing. This argument is unpersuasive. The fact that the agreements changed over time and that additional manufacturers were added as time passed does not negate the finding of agreement. It relates to anticompetitive effect.

Respondent argues that there can be no agreements because formal contract law requirements are missing. An antitrust agreement does not need to meet the Uniform Commercial Code.¹⁵⁸ Agreements to fix prices where parties were free to change their minds whenever they wanted are agreements nonetheless. "No formal agreement is necessary to constitute an unlawful conspiracy."¹⁵⁹ For an agreement under the antitrust laws, all that is required is a meeting of the minds.

D. Rule of Reason

1. Non-price vertical restraint

If the respondent's conduct was solely vertical and not motivated by price competition, such non-price vertical restraints of trade are governed by the rule of reason. *Continental T.V., Inc. v. GTE Sylvania*, 433 U.S. 36 (1977). Vertical restraints limiting the ability of retailers to compete in selling products of the same brand can be pro-competitive. While vertical restraints may diminish intrabrand competition, interbrand competition could offset any potential anticompetitive effects. *Sylvania*, 433 U.S. at 54-55.

Respondent argues that its discussions with manufacturers of its policy concerning the clubs was governed by *Sylvania*, *Monsanto*,¹⁶⁰ and *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988), protecting communication between manufacturers and dealers. The Supreme Court recognized that communication may be necessary to ensure efficient distribution. Complaints from one dealer to the manufacturer about another dealer may serve a legitimate function. In the absence of market power, competition with other manufacturers in the same industry

¹⁵⁸ *Isaksen v. Vermont Castings, Inc.*, 825 F.2d 1158, 1164 (7th Cir. 1987).

¹⁵⁹ *American Tobacco v. United States*, 328 U.S. 781, 809 (1946).

¹⁶⁰ *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752 (1984).

will prevent any anticompetitive effects from the dealer complaints about another dealer on the same brand.¹⁶¹ The communications at the heart of this case, however, are not dealer complaints about one brand. Here, manufacturers complain to respondent about other manufacturers, eliminating interbrand competition. By recognizing the possible pro-competitive efficiency of communication between a manufacturer and a dealer, the Court did not take conspiracy out of the antitrust laws.

Once there is proof that a vertical restraint adversely affects competition, respondent must show that the restraint in fact has a pro-competitive effect.¹⁶² Respondent argues that its policy prevents free-riding by the clubs. But, as shown later in this opinion, TRU fails to establish free-riding at retail. TRU is already compensated by toy manufacturers for the retailing "services" on which it claims the clubs are free-riding. The fact that manufacturers required assurances that their competitors would go along so they would not be placed at competitive disadvantage, shows that the restraints were not in the manufacturers' independent, unilateral self-interest. The anticompetitive purpose and effect of vertical non-price restraints and the lack of pro-competitive justifications make them illegal under the rule of reason.¹⁶³

2. Purpose of the restraint

The objective of TRU's limitations on sales by toy manufacturers was to suppress price competition and exclude competitors. The policy was to keep merchandise out of the clubs, and to make sure that the price of merchandise that was in the clubs was not directly comparable to TRU's price.¹⁶⁴ TRU approved packs for the clubs because they prevented the consumer from making price comparisons and finding TRU's prices were higher than the clubs' prices.¹⁶⁵

3. Competitive effects of the restraint

The campaign worked. The clubs had been viewed in the same class as Wal-Mart in setting the lowest prices for the toy industry,¹⁶⁶ and during

¹⁶¹ *Monsanto*, 465 U.S. at 762.

¹⁶² *Graphic Products Distributors v. Itek Corp.*, 717 F.2d 1560, 1576(11th Cir. 1983); *United States v. Brown University*, 5 F.3d 658, 669 (3d Cir. 1993) ("burden shifts to the defendant to show that the challenged conduct promotes a sufficiently pro-competitive objective.").

¹⁶³ *Eiberger v. Sony Corp.*, 622 F.2d 1068 (2d Cir. 1980)(vertical restraint by manufacturer of dictation equipment with 12% share unlawful where the agreement restricted intrabrand competition but did not promote interbrand competition).

¹⁶⁴ Goddu 31:6840/20 - 6841/7.

¹⁶⁵ Goddu IH (CX-1657) at 215/19 - 216/8; Lazarus IH (CX-1660) at 271/1-25; Nakasone IH (CX-1661) at 165/5 - 166/24.

¹⁶⁶ CX-1576-B.

1992 were "a strong competitive force."¹⁶⁷ But by mid-1993, TRU no longer viewed the clubs as significant competition.

The downward pressure on pricing was eliminated. Consumers who would have bought toys at the clubs now paid 10-20% higher prices at other retailers.¹⁶⁸ The special packs available to the clubs, were less attractive to consumers, and cost more. Clubs that purchased popular individual toys from diverters, raised their costs. Added costs were generally passed on to consumers who bought toys at the clubs.¹⁶⁹

The effects of TRU's conduct have been on TV-promoted items that had been carried by both TRU and the clubs. Roger Goddu called TV-promoted product the "lifeblood of the industry." It was these "lifeblood" products that the clubs sought and were denied so that TRU could preserve its price image. Toy prices to consumers were higher than they would have been in the absence of the agreements.¹⁷⁰

By 1993, the major manufacturers of TV toys sold only special packs to the clubs -- or they did not sell to the clubs at all. Respondent's conduct suppressed information that consumers needed to make informed price comparisons.¹⁷¹ The foreclosure succeeded in inhibiting the growth of the warehouse clubs, a promising entrant into toy retailing.¹⁷² The clubs, like Wal-Mart, set the lowest prices for the toy industry,¹⁷³ but were rendered less effective competitors. Respondent made no showing that this anticompetitive effect was offset by any increase in interbrand competition.

The anticompetitive effects caused by respondent's conduct are the best evidence of its market power. *FTC v. Indiana Federation of Dentists*, 476 U.S. 447, 460-61 (1986). Those effects "can obviate the need for an inquiry into market power, which is but a surrogate for detrimental effects."¹⁷⁴ Here, TRU's ability to bring about a sharp turnaround in the major manufacturers' dealings with the clubs (a "radical departure from the previous business practices of the industry.")¹⁷⁵ not only is a strong

¹⁶⁷ CX-1618.

¹⁶⁸ Weinberg IH (CX-1662) at 205/10-16, 206/24 - 211/22; Nakasone IH (CX-1661) at 42/13 - 45/9.

¹⁶⁹ Ojendyk 18:3999/8 - 4002/1.

¹⁷⁰ Goddu 30:6616/19-23.

¹⁷¹ *FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447, 463 (1986).

¹⁷² Scherer (CX-1822) at ¶ 54.

¹⁷³ CX-1576-B.

¹⁷⁴ "[W]hen a court finds actual anticompetitive effects, no detailed examination of market power is necessary to judge the practice unlawful." *International Ass'n of Conference Interpreters* ("AIIC"), Dkt. No. 9270 (Feb. 19, 1997) at 33-34.

¹⁷⁵ *Interstate Circuit*, 306 U.S. at 222.

indicator of its market power, but also proves the ultimate question of anticompetitive effects.¹⁷⁶

4. Market power

a. Retail market power

Respondent's share of all toys sold nationally in 1992, was []¹⁷⁷ However, retailing is local from the consumer's perspective.¹⁷⁸ TRU focuses on densely populated urban areas. TRU calculated its share among toy retailers in 30 local markets in 1990: TRU's share was over []¹⁷⁹ In 1993, TRU adjusted its national market share figures to account for the fact that "we reach geographically about 65% of the toy dollars in the U.S.A."¹⁸⁰ This consists of consumers within a 30 minute drive of a TRU store. Using this measure, TRU's market share was 32%.

Major toy manufacturers refer to TRU as dominant. TRU refers to itself as dominant.¹⁸¹ Market shares are used as a predictor of market power and anticompetitive effects: in this case, however, the anticompetitive effects are apparent, and TRU exercises market power as a buyer and as a seller of toys.

b. Leverage

Market power exists if Toys "R" Us can exert leverage over the manufacturers. Leverage exists when the manufacturer cannot find a ready substitute.¹⁸² A retailer has sufficient bargaining power to cause anticompetitive effects, when the retailer (1) has "hard-to-replace distribution skills or facilities," (2) is a multibrand retailer that could threaten to drop one brand in favor of another, or (3) "accounts for such a large volume of business that his replacement would involve substantial disruption that would not be outweighed by retaining a smaller complained-against dealer."¹⁸³

¹⁷⁶ *California Dental Ass'n*, Dkt. No. 9259 at 25 (March 25, 1996).

¹⁷⁷ CX-1039-E; CX-1040-A.

¹⁷⁸ Scherer (CX-1822) at ¶¶ 24-28.

¹⁷⁹ Chicago (42%), Detroit (44%), Los Angeles (41%), New York (43%), San Francisco (46%), Seattle (35%), and Washington, D.C. (43%). CX-1577-B.

¹⁸⁰ CX-1576-A, D.

¹⁸¹ On October 21, 1991, Mr. Goldstein, TRU's CEO, stated: "Toys R Us is dominating the toy industry and is gaining market share." CX-1040; CX-1048; CX-1042-G-I.

¹⁸² *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451, 476 n.23 (1992) (citing F.M. Scherer & D. Ross, *Industrial Market Structure and Economic Performance* 16-17 (3d ed. 1990)); *California Dental Ass'n*, Dkt. No. 9259 at 30.

¹⁸³ VII Areeda, *Antitrust Law* ¶ 1457-C 3 at 171.

TRU's share of the sales of the major toy manufacturers is high. TRU is usually the largest customer for the major traditional (non-video) toy manufacturers.¹⁸⁴ In 1994, TRU purchased [] of Mattel's toys, [] of Hasbro's toys, [] of Little Tikes' toys, and [] of Tyco's toys.¹⁸⁵ TRU accounts for [] of Fisher-Price's sales.¹⁸⁶ Conversely, each manufacturer accounts for a relatively low percentage of TRU sales. In 1994 TRU accounted for over [] of Little Tikes sales, but Little Tikes accounted for only [] of TRU's sales. In 1994, TRU accounted for over [] of Tyco's sales. Tyco accounted for under [] of TRU sales. Mattel and Hasbro account for more of TRU's sales [] but still below the share for which TRU accounts of their sales.¹⁸⁷ This gives TRU additional leverage over the manufacturers.

Respondent's national market share does not account for the geographic distribution of its stores across the country. Toy retailing is local,¹⁸⁸ and because TRU has high local market shares in major metropolitan areas, this adds to its buyer power. To be present in many metropolitan areas, the manufacturer must have TRU distribution.¹⁸⁹ In the New York metropolitan area, TRU had [] of retail toy sales. Its high market share in many important local retail markets shows market power.

In 1995 Wal-Mart accounted for 14% of the toy market, Kmart (8%), Target (6%), and Kay-Bee (4%), with the other retailers in the 1-2% range or less.¹⁹⁰ The manufacturers' dependence on TRU increased when Lionel Leisure and Child World went out of business, leaving TRU as the only remaining full line national toy chain.¹⁹¹

It would be very difficult for a manufacturer to replace respondent as a customer.¹⁹² Wal-Mart and Kmart, who are already promoting and selling as many toys as they can, could not absorb a [] increase in toy sale volume by adding another shift.

It would be difficult for manufacturers to produce products without TRU. For promoted product, a manufacturer has to generate volume to support the TV advertising, and TRU's distribution is needed to reach that

¹⁸⁴ Okun(Mattel) 13:2608/22-2609/1; Owen(Hasbro)6:1102/13-17, 1159/1-2; CX-1272(Tyco); DePersia (Little Tikes) 10:2256/8-10, 2257/15-16; Cohen (Fisher-Price) 35:7926/18-7927/4.

¹⁸⁵ Scherer (CX-1822) at Exh. 1; F. 504.

¹⁸⁶ Cohen 35:7927/2-4.

¹⁸⁷ CX-1141; CX-486-B.

¹⁸⁸ Scherer 23:5160-61.

¹⁸⁹ Shiffman 10:2249/12 - 2250/6, 2001/21 - 2002/1.

¹⁹⁰ F. 5.

¹⁹¹ Verrecchia 7:1549/13 - 1550/1; Okun 13:2664-65; Owen 6:1159/1-2.

¹⁹² Okun 13:2813/22 - 2814/1; Owen 6:1151/3-10; Verrecchia 7:1412/19-22.

volume. And for many basic products, TRU is almost the only purchaser.¹⁹³ The manufacturers also depend on TRU's international sales. Nearly half of Mattel's and Hasbro's sales are now outside the United States. The dollar volume at risk by alienating TRU is more substantial when these international sales are included.

Hasbro documents refer to their dependence on TRU.¹⁹⁴ A Tiger Electronics VP for Sales wrote "I am very worried about our future business as a whole for the following reasons:***(2) TRU dictating to Tiger and becoming even a bigger percentage of our business due to not selling and broadening our account base."¹⁹⁵ A Fisher-Price memo discusses the Fisher-Price desire to reduce dependence on TRU.¹⁹⁶

When TRU makes decisions regarding retail price, sales goals and incentive bonuses, it ignores "mom-and-pop" stores and focuses on its significant competitors.¹⁹⁷ TRU faced no significant competition in [] markets during 1994.¹⁹⁸ TRU's prices are highest where they have the least competition.¹⁹⁹ TRU has market power as a seller.

DEFENSES

A. Respondent's Legal Argument

Respondent relies on *Elder-Beerman Stores v. Federated Department Stores, Inc.*, 459 F.2d 138 (6th Cir. 1972). Plaintiff there alleged vertical conspiracies (involving the leading department store in Dayton, Ohio and numerous suppliers to boycott the second largest department store) and a horizontal conspiracy *per se* unlawful under Klor's. Each of the three opinions of the court rejected the horizontal conspiracy on a mere showing that the suppliers were aware that others were being coerced into vertical agreements. The "majority" opinion concluded that the record was "devoid" of any evidence of a group boycott,²⁰⁰ the two concurring/dissenting opinions similarly held that there could be no horizontal conspiracy without evidence that the suppliers "consulted with or agreed with each other"²⁰¹ or

¹⁹³ Owen 6:1153/1-17; 1154/10 - 1155/2.

¹⁹⁴ CX-444; CX-158-S-U; Owen 6:1158/9 - 1159/13.

¹⁹⁵ CX-813.

¹⁹⁶ CX-648-A-B.

¹⁹⁷ During various time periods, TRU included the following retail operations as competitors for the purpose of its knock-off calculations: [] CX-950-A; CX-970; CX-1003; CX-1014; CX-1017.

¹⁹⁸ CX-1014-A.

¹⁹⁹ F. 459.

²⁰⁰ *Elder-Beerman*, 459 F. 2d at 146 n.11.

²⁰¹ *Id.* at 155.

"any communication or agreement between them."²⁰² None of the opinions required communication directly between the competitors; an agreement or meeting of the minds, whether reached directly or through an intermediary, was sufficient. Judge Kent explained that the conspirators did not even need to know "the number of people involved"; they simply had to know that "other persons would be performing illegal acts in furtherance of the conspiracy."²⁰³ Judge Miller explained that the conspirators need not have knowledge of the actual conduct of the co-conspirators or even the "existence of their co-conspirators." The court did not find that "evidence of communication among the suppliers" was required.²⁰⁴

Respondent also cites *Toys "R" Us, Inc. v. R.H. Macy & Co.*, 728 F. Supp. 230 (S.D.N.Y. 1990). In *Macy*, the court found no *per se* violation where two manufacturers of children's swimwear bowed to pressure from Macy's not to deal with Kids "R" Us.²⁰⁵ Although there was some communication between the two manufacturers, there was "no evidence that Backflips and Little Dippers made any agreement with each other about not selling to Kids. Each company acted independently of the other in response to pressure by Macy."²⁰⁶ There was no evidence that manufacturers expressed concern about being placed at a competitive disadvantage, that Macy made it a point to assure its suppliers that it would apply its policy across the board so that none would be placed at a competitive disadvantage, or that either manufacturer made its participation contingent upon the other going along. The *Macy* decision was probably the impetus behind the TRU conduct at issue here; however, TRU crossed a line that Macy did not by orchestrating an agreement among the manufacturers and by using market power that Macy did not have.

²⁰² *Id.* at 163.

²⁰³ *Id.* at 146.

²⁰⁴ Respondent also relies on *U.S. Healthcare, Inc. v. Healthsource, Inc.*, 986 F.2d 589 (1st Cir. 1993). There, an HMO required its participating doctors to sign agreements whereby they received greater compensation if they agreed not to participate with other HMOs. The court noted that if the doctors had agreed among themselves not to provide services to competing HMOs, and the agreement was "devoid of joint venture efficiencies," the conduct might be *per se* illegal. *Id.* at 594. There was no evidence that doctors indicated that they would not participate unless the HMO forced other doctors to go along, or that the doctors feared being at a competitive disadvantage. In short, the court found no evidence of a horizontal agreement; rather, the facts disclosed merely a series of vertical agreements.

²⁰⁵ TRU did not prevail because TRU's complaint, filed prior to Sharp, relied on the theory that it was *per se* unlawful for Macy's to extract alleged vertical agreements from two children's clothing suppliers to stop selling certain merchandise to plaintiff's Kids "R" Us discount operation. Deciding the case after Sharp had been handed down, the district court held under Sharp that the *per se* rule was inapplicable. In any event, TRU did not present evidence that a restriction on only these two manufacturers could have any anticompetitive effect.

²⁰⁶ *Macy*, 728 F. Supp. at 232-33, 236.

B. Free-Rider and Efficiency Justifications

Respondent argues that the procompetitive nature of its conduct offsets anticompetitive effects. TRU must show that its conduct was (a) procompetitive or (b) that it was reasonably necessary to meet the competitive problems.²⁰⁷

TRU's free-rider argument focuses on its investment in creating hits for the industry in its "showroom." TRU's contemporaneous documents concerning the development of its campaign against the clubs refer to neither preventing "free-riding," nor the showroom issue. TRU's campaign was directed solely at the clubs, which threatened TRU with the lowest prices, with smaller selections than TRU, focusing on the more popular toys, on a more seasonal basis, with little advertising outside of the Christmas season. TRU shifts many retailing functions to toy manufacturers. TRU's dating terms with major toy manufacturers provide that payment for shipments it receives earlier in the year is not due until December. The cost of advertising and product promotions is born mostly by TRU's suppliers, not TRU.

The vertical agreements by the manufacturers did not help them compete more effectively against other manufacturers. Manufacturers agreed after being assured that other manufacturers would forgo selling open stock to the clubs, not in order to achieve efficiencies in distribution in each manufacturer's own individual, independent self-interest.

Toys are less susceptible to free-riding than higher cost goods where services are provided by the retailer.²⁰⁸ Consumers are unlikely to obtain services from TRU and then travel to a club to purchase the product.

1. TRU advertising

In the toy industry the manufacturer generates demand for products through television advertising.²⁰⁹ Consumers are informed by the manufacturer's advertising efforts, not TRU's. TRU on the other hand advertises availability and price of toys for sale in its stores.

Respondent receives compensation for this advertising. The manufacturers pay TRU to appear in TRU advertisements. In 1994, TRU spent [] million for advertising, and received [] million in compensation. Its net cost of advertising was [] As a percentage of net sales, TRU's net advertising expenditures were []²¹⁰ In 1993, TRU

²⁰⁷ *Graphic Products Dist. v. Itek Corp.*, 717 F.2d 1560, 1576, 1577 n.31 (11th Cir. 1983).

²⁰⁸ *Sylvania*, 433 U.S. at 55.

²⁰⁹ *Spencer* 9:1866/7-10; *Amerman* 17:3738/8-17; *Weinberg IH (CX-1662)* at 48/21-25.

²¹⁰ CX-1012.

415

Initial Decision

reported that "We are getting vendor funding for all the roto advertising - it's essentially free."²¹¹

Toy manufacturers spend over 8% of sales dollars on advertising.²¹² This figure includes manufacturers that do not engage in advertising. Mattel and Hasbro, the two largest manufacturers, spend a higher percentage of sales on advertising. Demand for toys is created in advertising by the manufacturer, not by TRU. TRU benefits from its own advertising and promotional efforts. There is no evidence that TRU advertising generates sales at warehouse club stores.

2. TRU in-store promotion

Respondent's stores resemble warehouses. Like Wal-Mart, Kmart, and the clubs, TRU does not provide demonstrations or informed sales personnel.²¹³ TRU characterizes itself as a low to non-existent service provider.²¹⁴

3. TRU's year-round full line

Respondent carries more toys year-round than the clubs or other toy retailers. TRU argues that this service saves manufacturers warehouses, smooths manufacturer production, and lowers costs to consumers; that it bears risk by obtaining product early in the season before hot toys are known; that TRU in fact helps create hot toys; that its compensation for providing this service is threatened by club sales, and the clubs learn which toys are hot based on the TRU efforts, and then free-ride on that information.

Respondent benefits from its full-year, full-line coverage. This is not just a cost to TRU. By taking product early, TRU reduces the risk of being out-of-stock, especially when a product becomes hot and is in short supply. TRU's full-line gives it an advantage over competitors with fewer toys.²¹⁵ TRU has higher profits on less popular items.²¹⁶

Respondent contends that the clubs order after winners and losers are determined. The clubs place most of their orders in the spring when it is uncertain which toys will be the "hot" toys for the Christmas season. The clubs' offer to carry toys all year did not change the manufacturers' refusal

²¹¹ CX-967-C.

²¹² CX-1624.

²¹³ TRU's low service reputation is reported in consumer surveys (CX-917-A-D) and is well known to the public. New York Times article ("Lost in Toyland," March 31, 1996, pp.3, 12) (CX-807).

²¹⁴ Goldstein IH (CX-1655) at 36/20-23; Lazarus 24:5356/11-22.

²¹⁵ CX-1586; CX-1597-A; CX-1611-F.

²¹⁶ Scherer (CX-1822) ¶ 18.

to sell the clubs identical toys.²¹⁷ The toy industry is seasonal. Manufacturers ship, and retailers sell most of the toys during the fourth quarter. Many promoted toys are not even available until then. (CX-1624.)²¹⁸ That the clubs sell a high percentage of toys in the fourth quarter is of little importance. There is little variation in seasonality between the warehouse clubs and TRU.²¹⁹

Respondent argues that it is not compensated for carrying inventory early in the year and promoting new toys. TRU receives compensation from the manufacturers which reduces this risk. []²²⁰ This compensates TRU for warehousing product early.²²¹ Manufacturers give respondent warehouse, early buy, early ship discounts or other allowances for purchasing early.²²² In 1994, TRU received [] in merchandising allowances. This covered TRU's early purchases and warehousing expenses, as well as compensation for endcaps, sidecaps, and register lane placement. Dating terms enable TRU to carry a full line of toys all year.²²³ Respondent has leverage to negotiate favorable terms.²²⁴ If TRU buys products early in the year that do not sell by late in the year, TRU obtains cost markdowns, credits, extended dating terms, redating, consumer coupons, and free goods. TRU received [] million in markdown allowances in 1994.²²⁵ If a toy still does not sell after the first markdown allowance manufacturers provide additional allowances to TRU or further extend the dating. Respondent is also compensated by manufacturers for promotions. And it receives a disproportionate share of hot, allocated product.²²⁶ It is compensated for ordering more toys earlier in the year. It gains price concessions from manufacturers. It is compensated for carrying toys not carried by the clubs.

²¹⁷ CX-1664.

²¹⁸ In 1992, Parker Brothers sold 72% of its toys in the 4th quarter, Milton Bradley 69%, and Tyco 64%. Toy sales and shipments are heavily skewed to the 4th quarter. In 1994, Mattel sold nearly 62% of its product in the 4th quarter; Hasbro sold almost 70% of its games and puzzles. (CX-139-K.)

²¹⁹ *RX-621*, Table 7 at 28 (62-64% for clubs; 56-57% for TRU).

²²⁰ []

²²¹ CX-686-B.

²²² CX-1730; CX-1012.

²²³ CX-1012; CX-1611.

²²⁴ CX-683-A-E.

²²⁵ CX-1012.

²²⁶ CX-530-A; CX-530-D; CX-527-A-B; CX-533-A ("... Toys R Us is receiving a disproportionate share of our quotas."); CX-5; CX-10-A-B; CX-444-B; CX-200.

4. "Hot" toys

Respondent argues that it orders toys earlier than the clubs, and that the clubs order only toys identified as "hot" by its efforts. TRU places most of its orders for the Christmas season in the spring, and receives some toys early in the year, and some later. The clubs order soon after TRU. At the time that the clubs order, neither the clubs nor the manufacturers know which toys will be hot.

5. Other retailers

Toy manufacturers offer their full line of toys to Wal-Mart, Kmart and drug stores and supermarkets which do not carry the manufacturers' full lines or advertise nearly to the extent TRU does.²²⁷ TRU's free-rider argument cannot justify its conduct targeted at the warehouse clubs. Despite the similarities between warehouse clubs and other discount retailers, respondent did not pressure the manufacturers regarding Wal-Mart or other retailers. The TRU campaign was not directed at "free-riding" by the clubs on TRU's retailing functions.

6. Canada

Respondent has expressed concern to manufacturers that their products were being carried by the clubs' stores in Canada and the United Kingdom.²²⁸ However, TRU was unsuccessful in Canada. TRU has less leverage in Canada, due to another retailer (Zellers), "about as tough a competitor in the toy business as we have in the world."²²⁹ If free-riding were the true rationale, the manufacturers would cut-off the clubs in Canada as they have at TRU's behest in the United States. This has not occurred.

CONCLUSIONS OF LAW

1. The Federal Trade Commission has jurisdiction over the subject matter of this proceeding and over the respondent, Toys "R" Us, Inc.

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

²²⁷ Mr. Goldstein, vice-chairman and CEO of TRU, testified that respondent provides more services for manufacturers than any other of the national chains, including Wal-Mart, Target and Kmart, by taking product earlier, carrying a fuller line, carrying less-popular or non-promoted toys, advertising year-round, test-marketing products, avoiding knock-off toys (imitations), and promoting manufacturer brands. (36:8252/18 - 8259/5.) TRU accounted for [] of the toy industry's retail advertising from January through May of 1994, while Wal-Mart accounted for []. (CX-1732; CX-155.) Wal-Mart does not advertise heavily, and instead, offers low prices. This policy is similar to that used by the warehouse clubs. (CX-137-B.)

²²⁸ Nakasone IH (CX-1661) at 84, 90, 118; Goldstein IH (CX-1659) at 102-04.

²²⁹ CX-1648-T.

3. TRU is a corporation, within the meaning of Section 4 of the Federal Trade Commission Act, 15 U.S.C. 44, as amended.

4. TRU's acts and practices are in or affect commerce as "commerce" is defined in the Federal Trade Commission Act.

5. Respondent engaged in agreements, contracts or combinations with toy manufacturers constituting unfair methods of competition, in violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. 45.

6. TRU's importance as a distributor of toys has given it market power over toy manufacturers.

7. Since 1989, TRU used its market power to gain agreements or understandings with suppliers relating to toy sales to the clubs. These agreements or understandings included:

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

(b) TRU and the suppliers agreed upon toys that could be sold to the clubs. These were "club specials" consisting of pack of items, differentiated from regular open stock items. The club specials could not be readily price-compared to products sold by TRU, cost more, and raised the clubs' prices to consumers; and

(c) The suppliers agreed to advise TRU in advance of club specials that the suppliers wanted to sell to the clubs.

8. Some major manufacturers were reluctant to give up their sales of individual toys to the clubs so long as their competitors were selling those products to the clubs. TRU then facilitated agreements or understandings among competing manufacturers to achieve substantial unity of action among them relating to their dealings with the clubs.

9. The agreements or understandings facilitated by TRU between competing manufacturers are *per se* unlawful.

10. The agreements or understandings between toy manufacturers and between TRU and toy manufacturers were not a legitimate effort to protect TRU and the manufacturers from "free-riding" by the warehouse clubs.

11. The purpose and effect of the agreements or understandings between toy manufacturers and between TRU and toy manufacturers was to restrain competition among toy retailers and among toy manufacturers.

12. The respondent has unreasonably restrained competition.

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

(b) Competition among toy manufacturers in the distribution of toys to 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 incipency; and

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

13. The agreements or understandings between the manufacturers and between TRU and the manufacturers tend substantially to reduce output and restrain competition. None of these agreements or understandings is supported by a cognizable or demonstrated efficiency or other procompetitive justification. As a result, under a rule of reason analysis, these agreements or understandings constitute an unreasonable restraint of trade.

14. The acts or practices of TRU prejudice and injure 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, 15 U.S.C. 45. These acts or practices are continuing.

15. TRU has failed to demonstrate that the complaint of the Commission herein was issued without reason to believe that TRU had violated the Federal Trade Commission Act or that the complaint was issued as a result of any legal insufficiency.

16. The order is in the public interest to remedy the violation of law and is necessary to bring to an end the challenged conduct and to dissipate the anticompetitive effects of the restraint.

ORDER

I.

A. "*Respondent*" means Toys "R" Us, its directors, officers, employees, agents and representatives, predecessors, successors and assigns; its subsidiaries, divisions, and groups, and affiliates controlled by Toys "R" Us, and the respective directors, officers, employees, agents and representatives, successors, and assigns of each.

B. "*Toy discounter*" means any retailer of toys, including but not limited to membership retail outlets such as Price-Costco, Sam's Club, and BJ's Wholesale Club, that sells toys at discounted prices.

C. "*Toys and related products*" means any product that is sold by respondent.

D. "*Commission*" means the Federal Trade Commission.

II.

It is ordered, That respondent, directly or indirectly, through any corporation, subsidiary, division or other device, in connection with the actual or potential purchase or distribution of toys and related products, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, forthwith cease and desist from:

A. Continuing, maintaining, entering into, and attempting to enter into any agreement or understanding with any supplier to limit supply or to refuse to sell toys and related products to any toy discounter.

B. Urging, inducing, coercing, or pressuring, or attempting to urge, induce, coerce, or pressure, any supplier to limit supply or to refuse to sell toys and related products to any toy discounter.

C. Requiring, soliciting, requesting or encouraging any supplier to furnish information to respondent relating to any supplier's sales or actual or intended shipments to any toy discounter.

D. Facilitating or attempting to facilitate agreements or understandings between or among suppliers relating to limiting the sale of toys and related products to any retailer(s) by, among other things, transmitting or conveying complaints, intentions, plans, actions, or other similar information from one supplier to another supplier relating to sales to such retailer(s).

E. For a period of five years, (1) announcing or communicating that respondent will or may discontinue purchasing or refuse to purchase toys and related products from any supplier because that supplier intends to sell or sells toys and related products to any toy discounter, or (2) refusing to purchase toys and related products from a supplier because, in whole or in part, that supplier offered to sell or sold toys and related products to any toy discounter.

Provided, however, that nothing in this order shall prevent respondent from seeking or entering into exclusive arrangements with suppliers with respect to particular toys.

III.

It is further ordered, That respondent shall:

A. Within thirty (30) days after the date on which this order becomes final, mail to each of its suppliers and employees who have purchasing responsibilities a copy of the Commission's complaint and order in this matter, along with a letter from respondent's chief executive officer stating that its suppliers can sell whatever products they wish to retailers, and that respondent will not take any adverse action for selling toys and related products to retailers in whole or in part due to the retailer's retail prices or price policies;

B. Within ten (10) days after the date on which any person becomes an employee of respondent with purchasing responsibilities for toys and related products, or a director, officer, or management employee of respondent, or a new supplier of respondent, provide a copy of this complaint and order to such person; and

C. Require each employee, director, or officer to whom a copy of this complaint and order is furnished pursuant to subparagraphs III A and B of

this order to sign and submit to Toys "R" Us, Inc., within thirty (30) days of the receipt thereof a statement that: (1) acknowledges receipt of the complaint and order; (2) represents that the undersigned has read and understands the complaint and order; and (3) acknowledges that the undersigned has been advised and understands that non-compliance with the order may subject Toys "R" Us, Inc. to penalties for violation of the order.

IV.

It is further ordered, That respondent shall:

A. Within sixty (60) days after the date on which this order becomes final, and annually thereafter on the anniversary of the date this order becomes final, and at such times as the Commission may by written notice to the respondent require, file with the Commission a verified written report setting forth in detail the manner and form in which respondent has complied and is complying with this order;

B. Maintain and make available to the staff of the Federal Trade Commission for inspection and copying, upon reasonable notice, all records of communications with suppliers of respondent relating to any aspect of actual or potential purchase or distribution of toys and related products, and records pertaining to any action taken in connection with any activity covered by paragraphs II and III of this order; and

C. Notify the Commission at least thirty (30) days prior to any change in respondent such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries, or any other change in the corporation that may affect compliance obligations arising out of this order.

V.

It is further ordered, That this order shall terminate twenty(20) years after the date on which this order becomes final.

OPINION OF THE COMMISSION*

BY PITOFISKY, *Chairman*:

INTRODUCTION.

Boiled down to essentials, this case is about how Toys "R" Us ("TRU"), the largest toy retailer in the United States, responded to a new type of competition in toy retailing posed by wholesale clubs ("clubs"), an innovative class of discount retailers. Instead of meeting this new competition in the market place, TRU communicated with all the toy

* Note: [] indicates *in camera* information has been redacted.

manufacturers that supplied both TRU and the clubs, and induced many suppliers to agree -- with TRU and each other -- either that they would not sell to the clubs at all, or more usually that they would sell on disadvantageous terms and conditions. TRU's goal was to prevent consumers from comparing the price and quality of products in the clubs to the price and quality of the same toys displayed and sold at TRU, and thereby to reduce the effectiveness of the clubs as competitors.

We find that TRU's conduct violates Section 5 of the FTC Act.¹ In doing so, we do not intrude on the right of a trader *unilaterally* to announce terms on which it will deal with suppliers, even if those terms disadvantage a rival. That is a company's long-recognized right under *United States v. Colgate & Co.*, 250 U.S. 300 (1919), reaffirmed by the Supreme Court in 1984 in *Monsanto Co. v. Spray-Rite Servs. Co.*, 465 U.S. 752 (1984). What a firm cannot do is (1) agree with each of its suppliers not to sell or to sell on discriminatory terms to particular objectionable rivals, and (2) organize a boycott of suppliers to put its rivals at a disadvantage. A finding of illegality is amply justified here. First, TRU's purpose was to eliminate a form of competition that many consumers prefer; second, TRU and the toy manufacturers both had "dominant" market power; and third, the effect was harmful to competition and consumers.

TRU's 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 TRU. The problems with that explanation, the so-called "free-rider defense," are many: (1) TRU's claimed services are not the type on which a "free-rider" defense is typically based; (2) TRU was compensated fully or in large part by toy manufacturers for all significant services it provided; and (3) TRU presents no evidence, beyond speculation, that the clubs' "no-frills" approach did or would drive valuable services out of the market place -- an essential element of the "free-rider defense."

If a large toy retailer can engage in the actions pursued by TRU, then any large retailer in any sector of retailing could do the same, foreclosing competition in what has been over the years the highly competitive, open and efficient retailing sector of the United States economy. Indeed, a remarkable irony of this case is that if the law were as TRU contends -- if a large incumbent or group of incumbent retailers could cut off or encumber a new or innovative entrant's source of supply by exercising market power against suppliers -- then TRU, itself an innovative marketer resented by larger and less dynamic incumbents a generation ago, could have been denied an opportunity to compete on the merits and win in the market place.

¹ 15 U.S.C. § 45.

I. DISCUSSION OF FACT.

A. *The Toy Industry.*

Hundreds of companies around the world make thousands of different toys. Overall concentration among toy manufacturers is low: the top ten firms in 1993 produced about half of the industry's output. RX 215 at 4.² Smaller firms come and go, while the big toy makers, such as Mattel and Hasbro, introduce many new products every year. Toy manufacturing is a fashion industry, driven by hit products, and characterized by rapid change among the top-selling toys. Toy sales are seasonal, with the industry's production schedule geared toward the year-end, holiday season. New products are introduced at the industry's annual "Toy Fair"³ in February and are promoted over the course of the year in anticipation of the fourth quarter, when 60% of yearly toy sales occur. RX 877 (Carlton) at 19; RX 143-G; RX 621-L.

Toys are highly differentiated products. As a result, not all toy products are good substitutes for one another. IDF 12. A child whose dearest wish is to own a G.I. Joe or Barbie doll is unlikely to be satisfied by the latest Parker Brothers board game. Thus, while *all* the toy companies compete with each other to a considerable extent, competition is most intense between and among companies offering products that are close substitutes for one another. For example, many Mattel products compete with Hasbro toys; Little Tikes' closest rival is Today's Kids, another maker of large plastic toys; and Fisher Price is a close rival of Hasbro's Playskool division.

Most toy manufacturers' revenue is generated by a handful of top-selling items. RX 877 (Carlton) ¶ 40. A successful product can turn a small company into an overnight success, but a few large firms lead industry sales year in and year out. Hasbro and Mattel are the largest toy manufacturers, each selling in recent years four times as many toys as the next largest

² The following abbreviations are used in citations to the record:

CX = Complaint Counsel's Exhibit, referenced by number and by page if applicable;

RX = Respondent's Exhibit, referenced by number and by page if applicable;

References to the trial transcript are made using witness name, page, and lines (Goddu 6681/15-21);

References to investigational hearing or deposition transcripts included in the trial record as exhibits are made using exhibit number, the witnesses' name, and transcript page and lines (CX 1658 (Goddu) at 271/23--272/22);

References to expert direct testimony, which was presented in written form and admitted into the record as exhibits, are made using the exhibit number, expert's name and relevant page, paragraph, or exhibit, e.g., CX 1822 (Scherer) ¶ 54;

RPFF = Respondent's Proposed Findings of Fact, referenced by finding number;

IDF = Initial Decision Findings, referenced by finding number;

App. Br. = TRU's Appeal Brief; Answering Br. = Complaint Counsel's Brief;

Reply Br. = TRU's Reply Brief.

³ Toy Fair is an annual event at which toy manufacturers and distributors gather in New York City. New toys are introduced, and many purchase orders are placed. TRU, the clubs, and all of the toy manufacturers discussed in this opinion attend Toy Fair.

traditional toy⁴ makers. RX 877 (Carlton) Ex. 4. Little Tikes and Tyco (before it was acquired by Mattel in 1997) occupied spots three and four. These top firms purchase by far the most television toy advertising. CX 1822 (Scherer) ¶ 53.

The charts below list the 1993 market shares of the top ten manufacturers of all traditional toys and the top fifteen makers of all toys including video games, as calculated by the NPD Group.⁵ Where available, 1992, 1994 and 1995 shares have also been listed. The NPD Group's estimates are consistently lower than other market share estimates in the record.⁶ By any measure, the total market share of just the top four manufacturers of traditional toys falls roughly between 34 and 45%.⁷

ALL TRADITIONAL TOYS

Manufacturer	1995	1994	1993	1992
Hasbro	11.8%	12.9%	16.0%	14.5%
Mattel	15.6	14.8	10.9	9.7
Fisher Price ⁸	*	*	4.7	4.6
Tyco	3.2	3.5	4.5	6.0
Little Tikes	2.8	2.9	3.6	3.6
Lego	1.9	1.8	2.3	2.5
Playmates	0.8	1.0	1.8	2.3
Hallmark (Binney & Smith)	2.3	2.0	1.6	1.4
Tiger Electronics	1.2	1.2	1.4	1.2
Ertl	1.0	0.9	1.3	1.0

ALL TOYS INCLUDING VIDEO GAMES

Manufacturer	1995	1994	1993	1992
Hasbro	10.0%	10.6%	12.6%	11.6%
Mattel	13.3	12.1	8.4	7.7
Sega	3.8	5.9	7.4	5.1
Nintendo	3.9	3.8	7.0	7.9
Fisher Price	*	*	3.6	3.6

⁴ Traditional toys means all toys except for video games. Sega and Nintendo, which are the largest manufacturers of video games, have been the nation's third and fourth largest toy companies in recent years, each selling about half as much as Hasbro or Mattel. RX 877 (Carlton) Ex. 2.

⁵ The NPD Group, an industry consultant, keeps separate market share statistics for manufacturers of traditional toys, excluding video games, and for all toys, including video games. Both parties' expert economists relied on NPD data.

⁶ Mattel estimated its 1994 share of traditional toys at 18%, and its and Hasbro's combined share of traditional toys at 35%. CX 1669-C. This compares to the NPD Group's calculation of a share of 14.8% for Mattel and 12.9% for Hasbro. The NPD's broad product market may include products Mattel does not deem relevant competition.

⁷ VTech and Today's Kids are two other toy manufacturers discussed in this opinion. Neither was among the top fifteen firms in the all toys market in 1993. In recent years, each has accounted for about 1 to 1.5% of the all toys market. CX 1230.

⁸ Fisher Price was acquired by Mattel in 1993.

415

Opinion of the Commission

Tyco	2.7	2.9	3.5	4.8
Little Tikes	2.4	2.4	2.8	2.8
Lego	1.6	1.5	1.8	2.0
Acclaim	1.1	2.0	1.6	0.7
Playmates	(no data)	0.8	1.4	1.9
Hallmark (Binney & Smith)	2.0	1.6	1.2	1.1
Tiger Electronics	1.1	1.0	1.1	0.7
Electronic Arts	1.3	1.6	1.0	0.7
Ertl	(no data)	0.8	1.0	0.8
Kransco	(no data)	(no data)	0.9	1.2

Sources: RX 215; RX 877 (Carlton) Ex. 2; RX 621 at 8; CX 1230 at I, J, K.

B. Toy Retailing.

The development of category-killers -- national chains of large, specialized, discount stores -- is one of several waves of retail innovation that have swept this country (and much of the world) since the Second World War. Charles Lazarus, the founder of TRU, entered the toy retail business in 1948; he opened the first store bearing the name Toys "R" Us in 1954; his emerging chain included 50 stores by 1974, at which point TRU quickly grew into a national chain. CX 1830 (Scherer) ¶ 14. Today, TRU operates about 650 United States stores and roughly 300 stores in other countries. IDF 2. Recently, Wal-Mart and other "hypermarket" chains -- meaning large discounters that stock an extremely broad array of products -- have challenged older discount chains like TRU by offering lower prices across their many lines of products, including toys, through efficient purchasing, distribution and in-store operations.

TRU offers an assortment of about 11,000 individual toy items throughout the year. No other toy retailer carries as many toys. Amerman 3625/8-9; Goldstein 8110/4-8; Reinebach 8674/4-5. TRU stores are typically 45,000 square feet (similar in size to a large food supermarket), and are located primarily in the suburbs outside major metropolitan areas. Goddu 6973/11-13. TRU 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. Like a food supermarket, these "toy supermarkets" employ few salespeople and offer few services; consumers are assumed to know what they want. CX 1822 (Scherer) ¶ 6; Goldstein 8242/18-8243/1. Thomas Kalinske, who has held management positions at Mattel and Sega, testified that he once reminded Charles Lazarus that, when TRU first started to succeed, "most of the existing toy trade ... hated the fact that companies like Mattel were supporting him" and felt that Mattel "shouldn't sell to Toys 'R' Us, because they were cutting prices too much" Kalinske 2516. TRU was, at this point in its history, able to distinguish itself from other toy outlets through lower prices and

wider selection. Today, TRU still strives to offer competitive prices, but it is TRU's broad range of toys that gives it a distinct competitive advantage.

1. TRU is a very large buyer and seller of toys in the United States and the world.

TRU sells about 20% of all the toys sold in the United States, counting areas where it does not have stores. RX 877 (Carlton) ¶ 13. TRU calculates that its average share of toy sales in the geographic regions within a 30 minute drive of a TRU store is 32%. CX 1822 (Scherer) ¶ 27c (discussing TRU 312284-287). In many major metropolitan areas, TRU's share is significantly higher: a June 21, 1990 study by TRU estimated local market shares of between 35 and 49% in 18 metropolitan areas; and, in eight other cities plus Puerto Rico, TRU's share was equal to or greater than 50%.⁹ Among the cities in which TRU's share exceeds 40% are some of the largest urban areas in the United States, including Los Angeles, Chicago, and New York. Complaint Counsel's expert economist testified that the appropriate antitrust market is likely to be smaller than the entire metropolitan area in many large cities, so TRU's estimates may actually understate its market power with respect to sales to consumers in these areas. CX 1822 (Scherer) ¶ 24.

TRU buys about 30% or more of the large, traditional toy companies' total output, and is usually their most important customer.¹⁰ As the ALJ found, toy manufacturers would have great difficulty replacing TRU. IDF 433. A Tiger Electronics Vice President of Sales wrote in 1994 that he was worried about his company's future business because of "TRU dictating to Tiger and becoming even a bigger percentage of our business" CX 813. Even the very largest traditional toy manufacturers, which were the most important of TRU's suppliers, felt a regrettable but growing dependence on TRU. Hasbro was worried about "increasingly powerful retailers." IDF 444 (citing CX 136-G). A Hasbro executive testified that Hasbro could not find other retailers to replace TRU. Owen 1151/3-10. Mattel's CEO explained

⁹ TRU's estimate of its share fell between 35 and 49% in these cities: Bakersfield, California 45.47%; Bowling Green, Kentucky 36.59%; Chicago, Illinois 41.98%; Detroit, Michigan 44.40%; Elmira, New York 48.78%; Harrisburg, Pennsylvania 36.21%; Hartford, Connecticut 35.01%; Los Angeles, California 41.01%; Lubbock, Texas 35.31%; New York, New York 43.88%; Philadelphia, Pennsylvania 39.57%; Reno, Nevada 41.84%; Richmond, Virginia 35.09%; Sacramento, California 48.28%; San Diego, California 44.74%; San Francisco, California 46.41%; Washington, D.C. 43.35%; Youngstown, Ohio 35.55%.

In these cities TRU estimates its share exceeded 50%: Gainesville, Florida 55.58%; Lafayette, Indiana 75.90%; Las Vegas, Nevada 53.85%; Lima, Ohio 88.47%; Miami, Florida 54.27%; Peoria, Illinois 53.64%; Salisbury, Maryland 51.48%; Utica, New York 54.15%. TRU also estimated its share of toy sales in Puerto Rico at 50%. See CX 1577.

¹⁰ The electronic toy makers, like Sega and Nintendo, which have other retail outlets including computer game stores, are an exception to the statement that TRU is invariably the most important outlet.

that "[TRU] is 30 percent of our business, so that would be a very big number to put [in] to other accounts that are already committed to what they [feel] is correct" Amerman 3618. Even TRU recognized the large degree to which its suppliers had become dependent upon TRU. In a speech delivered in preparation for the 1990 Toy Fair, a TRU executive explained: "The key to increased profitability [for TRU's suppliers] in the 90's will be doing more business with Toys R Us since most of the expansion in the toy industry, at retail, will be taking place in Toys R Us stores in the U.S. and throughout the world." CX 1650-E.

2. Retail prices of toys vary widely in different retail channels.

Retail margins enjoyed by different types of retailers vary widely. Department stores and other "traditional" toy stores sell toys for about 40% to 50% above their cost. TRU's average margins are close to 30% above cost, but there is significant variation across the range of products sold. Wal-Mart and the other similar discounters, such as K-Mart and Target, mark-up toys and other products by about 22% over cost. IDF 6; CX 1822 (Scherer) ¶ 5, 7. The clubs sell at mark-ups as low as 9% at Costco and as high as 14%, the highest margin at Pace. IDF 38. As a group, the clubs sell product at average gross margins -- the difference between the cost of merchandise and its selling price -- of between 9 and 12%. IDF 16.

Wal-Mart is generally acknowledged as the price leader among discount retailers of toys. Wal-Mart carries an inventory of between 3,000 to 4,000 toys (about a third as many as TRU), and as a rule Wal-Mart and similar discounters tend to carry the newer and more popular toy products. Although TRU does not always match Wal-Mart prices, it does sell items also available at Wal-Mart and the other discount chains at mark-ups lower than its average margin. CX 1822 (Scherer) ¶ 19, 20.¹¹ Maintaining a low "price image" is important to TRU. IDF 40. As one TRU document declared: "We are constantly aware of competitive pricing and are truly scared of being beaten." CX 1034-C.

Products sold *only* by TRU (and not by other discounters) are sold at significantly higher margins. On these items, TRU's only competition is traditional retailers, which sell at margins of 40 to 50%. IDF 6. TRU commonly sells these products at mark-ups as high as 39%. Even accounting for differences in sales volume, TRU makes the most money from the 4,000 moderately popular products in the middle of the line of about 11,000 items that it currently carries. CX 1822 (Scherer) ¶ 19, 20. This is a key fact about TRU's business strategy. TRU offers competitive

¹¹ A 1992 comparison by TRU of prices for 115 identical items showed that the Wal-Mart price was lower than that at TRU for 61 items, higher for another 24 and the same on 30 others. Other studies show that Wal-Mart prices are between 5 and 8% lower than TRU prices for identical goods. CX 1822-C (Scherer) ¶ 7 (discussing TRU 006689-92).

prices on the top-selling 100 to 500 products to attract customers to its stores, who then often purchase additional, less popular toy products that sell for higher prices relative to costs. *Id.* While these top selling products are not "loss leaders," they sell on much thinner margins at prices only slightly higher than Wal-Mart's. *Id.*

Although TRU's general price structure is consistent across the country, TRU varies the prices charged for some toy products to meet local competition. TRU creates so-called "price version charts" to estimate the degree of competition in a particular region. Goddu 6555/19 - 6558/5. These geographic areas, which TRU calls Areas of Dominant Influence ("ADIs") correspond roughly to newspaper circulation areas, because TRU uses the ADIs to determine the prices it advertises in local newspapers. Goddu 6556/6-23. There are about 200 ADIs for the United States. *Id.*; CX 992. In adjusting regional prices, TRU considers the strength and the number of the national discounters, such as Target, K-Mart and Wal-Mart, that are in the area as well as regional discounters, such as Hills or Caldors. Goddu 6527/11-19. The greater the level of competition, the lower the advertised price for promoted toy items. Goddu 6951/19-22. Since 1996, moreover, individual TRU store managers have been given the authority to lower the prices charged on specified popular toys to meet the prices of retailers in their immediate area. Goddu 6942/1-21.

TRU has continued to profit from its own unique strength of being a full-line toy discounter by charging greater retail mark-ups for its broad line of moderately popular products. Other specialized toy outlets were not able to profit from this strategy as effectively as TRU. Lionel Leisure and Child World, two toy discounters similar to TRU, went bankrupt in the early 90's, at which point TRU's principal remaining competition became Wal-Mart, Target, K-Mart, and other general merchandise discounters.¹² Goddu 6517/7-10.

C. The Warehouse Clubs.

Warehouse clubs are a recent retail innovation. The first warehouse club was founded in 1976. By 1992 the warehouse club chains, Sam's Club, Pace, Price Club, Costco, and BJ's, operated about 600 individual club stores. IDF 17. Subsequent acquisitions have reduced the major club chains to three: Price/Costco, Sam's, and BJ's. *Id.* In June of 1992, TRU estimated that 238 of its 497 then-existing stores in the United States were within five miles of a club. CX 912-A; IDF 391. Clubs, moreover, were within or near

¹² KayBee Toys, a discounter, is still in business but its market share is less than 5%. RX 877-M (Carlton). KayBee carries only 1,000 different toys, significantly fewer than Wal-Mart. RPFF 16.1 Regional discount chains such as Fred Meyer, Caldors, Ames, Hills, Bradlee's, Service Merchandise, and Shopko sell varying amounts of toys within a mix of general merchandise. These small chains have had less of an effect on retail toy prices than the national chains, which, other than the clubs, generally offer the lowest retail prices.

the regional ADIs of almost all of TRU's 1992 stores -- 486 of 497. CX 1823. This is not surprising since ADIs, which are designed to be the same size as the circulation area of local newspapers, such as the *Los Angeles Times*, are often significantly larger than five miles. In other words, if TRU lowered its prices on newspaper-advertised toys just in localities defined by the ADIs to meet club prices, then 97.8% of TRU's stores would have been affected by the adjustment.

Clubs employ a different business model than other discount outlets. The clubs sell only to members, who pay an annual fee of about \$30 for the opportunity to shop at the club. Sinegal 147/24-148/17; Zarkin 4784/1-2. Clubs target consumers who want to buy merchandise at low prices but are willing to forgo plentiful sales staff or other services. Ingene 9042/16-22; Sinegal 149/11-150/1.

Clubs offer the lowest prices of any retail store. As the President of Price/Costco testified, "[a]lmost invariably our presence in the community is going to have a tendency to drive prices down." IDF 38; Sinegal 200/10-12. The clubs are able to offer low prices by reducing operating costs and increasing the rate of inventory turnover. Club stores are located in areas where real estate is inexpensive. Club buildings are large (100,000 square feet or more, about the size of an airplane hangar) and sparsely decorated, typically employing industrial lighting and plain steel shelving. RX 894 (Buzzell) at 13; Ingene 9045/15-9046/3; Sinegal 156/23-157/11. Clubs are staffed with few employees. Checkout lanes have a single person operating the scanner and cash register, and customers pack their own purchases. Zarkin 4806/24-4807/16; RX 894 (Buzzell) at 14-15.

Another significant area of savings involves the clubs' techniques for handling and displaying merchandise. The clubs purchase products packed on shipping pallets, which can be lifted by forklifts so that boxes do not need to be moved individually, and pre-marked with computerized codes that can be read easily by the scanners at checkout lanes. Sinegal 157/13-21; Zarkin 4806/11-4807/3, 4809/9-15. To reduce freight costs, vendors ship goods to centralized distribution centers and these goods typically are dispatched to individual club stores the same day that they are received. Zarkin 4809/16-4810/8. Merchandise arriving at club stores is delivered directly to the sales floor and displayed on the pallets on which it was shipped by the vendor. Sinegal 157/12-21; Zarkin 4809/24-4810/6. This process eliminates significant labor costs and delay attendant to packing, unpacking, marking, and displaying goods on traditional racks and shelving. Sinegal 157/22-159/6.

The first club stores sold only to small business customers, such as restaurants, but by the late 1980s, sales to individuals had become common. RX 894 (Buzzell) at 8-9. While the mix of business and individual members varies among the warehouse club chains, Zarkin 4791/15-

4792/17, by 1992 individual customers accounted for at least half of all club sales. CX 178-C; CX 96-D. As the clubs attracted more individual customers, they began to carry a wider variety of products and compete with a larger range of retail outlets. *Sinegal* 207/25-208/11; *Zarkin* 4789/22-24. In addition to toys, the clubs carry food products, electronics, appliances, jewelry, cameras, video and audio recordings, books, hardware, housewares, sporting goods, automotive parts, office supplies, health and beauty aids, apparel, and seasonal goods. *Sinegal* 147/13-21; *Zarkin* 4789/11-15. Although some manufacturers have restricted the merchandise they offer to clubs, or refused to sell to clubs at all, these suppliers, as the ALJ found, usually "choose not to distribute in any discount or mass merchant channel, not merely warehouse clubs." IDF 25.

The clubs seek to offer name-brand merchandise. As one warehouse club executive put it, "generally speaking, by selling a branded product at a great price, that equals the best value." *Zarkin* 4797/15-16. Clubs also utilize an inventory strategy whereby the mix of non-food products changes regularly. *Zarkin* 4788/18-4791/14, 4794/1-18. This creates a "treasure hunt" atmosphere, meaning that customers can visit the same store often and always search out new bargain products. *Sinegal* 151/4-152/13. The BJ's club, for example, stocked between 50 and 150 toy items at any time, but over a full year carried 300 different toy items. IDF 32; *Hilson* 4417/23-4419/11. Costco carried 100 toy items at Christmas and as few as 15 at other times, but still offered its customers a total of 400 different toys over the whole year. *Moen* 615/5-616/20.

D. Toy Sales at the Clubs.

Since at least the end of the 1980s, toys have been a part of club offerings. Clubs sell toys at the same margins that they sell other products. The clubs attend the annual Toy Fair and other industry events, and generally place their orders between March and May for delivery in August or September. IDF 33. This is consistent with the practice of Wal-Mart and the other general merchandise, discount chains. IDF 487.

During the late 1980s and early 1990s, warehouse clubs could select and purchase from the toy manufacturers' full array of products. Clubs bought both the ordinary merchandise that was sold to all classes of retailers and customized products that were specially designed for the club class of trade. IDF 34; *Halverson* 357/3-359/12; *Moen* 606/8-22. Warehouse clubs sometimes worked with toy manufacturers to develop certain specially-packaged products that were intended to meet the clubs' business objectives of offering unique products that consumers wanted and recognized as valuable. For example, warehouse clubs purchased combination (or "combo") packs containing multiple inexpensive toys, such as Matchbox or Hot Wheels cars, *Moen* 606/23-608/22; *Halverson* 358/2-

22, or complementary products, such as a radio-controlled car with a battery. IDF 34; Hilson 4575/11-20.

The ALJ found, however, that clubs did not always, or even usually, prefer combo packs. IDF 35. Costco's toy buyer testified that regular products were generally preferable to combo packs because combo packs could make it difficult for consumers to compare the club's offerings to those sold by other retailers. Moen 608/9-22. The buyer for BJ's, the warehouse club with the most extensive toy selection, testified that club customers generally resisted purchasing toys in combo packs. Such packs could be perceived as designed to force the customer to buy a second unwanted product in order to obtain the one the customer's child wanted. Hilson 4573/15-4575/7. Pace's toy buyer also felt that combo packs needed to contain obvious, extra value to generate demand among club shoppers. Until roughly 1991, only 15-20% of Pace's toy selection was combo packs. Halverson 358/19-359/21.

Sam's carried the least extensive inventory of toys of the major warehouse clubs, reflecting Sam's unique business strategy among the clubs. Jette 996/2-997/22. Instead of demonstrating value by offering well-known, branded products at lower prices, Sam's targeted higher-income customers with products that were different from those available through other discount channels. As a result, Sam's sold larger quantities of combination packs than the other clubs. Jette 998/22-1001/7. Even at Sam's, however, 50 to 60% of the toy items offered were regular line products rather than combo packs. Jette 1001/18-1002/13.

Like all large retailers, clubs attempted to purchase toy items that they believed would sell well. Hilson 4580/14-23; Jette 1003/2-20. As the ALJ found, however, the clubs did not carry primarily best-sellers, even before TRU implemented its policy. Of the 310 toy products sold by clubs in 1991, only 11% were among the top 100 selling products and only 27% were among the top 500. IDF 37; Ingene 9078-79/20. The ALJ also found that, in deciding whether products are likely to sell well, club toy buyers relied on their own assessments of a product's characteristics, the strength of the product brand, and the manufacturer's planned advertising in support of the product. IDF 36; Halverson 352/4-353/18; Hilson 4581/4-4582/13; Jette 1003/12-1004/16. Warehouse club toy buyers testified that they typically did not make product selections based on other retailers' advertising plans or sales experience, since information on such matters, if available to them at all, was not available at the time they made their own purchasing decisions. Hilson 4582/14-21; Halverson 354/5-19; Jette 1004/17-23.

The effect of preventing the clubs from selling products identical to those carried by TRU will be discussed at pp.561-64, *infra*.

E. TRU's Club Policy.

By 1989, TRU senior executives were concerned that the clubs presented a threat to TRU's low-price image and its profits. IDF 52. TRU knew that consumers form opinions about a store's relative prices based on a few visible items. TRU referred to these products as "price image" or "price sensitive" items. IDF 43; CX 1077. As discussed, TRU had already lowered the prices of these popular items to meet Wal-Mart's challenge, but the clubs' marketing strategies threatened to bring prices even lower.

Contemporary analysis in the late 1980s predicted that the clubs would continue to grow at an accelerated rate. According to a May 1989 analysis prepared by Goldman, Sachs that was found in TRU's files:

[W]e continue to regard the warehouse club industry's prospects as quite bright [Price Company's] skills as a merchant and an operator are unsurpassed [W]e also believe that the combination of value and merchandise excitement offered by warehouse clubs is simply being discovered by more and more shoppers (indeed, we think the incremental business being garnered by warehouse clubs is coming largely from retail, as opposed to wholesale, customers, one of the principal themes of this report) ... Over the past year, we have perceived an unmistakable tilt in the warehouse club business toward the retail component of the business ... 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.

CX 1632 C-R (emphasis in original). Similarly, McKinsey & Company estimated for the Food Marketing Institute in 1992 that the number of warehouse clubs would grow from 450 in 1991 to 950 over the following ten years. CX 1743-J. The Allen Levis consulting firm estimated in 1992 that the number of warehouse club stores would grow from 425 in 1990 to 875 in 1995, with warehouse club sales rising from \$24 billion to \$77 billion. CX 178-E.

In 1989, TRU executives, including Chairman Lazarus, Vice-Chairman Goldstein, and President of Merchandising Goddu, began to formulate a response to club competition. They viewed the clubs' toy prices as "predatory." IDF 47; CX 1658 (Goddu) at 351/23-352/1. Based on "shops"¹³ of clubs other than Sam's, TRU learned that the clubs carried approximately 120-240 items in competition with TRU, priced as much as 25 to 30% below TRU's prices for the same items. IDF 48. According to TRU President Nakasone, the difference was "embarrassing." CX 1661 (Nakasone) at 35/3-11.¹⁴ TRU feared that clubs would surpass even Wal-

¹³ Here, "shops" and "shopping" refer to a market research technique whereby a researcher visits the clubs and gathers information about their toy inventory and prices.

¹⁴ Asked whether the clubs could hurt TRU, Lazarus testified:

A: Sure they could hurt us. Yeah.

Q: How so?

Mart as the downward price leader in the toy retail business. IDF 51, 53; Goddu 6615-16/12 ("[W]e were concerned that in the eyes of the customer [the clubs] would be recognized as being a price leader"). As the ALJ found, TRU also predicted that the clubs would sell 6 to 8% of the retail toys in the United States by 1997. IDF 54; CX 1070.

In 1989 and 1990, TRU began to discuss clubs with some of its suppliers, including Mattel, Hasbro, and Fisher Price. TRU made various general representations about not buying from manufacturers that sold to clubs. IDF 120 (Mattel), 171 (Hasbro), 218 (Fisher Price). TRU first attempted to set forth a written policy regarding the clubs in about late 1990. CX 957. The initial plan called for suppliers to treat the clubs and TRU differently for many different product categories (for example, video game accessories were only to be sold to clubs in packs of three or more items, batteries in packs of 24 or more, and candy in packs three to four times greater than weights TRU sells). *Id.* This was quickly abandoned as too complicated. IDF 59.

Thereafter, TRU renewed negotiations with its suppliers.¹⁵ Prior to and at Toy Fair (February) 1992, TRU informed manufacturers of a new club policy. Goddu, who took the lead in negotiations with TRU's suppliers, drafted the new plan in a document, dated January 29, 1992, which provides:

- 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.

A: By selling that product for a price that we couldn't afford to sell it at. Simple economics.

* * *

Q: Well, did the club[s] sell enough toys that this could affect your -- the price levels?

A: It could affect our reputation for sure. How much they could sell, I don't know.

Q: What do you mean your reputation?

A: Our reputation for being a low -- being a low cost seller of toys. Our reputation is the biggest selection at the lowest prices.

Lazarus (CX 1660) at 30/14-17, 46/20-47/2.

¹⁵ During this period -- in 1992 -- TRU acknowledged that club price competition was affecting its business and took steps to respond. TRU created a complete listing of stores that competed with warehouse clubs, specifically noting the number of TRU stores located within a five-mile radius of warehouse club. CX 912-A. This document was circulated, on June 4, 1992, to TRU's top officers, including Chairman Lazarus, CEC Goldstein, President Nakasone, and Goddu. CX 912-A. Also during 1992, TRU lowered its prices for several high-profile products by as much as 20% to match club prices and avoid "damaging perhaps [TRU's] price image with the customer." IDF 56. TRU also lowered its expectations for the performance of TRU stores that competed directly with a club outlet. IDF 57. TRU regularly calculates an index rating the level of competition faced by each of its stores. CX 1822 (Scherer) ¶ 27b. This index allows TRU to evaluate the performance of its store managers without unfairly punishing those who operate stores in more competitive areas. Among other things, end-of-the-year performance bonuses were based on the competition index. *Id.* In December of 1992, TRU included clubs located near TRU stores when it calculated its index. CX 1618. TRU explained this decision by noting that "[w]arehouse clubs have been a strong competitive force this season." *Id.* Clubs were *withdrawn* from later competition indices in 1993 -- after TRU's club policy was put into effect -- because clubs were then thought to have "no significant . . . impact on TRU stores." CX 1058.

- Old and basic product should be in special packs.
- Clearance/Closeouts are OK providing (sic) TRU is given first opportunity to buy this product.
- No discussion about prices.

CX 1681. TRU met with each supplier to explain and discuss this policy. After asserting its club policy, TRU asked each manufacturer individually what it intended to do. As a result of these discussions, TRU realized this second iteration of its club policy also would prove difficult to enforce because, among other reasons, there was confusion about what constituted "a new or promoted product." CX 913-C (noting the misunderstanding of Hasbro's Playskool Division that "less important" items *could* be sold to the clubs).

A prolonged and extensive period of negotiations between TRU and the toy manufacturers, which is described *infra* pp. 548-60, followed TRU's announcement of its club policy. TRU and its key suppliers eventually worked out a compromise whereby each manufacturer agreed with TRU that it would sell to the clubs only highly-differentiated products (either unique, individual items or "combo" packages of two or more toys) that were not offered to any other outlet including, of course, TRU. The details often varied from toy manufacturer to toy manufacturer but the core of the arrangement was consistent. The right to review club products described in Goddu's written policy ("specials and exclusives to be sold to the clubs should first be offered to TRU") continued to apply.

Through its announced policy and the related agreements discussed below, TRU sought to eliminate the competitive threat the clubs posed by denying them merchandise, forcing the clubs' customers to buy products they did not want, and frustrating consumers' ability to make direct price comparisons of club prices and TRU prices.¹⁶

The frequency, intensity and duration of negotiations leading to agreements between TRU and the various manufacturers, and among some of the manufacturers, was unusual. Set out below is a review of

¹⁶ By late summer of 1992, the clubs recognized that the toy orders they had placed earlier in the year were not being filled. In about August of 1992, Costco, BJ's and Pace sent letters to Mattel and other toy manufacturers complaining about the claimed "shortages" and threatening litigation. CX 1688 (Pace); CX 1330 (BJ's); CX 748 (Costco). Mattel responded by creating a "task force" to address the club issue. CX 553-B; Amerman 3693/6-13. In its memorandum establishing the task force, Mattel acknowledged that its "marketing independence was compromised in 1992 by uninvited communications from Toys R Us." CX 553-A. In late December 1992, Mattel's general counsel promulgated the formal club policy, which essentially stated the terms of the agreement Mattel had entered with TRU earlier in the year, *i.e.*, Mattel will offer only differentiated product to the clubs. RX 476; CX 688; Okun 2800/3-6. Mattel has followed this policy ever since. IDF 163; Okun 2805/7-11; Barad 7917/22-7918/16. Likewise, Hasbro, in June of 1994, issued a formal written statement that it would sell only differentiated product to the clubs. CX 243. This too merely stated the policy Hasbro had already adopted and followed for a year. The policy statement is dated after Hasbro received the Federal Trade Commission's letter of February 7, 1994, requesting documents for the investigation of this case. IDF 213; Verrecchia 1620/3-1622/14.

negotiations and agreements between TRU and its principal suppliers, and then of negotiations and agreements among the principal suppliers.

F. Evidence of Vertical Agreement.

There is direct evidence that TRU reached agreements with at least ten toy manufacturers.¹⁷ By the end of 1993, all of the big, traditional toy companies were selling to the clubs only on discriminatory terms that did not apply to any other class of retailers. This discriminatory policy was TRU's goal, obtained through extended and often heated negotiations with each of its suppliers. TRU began this process with Mattel and other large suppliers, whose agreement was most critical to the plan's success. Having obtained an initial commitment from these companies, TRU turned to the smaller toy companies, which also adopted the requested policy. After the agreements were reached, TRU supervised and enforced each toy company's compliance with its commitment.

For ease of exposition, we have organized the evidence of vertical agreement into four categories, which proceed in roughly chronological order. First, TRU asked for and received an initial verbal commitment from its suppliers; second, at TRU's request, many suppliers presented proposed club products to TRU for its prior approval, or otherwise negotiated with TRU about the appearance or content of club offerings; third, TRU engaged in extended negotiations with its suppliers over compliance with the club policy and often reached new points of agreement with them as the policy was implemented; and fourth, testimony and industry documents contain

¹⁷ The ten manufacturers are Mattel, Hasbro, Fisher Price, Tyco, Little Tikes, Today's Kids, Tiger Electronics, VTech, Binney & Smith and Sega. While the ALJ found that fourteen toy companies entered vertical agreements with TRU, we find that there is clear and direct evidence of agreement with respect to the ten above-listed companies. In the case of Sega, although TRU did not obtain all the concessions it sought from that supplier, the evidence shows that Sega promised to restrict sales to the clubs in the same manner as the other toy suppliers and then substantially complied with its word. CX 754 (letter from CEO of Sega to Chairman Lazarus promising not to sell new games to the club Sam's). Little Tikes' compliance with its commitment to TRU was fitful as a result of the ongoing disagreement between TRU and Little Tikes' parent company. But Little Tikes did restrict club sales after and as a result of detailed negotiations with TRU. IDF 277.

The only evidence of vertical agreements between TRU and Lego, Just Toys and New Bright, firms that the ALJ found had entered into agreements with TRU, is testimony that the companies were being "strong-armed" or pressured by TRU. IDF 331 (Lego) 359, (Just Toys), 362 (New Bright). The details of the communications between TRU and these companies are not developed in the record. Lego and New Bright restricted club sales for only one year. In view of the extremely strong pattern of evidence in the record showing that TRU aggressively sought agreements from its suppliers, the ALJ concluded that TRU reached agreements with these suppliers too. While this finding is reasonable, it is not necessary to resolve this case. We therefore decline to find that agreements were reached with specific companies without some more direct evidence of agreement.

As this factual discussion illustrates, there is also evidence that Huffy entered an agreement with TRU. Huffy, however, is a manufacturer of bicycles and other sports equipment, and may not be part of the relevant product market. Some evidence with respect to Huffy is included in our discussion primarily to illustrate TRU's pattern of conduct.

many examples of promissory language, indicating that the toy suppliers and TRU believed that they were bound by their commitments to one another. In our discussion, we use the term "commitment" to mean a forward-looking statement about or guaranty of future conduct similar to a promise. Commitments are most easily distinguished from mere statements of fact when, as here, they are made by parties negotiating a change in their course of conduct.

1. TRU sought and received initial verbal commitments from its suppliers.

TRU met individually with each of its suppliers to explain its policy. It did not simply state that policy, but asked the suppliers for express assurances that the supplier understood the proposal and agreed to go along. Goddu explained that this was TRU's purpose in the discussions with its suppliers that occurred during late 1991 and 1992:

Q: But did you want [the toy manufacturers], did you want to find out what their intentions were with respect to selling to the clubs?

A: Absolutely.

Q: And did you directly or indirectly ask them that to find out?

A: Yes.

CX 1657 (Goddu) at 130. Goddu also asked TRU's suppliers to tell TRU in advance about any items they planned to sell to the clubs:

A: [W]hat we tried to communicate was please tell us which items you plan on selling to the clubs.

Q: And when you asked them that, did any of the manufacturers say they would?

A: Oh, absolutely.

CX 1657 (Goddu) at 209. The ALJ credited Goddu's explanation that TRU wanted this commitment in advance to avoid misunderstandings. IDF 63. As Goddu explained: "We're going to find out anyhow. And then we have to have a meeting about that." CX 1657 (Goddu) at 209.¹⁸ Mattel, Hasbro, Tyco, and Little Tikes provide prominent examples of manufacturers giving advance commitments, but in view of Goddu's testimony, the ALJ correctly concluded that the practice was pervasive.

Mattel first promised TRU that Mattel would try to sell the clubs more customized products in 1990. At Toy Fair in February of that year, TRU officials met with Mattel and "threatened to 'review' their support of those manufacturers that overly supported the warehouse clubs." CX 529; Okun 2671/25-2673/14. Mattel committed to "do [its] best" to move the clubs away from its regular line of products. CX 530-B.¹⁹ Two Mattel documents

¹⁸ TRU told Mattel that TRU would support only companies that "agreed not to support the clubs." CX 532-A.

¹⁹ On September 26, 1991, in preparation for a meeting with TRU to discuss, *inter alia*, the clubs (CX 530-A; Barad 8067/15-8068/5; Okun 2626/21-2627/15), a Mattel executive sent a briefing memorandum to the president of Mattel's Girls Division which stated, in pertinent part:

demonstrate that this promise to TRU affected Mattel's business with the clubs. An April 1990 memorandum memorialized discussions between Mattel's then-president Bob Sansone and TRU affirming Mattel's "policy to grow the Wholesale Club business with non-competing SKU's."²⁰ CX 600-B; Okun 2673/25-2675/20. And, a December 1990 memorandum acknowledges TRU as an obstacle to aggressive pursuit of the club channel of distribution but concludes: "We must acknowledge the TRU issue, but if we give [the clubs] specials we should be ok." CX 595-B; CX 523; Okun 2677/7-2679/1.

These first efforts on the part of Mattel to change the terms on which it dealt with the clubs were not satisfactory to TRU, which asked Mattel to adopt a more rigorous policy. Mattel was one of the first toy manufacturers that TRU approached after developing the written club policy described above. TRU's Chairman Lazarus met with Mattel's CEO Amerman and other high-level executives from the two companies in October 1991. IDF 123. As one participant described it, "Lazarus was coming on very strong [I]n effect he was saying he didn't want us to do any business with the clubs." Okun 2684/4-2685/6. As the Mattel employee who summarized the meeting in a Mattel internal memorandum recalled, when TRU asked Amerman whether Mattel would continue to sell to the clubs, Amerman replied that "we [Mattel] would not sell the clubs the same items we were selling to [TRU]." CX 532-A; Okun 2685/11-2686/6. Goddu's recollection differed slightly. He testified that Amerman "made a commitment that they [Mattel] wouldn't sell the clubs any more merchandise," Goddu 6663/6-22, and after further discussions TRU and Mattel "wound up in a situation where ... Mattel ... committed to [sell] only exclusive [items to the clubs]." Goddu 6891/13-6892/14. By either account, Mattel's CEO *committed to* TRU's top officer that Mattel would comply with TRU's club policy.

Hasbro also *committed to* TRU that Hasbro would not sell promoted products to the clubs. On several occasions between late-1991 and mid-1992, TRU met with Hasbro to explain TRU's club policy and to complain about finding particular Playskool toys in the clubs. Owen 1106/5-1108/5. Executives from Hasbro's Playskool division were particularly concerned about the cost of restricting Hasbro's club sales. In preparation for one of

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 (emphasis in original). The commitment referred to in this memorandum was made at Toy Fair in February 1990. IDF 120.

²⁰ SKU is an acronym for stock keeping unit, which means an individual item carried by a retailer. For example, the board game Monopoly is one SKU at TRU.

the meetings with TRU, a Playskool executive wrote a memo to superiors at Hasbro suggesting that Hasbro "achieve some major concessions [from TRU] if we are to dramatically change the way we approach the Warehouse Clubs." CX 78. At the meeting, which occurred prior to the Toy Fair in 1992, TRU raised the subject of Hasbro's club sales, and Hasbro sought certain benefits from TRU (such as increased shelf space and a limitation on TRU's sale of imitations of Hasbro products). IDF 177-80. Hasbro's President of U.S. Sales and Marketing does not dispute that the meeting involved "some meeting of the minds" and calls it an example of "how we [Hasbro and TRU] do business together." Owen 1121/13-1123/10. During these negotiations, TRU sought a response from Hasbro regarding club sales, CX 1657 (Goddu) at 130/20-25, and Hasbro responded that it would refuse to sell promoted toys to the clubs. Owen 1114/23-1115/5, 1117/6-9. Soon after Toy Fair 1992, TRU grew dissatisfied with Hasbro's commitment not to sell promoted products and wanted Hasbro to adopt a "no identical items" policy like the other manufacturers. Towards this end, TRU kept asking Hasbro officials questions such as "what is your policy going to be, how are you going to deal with this [Hasbro products in the clubs] ... ?" Verrecchia 1502/16-1504/19, 1524/2-9. Hasbro changed its policy, as TRU wished, after checking with TRU about the proposed modification. Owen 1136/20-1141/14, 1143/2-1144/23.

TRU and Today's Kids discussed the clubs at several meetings in 1992 and 1993. Goddu 6733/23-6734/3. At these meetings, TRU said that it would not carry products that the clubs were also carrying, and that it wanted Today's Kids to notify TRU when Today's Kids sold any products to the clubs so that TRU could stop its purchases of those Today's Kids products. Butler 5524/6-5525/1. Today's Kids informed TRU that it would cease club sales, Goddu 6738/5-22, 6739/12-14, but also asked whether, if it did so, TRU would increase its purchases from Today's Kids. Goddu 6729/9-22. After TRU canceled its order for a Today's Kids product that had been sold to the clubs, CX 891, 892, Today's Kids informed the clubs that it would no longer sell to them. Stephens 5985/5-11. TRU later increased its business with Today's Kids by 40%. CX 1657 (Goddu) at 170/13-22; CX 902.

TRU likewise received verbal responses from Tyco and Little Tikes. After TRU explained its policy, Tyco's CEO told TRU he would "get back to" them, Goddu 6677/6-8, and then did so around the time of Toy Fair (February) 1992, when Tyco explained its "25-item" policy to TRU.²¹ Grey

²¹ Tyco announced it would sell only to customers that purchase a minimum order of \$20,000, and that the order must include at least 25 different products from the Tyco line. In addition, to prevent customers from ordering small quantities of some items, Tyco required that the smallest quantity of any item ordered must be at least 20% of the unit count of the highest quantity ordered. CX 1418. As described below, the policy was selectively enforced, so that in practice it applied only to the clubs'

2996/9-2997/9; CX 1657 (Goddu) at 176-177. When TRU raised the warehouse clubs issue with Little Tikes at Toy Fair 1993, Little Tikes told TRU that it would sell the clubs only combination packs or nearly discontinued items. Little Tikes repeated this commitment in conversations thereafter. DePersia 2145/15-2146/9, 2151/13-23; CX 1510. The toy company VTech "promised" TRU at Toy Fair 1992 that it would not sell to the clubs. IDF 314; CX 1318; O'Brien 2426/16-2427/18. Similarly, after meeting to discuss the clubs, the CEO of the electronic game company Sega wrote to Lazarus assuring him that "Sam's Wholesale Club will have old Genesis software bundled with Hardware this fall" IDF 339; CX 754.

As a whole, the evidence indicates that TRU did not just announce its policy, but sought a response in every -- or almost every -- instance in which it spoke to a supplier about its club policy.

2. TRU previewed and cleared or rejected the special products offered to the clubs.

After committing to TRU's policy, the toy companies, as TRU had asked them to do, presented examples of their specially-developed "club products" for TRU's preview and clearance before offering them to the clubs. On other occasions, TRU and its suppliers negotiated over the appearance of club packages. As Goddu explained at trial, TRU wanted the special products to be sufficiently differentiated from those it sold to "avoid the customer being able to make direct pricing comparison[s]." Goddu 6635/13-17.

Goddu testified that following the October 3, 1991 meeting between Mattel and TRU, "[t]here was (sic) constant questions [from Mattel] as what if we did this and what if we did that ... an opinion here, an opinion there, and we asked to see the product" Goddu 6670/13-6671/7. In February 1992, Goddu met with Mattel executives to discuss Mattel's adoption of the club policy. A Mattel memorandum summarized one of the points of agreement at that meeting: "Agreed to show TRU all [club] specials/exclusives ... they will have a right of first refusal." CX 541. On several later occasions Mattel fulfilled this obligation by presenting for TRU's review examples and photographs of Mattel products intended for the clubs. IDF 152; CX 626-B, 597.²²

TRU representative Peter Spencer, who screened the club specials of Mattel's Arco subdivision, testified (on cross-examination by TRU) that

purchases of regular products. Other retailers were exempted from the policy, and the clubs could buy combo or special packs without regard to the policy.

²² A memorandum prepared by a Mattel manager explained: "[O]ur 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.

this was not a conventional right of first refusal, but really a chance for TRU to supervise its suppliers' sales to the clubs:

I [Spencer] was going to have an opportunity to essentially regulate what was offered to the clubs [B]y saying yes you can show it to the clubs, or no you cannot show it to the clubs [T]hat exercise was to give a green light on what could be shown to the clubs. It was not a commitment on Toys 'R' Us' part to buy.

Spencer 1960/22-1961/12. Spencer also testified that this sort of involvement in the production and marketing decisions of suppliers was unprecedented. Spencer 1862/20-23.

Spencer's testimony about TRU's preclearance understandings is confirmed by TRU's conduct in other situations. In 1993, TRU found products from Tyco's Playtime subdivision in a club. TRU complained to Tyco, and at a subsequent meeting, Playtime sought TRU's approval of repackaged club versions of the products. After seeing the new packaging, TRU said it would continue to buy the original product from Playtime. IDF 255-258. TRU told Huffy and Today's Kids that changing the color or the name of a product did not sufficiently differentiate it from the same item sold at TRU. Stephens 5959/5-63 (discussing Today's Kids); IDF 355 (discussing Huffy). Goddu told Little Tikes to sell only discontinued items to the clubs because combination packs would not work for its large and expensive products. IDF 274-275; CX 1658 (Goddu) at 310/18-311/6. When Tiger Electronics asked TRU what type of packaging would meet its concerns, Goddu replied that selling to the clubs five year old product in "multipack[s] with high price points" would not hurt Tiger's sales with TRU. IDF 305; CX 811, 814.

In all, TRU either preapproved special club products, or otherwise negotiated over what was acceptable content and packaging for club products with these suppliers: Mattel (above), Fisher Price (IDF 228), Tyco (above), Little Tikes (above), Today's Kids (above; IDF 287), Tiger Electronics (above), Binney & Smith (IDF 325), and Huffy (above).

3. TRU negotiated with the toy companies
and reached new points of agreement.

TRU also engaged in extended negotiations to gain compliance with the club policy from reluctant toy manufacturers. In some instances, when breaches of the club policy were detected, TRU and the offending toy firm worked out a remedy to compensate TRU and encourage future compliance or otherwise reached new points of agreement. For example, as mentioned above, when Hasbro changed its policy from "no promoted products" to "special products only," Hasbro informed TRU of the proposed modification, and TRU responded that the new policy was "okay." Owen 1136/20-1141/14. Little Tikes' parent company, Rubbermaid, wanted Little

Tikes to continue club sales, creating a conflict with TRU. Little Tikes asked TRU for help in negotiating with Rubbermaid, and, in April 1993, TRU and Little Tikes met with Rubbermaid's CEO to "resolve the warehouse club issue." CX 1514-B, C; DePersia 2159/9-2160/7; Schmitt 2283/24-2284/23, 2288/2-7; Goddu 6715/15-6716/9. The two companies agreed that Little Tikes would sell only custom product and near-discontinued toys to the clubs. IDF 273-277.

A dispute during the summer of 1992 over Mattel's Air Pro Hockey is a particularly stark example of the extensive negotiations and the observed commitments between TRU and the manufacturers. Early in 1992, before TRU's club policy was in force, Mattel accepted an order for the popular product Air Pro Hockey from the Pace club. IDF 145. Mattel later tried to steer Pace to a "special" version of this product, which contained extra hockey sticks, but Pace refused. *Id.* After Pace complained that its order had not been delivered on time, Mattel shipped Pace some regular versions of the game. *Id.* TRU found (or found out about) the product at Pace and complained to Mattel. IDF 147. TRU then reduced its price on Air Pro Hockey (almost a 20% markdown) to meet the club prices. *Id.* TRU also put a hold on payment of over \$540,000 owed to Mattel in order "to send [Mattel] a message." Weinberg 7692/11-25, 7699/13-22. Eventually, TRU and Mattel reached a settlement in which the two companies agreed to split the cost of TRU's 20% markdown. CX 1810; Weinberg 7706/1-15.

Another episode involving Tyco illustrates how deeply TRU was involved in the details of administering the vertical agreements. As already discussed, Tyco initially adopted a unique club policy: it would sell only to customers who bought significant quantities of 25 different products from Tyco's line. IDF 240. Tyco said this policy favored distributors who broadly supported its line of products. Exceptions were made, however, for every class of distributor that might be affected by the policy but not for the clubs. Grey 3009/2-3010/15. The policy was broadly discussed in the industry. Goddu 6681/19-22. One club, BJ's, assembled a large order that it believed complied with Tyco's policy. Tyco told TRU about BJ's order, which both firms understood as a test of the policy's true purpose. CX 1657(Goddu) at 238/19-24 (Tyco told Goddu that it believed the order was a test of whether Tyco intended to ship product to the clubs under the 25-item policy). Tyco tried to ship BJ's some combination packs in lieu of the regular products BJ's had ordered, and the entire order was never filled. Hilson 4478-79/9, 4506-07. After 1992, no club purchased regular merchandise from Tyco under the "25-item" policy. IDF 252.

4. Documents and testimony used promissory language.

Many documents refer to "agreements" between the toy companies and TRU, or use other promissory language to describe their relationship. For

example, after finding its product in the clubs, TRU wrote to a Fisher Price Vice President of Sales, "you promised this wouldn't happen." Chase 1661/4-5. Similarly, a TRU document states that Fisher Price "agreed to stop selling [another item] to the clubs." CX 913-E. With respect to a Hasbro product, TRU noted "we have reached a corporate agreement on the sale" of the item to the clubs. CX 913-F.

While loose language in business documents is not necessarily the equivalent of an agreement, the consistent reference to such words of agreement, promise and commitment shows how far removed this policy was from a unilateral statement by TRU of its policy.²³

There is, in short, an abundance of evidence of promises, negotiations, compromises, and cooperative conduct with respect to the development, adoption, and enforcement of the club policy.²⁴

²³ The following list contains some additional examples of promissory language found in documents of the toy companies or TRU: CX 530-B (Mattel "committed to Toys R Us to do our best not to sell [the clubs] regular line goods."); CX 540 (Mattel CEO "Amerman committed only a short time ago that we would not do any business with the clubs") (Mattel's "agreement with TRU is that all of these items will be offered to them as well so we must plan for a presentation to TRU."); CX 541 (Mattel "[a]greed to show TRU all specials/exclusives . . ."); CX 550-B ("If [Mattel] ship[s], for example, our air hockey game to a club then arguably we [Mattel] are violating the spirit of our agreement" with TRU.); CX 1519 (CEO of Rubbermaid, the parent company of Little Tikes, noted "Discussion + Understanding(s) -- LT will offer all value packs first to TRU to create better value + REAL unique differentiation."); CX 1318 ("We [VTech] promised no warehouse clubs at Toy Fair."); CX 913-C ("Per [Binney & Smith's Vice President of Sales], understood our [TRU's] concern. Going forward they will offer special packs only for '93.").

²⁴ The following is a list of some of the evidence that the ten toy manufacturers entered into vertical agreements with TRU:

1. Mattel.

Initial commitment: CX 529, Okun 2671/25- 2673/14 (At Toy Fair 1990, "TRU threatened to 'review' their support of those manufacturers that overly supported the warehouse clubs."); CX 530-B (Mattel committed to "do [its] best not to sell [the clubs] regular line goods."); CX 532-A; Okun 2684/4 - 2690/4; Barad 7843/18 - 7844/1; Goddu 6663/6-22 (In October 1991, Mattel "said we [Mattel] would not sell the clubs the same items we were selling to them [TRU]."); CX 1658 (Goddu) 271/10-18; CX 1659 (Goldstein) at 87/17-88/7 (TRU's response to Mattel's commitment was "[T]hat's fine. We don't have anything else to talk about.").

Preview and clearance of club products: CX 540; CX 624 (Mattel agreed to show TRU club products before they were sold to the clubs.); Leighton 3267/21- 3268/6, 3269/3-3271/2, 3272/8-18, 3291/2-3295/14; CX 597; CX 626; Spencer 1860/3-1862/17, 1960/22-1961/14 (Mattel made several presentations of its proposed club specials to TRU before offering them to the clubs for the purpose of allowing TRU to regulate what was sold to the clubs.); Spencer 1862/20-23 (A TRU representative charged with previewing club products testified that this practice was unprecedented in his experience.).

Negotiation and new points of agreement: Goddu 6887/17-6888/15; CX 1658 (Goddu) at 282/13-284/12; Barad 7894/7-7897/20; CX 1659 (Goldstein) at 100/17-101/17; Goldstein 8266/25-8268/22 (After the October 3, 1991 meeting, Mattel told TRU's Goddu that Mattel would get back to TRU to "work this thing out." Mattel and TRU's Goldstein then agreed that Mattel would sell only special products to the clubs.); Goddu 6670/13-6671/7; Goddu 6891/13-6892/14 (Following the October 3, 1991 meeting, there were "constant questions" from Mattel, and Mattel later "committed [to sell] only exclusive[items to the clubs]."); Okun 2735/24- 2739/6; CX 541 (At a February 27, 1992 meeting, Mattel affirmed to TRU that Mattel would not sell "hot product[s]" to the clubs and that TRU would have a right to preview club products.); Amerman 3802/10-3804/14 (In July 1992, Mattel's CEO Amerman assured TRU's Chairman that Mattel was not shipping first line merchandise to the clubs.); Weinberg 7692-93/6, 7697-7706; CX 1808; CX 1810 (TRU withheld payment for a product that Mattel had sold to the clubs in violation of promises to TRU, and then agreed to a settlement of the disputed

debt in which TRU and Mattel split the cost of the markdown).

Promissory language: CX 530-B (Mattel "committed to [TRU] that we [Mattel] would do our best to sell [the clubs] regular line goods."); CX 540 (Mattel's "agreement with TRU is that all of these items will be offered to them as well . . ."); CX 541 (Mattel "[a]greed to show TRU all specials/exclusives"); CX 550-B (if Mattel were to "ship . . . our air hockey game to a club then arguably we [Mattel] are violating the spirit of our agreement [with TRU]."); Okun 2725/19-2726/5 ("TRU . . . came away thinking that there was an agreement . . .").

2. Hasbro.

Initial commitment: CX 78 (In January of 1992, Playskool advised that Hasbro should "achieve some major concessions [from TRU] if we are to dramatically change the way we approach the Warehouse Clubs."); Owen 1122/4-1123/10 (TRU and Hasbro discussed the clubs and other topics at a meeting during or about Toy Fair 1992. A Hasbro officer said that the meeting involved "some meeting of the minds" and was an example of how two companies "do business together."); CX 1657 (Goddu) at 130/20-25; Owen 1112/15-1115/5, 1117/6-9; Inano 3335/15-20; Butler 5535/5-9 (TRU sought a response from Hasbro regarding club sales, and Hasbro responded that it would refuse to sell promoted toys to the clubs).

Negotiation and new points of agreement: Verrecchia 1502/16-1504/19 ("During 1992, TRU kept asking Hasbro officials questions such as "what is your policy going to be, how are you going to deal with this [Hasbro products in the clubs] . . . ?"); Owen 1136/20-1144/23 (Starting in 1993, Hasbro changed its policy as TRU wished after checking with TRU to see if the proposed change was acceptable to TRU.).

Promissory language: CX 913-F ("We [Hasbro and TRU] have reached a corporate agreement on the sale of this item to the club stores.").

3. Fisher Price.

Initial commitment: Cohen 7992/10-19; Weinberg 7732/8-7733/19; CX 1662 (Weinberg) at 97/1-5 (In 1990 or 1991, TRU stated its policy and asked Fisher Price "how are you going to deal" with the clubs.); CX 1657 (Goddu) at 206/12-207/20 (Prior to Toy Fair (February) 1992, Goddu told Fisher Price that specially-configured products could be sold to the clubs.); Inano 3334/21-3335/5; Owens 1132/6-1135/8; Verrecchia 1393/5-1394/4 (At Toy Fair 1992, TRU informed Hasbro that Fisher Price had agreed not to sell promoted product to the clubs.); RX 256 (Fisher Price began to sell only specialized products to the clubs in 1993 and thereafter).

Preview and clearance of club products: Chase 1678, 1680/5-6 (At Toy Fair 1993, Fisher Price executives stopped the sale of a club combo pack, which was insufficiently differentiated from the similar regular product, because the product was a "sensitive item" for TRU.)

Negotiation and new points of agreement: Chase 1660/15-1661/5 (In September 1991, TRU sent to Fisher Price's Vice President for Sales a copy of a TRU shopping report showing Fisher Price products found in Price Club. The words "Byron [the Vice President], you promised this wouldn't happen" were written on the report.); Chase 1661/6-8 (After this event, Fisher Price imposed an extra level of review on products to be sold to the clubs and limited its sales to special and combination packs.); CX 913-E; Cohen 7970-74, 7997-98 (When a Fisher Price employee, in violation of the club policy, sold a regular product to a club in order to meet a sales volume target, TRU complained to Fisher Price. A TRU record of Fisher Price's response to its employee's error states that Fisher Price "agreed to stop selling this item to the clubs.").

Promissory language: Chase 1660/16-1661/5 ("Byron, you promised this wouldn't happen."); CX 913-E ("agreed to stop selling this item to the clubs.").

4. Tyco.

Initial commitment: CX 1657 (Goddu) at 176-177/17; Goddu 6677/6-8; Grey 2996/9-2997/9 (TRU told Tyco that club sales were not in Tyco's or TRU's best interest, and Tyco's CEO Dick Grey responded that he would think about what TRU had said, promising "we'll get back to you." In a subsequent meeting, Tyco told TRU about its 25-item policy.).

Preview and clearance of club products: Weinberg 7716/22-7724/9; CX 1662 (Weinberg) at 169/10-172-16, 177/18-178/4 (In 1993, TRU complained to Tyco's Playtime division after it found a top-selling toy in the clubs. At a subsequent meeting, Playtime sought TRU's approval of a repackaged version of that toy for sale to the clubs. After viewing the newly repackaged toy, TRU said it would continue to buy the original version of the toy.).

Negotiation and new points of agreement: CX 1657 (Goddu) at 238/19-24; CX 808; Hilson 4505/5-4507/13; Weinberg 7738/8-7739/4 (Tyco reported to TRU an order from the club BJ's, which complied with Tyco's 25-item policy. Tyco told TRU that Tyco believed the BJ's order was a test of whether

Tyco intended to ship any regular products to a club under the 25-item policy.); Moen 651/17-652/9 (TRU put pressure on Tyco to sell combination packs to the warehouse clubs.); CX 913-D; Weinberg 7719/7-22 (In April 1992, TRU contacted Tyco's Playtime division in order to "remind" them of TRU's policy after its products were found in the clubs. Playtime responded that the products that offended TRU's policy had been shipped to the clubs prior to the start of Tyco's policy, and that, in the future, Playtime would ship only special products to the clubs.).

Promissory language: CX 914-A (From a letter to TRU: "To confirm the meeting we had, Playtime will not offer any merchandise to Warehouse Clubs that is bought by Toys R Us. This will make our policy exactly the same as Tyco's.")

5. Little Tikes.

Initial commitment: DePersia 2145/15-2146/9, 2151/13-23; CX 1510 (When asked by TRU's Goddu, Little Tikes told TRU that it would only sell the clubs combination packs or nearly discontinued items. Little Tikes repeated this commitment in conversations thereafter.)

Preview and clearance of club products: CX 1658 (Goddu) at 310/18-311/6 (Goddu told Little Tikes to sell only discontinued items to the clubs, because combination packs would not work for Little Tikes' large and expensive products.).

Negotiation and new points of agreement: CX 1510; DePersia 2159/9-2164/10; Schmitt 2283/24-2284/23, 2288/2-7, 2291/16-2297/18; Goddu 6715/15-6717/1; CX 1516; CX 1514-B, C; CX 1521 (Baughman file memo); CX 1519 (Schmitt handwritten notes) (Little Tikes' President asked TRU's Goddu for "help" in dealing with Little Tikes' parent company, Rubbermaid, which resisted the adoption of any restrictive policy with respect to the clubs. In April of 1993, representatives of the three companies met and reached agreement on key aspects of the club issue. Little Tikes agreed to sell only value packs, discontinued and near-discontinued items to the clubs.); DePersia 2180/15-2181/3; Hilson 4494/3-9 (During the balance of 1993, Little Tikes limited the products available to the clubs consistent with the "value packs, discontinued and near-discontinued [items]" distribution strategy discussed with TRU at the April 1993 meeting.).

Promissory language: CX 1519 ("Discussion + Understanding(s) - LT will offer value packs first to TRU.").

6. Today's Kids.

Initial commitment: Goddu 6729/9-22, 6733/23-6734/3, 6738/5-22, 6739/15; Butler 5524/6-5525. (In the course of several meetings during 1992 and 1993, Today's Kids informed TRU that it would cease club sales, but also asked whether, if it did so, TRU would increase its purchases from Today's Kids.); Goddu 6739/4-7; CX 891, CX 892 (TRU canceled its order for a Today's Kids product, which was selling well at TRU, because the product had also been sold to the clubs.); CX 913-D (In about June of 1992, Today's Kids told TRU that Today's Kids would sell to the clubs "special items going forward.").

Preview and clearance of club products: Stephens 5960-63 (Goddu told Today's Kids that changing the name of product is insufficient differentiation.).

Negotiation and new points of agreement: Goddu 6739/4-7; CX 1657 (Goddu) at 167/11-168/12 (TRU continued to pressure Today's Kids to further restrict its sales to the clubs, and Today's Kids asked TRU "if we could have more time."); CX 1657 (Goddu) at 167/15-168/12; Goddu 6739/4-11 (Goddu said "you must get back to us because we're not going to let this ... sit the way it is."); CX 1657 (Goddu) at 168/19-170/22; Goddu 6729/9-22; Butler 5526/7-10, 5551/2-7; CX 902 (Later in 1993, Today's Kids replied to TRU, explaining Today's Kids intention of not selling to the clubs at all. Today's Kids also asked again whether TRU would increase its purchases from Today's Kids. TRU increased its business with Today's Kids by 40%).

7. Tiger Electronics.

Initial commitment: CX 809; Shiffman 2008/3-14 (Goddu told Tiger's Vice President that TRU would not buy any products Tiger sold to a club. Tiger's Vice President asked whether the policy also applied to BJ's, and Goddu responded that it applied to any club. The Vice President then wrote an internal memorandum saying Tiger would have to "face up to Pace and not ship them . . .").

Preview and clearance of club products: CX 811, 814 (When Tiger Electronics asked TRU what type of packaging would meet its concerns, Goddu replied that selling to the clubs five year old product in "multipack[s] with high price points" would not hurt Tiger's sales with TRU.); CX 814; Shiffman 2044/21-2045/9 (Goddu invited Tiger to review Tiger's club strategies with him and get approval in advance, even for specific individual products and packaging.).

Negotiation and new points of agreement: CX 814; Shiffman 2033/12-2045/9 (In January 1994, Tiger's Vice President met TRU's Goddu to get more information on TRU's club policy and to learn what products Tiger could sell to the clubs without jeopardizing its sales to TRU. Goddu told Tiger that

G. Evidence of Horizontal Agreement.

TRU worked for over a year and surmounted many obstacles to convince the large toy manufacturers to discriminate against the clubs by selling to them on less favorable terms and conditions. *See supra* pp. 548-60. The biggest hindrance TRU had to overcome was the major toy companies' reluctance to give up a new, fast-growing, and profitable channel of distribution, and their concern that any of their rivals who sold to the clubs might gain sales at their expense. TRU's solution was to build

he would let Tiger "off the hook" by permitting Tiger to sell a five-year-old product called Skip-It, as well as hand-held games "in multipack with high price point" to the clubs. This agreement was less restrictive than one previously discussed.).

Promissory language: CX 811 ("I understand that with regard to hot new product, television items, high profile items, etc., the only way these can be sold to the clubs is through very 'creative' packaging.")

8. VTech.

Initial commitment: CX 1318; O'Brien 2426-32/19; Goddu 6866/17-23 (VTech "promised" TRU at Toy Fair 1992 that it would not sell to the clubs.).

9. Binney & Smith.

Initial commitment: CX 1662 (Weinberg) at 148/19-149/18; CX 913-C; Weinberg 7614/8-7617/8 (TRU's Weinberg contacted Binney & Smith's Vice President of Sales after TRU found regular Binney & Smith product in a club.); CX-913-C; Weinberg 7666/15-7667/21 (A contemporaneous TRU memorandum noted with reference to this meeting: "Per [the Vice President], understood our concern. Going forward they will offer special packs only for '93. Commitments already made for '92.").

Preview and clearance of club products: Blaine 6421/1-6423/17; CX 1662 (Weinberg) at 162/1-164/5 (In December 1992, TRU previewed a series of prototype samples of warehouse club products, and informed Binney & Smith that its plans were acceptable to TRU.).

Negotiation and new points of agreement: CX 2 (Binney & Smith wrote to TRU on December 21, 1992: "Our intent is to differentiate our product offering to Membership Clubs from that sold through our traditional retail trade channels. We will do this with larger sets and multi-packs that move the clubs to higher price points. In addition, we will alter contents to present the club customer with a non-comparable value."); Blaine 6436/16-6438/14 (TRU called a third meeting with Binney & Smith in October of 1993. Just as in the prior meeting, Binney & Smith brought samples of its club products, however TRU apologized, saying someone on its staff had made a mistake and that TRU had no problem with Binney & Smith's warehouse club offerings.)

Promissory language: CX 913-C ("Per [Binney & Smith's Vice President of Sales], understood our [TRU's] concern. Going forward they will offer special packs only.").

10. Sega.

Initial commitment: CX 754; Kalinske 2475/3-9, 2476/11-23, 2540/17-20; CX 1658 (Goddu) at 387/1-388/6. (In a fall 1991 meeting, TRU's Lazarus asked Sega's CEO what Sega's policy was with respect to selling its Genesis products to the clubs. Sega initially explained to Lazarus that it was not selling any Genesis product to the club Sam's, but when he learned this was incorrect, the CEO of Sega wrote to Lazarus apologizing and assuring TRU that "Sam's Wholesale Club will have old Genesis software bundled with Hardware this fall."); CX 1658(Goddu) at 389/2-11 (Sega told TRU it only sells old product to the clubs.).

Negotiation and new points of agreement: CX 1657 (Goddu) at 229/7-15 (Goddu repeatedly spoke to Sega about product in the clubs that was identical to the product carried by TRU.) CX 1660 (Lazarus) at 123/21-124/2. (Sega complained to TRU that Nintendo's products were in the clubs.); CX 1659 (Goldstein) at 57/18-59/3 (TRU's Goldstein said that, when confronted about new Sega products found in club, the CEO of Sega said "he would look into it and this is not what he wanted to happen. And he would see what he could do to make sure it doesn't happen in the future."); CX 1657 (Goddu) at 231/15-22; Kalinske 2511/21-2512/6 (In response to TRU complaints, Sega assured TRU that it was only selling the clubs hardware "packouts," *i.e.*, hardware bundled with software.).

a horizontal understanding -- essentially an agreement to boycott the clubs -- among its key suppliers. This boycott agreement had its roots in TRU's first conversations with Mattel in October of 1991, but, as TRU's top executives consistently testified, the horizontal agreement grew and became a crucial feature of the implementation and enforcement of the club policy across most of the industry. The testimony from TRU's top officers describes TRU's pattern of conduct with its suppliers, and this and other evidence demonstrates that, at a minimum, Mattel, Hasbro, Fisher Price, Tyco, Little Tikes, Today's Kids, and Tiger Electronics agreed to join in the boycott on the condition that their competitors would do the same. Several were particularly concerned about their closest competitors; all were concerned about the behavior of competitors generally. With the cooperation of the toy manufacturers, TRU also monitored and policed the horizontal agreement after it was in place.

When TRU raised its club policy with the toy companies in late 1991 and 1992, the policy met with resistance. Lazarus testified that the manufacturers were not happy about it:

Q: Did any of the manufacturers, when you were presenting your policy, you said the responses were varied, did any of them express unhappiness to you concerning the policies?

A: Yeah, I think they wanted to do all the business they could do. Right.

* * * *

Q: I think you also mentioned that some others, correct me if I am wrong, did not seem happy about it.

A: I don't think any of them were happy. I think I can characterize no one as being happy.

Lazarus (CX 1660) at 72/9-14, 181/24-82/3.

The toy companies were afraid of yielding a potentially important new channel of distribution to their competitors. Small changes in sales volumes have a significant effect on toy manufacturers' overall profits, CX 1822 (Scherer) ¶ 17, 18, and no retail channel other than the clubs offered similar opportunities for rapid growth. For example, Mattel's sales volume to the clubs increased by 87% between 1989 and 1991. CX 574; Okun 2652/22-2653/19. Much of this growth was a result of Sam's emergence as a toy buyer, but sales to BJ's, Costco and Pace also increased at a rapid rate. By comparison, Mattel's overall sales grew by approximately 10% during this period. CX 530-E; Okun 2634/20-2636/4. A 1991 Lego memorandum said "clubs may be the most important new format development in retailing in the past century." CX 487-B. A Fisher Price report called the "opportunity for growth ... phenomenal." CX 698-B. Based on this and other evidence, the ALJ found that toy suppliers in the late 1980s and early 1990s saw the clubs as a new outlet of potentially great importance. IDF 64, 65.

When TRU introduced its club policy, the toy industry was looking to expand -- not restrict -- the number of major retail toy outlets. As already mentioned, Child's World and Lionel Leisure had recently fallen into bankruptcy. The few remaining national retailers comprised a large and growing share of the toy manufacturers' customers at wholesale. TRU was the biggest buyer and consistently the source of the greatest concern. Toy manufacturers' documents show that the toy companies were worried about the increasing concentration among toy retailers and sought alternatives to reverse the trend towards concentration. A 1993 VTech memorandum began: "Objective: To regain sales with the warehouse clubs in order to reduce our dependence on Toys R Us." CX 1318. Mattel was also on the lookout for new outlets to replace those it had recently lost. A December 1990 memorandum from Mattel CEO Amerman to his staff summarized his view of Mattel's place in this quickly changing retail environment: "The constriction in the number of traditional retail outlets that carry toys is going to become a bigger and bigger problem as time passes." CX 523. Noting the clubs' rapid growth rate, Amerman 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 and the other traditional retail outlets. CX 523; Okun 2624/19-2625/14. Mattel's Vice President of Sales testified that "our hope was that we could figure out a way to have them [the clubs] expand their business and become more like a traditional toy account" Okun 2652/1-4.

The club policy that TRU wanted to enforce ran squarely against the independent business strategies of its suppliers. TRU asserts that each toy manufacturer cared about competitor responses only to be sure that its competitors were subject to the same rule or policy. (Reply Br. at 17.) To the contrary, the record shows that a uniform, joint reaction to TRU's policy was a necessary element of each manufacturer's decision to restrict sales to the clubs. Each was simply unwilling to go forward with the proposed policy alone. Indeed, Goddu testified that it was "frustrating to [TRU] that [its suppliers] would always talk about ... their competition" and resisted making "*a decision on their own independent of what their competition did.*" Goddu 6877/4-13 (emphasis added).

1. TRU built a horizontal agreement among its suppliers to overcome their reluctance.

Toy manufacturers were unwilling to limit sales to the clubs without assurances their competitors would do the same. IDF 68, 75. Discrimination against the clubs simply would not happen without that additional element of horizontal coordination. For example, even after Amerman promised that

Mattel would comply with TRU's club policy,²⁵ other executives at Mattel did not believe it could afford to give up selling to the clubs on the same terms it sold to other outlets. These executives voiced their concern to TRU. IDF 129, 130. Fisher Price, likewise, said that "if their competitors [were] going to exploit [the club] channel of distribution, then they have to pay attention to it." CX 1658 (Goddu) at 328/18-329/2. And Hasbro made it clear to TRU that "[Hasbro] cannot sit by idly" if its competitors sold product to the clubs. CX 1658 (Goddu) at 273/12-15. According to TRU executives Lazarus and Goddu, virtually all of the manufacturers separately told TRU that they did not want to be prevented from selling regular line product to the clubs without assurances that competitors would also abstain. Lazarus 5443/6-10; CX 1657 (Goddu) 272-73.

Lazarus, Goldstein, and Goddu all explained that TRU assured the manufacturers that its policy would be applied equally to each of them, and told many of the major manufacturers that their closest competitors were only selling to the clubs because they were too. IDF 77-80; Lazarus 5441/5-5442/16; Goldstein 8157/23-8158/4; Goddu 6679/20-6680/11. This alleviated the manufacturers' concern about losing market share to a competitor that sold to the clubs. In Goddu's words, TRU, during its meetings and conversations with the manufacturers, communicated the message "I'll stop if they stop" from manufacturer to competing manufacturer. IDF 84; CX 1658 (Goddu) at 276-80.

Goddu testified that he relayed concerns from toy firm to toy firm about whether all (or at least their most direct rivals) would commit to TRU's policy. Mattel and Hasbro are specifically mentioned, but Goddu also said that these conversations "were always present" in TRU's negotiations with its suppliers:

... I do recall on a general basis us always acknowledging to a vendor that, you know, their competitor would say, "He's there because you're there." We had that conversation ongoing. Because they would always tell us, "I'm only there because my competitor is there." And we would say, "Well, he keeps saying he's only there because you're there."

So in that sense, you know, in response to your question, that conversation was always present, and, again, it was one of the amusing aspects. We kept saying nobody wants to take, you know, responsibility here and is always pointing the finger to the other guy. And they're all saying, "You wouldn't be there if the other guy wasn't there."

Q. Did you have those conversations with Mattel and Hasbro?

A. Oh, yes.

Q. And when you had these conversations with Mattel and Hasbro, in the conversation with Mattel did Hasbro come up in the context that you just discussed?

²⁵ As discussed below, this promise itself was based on the fact that the competition would do the same. CX 532.

A. In that context, yes.

* * *

Q. And did the same situation occur when you talked to Hasbro about Mattel?

A. Yes.

CX 1658 (Goddu) at 276/23-77.

Goddu clarified that TRU engaged in these conversations with all the key toy manufacturing firms. "We communicated to our vendors that we were communicating with all our key suppliers, and we did that I believe at Toy Fair 1992. We *made a point to tell each of the vendors* that we spoke to that we would be talking to our other key suppliers." CX 1658 (Goddu) at 278 (emphasis added).²⁶ Goddu also said: "We may have indicated to one supplier that his competitor is going to do nothing but warehouse club packs, and, you know, 'You should do the same.'" *Id.* at 279. As the ALJ found, "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." IDF 83.

As we will now discuss, the specific evidence of TRU's discussions with the large toy manufacturers corroborates the accuracy of Goddu's description. Conversations about the adoption of the club policy between TRU and its suppliers were frequent and constant. They were conducted by other top-level executives at TRU in addition to Goddu. CX 1659 (Goldstein) at 59/13-17; IDF 77 (discussing Lazarus' testimony that he told TRU's suppliers that TRU was talking to each of them, so they would know they were on "a level playing field").²⁷ Overall, documents and testimony connect at least seven firms -- Mattel, Hasbro, Fisher Price, Tyco, Little Tikes, Today's Kids, and Tiger Electronics -- to these conversations in which TRU discussed rivals' conduct with respect to TRU's club policy.²⁸ In light of Goddu's broad admission that TRU intentionally employed this method of bargaining with all of its "key suppliers," there is reason to conclude that the discussions were more widespread than the direct

²⁶ Little Tikes General Manager summarized for his files the contents of a telephone conversation with Goddu in 1993, noting among other things: "I asked why Roger [Goddu] had raised the warehouse club issue so strongly at our Toy Fair meeting? He said they were discussing it with everyone." CX 1510.

²⁷ Mattel's Okun mentioned Van Butler, Melody Young, and Peter Spencer as other people at TRU who may have complained to Mattel when its products were found in the clubs. Okun 2784/7-9.

²⁸ TRU aggressively used this kind of back-and-forth bargaining in its efforts to get Sega and Nintendo to agree to cease entirely distributing their product through the clubs. TRU's efforts with Nintendo were not successful, since Nintendo never adopted any kind of restricted distribution policy with respect to the clubs. Sega met TRU halfway by agreeing to adopt the same "special packs only" policy as the traditional toy companies. TRU did not think that club combo packs, which generally included video games and video game players, differed sufficiently from similar electronic game products sold at TRU. TRU's efforts to bring Sega and Nintendo into agreement illustrate the pattern of conduct described herein. IDF 340, 345.

evidence indicates. As the ALJ found, the toy manufacturers "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." IDF 80.

A Mattel memorandum summarized the October 3, 1991 meeting at which Mattel's CEO promised Lazarus that Mattel would comply with TRU's policy: "I believe we said we would not sell the clubs the same items we were selling to [TRU]. *This was based on the fact that competition would do the same.*" CX 532-A (emphasis added). Having obtained this guarantee from Mattel, TRU used it to induce others to join the conspiracy.

Hasbro's Director of Account Development testified that he recalls his supervisor telling him that at or just before Toy Fair in February 1992, TRU had met with Hasbro's competitors, including Mattel and Fisher Price. The Hasbro executive said: "because our competitors had agreed not to sell loaded [*i.e.*, promoted] product to the clubs, that we would ... go along with this, that he didn't believe that it would stick, meaning that ... somebody would break and sell promoted product to the clubs, at which time the door would be open to us." IDF 177; Inano 3334/2-3335/20. The executive further testified that TRU told him the other major manufacturers were going along with the policy, IDF 179, and that he had been assured by TRU that Hasbro would not be singled out. Verrecchia 1376/13-20. Hasbro's President of Sales and Marketing, Owen, similarly testified that in or about 1992 Goddu told him Tyco, Little Tikes, Mattel, and Fisher Price were all taking a similar position with respect to sales to the clubs. Owen 1128/5-1133/3. These statements were all made in the course of TRU's negotiations over Hasbro's policy toward the clubs. Owen admitted that these other companies' policies were of interest to Hasbro, at least in part, because Hasbro did not want others to gain sales volume that was unavailable to Hasbro. Owen 1131/3-15. As already mentioned, Fisher Price told TRU that Fisher Price would have to "pay attention" to the club "channel" if rivals did so. CX 1658 (Goddu) at 328/18-329/2. Finally, Little Tikes' Vice President of Sales for North America testified that, when he asked if his close competitor, Today's Kids, was selling to the clubs, Goddu told him that Today's Kids would be getting out of the clubs as well. The Little Tikes Vice President understood this as an assurance. DePersia 2147/7-2148/6, 2150/25-2151/3.

Notwithstanding Tyco's "25-item policy" (which actually functioned to prevent sales to the clubs, *see supra* note 21), TRU also encouraged Tyco to develop combination packs for the clubs to bring it in line with the other toy companies. Costco buyer Michelle Moen testified that TRU urged Tyco to develop special packs for sale to the clubs like the other toy manufacturers were doing, and told other manufacturers that Tyco would sell special packs to the clubs. Moen specifically mentioned Mattel and

Hasbro. Moen 651/17-652/9. Tyco's CEO Grey acknowledged that after the development of combination packs in mid-1993, the "approach in the [Tyco club] line is similar to that which other major toy companies have." CX 1412-B; Grey 3027/22-3029/12. Tyco sold the special club packs without regard to the 25-item policy previously announced. TRU's conduct in this instance illustrates that substantial uniformity of club policies across the toy industry was key to the continued success of the plan.

Direct communications between representatives of different toy companies about TRU's policy also demonstrate the toy manufacturers' anxiety over having to respond to TRU without knowledge of what their competitors would do. The CEOs of Hasbro and Tyco discussed their respective club policies early in 1992. IDF 189. Tyco's CEO explained his company's 25-item policy, and Hasbro's CEO said that Hasbro was still working on a company-wide response. *Id.* According to Fisher Price records, a Hasbro division representative told Fisher Price that Hasbro was "adamant that they would not be shipping key [items] to the [c]lubs, at least not yet." IDF 224. And, a Fisher Price representative asked a Little Tikes regional manager if he had experienced any repercussions from TRU for selling products to the clubs. IDF 227.

2. After the initial boycott agreement was in place, TRU organized a related agreement to enforce the boycott.

When asked if TRU ever indicated to a supplier that other, specific companies were going along, Goddu explained:

A. We may have indicated to one supplier that his competitor is going to do nothing but warehouse club packs and, you know, "You should do the same."

Q. Who was that?

A. I can't recall which one. I mean *we might use that as a ploy or a tactic to encourage them* to, you know, develop an intelligent distribution policy, but more or less, to get off the dime, you know. "You really ought to do these combo packs." *I mean we're talking to everybody and we're being told in a general sense that, you know, that's the way so and so's going.* Not necessarily any one special vendor. I wouldn't have ruled out that we did that.

CX 1658 (Goddu) at 279 (emphasis added). This "ploy or tactic" illustrates another reason the boycott agreement helped TRU to get its suppliers to adopt a distribution policy squarely contrary to the business strategy they favored only a year earlier. The horizontal agreement not only allowed TRU to overcome its suppliers' reluctance to restrict sales to the clubs, but TRU turned their apprehensions to its own advantage. As the ALJ found, for fear of reprisals from TRU, the toy companies did not want to be caught selling to the clubs when their competitors were abstaining. IDF 77.

TRU requested and then passed complaints about breaches of the boycott agreement from one supplier to another when regular product was

found in the clubs. TRU's President testified: "I would get phone calls all the time from Mattel saying Hasbro has this in the clubs or Fisher Price has that in the clubs So that occurred all the time." CX 1659 (Goldstein) at 59. Goddu explained that, on the many occasions he received these calls, he would "always thank them and tell them we would follow up" Goddu 6929-6930. Lazarus also admitted that these conversations took place. IDF 193; Lazarus 5452/12-18. TRU would speak to the offending firm and even assure the complainant that the offending firm would be brought into line. IDF 226. Violations of TRU's club policy were thus detected and punished, serving to enforce the horizontal agreement. IDF 91, 95. The toy companies participated in this exchange of complaints, which was frequent and continued over lengthy periods, effectively making their competitors' compliance a part of their agreements with TRU.

In the summer of 1992, TRU made a forceful presentation of Hasbro's complaints to Mattel. IDF 148. Hasbro told TRU about various Mattel regular products that Hasbro found in the clubs. These sales violated TRU's club policy and Mattel's promise not to sell the same products to the clubs that Mattel was selling to TRU. On July 17, 1992, TRU's Lazarus and Mattel's CEO Amerman met, and TRU communicated reports from Hasbro and other competitors of Mattel that Mattel was selling product to the clubs. CX 1772; Amerman 3795/9-3796/20, 3800/7-3801/25, 3806/24-3808/4. Amerman assured Lazarus that Mattel was not shipping "first line" merchandise to the clubs. Lazarus confirmed that he "could have" mentioned Hasbro as one of Mattel's competitors who had complained to TRU at the meeting. Lazarus 5451/4-5452/18. Mattel thereafter ceased filling orders from the clubs that it had accepted earlier in the year. Later on the same day (July 17), Lazarus met with Hasbro's CEO Allan Hassenfeld. CX 1772, 1773-B; Lazarus 5448/13-16.²⁹

Mattel also passed on to TRU complaints about Hasbro products sold in the clubs. TRU's Goldstein testified that either Mattel's Girls' Division President Barad or CEO Amerman complained to him "probably" more than once that Mattel had found some Hasbro products in the clubs. CX 1659 (Goldstein) at 59/10-17, 61/17-22.

The ALJ correctly found that "relaying Hasbro's complaints about Mattel to Mattel, as well as Mattel's complaints about Hasbro to Hasbro,

²⁹ There is other testimony and documentary evidence of TRU facilitating communications between Hasbro and Mattel. Following the July 17 meeting with Hasbro, TRU received confidential, internal Hasbro memoranda dated from June 30 to July 31, 1992, which reported information about Mattel's, Hasbro's, and other competitors' sales to the clubs. CX 1633.

On August 10, Goddu transmitted this information to TRU's CEO and other top executives. The same day, some of these TRU officials met with Mattel to review the products Mattel planned to ship to the clubs. CX 1633; Goddu 6689/13-6690/10; Leighton 3291/2-3294/24. And just two days later, on August 12, Goddu had a conversation with a Hasbro division president during which Goddu passed on to Hasbro a conversation he had with Mattel executives, including Amerman, concerning the warehouse clubs. CX 1612.

informed each manufacturer that the other one was willing to go along with TRU's club policy if its chief competitor stopped selling regular line products to the clubs and this behavior by TRU facilitated horizontal understandings among the toy manufacturers." IDF 149.

Another example concerns Fisher Price and Hasbro's Playskool division. John Chase, the Key Account Manager for Fisher Price, and his supervisor saw Playskool products in a club in November of 1992. Chase recalls his supervisor placed a telephone call to TRU, and the supervisor reported to Chase that Playskool was not "going to get away with it, that Toys "R" Us is going to take care of it." Chase 1666/14-1667/1. Playskool was the subject of many complaints in the fall of 1992. In August, Goddu had warned Playskool Vice President for Sales George Miller to cease club sales or TRU "wouldn't still buy [Playskool's] basic product." IDF 200. Later in the year and after hearing from Fisher Price, TRU called Miller to TRU's main office. IDF 201. As Miller later described the incident, TRU "took him to the shed." Chase 1673/17-23. Thereafter, Playskool improved its compliance with the club policy. Likewise, a Today's Kids document shows that it knew TRU was taking action with respect to a Tyco toy even before TRU spoke to Tyco. CX 874.³⁰

³⁰ In addition to the testimony from TRU's officers, particularly persuasive since TRU was the communications hub and initiator of the boycott strategy, that (1) the toy manufacturers were unhappy about TRU's club policy, (2) that they resisted any restrictions on their sales to clubs, and (3) that they would adopt the policy only if they were assured that their competitors would go along, the record also contains evidence of horizontal agreement specific to each of the seven toy companies. The following is a compilation of some of that evidence, organized by individual toy manufacturer:

1. Mattel.

CX 532-A-B; Barad 7891/4-18; Okun 2698/17-2699/1, 2693/14-2695/22; CX 1658 (Goddu) at 276/8-279/21 (Mattel's promise to restrict its sales to the clubs "was based on the fact that competition would do the same."); CX 1772; Lazarus 5451/4-5452/18; Amerman 3795/5-12, 3800-3808/4 (On July 17, 1992, TRU's Chairman Lazarus told Mattel's CEO Amerman that TRU had received reports from Mattel's competitors, including Hasbro, complaining that Mattel was shipping product to the clubs, and Amerman reaffirmed Mattel's commitment to restrict club sales.); CX 1772, 1773-B, 1774 (TRU met with Hasbro later that day.); CX 1659 (Goldstein) at 59/10-17, 61/17-22; CX 1658 (Goddu) at 276/17-277/25 (TRU's Goldstein and Goddu testified that Mattel complained about Hasbro products found in the clubs.); CX 626; Amerman 3844/22-3847/12 (The President of Mattel's Boys' Division suggested in a memorandum that Mattel should ascertain what its competition was shipping to the clubs so that the matter could be raised with TRU at the appropriate time.); CX 1612 (In August of 1992, Goddu had a conversation with a Hasbro Division President, during which Goddu passed on to Hasbro a prior conversation he had had with Mattel executives, including Amerman, concerning the warehouse clubs.); CX 1658 (Goddu) at 276/17-277/25 (Goddu testified that there were many such conversations concerning Mattel and Hasbro.); Moen 651/17-652/9 (TRU used Tyco, Hasbro, and Mattel's compliance with the special club packs policy to pressure each of the three companies to continue its compliance with the policy.).

2. Hasbro.

Inano 3333/12-3335/5, 3343/17-22; Owen 1132/6-1135/9; Verrecchia 1391/22-1393/14, 1393/23-1394/41; CX 1810 (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 3333/12-3343/22; CX 1630-A, B; Halverson 428/17-430/4; Owen 1129-1134; Verrecchia 1393/5-14, 1393/23-25, 1394/1-4 (At or just before Toy Fair 1992, a Hasbro executive came from a meeting with TRU and told a subordinate that TRU had met with several of Hasbro's competitors, including Mattel and Fisher Price, and that they had agreed not to sell promoted products to the clubs. Because Hasbro's competitors had

agreed not to sell promoted product to clubs, Hasbro said it would not do so, but when another company sold promoted product to the clubs "the door would be open for us."); CX 1658 (Goddu) at 273 (Hasbro made it clear to TRU that Hasbro would not "sit by idly" if its competitors sold product to the clubs.); Verrecchia 1385/7-25, 1376/16-1377/12 (Hasbro wanted to ensure that TRU's policy was being applied to Hasbro's competitors.); Verrecchia 1485/19-1486/4; Owen 1128/5-1131/2 (TRU assured Hasbro that it was talking to the major manufacturers about the clubs and that it was establishing a policy that it was going to apply to all of TRU's vendors.); CX 180, 309, 363, 47-50, 336; Verrecchia 1366/6-1367/21, 1374/13-1376/20, 1489/13-23; Lazarus 5451/14-5452/18; CX 1660 (Lazarus) at 141/4-8; Amerman 3795/9-3796/20, 3800/7-3801/25, 3806/24-3808/4; CX 1659 (Goldstein) at 62-63 (Hasbro monitored its competitors' sales to the clubs, and aggressively and frequently complained to TRU when it found violations.); CX 1658 (Goddu) at 329/23-24, 276/12-277/25; Goddu 6701/13-18 (Goddu testified that Hasbro complained more about its competition selling in the clubs than other manufacturers.); Grey 3011/12-3013/4 (In May of 1992, Hasbro's CEO discussed with Tyco's CEO what each company was doing or not doing with respect to the clubs.); CX 1772; 1773-B; Lazarus 5448/13-16; CX 1774 (TRU met separately with Mattel and Hasbro on July 17 1992.); CX 1633 (Following the July 17, 1992, meeting with Hasbro, TRU received confidential internal Hasbro memoranda dated from June 30 to July 31, 1992, reporting sales to the clubs by Mattel and other Hasbro competitors.); CX 1612 (On August 12, 1992, Goddu had a conversation with a Hasbro Division President during which Goddu passed on to Hasbro a conversation he had with Mattel executives, including CEO Amerman, concerning the warehouse clubs.); Moen 651/17-652/9 (When Tyco developed special club packs, this was communicated by TRU to Mattel and Hasbro.); CX 684-B; Cohen 8015/3-23 (A Fisher Price record shows that a Hasbro Division Representative told Fisher Price that Hasbro was "adamant they would not be shipping key [items] to the clubs, at least not yet.").

3. Fisher Price.

CX 1658 (Goddu) at 328/18- 329/29 (Goddu testified that Fisher Price was concerned because "if their competitors are going to exploit the club channel of distribution, then they [Fisher Price] have to pay attention to it."); Weinberg 7628/15- 7629/1 (TRU's Vice President Weinberg testified that Fisher Price complained to him about Playskool [Hasbro] products that Fisher Price found in the clubs.); TRU's Response to Complaint Counsel's Proposed Finding of Fact 278 (TRU admits that Fisher Price complained from time to time and that its particular concern was Hasbro's Playskool Division.); CX 563 (A Fisher Price representative spoke to a Little Tikes' regional manager to find out if Little Tikes had experienced any repercussions from TRU about products it offered to the clubs.); CX 684-B; Cohen 8015/3-23 (Fisher Price notes from Toy Fair 1992 state that Hasbro's Kenner and Playskool representatives told Fisher Price that their company was "adamant that they would not be shipping key skus to the Clubs, at least not yet.").

4. Tyco.

CX 1658 (Goddu) at 271/23-272/22, 273/24-274/3; Goddu 6876/20-6877/13 (TRU's Goddu testified that Tyco had an ongoing concern about "having to be in the clubs because their competition was there."); Inano 3345/2-3347/4; CX 532; CX 553 (Tyco knew of Mattel's club policy before it was formally announced.); Moen 651/17-652/9 (TRU urged Tyco to adopt the same policy as the other large toy makers by developing special club packs, and told other manufacturers that Tyco would sell such packs to the clubs.); CX 1412-B; Grey 3027/22-3029/12 (Tyco's CEO acknowledged, in 1993, that Tyco had adopted the same policy as its competitors.); Grey 3011/12-3013/4 (In May 1992, Tyco's CEO and Hasbro's CEO discussed their companies' policies regarding sales to clubs.).

5, 6. Little Tikes and Today's Kids.

DePersia 2146/10-2147/6, 2148/7-22 (When confronted by TRU about stopping or restricting sales to the clubs, Little Tikes executives asked about other manufacturers' sales to the clubs and asked specifically whether TRU's policy also would be applied to Today's Kids.); DePersia 2214/23-2215/3 (Little Tikes was concerned that Today's Kids might take away market share from Little Tikes.); DePersia 2147/7-14, 2150/3-12 (Goddu responded that Today's Kids would be "getting out of the business" of selling to the clubs.); DePersia 2147/18-24, 2150/25-2151/4 (A Little Tikes Sales Vice-President understood that Goddu had spoken with Today's Kids and that the response was a reassurance of Little Tikes' concerns.); Goddu 6726/2-11, 6727/8-12, 6730/20-6732/2, 6738/5-6739/25 (Goddu had spoken to Today's Kids about TRU's policy, and Today's Kids had told Goddu it would slow or discontinue sales to the clubs.); CX 874 (A Today's Kids memorandum lists several Mattel and Tyco-Playtime products sold by clubs, and states that Today's Kids knew that TRU was taking these items from its shelves. The memo is dated a week before TRU met with Tyco regarding these products.).

7. Tiger Electronics.

H. Effect of the "No-Identical-Items" Policy.

TRU's initial position was that the toy manufacturers should not "overly support" the warehouse clubs. CX 529. That position was modified to agreements not to sell "hot products" to the clubs and to specially package other products for the clubs. Eventually (and primarily as a result of negotiations with Mattel),³¹ these first agreements changed into new agreements from and among the toy companies not to sell any of the same products to the clubs that the toy manufacturers sold to TRU. Thus, the focus on hot products was dropped in favor of a uniform policy of offering the clubs only goods that were significantly differentiated from those carried at TRU. Toy companies like Tyco also agreed to develop a special line of differentiated products for the clubs if they had not already done so. These special lines were comprised of combination packs, but in a few instances individually packaged toys were redesigned to make them visually distinct from the items sold at TRU and other traditional retailers. As discussed above, TRU supervised the policy by reviewing and approving many club products before they were offered to the clubs.

The no-identical products policy met TRU's goals. TRU wanted to prevent toy manufacturers from competing with each other to sell products to the clubs, CX 1658 (Goddu) at 276/23-277/25; Kalinske 2488/20-2489/3, 2491/19-2492/6, to prevent consumers from making direct price comparisons between products sold by TRU and products sold by the clubs, Butler 5560/13-24; Goddu 6635/7-21, and to prevent the clubs from competing with TRU. Okun 2684/15-2685/6.

TRU approved of the sale of special packs to the clubs because special packs make it difficult for customers to compare the prices at different retail outlets. Asked whether a customer could compare the price of an individual toy with that of a club pack, TRU's Goddu answered:

the objective was that the consumer not be able to do it easily. And if, can I give you an example on that? If Sunshine Barbie individual doll is found everywhere at \$9.99 and then the warehouse clubs sell Sunshine Barbie and two little friends with it and the warehouse clubs sell that for \$14.99 or \$16.99, the customer doesn't

Shiffman 2016/18-2017/1 (Tiger's Executive Vice-President got the "impression" from his initial conversation with TRU's Goddu that TRU's club policy would apply to all manufacturers in the industry.); CX 811; Shiffman 2017/2-2028/13 (After agreeing to restrict its own sales, Tiger wrote TRU a letter complaining about a competitor's product in a club.); CX 811 (Tiger said that it had not sold

any such easily-comparable products to a club, but that Tiger could sell such products "if we had known that it was acceptable to you.").

³¹ IDF 130 ("[Mattel's] 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 During this phone call, Goldstein also indicated to Barad that selling special packs to the clubs was acceptable to TRU.").

really know the value of the little dolls. I mean, it's hard to say is that worth -- are the other retailers competitive or not competitive at \$9.99 relative to that version being \$14.99? Will you get more product? So those were the objectives, you know, so that they're not easily comparable. Those were always our objectives. CX 1657 (Goddu) at 215/22-16/8.

Most special packs were less popular with customers than individually packaged items. Lazarus believed that consumers would not want combination packs, and he knew he did not want them for TRU. Lazarus 5431/16-5433/10. The policy also raised the average prices of toys available at the clubs, even when consumers saw no improvement in value. For example, both Mattel and Hasbro, as a matter of policy, would not produce a club combo pack that would sell for a lower price at a club than any one of the items sold alone at other retailers. IDF 394, 395. A 1993 Mattel memorandum describing problems with the Barbie Gift Sets developed for the clubs illustrates the point:

The biggest complaint the clubs have is that there is no perceived value to the Barbie gift sets. They attempt to sell the gift sets at \$14-\$18, while the traditional retailers sell the regular line feature Barbie for \$11-\$16. Their [the clubs'] customer sees only the doll and sees them as being higher priced. This also creates a problem for their entire department which a consumer could view as being higher priced.

CX 592. The memorandum also says that "putting costumes with a doll and calling it a gift set does not work. They sell costumes for as little as 75 [cents] each ... and we're charging them \$2-\$4. No value." *Id.* While not all combination packs fared as poorly as these Barbie Gift Sets, the problem they created was pervasive.

The ALJ correctly found that TRU halted a pattern of rapid growth of toy sales at the clubs. IDF 368, 375. In just the year before the boycott, clubs' share of all toy sales in the United States grew from 1.5% in 1991 to 1.9% in 1992. But, toy sales by the clubs fell steadily to 1.4% by 1995 after the boycott took hold.³² CX 1822 (Scherer) Ex. 4a.

The boycott hobbled individual clubs toy business. Costco's experience is illustrative. While its overall growth on sales of all products during the period 1991 to 1993 was 25%, Costco's toy sales increased during the same period by 51%. IDF 385; CX 1745-Z-9. But, after the boycott took hold in 1993, Costco's toy sales *decreased* by 1.6% despite total sales growth of 19.5%. *Id.* While there is no assurance that Costco's toy business would have continued to grow at an annual rate of 25% or more, TRU's policy clearly took the wind out of Costco's sails. This change reflects the sudden loss of supply of key toy products. In 1989, over 90% of Mattel toys

³² The clubs' overall sales of all goods grew at an annual rate of 26.4% in 1991, 22.8% in 1992, 10.8% in 1993, 3.9% in 1994, and 5% in 1995. CX 1824. Professor Buzzell, a marketing expert called by TRU, testified that the sales volume of all clubs grew at an average annual rate of 48 % from 1985 to 1988 and of 24.3 % from 1988 to 1992, before slowing to an annual rate of 6.5 % from 1992 to 1995. RX 894 (Buzzell) at 21-22.

purchased by Costco and the other clubs were regular items, but this number fell to zero in 1993. CX 1822 (Scherer) ¶ 51. The clubs' share of the 100 most popular toys from all manufacturers dropped by more than half between 1992 and 1995. Most of Costco's 1995 sales were video products, so the reduction in popular traditional toys was even greater. CX 1822 (Scherer) Ex. 5, 6a.

The reversal of the clubs' success as toy retailers can also be seen by examining toy manufacturers' sales to the clubs. For example, the sales volume of Fisher Price to Price Club dropped from around \$6 million in the late 1980s to approximately \$220,000 in 1993. Chase 1775/14-1776/6. Sales to the clubs by Hasbro, including its Playskool, Playskool Baby, and Kenner divisions, declined from \$9.5 million in 1991 to \$3.2 million in 1993. IDF 212; CX 448; CX 447A-E; Owen 1294/2-5. Mattel's sales to all clubs, which grew at about 50% annually in both 1989 and 1990, dropped from over \$23 million in 1991 to \$7.5 million in 1993.³³ IDF 165. From 1991 to 1993, Tiger Electronics sold the clubs regular products, and its sales to the clubs climbed from \$273,000 to \$3.5 million, at which time clubs accounted for 2.5% of Tiger's sales. IDF 301; CX 1756-C. But after Tiger adopted TRU's policy in 1994, club sales dropped to less than \$32,000. IDF 309.

Most significantly, competition would have driven TRU to lower its prices had TRU not taken action to stifle the competitive threat posed by the clubs.³⁴ In turn, if TRU lowered its prices, other retailers would have been forced to do so as well. IDF 392. Several industry witnesses expressed this view. Goddu thought that the clubs were going to force down toy prices at all retailers, in the same way that Wal-Mart had done. Goddu 6616/19-23. A Binney & Smith executive believed that the prices charged by the warehouse clubs would become the prevailing market price. Blaine 6372/12-16. The ALJ also found that, because clubs carry many less popular items at prices substantially lower than TRU's, TRU would have lowered prices for toys beyond the top 100 to 250 best-selling items to protect its price image. IDF 405.

If TRU had matched the clubs' prices by reducing its average margin on its five hundred best-selling products from 20.5% (TRU's average margin on the top 500 toys) to 9% (Costco's average margin), its customers would have saved \$55 million per year.³⁵ CX 1822 (Scherer) ¶ 58. By the

³³ Mattel's sales of regular product to clubs dropped from about \$17 million in 1991 to zero in 1993, and during the same period sales of custom product grew from \$6.7 to \$7.5 million. IDF 165.

³⁴ Indeed, TRU *did* lower its prices for several items when clubs were able to sell the *same* items at a substantially lower price. See *supra* p.547.

³⁵ Of course, if TRU lowered the prices on fewer than five hundred items to meet club competition -- which in fact it was more likely to do -- this number would be lowered accordingly.

same token, TRU's policy raised the costs of toys at the clubs, obstructing their advantage as the lowest price outlet. This too weakened their effectiveness as competitors to the advantage of TRU and the injury of consumers.³⁶

I. Evidence of "Free-Riding."

TRU provides several services that might be important to consumers. These include advertising, carrying an inventory of goods early in the year, and supporting a full line of products. But the evidence indicates that the manufacturers compensate TRU for advertising toys, storing toys made early in the year, and stocking a broad line of each maker's toys under one roof. Given TRU's hard bargaining with the toy companies over prices and other terms of sale, and due to the industry's desire to support TRU, TRU has consistently been able to extract subsidies, discounts, and other concessions from the toy companies that enable TRU to provide the services the toy industry wants.

TRU does not purchase "image advertising" designed to boost the demand for toy products generally. Television advertising, for example, is paid for entirely by the toy companies. IDF 470; CX 1822 (Scherer) ¶ 60. TRU advertises in local newspapers, and via catalogs, to promote the availability and prices of products in TRU stores. IDF 471. There is no reason to believe that the small amount of local advertising by TRU boosts sales at nearby club stores. IDF 480. To the contrary, Professor Scherer convincingly demonstrated that, if anything, TRU's local advertisements lower toy sales at its competitor stores in the same area. CX 1831 (Scherer) ¶¶ 1-10.

Toy manufacturers also pay TRU for its local ads. A 1993 TRU memorandum states that advertising is vendor-funded and calls it "essentially free." CX 967-C.³⁷ TRU's cost calculations confirm this statement. TRU's calculations do not indicate the amount of advertising expenditures in 1993, but do show advertising allowances of more than

³⁶ In an effort to show that TRU's pricing is already constrained in local markets by competition from Wal-Mart and the other national discounters, TRU's economist, Professor Carlton, performed a regression equation comparing the number of local competitors to the prices charged for *all* of the toys at TRU stores and found a very small (1-2%) relationship between the number of local competitors and prices charged by TRU. Complaint Counsel's expert, Professor Scherer, responded that Carlton erred in using the average price of all toy items, because TRU only adjusts its prices on the top several hundred items to meet price competition from other discounters. Reinterpreted to measure not average price, but only the prices of the top 100 to 250 items, Carlton's analysis shows pricing differences of between 5.08 and 7.08% for top-selling items at locations where TRU stores compete with Target, Wal-Mart or other discounters. If allowed to continue, head-to-head price competition with the clubs was likely to lower toy prices further in the 238 or more areas where TRU stores compete with club outlets. CX 1830 (Scherer) ¶¶ 10, 11.

³⁷ According to Spencer, a TRU toy buyer, TRU's Senior Vice President of Advertising repeatedly explained that TRU received more in advertising allowances than it spent on advertising. Spencer 1867/7-14.

\$183 million from toy manufacturers. CX 1012. In 1994, TRU spent \$199 million on advertising-related expenses and received compensation in excess of \$198 million. *Id.* TRU's net cost of advertising was \$750,000, or 0.02% of total sales. In 1995, TRU's calculations show that it spent about \$263 million on advertising and was paid a bit more than \$225 million, roughly 90% of its costs. TRU projected that 1996 payments would cover 95% of advertising costs. CX 1009. Advertising, in short, was a service the *toy manufacturers* provided for TRU and not the other way around.

Manufacturers also compensate TRU for storing the goods that it buys before the Christmas selling season. Most often compensation is made by extremely favorable "dating," meaning delay in the date payment is due for goods received over the year. TRU's Chairman Lazarus explained dating:

it's financed in large part by the manufacturers who build extra margin into the price and then give "dating." You buy now; you pay later. Because you don't sell evenly throughout the year. That was and is the premise. They [the toy companies] build the price margin into it so they can produce 12 months a year. Without this dating, I never would have been able to afford the inventory.

CX 1611-C (emphasis in original). TRU is the only toy retailer that pays for all of its Mattel inventory on [], even if products are purchased in January of that year. [citation redacted]. By comparison, Wal-Mart is required to pay within 90 days of shipment. *Id.* Mattel documents describe this late payment deadline as compensation for storage services. CX 686-B. When Playskool shipped an order of products unexpectedly early (late June), Playskool agreed to lower the price of the shipment by an amount equal to four months' storage costs. CX 1730. TRU's records show that manufacturers routinely paid TRU credits for warehousing services. CX 1012.

TRU is compensated for supporting the toy companies' full line of products. TRU receives a disproportionately large supply of hit products in short supply. In 1992, for example, TRU got 40 to 50% of Mattel's "hot" products while it sold only 29% of Mattel's total output. CX 530-D. A 1990 letter from Mattel to TRU explained, TRU "is receiving a disproportionate share of our quotas [W]e will continue to provide the maximum possible support to insure a great sell-through." CX 533-A. "Great sell-through" means that TRU, by stocking hit product unavailable at other toy retailers, is able to sell additional toy items to the customers who come to TRU stores to purchase the hit products. In other words, even though TRU's margins are lower for "hit" products, TRU is able to profit from its access to hits by also selling some less popular products to the customers who come to its stores to purchase hits. CX 1822 (Scherer) ¶ 20. Thus, liberal access to scarce products compensates TRU for its full-line stocking service to the toy industry. A 1990 Tonka (Hasbro) memorandum reports: "Tonka has fulfilled its obligation to provide 'more than a fair share' of hot

product to TRU (including the 8,000 ... Wrestling Buddies that [were] bound for other retailers)." CX 5.

The toy companies also give TRU post-sale discounts ("markdowns") on the prices paid for slow-moving products. In this way, if TRU is burdened by an unsuccessful product it carries, the manufacturer pays a large part of the cost. Kenner (Hasbro) document states that TRU "murdered us" on Kenner-funded markdowns on products that flop. CX 10 A, B. Many documents in the record memorialize discounts extended to TRU when products did not sell as well as expected: for example, a 1992 Mattel memorandum titled "Toys 'R' Us -- Special Pricing" records granting TRU well over \$1 million in free goods in compensation for "special discounts" on slow-moving items; and a 1994 memorandum suggests that Mattel, as "done in the past," should fund discount coupons for twenty-eight items overstocked at TRU. CX 556, 584-A; IDF 507 (listing documents). TRU's standard purchase contract includes a most favored nation clause to guarantee that it pays no more than the lowest price in the industry. CX 1030-F.

There is no evidence that club competition without comparable services threatened to drive TRU's services out of the market or harm consumers. TRU's *only* illustration of its claim that it was forced to change (or even considered changing) its marketing policy as a result of purported free-riding involves a decision in 1996 to cut back the average inventory in TRU stores from approximately 16,000 to 18,000 units to about 11,000 units. Goddu 6574/22-25. Based on the record, it is difficult to connect this TRU marketing change to "free-riding" or even competition by the clubs. TRU's executive in charge of these changes testified that the reduction in the number of units in its inventory was an effort to create a cleaner looking shopping floor. Goddu 6576. Studies undertaken by the company prior to the decision to cut back on inventory all related that decision to consumer preferences for a less crowded store, not to free-riding issues. Goddu 6574-75.³⁸

³⁸ Competition with Wal-Mart caused TRU to lower prices and "to give the customer a better in-store shopping experience." Goddu 6523-24. TRU decided to reduce the number of products in its inventory in an effort to create a cleaner looking shopping floor. Goddu 6574/16-25. Three studies were undertaken to find the optimal number of items for TRU; all recommended 9,000, as additional items do not register in the eyes of consumers. Goddu decided to cut his inventory to about 10,000 and ended up with an inventory of a little less than 11,000. Goddu testified that any greater inventory reduction would cause TRU to lose its distinct edge. He speculated that if TRU attempted any inventory cut greater than the one he made TRU would "close [its] doors." Goddu 6578. TRU documents echo Goddu's conclusion, "[o]ur broad selection continues to be a strong competitive defense versus virtually all of our competitors. We must leverage this as much as possible." CX 1586-B. And, "[m]ost competitive stores that you go into, you often can't find what you want, which gives us an enormous marketing opportunity particularly in the current environment." CX 1611-F. Professor Scherer concurred with Goddu's evaluation: "I don't think that [a \$55 million] loss in profit would lead to a significant change [in TRU's stocking policy] because for Toys 'R' Us not to pursue the policy it has pursued with such great success would be to undermine the basis of its success." Scherer 4919/3-7. Scherer also observed that TRU lost money on the 6,000 or so slow-moving items that it cut from its

No contemporaneous document suggests that TRU was concerned about "free-riding" when it developed its club policy.

J. Before TRU's Policy Was Implemented, Almost All the Toy Companies Sold to All Retail Outlets Including Warehouse Clubs.

Most toy companies are saturation retailers, meaning that they seek sales whenever and wherever possible. Toys are sold at supermarkets, pharmacies and convenience store gas stations. To the extent that the toy industry needed costly services from any of its retail outlets, it traditionally has chosen to pay for these services itself through one of the several methods described earlier. There is no evidence that a toy company, prior to TRU's policy announcement, ever restricted the distribution of its toy products in an effort to preserve or enhance the quality of its retailers' services. Two small companies, Little Tikes and Lego, restricted the clubs to custom or discontinued products prior to 1992 (when the TRU policy was announced). IDF 262, 330. There is no indication why Lego in the late 1980s limited the clubs to old products, but Lego began to sell regular products to BJ's in the early 1990s. Little Tikes was motivated by product prestige. IDF 262-65. Little Tikes' founder believed his company's image would be eroded if products were sold at steep discounts in clubs and similar outlets, and therefore declined to sell to the clubs. *Id.* All other toy companies (and eventually Little Tikes, after it was purchased by Rubbermaid) courted the clubs and other new channels of distribution.

No toy company document before 1992 even hints that "free-riding" by one toy retailer on the efforts of another could be a problem in the industry. On the contrary, before 1992 all the big toy companies (Mattel, Hasbro, Fisher Price, Tyco, etc.) actively searched for new low-cost distributors and aggressively sought to expand toy sales to and through the clubs.³⁹

inventory in 1996, but that the remaining stock is profitable for TRU. Scherer 4921/9-22.

³⁹ Several toy manufacturer witnesses testified that they *did* view the clubs as free-riders, even before they were confronted by TRU. The ALJ did not credit this testimony, in some instances expressly dismissing these witnesses as not credible. IDF 296 (Today's Kids executive's testimony not credible), 316 (VTech executive's testimony includes "much post hoc rationalization"). Other testimony of this kind was inconsistent with specific evidence in the rest of the record. For example, Fisher Price's Senior Vice President of Sales gave several reasons why Fisher-Price decided to restrict club sales in 1990 prior to any request from TRU, including the desire to protect the margins of its core retail customers. Cohen 7955, 7960-61. But these statements were contradicted by a 1990 memorandum showing that Fisher-Price planned to sell both regular product and special packs to the clubs that year. RX 280. TRU attempted to rely on a 1993 document, RX 256, for corroboration of the Fisher Price executive's testimony. Cohen 7948/8-22.

Obviously a 1993 document is not as reliable as contemporaneous documents with respect to a decision purportedly made in 1990. TRU's reliance on this 1993 document underscores the weakness of TRU's contemporary evidence on this point. *Cf. United States v. U.S. Gypsum, Co.*, 333 U.S. 364, 396 (1948) (where antitrust defendants' trial "testimony is in conflict with contemporary documents, we can give it little weight.").

All of the manufacturers' testimony giving independent reasons why they decided to discriminate

against the clubs is also contradicted by the consistent testimony from TRU's own officials that the club

II. DISCUSSION OF LAW.

Set out below is a discussion of fact and law demonstrating, first, the existence of vertical agreements between TRU and at least ten toy manufacturers, and second, the existence of horizontal agreements among at least seven toy manufacturers. We then turn to an application of substantive legal standards to these agreements.

The boycott organized by TRU and the toy manufacturers could be declared illegal *per se* under the Supreme Court's decision in *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959). For a number of reasons, we choose not to rely primarily or exclusively on *Klor's*, but rather find a violation on alternative grounds. First, the boycott is illegal *per se* because it demonstrates all the characteristics that the Supreme Court set forth in *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284 (1985), as a predicate to applying *per se* rules. Second, the boycott is illegal under a full rule of reason analysis because the anticompetitive effects clearly outweigh any possible business justifications. Third, the vertical agreements between TRU and each toy manufacturer, entered into *seriatim* with clear anticompetitive intent, violate Section 1 of the Sherman Act.

A. *TRU Entered Unlawful Vertical Agreements
With at Least Ten Toy Manufacturers.*

TRU entered vertical agreements with at least ten toy companies, including all of the large, traditional toy manufacturers, not to deal with clubs except on discriminatory terms that limited the clubs' ability to compete.

Contrary to TRU's assertions, the doctrine of *United States v. Colgate & Co.*, 250 U.S. 300 (1919), does not protect TRU's conduct. *Colgate* and its progeny protect unilateral conduct from antitrust liability under Section 1 of the Sherman Act. For example, when a manufacturer states a distribution policy -- typically a suggested retail price -- and then refuses to deal with any distributor that does not comply, no "agreement" between the manufacturer and distributor can be inferred from the manufacturer's actions. This is so even if all of the manufacturer's dealers comply out of fear of losing a key supplier. In the present case, the distribution policy was announced by a large distributor, and it was the manufacturers that had to

policy was difficult to implement. As quoted above, TRU's Chairman Lazarus said that *none* of the toy manufacturers was happy about TRU's club policy.

We thus agree with the ALJ's decision to reject this line of testimony, which was self-serving, unsupported, and directly inconsistent with the rest of the evidence showing that virtually all toy manufacturers viewed the clubs' emergence as toy retailers as a *positive* development for the industry which was thwarted by uninvited pressure from TRU.

decide whether to comply. Were these the only facts, the participants would still be entitled to *Colgate* protection. See *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984) (reaffirming *Colgate*); *FTC v. Raymond Bros.-Clark Co.*, 263 U.S. 565, 573 (1924). But they are not.

TRU overstepped the bounds of *Colgate* repeatedly and in several different ways. TRU's goal was to work out arrangements whereby the toy manufacturers would sell to the clubs only on discriminatory terms, thereby diminishing the clubs' ability to compete effectively with TRU. *Colgate* would protect this policy, if it had been confined to an announcement, followed by firms making independent business decisions. But that is not what occurred. First, TRU asked toy companies for an express response -- yea or nay -- after it told them of its policy, see *supra* pp. 542-45; second, it engaged in extended negotiations with companies that were reluctant to adopt the restraint, and worked out agreed-upon compromise solutions, see *supra* pp. 545-46; third, it asked to, and in fact did, preview and clear products developed for the clubs to assure that they were sufficiently differentiated from its own, see *id.*; fourth, on at least one occasion, a supplier agreed to split the cost of a discount that TRU offered after a toy company breached the policy by selling a product to a club, and TRU elected to meet the club's lower price, see *supra* p. 547; fifth, on other occasions, TRU invited toy manufacturers to police compliance by competitors and, when toy companies complained about competitors' sales to the clubs, TRU called meetings with the firms violating the agreement to demand again that they cease club sales, see *supra* pp. 557-59. On the last point, the fact that toy manufacturers asked for enforcement of TRU's policy perhaps would not be enough, without more, to form an agreement. See *Parkway Gallery Furniture, Inc. v. Kittinger/Pennsylvania House Group, Inc.*, 878 F.2d 801 (4th Cir. 1989). We need not resolve that issue because the systematic give-and-take of negotiations between TRU and the various manufacturers went well beyond the simple announcement of a policy followed by terminations if that policy was not followed.

The parties constantly described their arrangements as "agreements," "promises," "understandings" and like terms, see *supra* pp. 547-48 & note 23, -- all indicating a conscious commitment to a common plan or scheme.

Recent case law interpreting *Colgate* demonstrates why TRU's conduct and the toy suppliers' responses evidence agreements. The *Colgate* doctrine was discussed at length in *Monsanto*. 465 U.S. at 761-63. In *Monsanto*, the Court addressed the question of the type of evidence that a plaintiff must present to create an issue for the trier of fact in an action for vertical price fixing. *Id.* at 760-64. The Court rejected the proposition that complaints by one party in the distribution network to another (most often the manufacturer) about a price cutter, followed by termination of the price cutter, could alone amount to adequate evidence of an agreement. *Id.* The

proper test, the Court concluded, was that a plaintiff must produce "direct or circumstantial evidence that reasonably tends to prove that the manufacturers and the others 'had a conscious commitment to a common scheme designed to achieve an unlawful objective.'" *Id.* at 764 (quoting *Edward J. Sweeney & Sons, Inc. v. Texaco, Inc.*, 637 F.2d 105, 111 (3d Cir. 1980)). This test was alternatively stated with a focus on the refutation of independent business justification: "There must be evidence that tends to exclude the possibility that the manufacturer and the nonterminated distributors were acting independently." *Id.* In this case, there is no question that complaint counsel presented evidence tending to exclude the possibility of independent action under the standard of *Monsanto*.

In *Monsanto*, the Court found "substantial direct evidence of [an unlawful agreement] to maintain prices" where Monsanto advised a discounting dealer other than the one terminated that it would not receive adequate supplies if it continued discounting; Monsanto, frustrated by the dealer's continued discounting, complained to the dealer's parent company, which then instructed its subsidiary to comply; and the dealer later informed Monsanto that it would comply. *Id.* at 765.⁴⁰

The record here contains similar evidence (and more) of agreement. TRU asked its suppliers to comply with its policy, and they responded with commitments; most agreed on the understanding that all would do the same; and when some did not do as they had promised, TRU engaged in often-protracted negotiations with the "non-complying" manufacturer. Indeed, the presentation of packages of club products to TRU to determine whether they were acceptable to TRU, and the subsequent offer of products to the clubs only after content and packaging were deemed acceptable to TRU, went well beyond any evidence of "a conscious commitment to a common scheme" found in *Monsanto*. *Id.* at 764 (quoting *Edward J. Sweeney & Sons*, 637 F.2d at 111). Finally, in the case of Little Tikes, TRU employed exactly the same tactic as did Monsanto -- it complained to

⁴⁰ The Court also found more ambiguous, but nonetheless adequate evidence of a vertical agreement to create a question for the trier-of-fact in the following newsletter sent by a Monsanto distributor to its retail clients:

In other words, we are assured that Monsanto's company-owned outlets will not retail at less than their suggested retail price to the trade as a whole. Furthermore, those of us on the distributor level are not likely to deviate downward on price to anyone as the idea is implied that doing this possibly could discolor the outlook for continuity as one of the approved distributors during the future upcoming seasons. So, none interested in the retention of this arrangement is likely to risk being deleted from this customer service opportunity. Also, so far as the national accounts are concerned, they are sure to recognize the desirability of retaining Monsanto's favor on a continuing basis by respecting the wisdom of participating in the suggested program in a manner assuring order on the retail level "playground" throughout the entire country. It is elementary that harmony can only come from following the rules of the game and that in case of dispute, the decision of the umpire is final.

Monsanto, 465 U.S. at 766.

Rubbermaid, Little Tikes' parent company. As in *Monsanto*, Little Tikes, instructed by its parent to comply, told TRU that it would do so.

Judge Posner's opinion for the Seventh Circuit in *Isaksen v. Vermont Castings, Inc.*, 825 F.2d 1158 (7th Cir. 1987), much like *Monsanto*, supports the finding of agreements here. Isaksen was a distributor of wood burning stoves. The defendant-manufacturer, Vermont Castings, distributed a list of suggested retail prices, but did not require its dealers to sell at those prices. Isaksen sold stoves at deep discounts, and, as a result, Vermont Castings was "bombarded" with complaints from its other dealers. Isaksen testified that Vermont Castings threatened to "mix up" his orders if he did not raise prices.⁴¹ About a year after this threat, Isaksen raised prices and brought a Sherman Act Section 1 action alleging an illegal price maintenance agreement. Isaksen prevailed with the jury, but the district court set aside the verdict.

The Seventh Circuit found sufficient proof of vertical agreement to create a jury question based on (1) the manufacturer's threat that orders would be "mix[ed] up" if the discount dealer did not raise its prices and (2) the dealer's subsequent price increase. *Isaksen*, 825 F.2d at 1163-64. The court found that the manufacturer stepped beyond *Colgate*-protected conduct when it asked its dealer to raise prices and the dealer complied. *Id.* *Colgate* protects announced conditions followed by termination, but does not insulate negotiations with recalcitrant suppliers or dealers. In Judge Posner's words, after the supplier has asked its dealer to adopt a specific policy, the acceptance could be "implicit, or signified by conduct in lieu of promissory language." *Id.* at 1164. *Monsanto* has been similarly interpreted in other circuits. For example, in *Big Apple BMW v. BMW of North America, Inc.*, 974 F.2d 1358 (3d Cir. 1992), the Third Circuit reversed a grant of summary judgment for the defendant because the plaintiffs were able to produce evidence tending to show that the defendant's purported independent business justifications for the challenged conduct were a pretext. *Id.* at 1374-80; see also *McCabe's Furniture, Inc. v. La-Z-Boy Chair Co.*, 798 F.2d 323, 328 (8th Cir. 1986) (holding jury could conclude that a supplier and its dealer entered into an agreement to terminate a second dealer where, *inter alia*, the supplier subsequently reported the termination to the first dealer).

United States v. Parke, Davis & Co., 362 U.S. 29 (1960), examined and held illegal a pattern of conduct analogous to that engaged in by TRU. Parke, Davis, a pharmaceutical company, sought an agreement from retail druggists to maintain prices and, when retailers resisted, modified its requirement and sought a discontinuance of price advertising. Parke, Davis

⁴¹ TRU's behavior in holding up payment for a shipment from Mattel, followed by Mattel's compliance with the scheme to discriminate against the clubs, see *supra* p. 547, involves similar conduct.

negotiated first with one and then other retailers, obtained assurances that price advertising would be discontinued, and eventually brought all retailers into line. The Supreme Court explained that a manufacturer that actively negotiates with its distributors in this manner goes "far ... beyond the limits of the *Colgate* doctrine." 362 U.S. at 46.⁴² Except for the fact that the instant case involves a retailer seeking assurances from its suppliers (rather than the other way around), this precedent squarely covers the precise conduct at issue here.

TRU cites three post-*Monsanto* lower court cases in support of its view that "courts of appeals have consistently ruled that a manufacturer's communication to a complaining retailer of its decision not to deal with a competing retailer in response to the complaining dealer's demand is insufficient to establish agreement under the standard set forth in *Monsanto*." (Reply Br. at 32.) TRU believes that these decisions protect TRU's conduct in this case. We disagree. It is true that in both *Garment Dist., Inc. v. Belk Stores Servs., Inc.*, 799 F.2d 905 (4th Cir. 1986), and *Jeanery, Inc. v. James Jeans, Inc.*, 849 F.2d 1148 (9th Cir. 1988), dealers complained to a manufacturer about a rival price cutter and, following those complaints, the price cutter was terminated. But TRU's conduct went beyond simple complaints to toy manufacturers about low prices at the clubs and each manufacturer's simple response that it was no longer dealing with the clubs. Rather, TRU negotiated with suppliers about the terms on which they would sell to the clubs, reviewed and agreed to assortments of products that could be sold to the clubs on terms acceptable to TRU, and then negotiated about and policed compliance by companies caught in violation of its policy. The decisions TRU cites lack such additional proof of conspiracy that is present here, which as in *Parke, Davis* goes "far beyond" the manufacturer's communication of its policy to its dealers in response to complaints, and subsequent cut-off.

TRU also relies on *H. L. Hayden Co. v. Siemens Medical Sys., Inc.*, 879 F.2d 1005 (2d Cir. 1989), and particularly that portion of the opinion in which the Second Circuit found that Siemens did not overstep its *Colgate* rights when it said to a group of complaining full service dealers that it was "working on the problem" presented by a discount mail-order dealer. It was undisputed that the full service dealers had complained about free-riding by the mail-order outlet and also clear that the mail-order outlet really was a free-rider, providing none of the presale, point-of-sale and post-sale services that the manufacturer desired from its distributors. The court of appeals emphasized that the "correct standard" requires evidence that tends to exclude the possibility of independent action by the manufacturer in response to distributor complaints. *Id.* at 1014. Except for the complaints,

⁴² The Court's analysis is quoted at p. 576, *infra*.

there was no evidence of agreements between the manufacturer and dealers, and there was also clear evidence of a "negative impact" upon Siemens' reputation and its ability to protect its distribution system arising from the mail-order outlet's "free-ride" on services. *Id.* The single comment by Siemens -- that it was "working on" the mail-order problem -- was insufficient to persuade the court that termination of the mail-order price cutter was not an independent decision by the manufacturer. *Id.* at 1016. Similarly, if each toy manufacturer had responded to TRU's complaints by saying only that it was "working on the problem," and later cut-off or discriminated against the clubs, we would not conclude that there was a "conscious commitment" to a common plan between TRU and each manufacturer.

This case does not present a similarly close call. We 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 TRU offered to meet a competitor's low price, or presenting products for preview and agreed-upon clearance by TRU can in any way be understood as unilateral decision making by the toy manufacturers.⁴³

*B. TRU Organized a Horizontal Agreement
Among the Toy Manufacturers.*

The record demonstrates that TRU organized and enforced a horizontal agreement among its various suppliers. Despite TRU's considerable market power, key toy manufacturers were unwilling to refuse to sell to or discriminate against the clubs unless they were assured that their competitors would do the same, *see supra* pp. 552-53. To overcome that resistance, TRU gave initial assurances that rival toy manufacturers would commit to comparable sales programs, *see supra* pp. 553-57; TRU representatives then acted as the central player in the middle of what might be called a hub-and-spoke conspiracy, shuttling commitments back and forth between toy manufacturers and helping to hammer out points of shared understanding, *see supra* pp. 557-59; toy manufacturers' commitments were carefully conditioned on comparable behavior by rivals, *see id.*; and, after the discriminatory program was in place, TRU and the toy manufacturers worked out a program to detect, bring back into line, and

⁴³ There is no question that parties, though reluctant, may be pressured into antitrust agreements against their will or better judgment. *See Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U.S. 134, 139-40 (1968); *In re Brand Name Prescription Drugs Antitrust Litig.*, 123 F.3d 599, 614 (7th Cir. 1997); *MCM Partners, Inc. v. Andrews-Bartlett & Assocs., Inc.*, 62 F.3d 967, 972-73 (7th Cir. 1995) (citing cases); *Kohler Co. v. Briggs & Stratton Corp.*, 1986-1 Trade Cas. (CCH) ¶ 67,047, at 62,416-17 (E.D. Wis. 1986). *See also* 6 Phillip E. Areeda, *Antitrust Law* ¶ 1408, at 39 (1986). *Cf. Lorain Journal Co. v. United States*, 342 U.S. 143, 152 (1951) (discussing unwilling compliance in the context of § 2 of the Sherman Act). TRU has not advanced any argument that the toy companies' hesitation prevents a legal conclusion that agreements were reached.

sometimes discipline, manufacturers that sold to the clubs, *see supra* pp. 557-59.

TRU's witnesses (principally Lazarus and Goddu) testified that *all* toy manufacturers resisted TRU's proposed sales policies and insisted on assurances that rivals would fall into line. The ALJ found that fourteen toy manufacturers were part of the horizontal conspiracy. While that may be true, we are inclined to include only those toy manufacturers that required assurances that rivals would sell on discriminatory terms to the clubs, and that were satisfied with TRU's assurances that such uniform policies would be adopted. Evidence of that exchange of commitments -- not necessarily direct communications among the toy manufacturers but clearly through the intermediation of TRU -- is present with respect to Mattel, Hasbro, Fisher Price, Tyco, Little Tykes, Today's Kids, and Tiger Electronics.

The ALJ's conclusion that TRU built a horizontal agreement finds strong support in *Parke, Davis*, 362 U.S. 29, *Interstate Circuit, Inc. v. United States*, 306 U.S. 208 (1939), and *Ambook Enters. v. Time, Inc.*, 612 F.2d 604 (2d Cir. 1979). The evidence also reveals all of the elements required to find a hub-and-spoke conspiracy in legal contexts other than antitrust. And finally, TRU organized a horizontal agreement to enforce the club boycott which is similar to that held illegal in *United States v. General Motors Corp.*, 384 U.S. 127 (1966).

1. The ALJ's finding of horizontal agreement finds strong support in *Parke, Davis*, *Interstate Circuit*, and *Ambook*.

a. Parke, Davis.

In *Parke, Davis*, the government challenged vertical price fixing agreements between *Parke, Davis* and several drug stores. In its discussion of just how far *Parke, Davis* had strayed beyond the unilateral conduct permitted by *Colgate*, the Court described an agreement that *Parke, Davis* had orchestrated among its retailers:

First [*Parke, Davis*] discussed the subject with Dart Drug. When Dart indicated willingness to go along the other retailers were approached and Dart's apparent willingness to cooperate was used as the lever to gain their acquiescence in the program. Having secured those acquiescences *Parke Davis* returned to Dart Drug with the report of that accomplishment. Not until all this was done was the advertising suspended and sales to all the retailers resumed. In this manner *Parke Davis* sought assurances of compliance and got them, as well as the compliance itself. It was only by actively bringing about substantial unanimity among the competitors that *Parke Davis* was able to gain adherence to its policy.

Parke, Davis, 362 U.S. at 46. The Court then turned to a review of "agreement" law in a broader context:

It must be admitted that a seller's announcement that he will not deal with customers who do not observe his policy may tend to engender confidence in each customer that if he complies his competitors will also. But if a manufacturer is unwilling to rely on individual self-interest to bring about general voluntary acquiescence which has the collateral effect of eliminating price competition, and takes affirmative action to achieve uniform adherence by inducing each customer to adhere to avoid such price competition, the customers' acquiescence is not then a matter of individual free choice prompted alone by the desirability of the product. The product then comes packaged in a competition-free wrapping--a valuable feature in itself--by virtue of concerted action induced by the manufacturer. The manufacturer is thus the organizer of a price-maintenance combination or conspiracy in violation of the Sherman Act.

Id. at 46-47.⁴⁴ As the Court indicated, if Parke, Davis' distributors had met and each said that it would stop advertising prices if the others did so as well, there would be no doubt that a horizontal agreement had been reached. It is equally true that if the toy manufacturers had met and collectively committed that they would not sell, or sell only on discriminatory terms, to a class of customers such as the clubs, the law would recognize this as an agreement. Thus, when TRU engaged in "shuttle diplomacy" and brokered both agreement and compliance, it achieved the same objective.

Just as TRU's conduct was almost identical to the conduct condemned as a vertical agreement in *Parke, Davis*, TRU's conduct was also similar to Parke, Davis' behavior in orchestrating a horizontal agreement not to advertise prices. TRU's actions of shuttling commitments between toy manufacturers allowed the manufacturers to come into an agreement with each other. The manufacturers did not have to meet to hammer out a horizontal agreement. Their conscious commitment was extracted and then communicated each to each by TRU.

TRU was not content to rely on its suppliers' assessment of their individual business interests when it asked them to adopt restrictions on distribution through the clubs. Just as Parke, Davis used Dart's willingness "as a lever to gain [its competitors'] acquiescence in the program," 362 U.S. at 46, TRU used Mattel's promise -- itself "based on the fact that the competition would do the same" -- to gain a commitment from Hasbro and then others. There is similar evidence of *express*, interdependent commitments among at least seven major toy manufacturers. *See supra* pp. 553-59 & note 30. Their subsequent decisions to enter the proposed boycott were made despite the fact that it might have been a competitively foolish thing to do as an individual matter, or that others might gain if it was -- or proved to be

⁴⁴ The Supreme Court in *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 735 (1988), removed any doubt that *Parke, Davis* found both vertical price fixing agreements and a separate and related horizontal conspiracy to refrain from price advertising by characterizing the latter agreement as horizontal.

-- a mistake. As in *Parke, Davis*, the boycott was presented to TRU's suppliers in "competition-free wrapping." *Id.* at 47. Due to this, the agreement ultimately obtained was in all likelihood different from, and more stable than, any agreements TRU would have obtained had it negotiated separately with each supplier, and had each not requested and received assurances about the behavior of its rivals. TRU would not have gone to the trouble of conducting these negotiations and working out the horizontal agreements if it believed it could have enforced its will without them.

b. Interstate Circuit.

A sensible reading of *Interstate Circuit*, 306 U.S. 208, an important Supreme Court case on proof of horizontal agreement, supports our analysis here. *Interstate Circuit*⁴⁵ wrote identical letters to eight competing film distributors, naming all the distributors as addressees in each letter. As a condition for the exhibition of movies in its first-run theaters at an evening price of at least 40 cents, *Interstate Circuit* asked the distributors to impose two restrictions in their contracts for the exhibition of such films: (1) subsequent-run evening exhibitions of "A" movies must be at an admission price of at least 25 cents, and (2) first-run, evening exhibitions of "A" movies may not be part of a double feature. 306 U.S. 216-17 & n.3. There was no evidence of direct communication among the distributors, but each met separately with representatives of *Interstate Circuit* to discuss the demands made in its letter. *Id.* at 218. Each distributor eventually acceded to *Interstate Circuit*'s request, except that each declined to adopt the restrictions in Austin, Galveston and the Rio Grande Valley. *Id.* at 219. No witnesses from the distributor defendants testified to offer explanations as to why these "far-reaching changes" were introduced with such uniformity. *Id.* at 223. The Supreme Court affirmed the district court's finding that *Interstate Circuit* and the national movie distributors had violated Section 1 of the Sherman Act, and upheld the injunction against enforcing their illegal agreement or continuing their conspiracy.

In a famous passage, the Court concluded that there was horizontal agreement between the national film distributors as well as agreement with *Interstate Circuit*:

Each was aware that all were in active competition and that without substantially unanimous action with respect to the restrictions for any given territory there was risk of a substantial loss of the business and good will of the subsequent-run and independent exhibitors

There was risk, too, that without agreement diversity of action would follow.

⁴⁵ *Interstate Circuit* was one of two affiliated chains of Texas movie theaters under common management. Both chains, and the individuals who served as their President and General Manager, were named as defendants. For convenience, we refer to all movie exhibitor defendants as "*Interstate Circuit*."

Id. at 222.

We agree with Professor Areeda's analysis that it would be a mistake to give the Court's sweeping language in *Interstate Circuit* the broadest construction it could support. 6 Areeda, *supra* note 43, ¶1426b, at 162. Not every unanimous action taken in response to an invitation -- even where a uniform response is sought or preferred -- constitutes an agreement. If that were the law, a simple price increase, followed by parallel price increases by competitors, could be characterized as a horizontal agreement. Subsequent cases make clear that parallel conduct alone does not constitute antitrust agreement. See, e.g., *Theatre Enters. v. Paramount Film Distrib. Corp.*, 346 U.S. 537, 541 (1954); *Modern Home Inst., Inc. v. Hartford Acc. & Indem. Co.*, 513 F.2d 102, 108-10 (2d Cir. 1975). This may be true even where, as with oligopoly pricing, there is some indication that success in raising price requires a uniform response. See, e.g., *Pevely Dairy Co. v. United States*, 178 F.2d 363, 369 (8th Cir. 1949). However, we also agree with Professor Areeda that, on a full examination of the facts and analysis of *Interstate Circuit*, the finding of horizontal agreement was entirely justified there, and note that the same logic requires a similar finding here.

The Court in *Interstate Circuit* discussed a host of factors before concluding that, viewed in context, the evidence supported the district court's finding that the national film distributors had entered into agreement with one another. 306 U.S. at 221-27. By its letter, *Interstate Circuit* literally addressed its invitation to all of the film distributors. *Id.* at 222. Each knew that the others were asked to make the same choice. Their later course of conduct was a dramatic change that was not only far-reaching and complex, but also difficult and costly to undo because prices were set at 25 cents by contracts lasting for a year or more. *Id.* at 224. This change lacked any convincing explanation or business justification because the high-level officials, who would have been in a position to explain the distributors' actions, did not testify to explain the reasons for their companies' change of course. *Id.* at 223. Finally, the distributors' decisions to accede to *Interstate Circuit*'s requests were "interdependent" in nature, that is they made economic sense only if each had reason to believe the others would go along. *Id.* at 224-25. Thus, in the passage just quoted, the Court explained that "[e]ach was aware ... that without substantially unanimous action with respect to the restrictions ... there was risk of a substantial loss of the business and good will" *Id.* at 222. Together these facts and circumstances suggested to the Court that -- more likely than not -- the movie distributors responded to *Interstate Circuit*'s request in a concerted fashion. Subsequent cases, following scholars and other lower court

judges,⁴⁶ have emphasized that interdependence is crucial if an antitrust agreement is to be inferred from circumstantial evidence.

A similar, and in some respects stronger, set of facts is present here, and the same inference of conspiracy is appropriate. As in *Interstate Circuit*, there was an invitation clearly addressed to all of the participants in the proposed conspiracy. Like the listing of all the film distributors as addressees in the letter sent by Interstate Circuit, TRU, in Goddu's phrase, "made a point of telling" its suppliers that its club "policy" was to be extended to each and every one of them. Each therefore knew that the others were asked to make a similar decision.

The changed conduct that followed here, like that in *Interstate Circuit*, was far-reaching, complex, and, by its nature, costly to implement. As Professor Areeda explained, "[t]he principle is clear: if rational defendants would not act without mutual assurances of common action, then the act proves that such assurances took place." 6 Areeda, *supra* note 43, ¶ 1426, at 161 (1986).⁴⁷ Toy manufacturers began to produce customized lines of product for sale to the clubs, even though doing so imposed extra costs on the manufacturers with no perceived benefit to their club customers. Sales to club customers dramatically declined, and the goodwill of the suppliers fell to the point that by mid-1992 several clubs threatened suit. *See supra* note 16. By early 1993, toy manufacturers had adopted policies of discriminating against the clubs, policies that manufacturers vowed to follow indefinitely. This was an unusual and controversial measure in an industry that had no history of imposing such formalized restraints on toy manufacturers' business discretion. *See supra* pp.567-68.

These far-reaching and expensive changes are made more suspicious by their lack of convincing explanation or justification. Changes in business strategy do not generally need to be explained or justified. But when the pattern of evidence -- as here -- strongly suggests that the change was likely the result of some kind of agreement, the trier of fact may properly ask why a party acted as it did. The inability to offer a plausible explanation creates another reason to think that the change in fact resulted from an agreement. The Court in *Interstate Circuit* drew an inference of conspiracy from the failure of the distributors' executives to explain what they had done. Here, TRU and some toy company executives testified about "free-rider" problems, and the toy companies hinted at such problems after the clubs threatened to sue them in 1992. But no toy company mentioned a free-rider problem before TRU extended its unwelcome invitation to boycott the

⁴⁶ See, e.g., *Bogosian v. Gulf Oil Corp.*, 561 F.2d 434, 446-47 (3d Cir. 1977); *Ambook Enters. v. Time, Inc.*, 612 F.2d 604 (2d Cir. 1979); Donald F. Turner, *The Definition of Agreement under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 Harv. L. Rev. 655, 663 (1962).

⁴⁷ As discussed below, we do not have to infer "that such assurances took place" as the Court did in *Interstate Circuit*, because there is direct evidence that assurances were solicited and given.

clubs. As we discuss in detail below, *see infra* pp. 601-08, the free-rider explanation for discrimination against the clubs is simply a pretext. *Cf. Rossi v. Standard Roofing Inc.*, No. 97-5185, 1998 U.S. App. LEXIS 21911, *81-85 (3d Cir. September 9, 1998) (holding that reliance on pretextual excuses to justify boycott of a price-cutting retailer, combined with other circumstantial evidence, supports inference of agreement).

Professor Areeda noted that the parallel behavior of the national movie distributors in adopting both of Interstate Circuit's requests in four cities but rejecting them in Austin, Galveston, and the Rio Grand Valley was highly suspicious. 6 Areeda, *supra* note 43, ¶ 1426, at 159. The Court naturally questioned how a simple request for terms of sale across Texas could have been converted into a common policy everywhere but Austin, Galveston, and the Rio Grande Valley without the movie distributors discussing the matter among themselves or through Interstate Circuit. If the record required us to draw inferences, we might likewise find it "highly suspicious" that an initial promise from Mattel not to support the clubs changed to a commitment identical to that of Hasbro and Fisher Price not to sell "hot" or advertised products to the clubs, and then changed again to a policy that "no identical product" will be sold to the clubs, at which point all of the major toy companies developed special lines of similarly highly-differentiated products for sale to the clubs. It is difficult to imagine this course of events taking place without direct communications among the toy manufacturers or indirect communications through TRU. But in this case, it is not necessary to draw an inference of conspiracy from entirely circumstantial evidence, because there is testimony, which is supported by significant documentary evidence, that these communications *did* occur and that TRU in fact acted as the "hub" in a conspiracy to disadvantage the clubs by inducing all the key suppliers of toys to adopt parallel restrictions on club sales.

Finally, just as the facts and broader context of *Interstate Circuit* indicated that the decision to adopt Interstate Circuit's suggestions was interdependent -- *i.e.*, that uniformity was necessary for all to profit -- there is likewise every reason to think that the boycott here was the result of such interdependence. Recent cases have reaffirmed the requirement of interdependence for any finding of antitrust agreement particularly when based on circumstantial evidence. *See, e.g., Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586, 589-97 (1986); *Bogossian*, 561 F.2d at 447. It has been alternatively described as a "motivation to conspire" or an apparent "benefit from the agreement." *See First Nat'l Bank of Arizona v. Cities Serv. Co.*, 391 U.S. 253, 278-80 & n.16 (1968).

In *Interstate Circuit*, the existence of agreement was the best explanation for what occurred. Even putting aside the unique facts of that case, the proposed restrictions on price ("25 cent minimum admission

price") and output ("no double features") were not likely to benefit the film distributors unless a substantial number of them went along. No sensible competitor enters contracts by which it agrees to charge a price greater than the market will support in the absence of market power *and* without a strong assurance that rivals will do the same. The eight film distributors that did just this in four Texas cities collectively distributed about 75% of all of the "A" movies in the United States. Thus, in the passage we have quoted the Court commented: "each [movie distributor] was aware ... that without substantially unanimous action with respect to the restrictions ... there was risk of a substantial loss of the business and good will" 306 U.S. at 222.

The success of the club boycott similarly depended on having a substantial and significant number of participants. If only one company -- or even several companies collectively selling a small share of all toys -- had joined, the boycott would not have worked. Instead, the toy manufacturers that agreed to the boycott would have lost sales, while their rivals that continued to sell all of their products to the clubs would have gained this business to their own benefit. This risk attended any toy company that decided unilaterally to cut off the clubs. And for this reason, they all clearly told TRU that they were unwilling to make a decision on their own.

TRU offers some theoretical speculation as to why interdependence was not present, *i.e.*, that a toy manufacturer might be pleased to see a competitor ignore TRU's demands and threats because the manufacture could gain favor with TRU. There is little doubt that, after the boycott was in place, efforts to curry favor at the expense of a rival helped TRU to police and maintain the initial agreement. But TRU's speculation that this was a motive for the adoption of the boycott agreement in the first place is refuted by the evidence. TRU's own executives, from Lazarus to Goddu, with admirable clarity, explained that the toy manufacturers were simply unwilling to comply with TRU's demand unless they were confident that competitors would do the same.

In two respects, proof of agreement here is even stronger than *Interstate Circuit*. First, we have clear evidence that TRU engaged in a kind of commercial "shuttle diplomacy" -- communicating back and forth among toy suppliers the message "they'll stop if you'll stop" -- that was only probable in *Interstate Circuit*. And because there is direct evidence of actual agreements reached by this method of negotiation, we do not need to rely entirely on inferences to find agreement with respect to Mattel, Hasbro, Tyco, Fisher Price, Little Tikes, Today's Kids, and Tiger Electronics. Second, the record here contains clear statements that the "club policy" was squarely *contrary* to the independently determined business interests of the toy manufacturers. The toy companies were keenly interested in expanding their club sales in part to reduce reliance on TRU.

Action against unilateral interest suggests agreement even more strongly than actions that are simply unexplained or curious.

c. Ambook.

The Second Circuit's decision in *Ambook*, 612 F.2d 604, also supports our analysis. In *Ambook*, a plaintiff advertiser challenged the dual rate card system adopted by many media companies, *e.g.*, Time Magazine, New York Times, and hundreds of other magazines and newspapers. *Id.* at 607-09. The media firms had adopted a uniform policy of charging advertisers a full rate when they placed the ad directly with the publication, but granted a uniform 15% discount when they placed the ad through an advertising agency. *Id.* at 607-09. Plaintiffs claimed that the dual rate card system (and specifically the uniform 15% discount) was the consequence of an illegal agreement under Section 1 of the Sherman Act. *Id.*

The Second Circuit concluded that a jury could have found that the uniform policy adopted by the media with respect to price was the result of agreement. *Id.* at 614-18. It emphasized two points relevant here: first, there was no evidence to show what legitimate business reason would have led the media to discriminate in favor of ads placed through advertising agencies; and second, there was evidence that the ad agencies had placed pressure on the media not to give discounts when the ad agencies were bypassed. *Id.* The appellate court found that a reasonable fact-finder could conclude that the uniform program of discriminating against ads that were placed directly was not the result of individual decisions but rather of an agreement that publishers went along with "only because of sloth or fear of reprisal." *Id.* at 618.

The evidence of agreement in the present case is stronger because we *know* -- and need not infer -- that the toy manufacturers initially thought discrimination against the clubs was not in their own independent interests, that combo packs and other discriminatory devices made no independent business sense, and that the manufacturers were pressured or coerced into adopting roughly uniform policies. We appreciate that the toy manufacturers' discriminatory policies were not *identical* (as in *Ambook*), but they were sufficiently uniform to serve TRU's anticompetitive purpose.

Given all these factors, we agree with the ALJ that the record demonstrates that there was a horizontal agreement among the identified toy companies, orchestrated by TRU, to deal with the clubs in a discriminatory fashion.

2. TRU also organized a horizontal agreement to enforce the boycott.

As we saw earlier, TRU, with the cooperation of various toy manufacturers, acted as a clearinghouse of information about firms not abiding by the terms of the horizontal agreement, and TRU also acted as the enforcement arm of the boycott. *See supra* pp. 553-59. This collateral

enforcement agreement, which could be considered either as part of, or separately from, the boycott agreement itself, is similar to conduct declared illegal in *United States v. General Motors Corp.*, 384 U.S. 127, 140-41 (1966). In *General Motors*, the government challenged a group boycott that included General Motors ("GM") and several trade associations of its car dealers in the Los Angeles area. The Government established that GM had reached agreements with all of its dealers not to resell GM cars to a group of automobile discounters. GM then invited its dealers to survey each other's compliance with these agreements. The dealers' trade associations created a joint investigating committee and hired automobile "shoppers" to test whether resold GM cars still were being offered by the discounters. The dealers' associations then "supplied [this] information to General Motors for use by it in bringing wayward dealers into line." *Id.* at 140-41. Several dealers were persuaded by GM and the dealers' associations to repurchase at a loss cars that they had sold to discounters in violation of their promises to GM. *Id.*

Observing that the agreement to enforce the boycott of the automobile discounters was very similar to the agreement in *Parke, Davis*, the Court commented on the obvious interdependence of the dealers' collective efforts to police their group boycott:

As Parke Davis had done, General Motors sought to elicit from all the dealers agreements, substantially interrelated and interdependent, that none of them would do business with the discounters. These agreements were hammered out in meetings between nonconforming dealers and officials of General Motors' Chevrolet Division, and in telephone conversations with other dealers. It was acknowledged from the beginning that substantial unanimity would be essential if the agreements were to be forthcoming. And once the agreements were secured, General Motors both solicited and employed the assistance of its alleged co-conspirators in helping to police them. What resulted was a fabric interwoven by many strands of joint action to eliminate the discounters from participation in the market, to inhibit the free choice of franchised dealers to select their own methods of trade and to provide multilateral surveillance and enforcement. This process for achieving and enforcing the desired objective can by no stretch of the imagination be described as "unilateral" or merely "parallel."

General Motors, 384 U.S. at 144-45.

While the toy companies did not band together and jointly hire professional shoppers to enforce the club boycott, there is no question that TRU "both solicited and employed the assistance of its" suppliers "in helping to police" each other. "What resulted was a fabric interwoven by many strands of joint action to eliminate the discounters [the clubs] from participation in the market, to inhibit the free choice of [toy manufacturers]

to select their own methods of trade and to provide multilateral surveillance and enforcement." *Id.* at 144.⁴⁸

3. Under the general principles used to evaluate allegations of hub-and-spoke conspiracy, TRU's suppliers entered an agreement.

The relationship between TRU and its suppliers is an example of a hub-and-spoke conspiracy. See *Blumenthal v. United States*, 332 U.S. 539 (1947); cf. *Kotteakos v. United States*, 328 U.S. 750 (1946). In such conspiracies, a "hub" firm has separate relationships with individual or separate groups of other firms and these "spoke" relationships (often vertical conspiracies in their own right) are connected into a horizontal conspiracy by a unifying "rim." *Blumenthal* concerned a conspiracy to sell whiskey at prices in excess of those set pursuant to the Emergency Price Control Act. The Supreme Court reasoned that even though several conspirators lacked knowledge of the identity of a key co-conspirator, the proof was still sufficient to find action in accordance with a criminal conspiracy to evade price controls:

All knew of and joined in the overriding scheme. All intended to aid the owner [of the whiskey] ... to sell the whiskey unlawfully, though the two groups of defendants differed on the proof in knowledge and belief concerning the owner's identity. All by reason of their knowledge of the plan's general scope, if not its exact limits, sought a common end, to aid in disposing of the whiskey. True, each salesman aided in selling only his part. But he knew the lot to be sold was larger and thus that he was aiding in a larger plan. He thus became a party to it

Blumenthal, 332 U.S. at 559.

Although *Blumenthal* and *Kotteakos* are criminal cases, the concept of hub and spoke conspiracy is also accepted in civil antitrust. *Interstate Circuit*, which we have discussed at length, is perhaps the most prominent example, but there are many lower court decisions as well. *E.g.*, *Impro Prods., Inc. v. John B. Herrick*, 715 F.2d 1267, 1279 (8th Cir. 1983); *Elder-Beerman Stores Corp. v. Federated Dep't Stores, Inc.*, 459 F.2d 138, 146-47 (6th Cir. 1972); cf. *Mylan Labs., Inc. v. Akzo N.V.*, 770 F. Supp. 1053, 1066 (D. Md. 1991); *Lomar Wholesale Grocery, Inc. v. Dieter's Gourmet Foods, Inc.*, 627 F. Supp. 105, 111 (S.D. Iowa 1985). In *Impro*, the Eighth Circuit stated that to demonstrate a hub and spoke conspiracy in a civil antitrust matter, it must be shown:

(1) that there is an *overall*-unlawful plan or "common design" in existence; (2) that knowledge that others must be involved is inferable to each member because of his

⁴⁸ See also the Third Circuit's decision in *Rossi*, 1998 U.S. App. LEXIS 2191, at *53-61, *70-75, *77-81, which concluded that there was sufficient evidence of vertical and horizontal antitrust agreements to avoid summary judgment because, among other evidence, defendant retailers (1) pressured or threatened manufacturers not to deal with a price-cutting competitor, (2) set up a monitoring system, and (3) reported detected breaches of the boycott to a key manufacturer.

knowledge of the unlawful nature of the subject of the conspiracy but knowledge on the part of each member of the exact scope of the operation or the number of people involved is not required, and (3) there must be a showing of each alleged member's participation.

715 F.2d at 1279 (quoting *Elder-Beerman*, 459 F.2d at 146-47). These elements of a hub and spoke conspiracy are evident here. Each manufacturer was told of the nature and the goal of TRU's plan and each knew others were involved. They adopted TRU's anticompetitive purpose by joining the boycott and by developing special club packs that would not force TRU to lower its retail toy prices to meet lower club prices.

4. TRU's arguments against finding a horizontal agreement are without merit.

TRU offered several arguments against the application of *Parke, Davis, Interstate Circuit, Ambook*, or *General Motors* here. Many of its points have been disposed of by our discussion above,⁴⁹ and we now address those that remain.

TRU's essential argument is that it was entitled to demand that each of its suppliers discriminate against the clubs to prevent their free-riding -- or even simply to retain TRU's business -- and those toy manufacturers that did discriminate would not necessarily have entered into a horizontal agreement. Thus, TRU posits that each could have independently decided to discriminate for its own business reasons, in which case the conduct would be protected by *Matsushita* and other similar cases cited by TRU. See, e.g., *Alvord-Polk, Inc. v. F. Schumacher & Co.*, 37 F.3d 996, 1010-14 (3d Cir. 1994).

Even if we accept the validity of that contention for the sake of argument, that is not what happened here. There is evidence that at least seven toy manufacturers did not act independently. According to TRU's own witnesses, the manufacturers uniformly resisted TRU's ultimatum *until* each could be assured that rivals would behave in the same way. Unless

⁴⁹ TRU argues, for example, that the manufacturers did not benefit from the alleged agreement. While the boycott primarily advanced the economic interest of TRU, the manufacturers did benefit from the horizontal boycott agreement by not having to respond unilaterally to TRU's proposal. While most -- if not all -- of the toy companies disliked having to choose between what they saw as two bad options -- (1) sell to TRU and restrict club sales, or (2) sell to the clubs and risk retaliation from TRU -- the decision was made easier by the horizontal agreement which took the sting out of reducing sales to the clubs. From the manufacturers' point of view, the boycott was the second-best alternative, but that does not mean the toy manufacturers did not benefit from the agreement.

TRU also argues that there is no direct evidence of horizontal conspiracy. By that, TRU means there is no evidence of *direct* horizontal conspiracy, because, as in *Parke, Davis* and *Interstate Circuit*, the agreement was initiated and organized by TRU as the hub and facilitator. There is direct evidence of an agreement -- through TRU as organizer and coordinator -- which makes this case stronger than *Interstate Circuit*. There is also some evidence of direct communications between the toy companies, although none alone proves the existence of an agreement.

that condition assuring uniform action was satisfied, discriminatory action against the clubs would not occur. TRU therefore embarked on its missions of "shuttle diplomacy," reassuring each toy manufacturer that rivals would fall into line. It was only after assurances were exchanged that the toy manufacturers, overcoming their natural inclination to sell through all potential outlets, became willing to discriminate against the clubs. At that point, a "conscious commitment to a common scheme" was perfected, and a uniform, clearly interdependent, course of conduct came into being. *Monsanto*, 465 U.S. at 764 (internal citation omitted); *see also Parke, Davis*, 362 U.S. at 46-47; *Interstate Circuit*, 306 U.S. at 221-27.

Several of TRU's other arguments are similarly based on theories that are inconsistent with the record. First, TRU claims that this analysis "ignore[s] the choice posed by TRU." (Reply Br. at 14.) TRU argues that the allegation of horizontal conspiracy is "based on the fallacy that toy manufacturers were able to enjoy unrestrained sales of their product to both [TRU] and the warehouse clubs." *Id.* (emphasis in original). It further argues that when the toy companies were forced to make a choice, it was "entirely logical" to pick TRU. *Id.* TRU was the most important customer, and the clubs were comparatively small fish. A manufacturer might even hope that its competitors would forgo TRU in favor of the clubs, thereby leaving more TRU shelf space for itself.

As is clear from our discussion, TRU's speculations run against the weight of the evidence. Mattel, Hasbro, and other key suppliers initially were not sure whether TRU would be able to "force" them to choose between it and the clubs. TRU's announcement of its new policy began a period of aggressive and sustained negotiations, the results of which were uncertain. TRU enjoyed significant bargaining power, but Mattel also knew that TRU would be reluctant to refuse to stock popular Mattel products. To paraphrase Mattel's CEO, TRU needed Mattel as much as Mattel needed TRU. Hasbro likewise first dragged its feet, and when it finally adopted TRU's policy, promised only to adhere to that policy as long as its competitors did so. Had TRU not resorted to the organization of a horizontal boycott agreement (as it immediately perceived the need to do), the club policy very well may have failed.

The ALJ found clear evidence that specific toy manufacturers would not go along unless their rivals -- certainly those rivals that were their most direct competitors -- did the same. *See supra* pp.553-56. TRU's suggestion that toy manufacturers inquired only about rivals because they were "curious" or because they wanted to know that the "same rule was applied to all" does not hold up in the face of evidence that the toy manufacturers did not adopt the "club policy" until they knew or had been assured of the others' responses. TRU's suggestion that any manufacturer would have been

pleased to see a rival continue to sell to the clubs while it abstained is not supported by the evidence.

TRU argues that language in *Monsanto* and *Sharp* protects the communications at issue here from serving as a basis for a finding of agreement.⁵⁰ We do not believe those decisions addressed the pattern of conduct here, much less sanction the systematic organization of a boycott. Those cases addressed, in the context of an allegation of vertical price fixing, only communications from a dealer to a single supplier about the practices of another dealer, or other dealers, in the same brand of merchandise. Such conversations are a far cry from those at issue here -- *i.e.*, a dealer telling its suppliers about their rivals' business decisions for the purpose of encouraging those suppliers to adopt an agreement with the dealer and between and among rival manufacturers of different product brands.

If TRU merely had complained to the toy companies about the clubs' low prices -- thereby drawing their attention to a threat (perceived by TRU) to the toy distribution system -- these complaints would have been similar to those in *Sharp* and *Monsanto*. Even if TRU only told each of its suppliers that it also was complaining to the others, it would be more difficult to infer that their later adoption of a restrictive policy was concerted. But TRU did more. TRU told each of its suppliers what *their* rivals (not its own as in *Sharp* or *Monsanto*) were doing, suggested they do the same and, on that basis, extracted mutual commitments from many of them.

The toy suppliers committed to TRU's policy (gave in, really) only after they were assured others would do the same. There is, therefore, no reason to think the toy suppliers were using information gathered by TRU to evaluate their distribution practices in view of their own best interest. We do not think the Supreme Court's solicitude for communications up and down the supply chain of a manufacturer of a single brand of products can be stretched to cover negotiations between interbrand competitors conducted by their shared distributor for the purpose of obtaining a horizontal agreement among them. This pattern of conduct is also different from the common situation in which a dealer bargains with several suppliers to achieve the lowest price, or other favorable terms of sale. There, the dealer is playing one supplier against the other to gain a lower price, but here, the dealer is bringing the two together to obtain an outcome that would be impossible in a competitive market of firms making independent decisions.

TRU also argues that the finding of horizontal agreement is improper because substantial unanimity was never achieved. While it is true that not all of the many hundreds of toy companies adopted TRU's policy, and also

⁵⁰ *Monsanto* and *Sharp* hold, *inter alia*, that dealer complaints about another dealer's prices followed by termination is not sufficient evidence of a vertical price-fixing conspiracy to give the case to a jury. See *Sharp*, 485 U.S. at 722, 731; *Monsanto*, 465 U.S. at 763-64.

that the compliance of some firms that did agree occasionally wavered, we do not think that this defeats the evidence of agreement.⁵¹ Ten of the largest (other than Nintendo) and most important toy makers all adopted essentially the same policy, and most substantially complied with that policy from approximately early 1993. The large, traditional toy companies follow this policy to the present. *See supra* note 16. The evidence that the agreement was in some instances unstable does not undermine the existence of the agreement, but rather is likely an indication that the agreement was against the individual business interests of the toy suppliers, tempting some of them to cheat until caught and disciplined.

TRU cites two circuit court cases, *H.L. Hayden Co.*, 879 F.2d 1005 (2d Cir. 1989) (*see* discussion *supra* p. 573-74), and *Davis-Watkins Co. v. Service Merchandise*, 686 F.2d 1190 (6th Cir. 1982) in further support of its claim that its conduct was permissible. (Reply Br. at 24.) TRU's reliance on these cases is misplaced, and indeed the cases reveal the weakness of TRU's argument on this record. *H.L. Hayden* concerned steps taken by a single manufacturer to address *bona fide* free-rider problems in its system of distribution. *H.L. Hayden Co.*, 879 F. 2d at 1014. In view of these strong independent reasons for the manufacturer's actions, both the district court and the Second Circuit found the very slight evidence of concerted conduct insufficient to support a finding of agreement. *Id.* at 1016.

Davis-Watkins Co., 686 F. 2d 1190, presents a pattern of facts very similar to that in *H.L. Hayden Co.* Amana was a manufacturer of microwave ovens accounting for 11 to 18% of that market. *Id.* at 1193. From the outset, Amana insisted that its distributors provide substantial pre-sale, point of sale, and post-sale services including advertisements, in-store demonstrations by sales staff, explanations and warranty service. *Id.* at 1195. Plaintiff SMC was a showroom catalog business that provided few, if any, of those services. *Id.* Competing dealers complained to Amana, which refused to sell to SMC and also took steps to prevent other dealers from transshipping to it. *Id.* at 1194-95. But SMC was a true free-rider. Moreover, the court found no evidence that the dealer complaints were coordinated, or that Amana adopted transshipping restrictions for reasons other than to serve its own, independent marketing strategy. *Id.* at 1199. There was, unlike this case, no evidence that any party was coerced into discriminating against SMC, or that any party sought to coordinate behavior vertically or horizontally. Many cases similarly decline to find non-price vertical or horizontal restrictions where all parties pursue their own legitimate business interests. *See* discussion and cases cited *supra* pp. 577-83; *see also Michelman v. Clark-Schwebel Fiber Glass Corp.*, 534

⁵¹ Little Tikes, for example, sold to Costco on several occasions despite Little Tikes' commitment to TRU, and some of the smaller companies like Lego restricted their sales to the clubs for only a short period.

F.2d 1036, 1043 (2d Cir. 1976) (finding a pattern of denials of credit explained by independent interest of defendants to minimize losses from default); *Solomon v. Houston Corrugated Box Co.*, 526 F.2d 389, 395 (5th Cir. 1976) (finding that independent self-interest explained rivals' similar decisions to replace the plaintiff with a customer offering them more favorable terms).

In conclusion, none of TRU's objections dissuades us from our conclusion that, in addition to entering vertical agreements with ten or more toy companies, TRU also organized a horizontal agreement among at least seven key toy manufacturers. Direct evidence indicates that these seven toy companies joined the conspiracy with the knowledge and assurance that the others would go along. Although other toy manufacturers similarly discriminated against the clubs, they may have done so only because of their agreements with TRU -- not with each other. Finally, TRU and the seven toy manufacturers entered a horizontal agreement to enforce the boycott agreement.

*C. The Agreements Could Be Considered
Per Se Illegal Under the Klor's Rule.*

In *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959), the Supreme Court held that Klor's, an independent appliance distributor, had successfully pled a *per se* violation of section 1 when it alleged that a rival distributor enlisted several suppliers to boycott Klor's. *Id.* at 212-13. *Klor's* came to the Supreme Court following the grant of a motion for summary judgment for the defendant. *Id.* at 210. The Court reversed, based primarily on the allegations of the complaint. *Id.*

Klor's had alleged that Broadway-Hale, a department store chain, orchestrated an agreement with and among ten appliance manufacturers to sell to Klor's only on highly-unfavorable terms or not to sell to it at all. *Id.* at 209. Klor's was an appliance store in Broadway-Hale's neighborhood. *Id.* at 208. The Court noted that the combination "takes from Klor's its freedom to buy appliances in an open competitive market and drives it out of business as a dealer in the defendants' products." 359 U.S. at 213. It held that the allegations, if proved at trial, merited *per se* condemnation because Broadway-Hale would have arranged a "wide combination consisting of manufacturers, distributors and a retailer." *Id.* The Court distinguished this from the "case of a single trader refusing to deal with another, or even of a manufacturer and a dealer agreeing to an exclusive distributorship." *Id.* at 212.

This case presents *Klor's*, not on the pleadings but rather after the development of an unusually complete record. The ALJ found that, like Broadway-Hale, TRU entered vertical agreements with each of its key suppliers to disadvantage its rivals, the clubs. He further found that TRU

organized a horizontal agreement among key suppliers to the same purpose and effect -- to disadvantage the clubs. Under the Supreme Court's *Klor's* decision, TRU's conduct would be *per se* illegal.

If *Klor's* is still good law -- it is after all a Supreme Court decision that has never been overruled and indeed has been cited with approval in many subsequent decisions⁵² -- it would be dispositive and our analysis would be complete. Nevertheless, we elect not to rely exclusively, or even primarily, on the *Klor's per se* rule.

We are reluctant to apply the *Klor's per se* rule for several reasons. First, the Supreme Court has made it clear that it will not apply *per se* rules mechanically. When there is adequate reason, *per se* rules have been bypassed with respect to price fixing,⁵³ and boycotts,⁵⁴ and have been eased and clarified in connection with tie-in sales.⁵⁵ Some lower courts have speculated that the Supreme Court would not reaffirm a broad interpretation of *Klor's* today.⁵⁶ Also the Supreme Court has recognized that manufacturers can terminate dealers and restrict channels of distribution in order to diminish the adverse impact of "free-riding"⁵⁷ -- a theory that was little known when the Supreme Court in *Klor's* found a violation without according any opportunity to the defendants to explain their business behavior.

Finally, in *Northwest Wholesale Stationers*, a boycott case decided 26 years after *Klor's*, the Supreme Court observed that the question of which types of "group boycotts" merit *per se* treatment is "far from certain" and that "care" is necessary in defining the category of concerted refusals to deal that mandate *per se* condemnation. 472 U.S. at 294. The Court offered a list of factors that must be taken into account before "group boycotts" can justifiably be treated under the *per se* doctrine. *Id.* It is to that mode of analysis and those factors that we now turn.

D. "Group Boycotts" That Merit Summary Condemnation:
The Northwest Wholesale Stationers Approach.

⁵² The Court has cited *Klor's* as authoritative at least four times in recent years. See *Summit Health, Ltd. v. Pinhas*, 500 U.S. 322, 332 (1991); *FTC v. Superior Court Trial Lawyers Ass'n*, 493 U.S. 411, 452 n.9 (1990); *Sharp*, 485 U.S. at 734; *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284, 293, 294 (1985).

⁵³ *Broadcast Music, Inc. v. CBS, Inc.*, 441 U.S. 1, 16-24 (1979).

⁵⁴ *Northwest Wholesale Stationers*, 472 U.S. at 293-98.

⁵⁵ *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 11-18 (1984).

⁵⁶ See, e.g., *Betkerur v. Aultman Hosp. Ass'n*, 78 F.3d 1079, 1089-90 (6th Cir. 1996); *United States Trotting Ass'n v. Chicago Downs Ass'n, Inc.*, 665 F.2d 781, 788 (7th Cir. 1981).

⁵⁷ *Sharp*, 485 U.S. at 724-25; *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 55 (1977).

The Court in *Northwest Wholesale Stationers* looked to *Klor's* and other cases to provide guidance as to which collective refusals to deal constitute *per se* unlawful group boycotts, and found that they generally displayed four common factors. *Id.* As the Court described them:

Cases to which this Court has applied the *per se* approach have generally involved joint efforts by a firm or firms to disadvantage competitors by "either directly denying or persuading or coercing suppliers or customers to deny relationships the competitors need in the competitive struggle." Sullivan, *supra*, at 261-262. See, e.g., *Silver, supra* (denial of necessary access to exchange members); *Radiant Burners, Inc. v. Peoples Gas Light & Coke Co.*, 364 U. S. 656 (1961) (denial of necessary certification of product); *Associated Press v. United States*, 326 U. S. 1 (1945) (denial of important sources of news); *Klor's, Inc., supra* (denial of wholesale supplies). In these cases, the boycott often cut off access to a supply, facility, or market necessary to enable the boycotted firm to compete, *Silver, supra*; *Radiant Burners, Inc., supra*, and frequently the boycotting firms possessed a dominant position in the relevant market. E.g., *Silver, supra*; *Associated Press, supra*; *Fashion Originators' Guild of America, Inc. v. FTC*, 312 U. S. 457 (1941). See generally Brodley, Joint Ventures and Antitrust Policy, 95 Harv. L. Rev. 1523, 1533, 1563-1565 (1982). In addition, the practices were generally not justified by plausible arguments that they were intended to enhance overall efficiency and make markets more competitive. Under such circumstances the likelihood of anticompetitive effects is clear and the possibility of countervailing procompetitive effects is remote.

Northwest Wholesale Stationers, 472 U.S. at 294. We conclude from the evidence in this case that each of the factors suggested by this passage is present. The same approach to boycott analysis was followed by the Third Circuit in *Rossi v. Standard Roofing Inc.*, No. 97-5185, 1998 U.S. App. LEXIS 21911, *28-33 (3d Cir. September 9, 1998). The purpose of the group boycott agreement was anticompetitive, in that it was designed to disadvantage competitors of one of the participants; the firms involved were dominant in their markets; the boycott cut off access to products and relationships needed for the boycotted firms to compete effectively; and lastly, the practice was not justified by plausible arguments that it enhanced overall efficiency. We consider each of these factors in turn below.

1. Intent: Purpose of disadvantaging competitors.

The primary (if not the only) purpose of the agreements that TRU obtained with and between its suppliers was to disadvantage a group of new entrants in the toy retailing market. Those new entrants -- the warehouse clubs -- were obviously competitors of TRU and thus in a "horizontal" economic relationship to it. The agreed-upon practices reduced direct price competition between the clubs and all other toy outlets, including TRU. The toy manufacturers committed to TRU to sell only highly differentiated products to the clubs, which in turn would usually be resold by the clubs at

retail prices higher than the closest comparable toy at TRU. As TRU's Goddu explained, what made special packs and other custom products acceptable to TRU was that customized products could not readily be compared with the products sold at TRU and other retailers. *See supra* p. 561-62. TRU's suppliers understood that this was the purpose of the policy to which they subscribed.

Customized products also tended to raise the cost of toys to the clubs and the prices of toys to consumers who bought toys at the clubs. This too redounded to the benefit of TRU (and other traditional discounters), which no longer had to worry that their reputation as "the" or "a" low-price toy retailer might be eroded. The savings generated by the clubs' innovative method of retailing would not be recognized by the market if their average cost of goods was both higher than that of other retailers and greater than the value that customers placed on the products available at the clubs. Putting the point plainly, TRU wanted the clubs to run the race carrying extra weight.

2. Market dominance.

Preliminarily, we note that it may not be necessary to demonstrate market power under the *Northwest Wholesale Stationers* approach, which examines behavior from several perspectives before deciding whether it is appropriate to attach a *per se* label. Ordinarily, market power is a proxy for competitive effects. Where evidence of actual competitive injury is available and there is no plausible justification, it may not be necessary to demonstrate market power. As the Supreme Court observed:

Since the purpose of the inquiries into market definition and market power is to determine whether an arrangement has the potential for genuine adverse effects on competition, "proof of actual detrimental effects, such as reduction of output," can obviate the need for an inquiry into market power, which is but a "surrogate for detrimental effects."

FTC v. Indiana Fed'n of Dentists, 476 U.S. 447, 460-61 (1986) (quoting 7 Areeda, *supra* note 43, ¶1511, at 429).⁵⁸ Anticompetitive injury is evident here, *see* discussion of effect *infra* pp. 609-14, and the claimed competitive virtues do not exist. *See* discussion of free-rider issues *infra* pp. 601-08.

Notwithstanding the above, TRU does have market power as a purchaser and seller of toys. As in all market power assessments, it is necessary to look not just at market share statistics, but at the industry

⁵⁸ *Accord Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 477 (1992) (holding that "[i]t is clearly reasonable to infer that Kodak has market power to raise prices and drive out competition in the aftermarkets, since respondents offer direct evidence that Kodak did so."); *NCAA v. Board of Regents*, 468 U.S. 85, 110-11 n.42 (1984) (recognizing that "where the anticompetitive effects of conduct can be ascertained through means short of extensive market analysis, and where no countervailing competitive virtues are evident, a lengthy analysis of market power is not necessary."). *See also Chicago Prof'l Sports Ltd. v. NBA*, 961 F.2d 667, 674 (7th Cir. 1992).

characteristics that give those statistics meaning. In this light, the following discussion considers TRU's market position, first as a buyer, and then as a seller, of toys.

To measure market power, it is necessary to define relevant product and geographic markets and then to look at barriers to entry. There seems little room for dispute on this record that the relevant geographic market in which TRU buys (*i.e.*, competition among toy manufacturers for the business of toy retailers) is national, and the relevant geographic markets in which TRU's sells (*i.e.*, competition for the business of individual consumers) are local. Toy retailers generally do not search for supplies outside of the United States, and toy customers shop in relatively local areas -- usually a city and its environs.⁵⁹ CX 1822 (Scherer) ¶ 24.

The record supports the conclusion that the relevant product market is all traditional toys. Under that interpretation, electronic toys would be excluded, largely because they tend to sell in a different and higher price range, have different characteristics, are used with special complementary products, and tend to be sold in a wider variety of outlets than traditional toys. IDF 346 (discussing Sega's ability to find other outlets for its products). We do not linger on the point because inclusion or exclusion of electronic toys makes little or no difference to the result in this case.⁶⁰

Barriers to entry into toy manufacturing are moderate, although there does appear to be a trend toward concentration among the makers of the most well-known branded toys. Brand name recognition, existing manufacturing facilities, and economies of scale mean that, while many entrepreneurs can and do introduce a single successful toy, none is able to

⁵⁹ In its briefs to the Commission, TRU has argued that local, retail markets were not pled in the initial complaint. This argument is misguided. Power in local retail markets is encompassed by the allegation of market power. Compl. ¶ 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."). Retail market power is routinely evaluated in such markets, as the many dozens of supermarket mergers investigated by the Commission demonstrate. See, e.g., *Vons Companies, Inc.*, 111 F.T.C. 64 (1988). The issue, moreover, was actually litigated in front of the ALJ. Indeed, TRU's expert economist, Professor Carlton, offered a regression equation based on competition in various local markets in an effort to disprove TRU's local retail power. RX-877 (Carlton) ¶ 238-248.

TRU correctly points out that the market power allegation in this case differs from that in the Commission's recent enforcement action challenging a merger between Staples and Office Depot, two chains of office supply superstores. *FTC v. Staples, Inc.*, 970 F. Supp. 1066 (D.D.C. 1997). TRU notes that local markets were pled with specificity in that case. (Reply Br. at 53 n.38.) The complaint in *Staples* addressed *only* the likely effects of the proposed merger on the combined entity's local market power as a seller of office supplies. The power of Staples and Office Depot as *buyers* of office supplies was not an issue. By contrast, TRU's power on *both* the buying and the selling side is relevant to the antitrust analysis of the boycott allegation in the Commission's Complaint. The allegation of market power was therefore stated more generally. The significance of both local and national markets was understood by the parties and their experts since both kinds of power were vigorously litigated below.

⁶⁰ When possible, we have included market share statistics for both traditional toys and the broader all toys (including electronic toys) market.

enter the market on the same scale and with the same scope of products as Mattel or Hasbro. Barriers to entry into toy retailing -- at least at the level of a national chain like TRU, Wal-Mart, Target, or K-Mart -- are high. IDF 464; CX 1830-G (Scherer) ¶14 (testifying that timely entry on a meaningful scale is unlikely). Among discount retailers selling toys exclusively, moreover, the pronounced trend is toward exit rather than entry into the market.

a. TRU's dominance as a buyer and seller of toys.

TRU's market share is extraordinarily high for a retailer and, due to several other distinctive factors discussed below, this large percentage share understates TRU's actual market power. While not a monopolist or a monopsonist, TRU enjoys a dominant position in buying and selling toys.

As noted in our discussion of fact, *see supra* pp.531-33, TRU is the largest retail buyer of toys in the United States and in the world. At the time it orchestrated its program of inducing toy manufacturers to discriminate against the clubs, it purchased about 20% of toys sold at wholesale in the United States. That percentage share is deceptive because it includes areas of the United States where TRU is not present. In just the localities that it serves (and where toy manufacturers depend on it for distribution), TRU buys and resells 32% of all toys sold. In many local areas (where retail competition is focused) its market share is much higher. In 18 metropolitan areas, it accounts for 35% to 49%, and in eight other cities plus Puerto Rico, its share was greater than 50%. Cities where its market share exceeds 40% include Los Angeles, Chicago, and New York. TRU is invariably the largest customer for traditional toy companies' output. As we have discussed, toy company executives describe TRU as irreplaceable. *See supra* p. 532-33.

TRU's extraordinarily high market shares for the retail sector in fact understate its true dominance as a purchaser and seller of toys for a number of reasons. First, TRU 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 TRU decide to terminate its relationship with the supplier. *See supra* pp.532-33. Second, TRU maintains a uniquely broad inventory. No other discount retailer carries nearly as many toys. For many toy manufacturers, TRU is the only large buyer of some of their older or low volume toy products. These toys significantly affect the manufacturer's overall profitability. Third, TRU, which operates 300 stores in 20 countries outside the United States, is by far the largest United States toy retailer operating in overseas markets. This is an important ingredient in TRU's influence over manufacturers. For example, half of Mattel's and Hasbro's revenues are derived from foreign sales. CX 1822 (Scherer) ¶16. Fourth, without TRU's support, many toy manufacturers will not pay for an effective marketing campaign, because the manufacturers believe they

cannot attain the necessary volume of sales if products are not sold at TRU.⁶¹

Last, and of great importance in explaining why TRU was so successful in organizing its boycott, is that TRU, as a very large multi-brand retailer, has the ability to amplify its own market power by playing favorites -- or even threatening to play favorites -- among its suppliers. This is a source of market power that is not available to single-brand retailers (e.g., an Exxon station or Whirlpool distributor). 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 the 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. Sometimes, as here, this may be impossible for a manufacturer to do at all within a reasonable period of time. This potential for added market power of a multi-brand retailer is persuasively described in 8 Areeda, *supra* note 43, ¶ 1648C, at 535-37. TRU can also exercise subtle forms of discrimination short of termination. For example, it can deny companies the highly valued shelf space positions at the end of an aisle or at the front of a store. Areeda explains how this can create dealer favoritism even when retail markets are unconcentrated:

[S]ubtle exertions of dealer power are possible when dealers handle the brands of several manufacturers. If some manufacturers restrict intrabrand competition, the dealers might, without horizontal agreement or coordination, disfavor the brands of manufacturers who do not. If dealers have and exercise such power, rival manufacturers may be forced, one by one, to adopt similar restraints.

Id. at 535. As a single, dominant, multi-brand retailer, TRU is similarly able to use its power to enforce collusion among its various suppliers. Of course, multi-brand dealers are not always able to exercise this potential source of power. The presence of a strong competitor which offers the manufacturers adequate substitute distribution for their products would be expected to check any attempt to exercise this power. For example, the toy retailer Zeller's appears to be such a competitor for TRU in Canada.

The very toy manufacturers that joined TRU's boycott in the United States never similarly restricted their distribution of toys in Canada. This

⁶¹ TRU's importance as a retailer is so great that it often could squelch an item before the item made it to the market. This power is aptly illustrated by an incident involving Just Toys. Just Toys introduced what it believed was a promising new toy. When TRU found the item for sale at several BJ's club stores in the New York City area, TRU canceled its order for the product. Just Toys thereafter canceled its advertising plans for the product, despite its belief that the item could have been a successful product. Without TRU's support, Just Toys was unwilling to risk the expense of an advertising campaign. IDF 360.

comparison of the United States to Canada provides another indication that the U.S. boycott was a result of TRU's power as a dealer of toys in the United States and not some legitimate business purpose. The Canadian branches of Mattel, Hasbro, Tyco, and Binney & Smith all market their products independently of their U.S. affiliates. Nickel 922/25-924/2, 967/21-969/24, 972/21-975/25. Costco Canada has always been able to purchase from these companies a full line of toy products, even though the toy manufacturers' U.S. affiliates were restricting toy sales to Costco U.S. and the other clubs in this country. Nickel 920/20-922/16. In sum, the boycott orchestrated by TRU took hold only in the United States, where TRU is unchallenged as the only full-line, national, discount toy retailer. TRU's documents indicate that it occupies a weaker position as a toy outlet in Canada due to fierce competition from Zeller's. CX 1648-T,V (stating that Zeller's in Canada is "about as tough a competitor in the toy business as [TRU has] in the world").

TRU's claim that its suppliers were convinced of the wisdom of its policy in the United States, and therefore acceded to its proposals, is undermined by the failure of those same suppliers to take similar steps in Canada where traditional toy outlets similar to those in the United States also met new club competition. A reasonable conclusion is that the successful boycott in the United States was a result of a powerful dealer's ability to negotiate with suppliers that had nowhere else to turn, because in Canada, where they could turn to Zeller's, no restraint was imposed. *See* 8 Areeda, *supra* note 43, ¶1648(E), at 539 (suggesting that "selective" adoption of a restraint in only certain markets may help prove that the restriction was a result of dealer coercion). While other differences in market conditions might also explain the result, TRU has not offered any reason that withstands scrutiny.⁶²

The evidence is clear -- indeed, TRU does not really contest the point -- that TRU had sufficient market power to induce the toy manufacturers to bend to its will with regard to their sales to the clubs. That such a wide range of toy manufacturers, all with serious reservations about the wisdom of discriminating against the clubs on toy sales, fell in line when TRU asserted its demands is proof in itself of TRU's extraordinary power to coerce its suppliers.⁶³

⁶² TRU explains the failure to implement a similar boycott in Canada by noting that "[i]n Canada, unlike the United States, product shortages are rare and popular toys need not be rationed." (App. Br. at 79 n.37.) There are several problems with this expedient explanation: (1) the club policy does not address the issue of shortages, IDF 60; CX 1681; CX 1651(Goddu) at 49/5-13 (stating that shortages were not the reason for the club policy); (2) the free-riding justification advanced by TRU, if valid, applies whether or not shortages are a problem; and (3) according to the witness from Costco Canada, toy products sometimes *are* in short supply in Canada. Nickel 964/8-20.

⁶³ Professor Areeda remarks:

Dealers cannot force an unwilling manufacturer to restrict intrabrand competition to their advantage unless they possess some power over him. Of course, there is no better demonstration

b. The toy manufacturers' dominance.

Turning to the point of view of the clubs, the "dominance" they cared about was not just the ability of TRU to orchestrate a boycott, but the combined market power of the various toy manufacturers who entered into the boycott orchestrated by TRU. We have already seen that those toy manufacturers accounted for roughly 40% of all toy sales in the United States. *See supra* pp. 530-31. That figure understates their significance since, as the leading toy manufacturers and principal television advertisers, they accounted for a far larger proportion of the "hit" toy products that lead consumers to shop at a particular outlet.

Another way to look at TRU's and its suppliers' market power is to examine the effect of the boycott on the clubs. As noted earlier, the clubs' combined market shares increased steadily until 1992, and reliable observers predicted that the increase would continue. *See supra* pp. 538-41. Club sales reached a high of 1.9% of the toy market in 1992 and then, after TRU introduced its policy, steadily declined to 1.4% of the market by 1995. We will address more fully the effect of TRU's policies on the clubs and on the marketplace at pp. 609-14, *infra*. The significant point here is that the participants in the boycott clearly had enough market power to retard the clubs' ability to continue to compete.

TRU challenges the ALJ's conclusion that TRU and the toy manufacturers had market power by arguing that there is no evidence that TRU had the power generally to curtail output and raise price in the marketplace, or evidence that overall output actually was curtailed and overall prices raised. There are several problems with this argument. First, there is little question that the boycott of the warehouse clubs that TRU organized *could* and *did* lower output by avoiding a decrease in toy prices by TRU and TRU's non-club competitors. *See infra* pp. 561-64. TRU, which lowered prices in 1992 to meet club prices, found that those price cuts were no longer necessary after the boycott limited club access to toy products. Second, in pressing its argument, TRU confuses the concept of *monopoly* power (which except in extraordinary circumstances does not exist at market share levels below 60% or 70%) with *market* power under the rule of reason (which may occur at lower percentage levels). Thus, TRU's argument ignores the clear directive in *Northwest Stationers* that courts should examine whether the boycotting firms possess "a dominant position," language that traditionally has required market shares in the 30%

of power than its exercise. Suppose, for example, that a manufacturer explicitly declared that distribution restraints would be inefficient but nevertheless adopted them after dealers threatened, "Restrain intrabrand competition or we cease handling your product." The resulting restraint could then readily be attributed to dealer power and fairly judged unreasonable. Few cases will be so clear.

8 Areeda, *supra* note 43, ¶ 1604 (g), at 65-66 (footnote omitted). This is precisely what happened here.

range, not the 60 or 70% range. A requirement that a boycott violation could be found only where the boycotting firms hold 60% or more of the market and all by themselves can curtail output and raise price, in effect would read Section 1 out of the Sherman Act. Only monopolization or conspiracies to monopolize would be actionable. See *Eastman Kodak*, 504 U.S. at 481 ("Monopoly power under § 2 requires, of course, something greater than market power under § 1."); *Reazin v. Blue Cross and Blue Shield*, 899 F.2d 951, 967 (10th Cir. 1990) ("Market and monopoly power only differ in degree -- monopoly power is commonly thought of as 'substantial' market power.") Many rule of reason cases find "market power" at less than the monopoly level. See, e.g., *Twin City Sportservice, Inc. v. Charles O. Finley & Co.*, 676 F.2d 1291, 1301, 1303-05 (9th Cir. 1982). See also *Rossi*, 1998 U.S. App. LEXIS 21911, at *17-18 (reversing summary judgment for defendants and remanding for trial where defendant manufacturer, who along with retailers allegedly was part of a boycott of a price-cutting retailer, accounted for 38% of sales in a local geographic market); *Valley Liquors, Inc. v. Renfield Importers, Ltd.*, 822 F.2d 656, 667 (7th Cir. 1987) ("Without a showing of special market conditions or other compelling evidence of market power, the lowest possible market share legally sufficient to sustain a finding of monopolization [or substantial market power] is between 17% and 25%.")(citation omitted); *United States v. Realty Multi-List, Inc.*, 629 F.2d 1351, 1373 (5th Cir. 1980) ("When the cooperating group possesses sufficient market power that a nonmember can no longer compete effectively with members, the restraint must be found to have sufficient adverse competitive impact to violate Section 1.").

TRU argues that non-price, vertical restrictions cannot be found illegal without a showing of substantial market power. (Reply Br. at 52-58.) TRU cites exclusive dealing, exclusive territory, and dealer termination cases. See, e.g., *Omega Envtl., Inc. v. Gilbarco, Inc.*, 127 F.3d 1157, 1161, 1165 (9th Cir. 1997) (exclusive dealing); *Murrow Furniture Galleries, Inc. v. Thomasville Furniture Indus., Inc.*, 889 F.2d 524, 525, 528-29 (4th Cir. 1989) (exclusive territories); *Muenster Butane, Inc. v. Stewart Co.*, 651 F.2d 292, 294, 297-98 (5th Cir. 1981) (dealer termination). Characteristically, manufacturers with 30% or so of a market do not violate the antitrust laws when they impose non-price vertical restraints because customers of those manufacturers can turn to the other 70% of the market for a source of supply. Yet even in this area, it is hornbook law that exclusive dealing contracts that tie up 40% or more of the supply in a relevant antitrust market can create cognizable competitive problems.⁶⁴ See

⁶⁴ *Roland Mach. Co. v. Dresser Indus., Inc.*, 749 F.2d 380 (7th Cir. 1984), a decision of the Seventh Circuit authored by Judge Posner, requires a showing only that one significant competitor was excluded from the relevant market and that there is a likelihood the exclusion will raise price:

The exclusion of competitors is cause for antitrust concern only if it impairs the health of the competitive process itself. See *Products Liability Ins. Agency, Inc. v. Crum & Forster Ins. Cos.*,

Herbert Hovenkamp, *Federal Antitrust Policy*, 389-90 (1994) ("Exclusive dealing is still condemned where the shares exceed 40% or so."). TRU accounted for more than 30% of toy purchases in areas of the country where it did business, and 40 to 50% in many cities. And of course, TRU's boycott ultimately affected the supply of toys representing about 40% of the market. Finally, TRU and the toy manufacturer boycotters had more market power than bare numbers suggest.

Exclusive dealing and other non-price vertical cases, moreover, are easily distinguished from the boycott orchestrated by TRU. For example, many of the exclusive dealing cases involved short term contracts, usually a year or less in duration and often terminable at will. The boycott orchestrated by TRU was not limited in duration and, if effective, would go on indefinitely. More important, there are substantial efficiencies, consistently recognized by the Supreme Court, flowing from exclusive dealing and other non-price vertical restrictions. As Justice Frankfurter explained in the majority opinion in *Standard Oil Co. v. United States*, 337 U.S. 293, 306-07 (1949) ("*Standard Stations*"), exclusive distribution arrangements remove substantial uncertainties, aid planning and reduce costs, permitting investments that might not otherwise occur. See also *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 12 (1984) (discussing business justifications for tie-in sales); *id.* at 40-42 (O'Connor, J., concurring); *Sylvania*, 433 U.S. at 54-55 (discussing business justifications for territorial and customer allocation).

But as we will show in our discussion of TRU's justification or defense, there are no efficiencies to the boycott orchestrated by TRU.

3. Terminating access to a necessary supply or relationship.

TRU does not really contest the proposition that its "club policy" was designed to and had the effect of denying the clubs "a supply ... necessary to enable [the clubs] to compete." *Northwest Wholesale Stationers*, 472 U.S. at 294. The whole point of its club policy was to deny the clubs

682 F.2d 660, 663-65 (7th Cir.1982). Hence a plaintiff must prove two things to show that an exclusive-dealing agreement is unreasonable. First, he must prove that it is likely to keep at least one significant competitor of the defendant from doing business in a relevant market. If there is no exclusion of a significant competitor, the agreement cannot possibly harm competition. Second, he must prove that the probable (not certain) effect of the exclusion will be to raise prices above (and therefore reduce output below) the competitive level, or otherwise injure competition; he must show in other words that the anticompetitive effects (if any) of the exclusion outweigh any benefits to competition from it.

Id. at 394.

While *Roland Mach.* addressed an exclusive dealing case rather than an orchestrated boycott, the central points that it made are still valid -- there must be exclusion of a significant competitor and that exclusion must have a likely anticompetitive effect that outweighs any business justification. Here, the warehouse clubs were increasingly significant competitors that were denied the opportunity to compete effectively in the market, their exclusion (as we will show in the next section) had a marketplace effect, and (as we will show in the final section) there was no credible business justification for the boycott.

product, or at least product in a form capable of being compared to TRU's products, in order to eliminate price competition. The sharp decline in club toy sales, and consequent decline in price pressure on TRU, demonstrates that TRU did not miscalculate.

The clubs' competitive advantage over other retailers is their low prices, and TRU's policy denied the clubs toy products necessary to engage in price competition. As club executives testified, *see supra* p. 536, clubs seek to carry branded products that their customers will recognize. Their objective is to offer well-defined values, and this is most easily achieved if customers know the value of the product and its price at other retail outlets. TRU's policy denied the clubs access to precisely that class of toy products.

TRU's club policy also imposed costs on the clubs and unavoidably added to shoppers' perceptions that warehouse club inventory tends to be irregular and limited, or characterized by cumbersome and over-sized products. Finally, the policy led to a denial of the clubs' preferences (as buyers from the manufacturers) and of consumers' preferences (as shoppers at the clubs) for a kind of service they preferred and that would have been provided but for TRU's intervention. *See Indiana Fed'n of Dentists*, 476 U.S. at 462 ("The Federation is not entitled to pre-empt the working of the market by deciding for itself that its customers do not need that which they demand."); *cf. Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 606 (1985)("[T]he evidence supports a conclusion that consumers were adversely affected by the elimination of the 4-area ticket [S]kiers demonstrably preferred four mountains to three.").

The drop in toy sales by the clubs demonstrates the importance of full and non-discriminatory access to toy products. As discussed above, *see pp. __*, TRU's boycott halted a pattern of rapid growth of toy sales at the clubs. While the clubs' share of all toy sales in the United States was growing rapidly before the boycott, toy sales at clubs fell steadily from 1.9% of all U.S. toy sales in 1992 to 1.4% in 1995. Equally important, many (if not most) of the toys that continued to be sold by clubs did not threaten TRU's own prices.

4. The boycott lacked a business justification.

TRU has offered only one business justification for its conduct. It claims that the clubs were "free-riders" that took advantage of services provided by TRU, and that the continued presence of these "free-riders" would have the long term adverse effect of driving these services out of the marketplace. It argues that it therefore was justified in urging toy manufacturers to curtail the ability of the clubs to compete with TRU.

Free-rider concerns arise where there are two classes of competing distributors; one group provides services valued by some consumers, while

the other does not but usually charges lower prices. It is now well-recognized in antitrust jurisprudence that a manufacturer can take steps to eliminate free-riding when it is likely to drive services valuable to the manufacturer and consumers out of the marketplace and reduce overall consumer welfare. It is also well accepted that a retailer providing services may urge a manufacturer to eliminate free-riding by terminating the free-riding retailer or taking other action to curtail the problem. *See Sharp*, 485 U.S. at 731; *Sylvania*, 433 U.S. at 54-55.

The simple fact that two sets of distributors elect to adopt different sales formats -- one high-service and the other no-frills discounting -- is insufficient to establish free-rider concerns. As pointed out by Judge Easterbrook, one of the scholars most responsible for calling attention to the validity of a free-rider defense, "[w]hat gives this the name *free-riding* is the lack of charge. When payment is possible, free-riding is not a problem because the 'ride' is not free." *Chicago Prof'l Sports*, 961 F.2d at 675.

a. Dealer compensation cures any free-rider problems.

As we will discuss below, several of the services that TRU points to do not really raise free-rider concerns because they are services that provide advantages only to the toy manufacturers, not to the clubs or any other retailers. But even if they do, the concerns evaporate because TRU is compensated for the services, and there is no threat that the services will be driven from the market. In the words of Professor Scherer, "[s]ufficiency of incentive [to continue the beneficial activity], not the absolute elimination of [positive] spillovers, is the appropriate test for judging whether vertical restraints are necessary when spillovers are shown to exist." CX 1822-Z-8 (Scherer) at 33; IDF 468.

There are at least three ways a distributor can be compensated for valuable services that it provides. First, the consumer may pay separately for the service. That is feasible, for example, when an automobile dealership provides excellent post-sales servicing at a separate price from purchase of the car, thereby leaving the customer with a good opinion of the dealer and the manufacturer of the car. But consumer compensation is often not feasible. For example, it is not practical to charge customers separately for access to a showroom or pre-sale advertising. *General Leaseways, Inc. v. National Truck Leasing Ass'n*, 744 F.2d 588, 592 (7th Cir. 1984)("[V]irtually no one will pay to consume advertising."). A second, theoretically elegant possibility is for a group of dealers who do not supply the service to pay full service dealers roughly the amount the first group benefits from the services. *See White Motor Co. v. United States*, 372 U.S. 253, 270-72 (Brennan, J. concurring)(discussing use of pass-over payments between distributors as an alternative to exclusive territories).

Pass-over payments from one set of dealers to another are possible but often extremely difficult to negotiate. Neither of these techniques was used to compensate TRU in connection with the services it claims to provide.

A third technique for compensating dealers for their investments in services that advance consumer welfare is much more common and practical. The manufacturer might decide that the services are important to its long-term market success, but prefer to keep both types of dealers. It may therefore elect to pay the high service dealers an amount roughly equal to their investment. In effect the manufacturer, once it recognizes that the services are valuable to consumers and therefore to its reputation, has a choice. It can either cut off or discriminate against those distributors that fail to provide the service, or continue to do business with those dealers because it believes it is in its interest to do so, but ensure that others continue to provide the service by paying for it. Cooperative advertising programs, whereby manufacturers of trademarked goods pay all or part of the expenses of dealer programs for advertising the manufacturer's product, are the most common example.

The fact that compensation to the high service retailer eliminates free-rider problems was emphasized by Judge Easterbrook in *Chicago Prof'l Sports*, 961 F.2d at 675, and by Judge Posner in *General Leaseways*, 744 F. 2d at 592. *General Leaseways* challenged the exclusive, territorial divisions imposed by an association of full service, over the road, commercial truck leasing firms. 744 F. 2d at 590. Members of the association provided each other's trucks with repair services at a reasonable rate, allowing them to receive repair services over a geographic scope comparable to that of a national company. *Id.* at 589-90. The association defended the exclusive territories as a restraint on would-be free-riders who might try to take advantage of the association's reasonable rates. *Id.* at 592. However, the court rejected this defense as too speculative, noting that the association's "members ... charge each other for emergency repair service[s]" they provide -- a kind of compensation by barter. *Id.* The Court did not stop to examine whether the compensation from dealer to dealer was exactly the right amount. It was sufficient that it ensured the continuation of the beneficial activity.

Chicago Prof'l Sports concerned a challenge to the NBA's rule that so-called television "superstations" (nominally-local television networks carried by national cable systems) could carry no more than 20 basketball games a season. 961 F. 2d at 669. The NBA attempted to justify its rule as a necessary constraint on free-riding by member teams on the NBA's promotional efforts. The Seventh Circuit again rejected this argument explaining that, because the NBA and its members are in an ongoing, contractual relationship, payment may be made for benefits conferred by

the NBA; the court supported this point with a comparison to the relationship between two retailers:

What gives this the name *free-riding* is the lack of charge. Retailer # 1 does not charge the customer for a valuable service; Retailer # 2 does not pay Retailer # 1 for delivering this service. Put the retailers in a contractual relation, however, and they could adjust their accounts so that the person providing a valuable service gets paid. When payment is possible, free-riding is not a problem because the "ride" is not free. Here lies the flaw in the NBA's story. It may (and does) charge members for value delivered.

Chicago Prof'l Sports, 961 F.2d at 675.⁶⁵ See also *NBA v. Motorola, Inc.*, 105 F.3d 841, 854 (2d Cir. 1997)(rejecting claim of free-riding as unsupported by the evidence).

b. TRU's free-riding claims are atypical.

Before turning to TRU's specific contentions, it is useful to note that the services that TRU claims are exploited by others are not the "classic" services that the courts have been increasingly willing to protect. Free-riding is most often a problem for manufacturers and distributors of expensive, complex goods. For example, promotion, demonstration, and explanation of complex products are services most vulnerable to free-riders; customers visit the full service retailer to learn about products and then buy them somewhere else. See generally *Sylvania*, 433 U.S. at 54-56; Richard Posner, *Economic Analysis of Law*, 295-97 (4th ed. 1992). If a product requires installation or extensive service, customers may buy it at a low-cost discount outlet and then take it to the full service dealer for post-sale servicing. The second dealer may incur significant costs to see that it is properly installed, used, and maintained. See, e.g., *H.L. Hayden Co.*, 879 F.2d at 1014.

By contrast, toys are usually simple and inexpensive products. They generally do not require demonstration and do not require significant installation or maintenance. TRU's method of retailing, moreover, is built on the assumption that customers (or perhaps their children) know what they want when they come to the store. TRU does not dispute that it provides no customer services such as product demonstration or installation assistance. There are few if any sales people in a TRU store available to guide or advise shoppers. There was no evidence in the record that anyone

⁶⁵ Both *Chicago Sports and General Leaseways* dealt with fact situations in which the compensation could be paid (*Chicago Sports*) or actually was paid (*General Leaseways*) by a horizontal competitor of the parties supplying the services. But the fact that payment is made vertically by a manufacturer to a dealer should make no difference. While some discounters may receive an advantage they did not pay for, that advantage is not the critical issue if the focus is on the welfare of consumers, as it should be in sensible antitrust enforcement. The point is rather that services valued by consumers will be preserved in the marketplace, and not driven out by so called "free-riders."

sought demonstration or explanation of a toy product at TRU and then purchased the product at a club.

c. TRU was compensated for any services it provides.

Turning now to TRU's specific contentions, it argues that it provides three important and costly services that are not provided by the clubs but that advance the club's interests: (1) TRU advertises products in catalogs and newspaper inserts (called rotos) regularly over the year; (2) it provides a year-round, full-line, industry showroom, which generates sales information and marketing guidance for the toy industry; and (3) it accepts inventory early and regularly over the course of the year, saving the toy manufacturers warehousing costs and permitting steady, less costly production schedules. The record indicates, however, that TRU's services largely benefit the manufacturers and that TRU is compensated generously for any costs incurred in providing these services.

Advertising can raise legitimate free-rider problems if one group of distributors commits resources to promotional efforts and another group, spending no resources, enjoys some of the benefits. *See* discussion of *General Leaseways*, *supra* pp. 601-02. But it is the toy manufacturers who finance advertising in this market. Television advertising is paid for entirely by the toy manufacturers. *See supra* p. 564. As to catalogs and newspaper inserts, the bulk of these expenses -- over 99% in one year and more than 90% in several other years under review -- was paid by the toy manufacturers. A 1993 TRU memorandum called advertising "essentially free," and a former TRU employee testified that in some instances advertising allowances actually exceeded the amount TRU spent for advertising. *See supra* note 37.

TRU argues that its large showrooms and year-round display of toys create hits and generate valuable information on sales trends. This argument does not hold up under analysis. "Creating hits" -- *i.e.*, hot products that are sold in great volume -- obviously does not apply to the overwhelming majority of products on the shelves of toy retailers. Toy stores do not stock the boardgame Monopoly because TRU's earlier display made it a hit. With respect to other products there is little reason to believe that a "large showroom" is a major influence on consumer demand. Products become hits because of the quality of the toys, word-of-mouth reactions, and heavy television advertising. Even if the presence of a particular toy at TRU is a factor among many in creating "hit" toys, TRU is compensated indirectly for any part it plays in the production of hit products by receiving a disproportionately large share of those products. As shown in our discussion of facts, the evidence convincingly shows that (1) TRU gets a lion's share of the hot and promoted products, and (2) more than any other retailer, TRU is granted post-sale discounts from its

suppliers on products that do not meet sales expectations. *See supra* pp. 566-68. These two methods of compensation reward TRU for carrying a full line of products and compensate TRU for whatever small part it may play in generating hit products for the toy industry. The important point is that there is no reason to expect that TRU will cease carrying hit products in its unusually broad year-round inventory because the same products are carried by the clubs with a narrower range of offerings.

The marketing surveys that TRU prepares before the annual Toy Fair may, as TRU claims, help manufacturers identify probable hits and plan advertising expenditures. But TRU overlooks the facts that the toy companies create the products and pay for the advertising that helps a promising product become a hit. TRU can be compensated for any market research it does for its suppliers, and the evidence shows that it is compensated by several of the methods just mentioned. In other words, "reimbursed" market research for a manufacturer by a dealer is not the kind of service that has been recognized as creating free-rider problems by other dealers that justify exclusionary restraints.

As to TRU's claim that it accepts inventory early in the course of the year, permitting toy manufacturers to save warehousing costs, the evidence again clearly shows that TRU is paid for this service. Warehousing, moreover, is far from the type of dealer services at issue in the case law on free-riding. It is largely the toy manufacturers and TRU, not the clubs or any other rival of TRU, that benefit from the use of TRU's warehouse space. TRU is allowed to pay later for the delivery of goods (described by several toy manufacturers as compensation for storage services), and receives a disproportionately large share of hit products and generous post-sale discounts for slow-moving inventory. *See supra* pp. 565-66.

Even assuming that the various services provided by TRU were valuable to manufacturers and consumers, there is no evidence that the clubs' failure to provide those services (or Wal-Mart's and K-Mart's for that matter) had, or was likely to have, the effect of driving those services from the market. TRU did argue that "free-riding" by Wal-Mart had forced TRU to reduce the number of items it carried and, if competition from the clubs were not curtailed, that inventory reduction might have to occur again. (Reply Br. at 74-75.) But the claim that inventory reduction was a consequence of no-frills price competition by the clubs and therefore was a justification for organizing a boycott against the clubs does not hold up. The decision to cut back on inventory did not occur until 1996 -- a full four years after the clubs' market share peaked and TRU introduced its club policy. According to Goddu, the TRU executive in charge of the policy change, the inventory reduction resulted primarily from competition from Wal-Mart, not from free-riding by Wal-Mart. Goddu testified that the

purpose of the reduction was to create a cleaner looking shopping floor and less cluttered stores. *See supra* note 38.

TRU argues that services remained in the market only because of its policy of inducing toy manufacturers to restrict sales to the clubs. (Reply Br. at 75.) That argument would be far more persuasive if there was any indication, prior to the time TRU's policy was implemented, that any services were on the decline. There is also no indication in the documents -- either those produced by the toy manufacturers or TRU -- that any party had the slightest concern, before the clubs threatened to sue TRU under the antitrust laws, that the clubs were free-riders that endangered the continued availability of any services that consumers valued.⁶⁶

d. Significantly less restrictive alternatives were available.

Another reason why TRU's policies do not qualify under *Northwest Stationers* is that TRU could have achieved its purported objectives through policies and conduct that restricted competition far less than a boycott among suppliers of its club rivals. Consequently, the boycott cannot be "justified by plausible arguments that they were intended to enhance overall efficiency and make markets more competitive." 472 U.S. at 294.

TRU's essential argument is that its advertising, other forms of promotion, and large year-round inventory, "created" hit products. According to TRU, the clubs observed TRU's activities and then elected to carry only those hit products in the Christmas season. Other services pointed to by TRU involved the accumulation of market data which was communicated to the toy manufacturers so that they could predict proper levels of production for the last part of the year.

TRU could have adopted policies, however, that fell well short of orchestrating arrangements whereby products identical to those carried by TRU would not be provided to the clubs. If TRU's concern was that club purchases would prevent TRU from receiving all the "hit" products it needed during the Christmas season, it could have asked for assurances that it would receive an adequate supply of "hit products." This would protect TRU's alleged position as the industry hit-maker without eliminating clubs as effective competitors on the vast majority of toys. Instead, TRU adopted a policy that all products -- new and old, hit and non-hit products -- could be sold to the clubs as long as they were part of a combination pack that could not be compared easily to TRU product prices. This disconnect between purpose and policy indicates that elimination of effective price competition was TRU's true motivating concern. TRU claims that compensation for the services provided -- advertising, inventory, marketing

⁶⁶ Cf. *Eastman Kodak*, 504 U.S. at 485 n.33 (rejecting a free-riding defense when there is no evidence that manufacturer-imposed restrictions are necessary to induce competent and aggressive retailers to make the investment of capital and labor necessary to distribute the product).

data -- was not adequate in light of its investment in those services. But TRU, as the largest toy retailer in the United States, could have bargained harder with toy manufacturers for compensation instead of organizing a boycott of the clubs. To the extent the adequacy of compensation is addressed in this record, the evidence is overwhelming that TRU was an exceptionally capable and aggressive bargainer and that TRU received compensation that equaled or exceeded its investment.

e. TRU's free-riding claims are a pretext.

Before TRU introduced its policy of curtailing toy manufacturers' sales to clubs, there is no indication in the documents that any toy manufacturer declined to do business with the clubs because of possible free-riding. Indeed, TRU's suppliers' adoption of the club policy was an abrupt departure from the toy companies' longstanding distribution policies. Few toy manufacturers avoided doing business with discounters, or even with retailers that provided a narrow range of services, nor did they require distributors to carry their full line. The few who did avoid sales to the clubs did so for reasons unrelated to "free-riding." *See supra* pp. 568-69.

Similarly, there is absolutely no evidence -- certainly no contemporaneous document -- that TRU developed and implemented its policy with respect to competition by the clubs because of a free-riding concern. Indeed, the first mention of free-riding within TRU was in the late summer of 1992, when the clubs threatened to sue TRU and its suppliers for discriminatory sales policies. Also, TRU never asked the toy manufacturers to discipline Wal-Mart, Target, K-Mart or other established discounters -- even though they, like the clubs, did not provide services such as early purchasing of inventory, stocking a large number of toy products, and advertising. The difference was that the clubs offered a form of extreme price competition that TRU came to believe it could not tolerate. Although concerns about free-riding often will be difficult to distinguish from generic concerns about "unfair" price cutting, the lack of any more specific, contemporaneous discussion of free-riding, and the focus of TRU's animus on the clubs alone, severely weakens TRU's claimed justification.

We therefore conclude that TRU's claim that concerns about free-riding motivated its policy of orchestrating a boycott against the clubs is a pretext. TRU's real motive was simply to eliminate the increasing competition provided by the clubs, which not only cut into TRU's sales, but threatened its reputation as a low price discounter.

5. Conclusion to Northwest Wholesale Stationers approach.

For all the reasons set forth above, we conclude that TRU's practices satisfy each of the conditions described in *Northwest Wholesale Stationers* as a preliminary to application of a *per se* rule. The boycott orchestrated by

TRU was anticompetitive in purpose and effect, effectuated by participants which, as a group, held a powerful market position, and resulted in denying the clubs products in a format reasonably necessary to allow them to compete effectively. Perhaps most important is the ALJ's finding, with which we thoroughly agree, that there was no plausible business justification for the group's behavior. IDF 533; Initial Decision at 123, Conclusion of Law 10. Looked at from the point of view of consumers, they got nothing at all out of the boycott organized by TRU. Rather, they were denied an opportunity to buy toys at low prices from outlets that many were coming to prefer.

Following the teaching of *Northwest Wholesale Stationers*, we examined market power here and found that the participants in the boycott had substantial market power. Certainly, TRU had little difficulty coercing a substantial number of toy manufacturers to discriminate against the clubs, and the manufacturers as a group suppressed the ability of the clubs to compete effectively. But the Supreme Court stated in *Indiana Fed'n of Dentists*, a boycott case decided one year after *Northwest Wholesale Stationers*, that a finding of market power is not necessary to find illegal a course of conduct leading to "actual detrimental effects." 476 U.S. at 460. The Court concluded that evidence of such effects "can obviate the need for an inquiry into market power which is but a 'surrogate for detrimental effects.'" *Id.* at 460-61 (quoting 7 Areeda, *supra* note 43, ¶1511, at 429. See also *Wilk v. AMA*, 895 F.2d 352, 360-62 (7th Cir. 1990) (holding that a showing of actual adverse competitive effects obviates the need to present detailed evidence of the market definition and market power) (citing and discussing *Indiana Fed'n of Dentists*). That is particularly clear where the boycott prevents economic activity that the market would otherwise produce, see *id.* at 360, and there are no countervailing procompetitive virtues such as the creation of efficiencies in the operation of the market or the provision of goods and services. *Id.* at 361.

That is exactly the situation we have here. There were clear anticompetitive effects, see *infra* pp. 609-14, and no plausible business justification. TRU and its reluctant collaborators set out to eliminate from the marketplace a form of price competition and a style of service that increasing numbers of consumers preferred.

In conclusion, we note that all elements required by *Northwest Wholesale Stationers* to justify application of a *per se* rule are present; even if market power were not present, a violation would nevertheless be found.

*E. The Group Boycott Organized By TRU Is Also
Illegal Under a Full Rule of Reason Analysis.*

Even if TRU's conduct is analyzed under the full rule of reason, its behavior must still be found illegal. The principal additional factors that

must be examined under a full rule of reason -- as opposed to *Northwest Wholesale Stationers'* modified *per se* approach -- are, first, whether TRU's behavior had a significant anticompetitive effect, and, second, whether any such effect is outweighed by legitimate business justifications.

1. The boycott produced anticompetitive effects.

The boycott TRU orchestrated had harmful effects for the clubs, for competition, and for consumers. TRU prevented a decrease in the price paid by many consumers for many toy items, reduced the options available to consumers, and weakened both intrabrand and interbrand competition in the retail toy market.

TRU argues that Complaint Counsel has failed to demonstrate anticompetitive effects. TRU's arguments reduce to an assertion that, because the clubs were small -- accounting for no more than an estimated 1.9%⁶⁷ of the United States toy market when TRU's policy went into effect -- TRU was privileged to organize a boycott designed to disadvantage and impose extra costs on them without being accountable for having caused harm cognizable under the antitrust laws. The clubs, according to TRU, were too small to matter. (App. Br. at 69-72; Reply Br. at 64 ("A 'restraint' that leads to 1% of the market being excluded from toys making up 40% of industry sales is barely foreclosure at all").) When a similar argument was advanced in *Klor's*, the Supreme Court commented:

It [the boycott allegation] clearly has, by its "nature" and "character," a "monopolistic tendency." As such it is not to be tolerated merely because the victim is just one merchant whose business is so small that his destruction makes little difference to the economy. Monopoly can as surely thrive by the elimination of such small businessmen, one at a time, as it can by driving them out in large groups.

Klor's, 359 U.S. at 213 (footnote omitted).

This remark applies with even greater force to the boycott orchestrated by TRU. Far from a single small business, the clubs were growing chains of retailers operating hundreds of outlets nationally and employing a distinctly new and efficient method of distribution. Because the boycott injured the clubs, it also harmed competition, and because competition was harmed, consumer welfare was reduced. Although the antitrust laws protect competition and not competitors, there can be no competition without able competitors. 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. Our discussion of

⁶⁷ Mattel estimated the clubs' total share of the retail toys sold in the United States in 1992 at 2.3%. CX 695-L. Although we have no reason to think this estimate is any less accurate than the lower statistic offered by the NPD Group, we have given TRU the benefit of the doubt by picking the lower number for this discussion.

effects looks first at the harm caused to the clubs' toy sales and then at the repercussions of this for consumers.

As noted previously, *see supra* p. 562, club toy sales reached a high of 1.9% of total U.S. sales in 1992, and business observers expected toy sales to continue to grow rapidly. Although club sales generally continued to increase in the next several years, club toy sales declined steadily after the TRU-orchestrated boycott went into effect to 1.4% in 1995. Perhaps there were other factors involved in declining toy sales at the clubs after 1992 (although TRU offered none for the record), but clearly the boycott was a major factor.

Because TRU's policy undermined the clubs' strength as competitors, TRU was not "embarrassed," CX 661 at 35, into lowering prices to meet club competition. As already discussed, in 1992 TRU had set its prices for many items based on price competition from the clubs. After the club policy was established, this was no longer necessary, and TRU was able to avoid similar price cuts thereafter. As explained at p. 563, *supra*, if TRU had reduced its average margin on its five hundred best-selling products to match Costco's average margin of 9%, TRU's customers would have saved \$55 million per year.⁶⁸ And of course the boycott raised the costs of toys at the clubs, obstructing their advantage as the lowest price outlet to the advantage of TRU and the injury of consumers.

The boycott orchestrated by TRU reduced the range of choices available to consumers and eliminated forms of competition that consumers desired and would have been able to enjoy absent TRU's policy. Club shoppers were not able to buy the products they wanted at the clubs. They either had to buy their second-choice goods (*e.g.*, custom or combo packs of goods) at their first-choice stores (warehouse clubs) or their first-choice goods (*e.g.*, individually packaged branded toys) at their second-choice stores (TRU, Wal-Mart, Target). The Supreme Court has recognized similar restrictions on the forms of competition in the marketplace, and similar hindrances to products or services consumers desire, as anti-competitive effects cognizable under the antitrust laws. See the discussion of *Aspen Ski* and *Indiana Fed'n of Dentists* at pp.600, *supra*.

It is noteworthy that the boycott restrained both intrabrand and interbrand competition in the retail toy market. Thus, we do not face the difficult balancing process of weighing a loss of intrabrand competition (often resulting from non-price vertical restraints) against benefits to interbrand competition. As we have already discussed, Goddu carefully explained that combination packs made it difficult for consumers to compare the prices of products sold at the clubs to the same items at TRU.

⁶⁸ Cf. *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1082 n.14 (D.D.C. 1997) (recognizing an averted price decrease as an anticompetitive effect).

This is a restraint on intrabrand competition -- that is, on competition between products of the same brand sold at different retail outlets. The fact that intrabrand competition is restricted is not enough to warrant condemnation of a restraint. Vertical restraints ordinarily reduce competition between dealers marketing the same goods for the positive purpose of enhancing competition with respect to similar products of other manufacturers. *See Sylvania*, 433 U.S. at 54; *Sharp*, 485 U.S. at 724-25. But here the boycott did not strengthen competition among the toy companies. Our conclusion that TRU's free-rider justification lacks merit -- that it was merely a pretext for a policy aimed at reducing price competition -- means that the boycott did not serve to protect dealer services that drive the demand for toys to the benefit of toy companies and consumers.

For these reasons, we conclude that actual anticompetitive effects resulted from TRU's conduct, including reduced consumer choice and higher prices.

With respect to cases cited by TRU, we note once again that the company relies almost entirely on exclusive dealing, territorial allocation, customer allocation, and similar non-price vertical distribution cases. Examples of these are cited above, *see supra* p.599. As we noted in examining some of these cases in connection with the existence of market power, those types of cases are different because the Supreme Court has emphasized with respect to each category that there are substantial efficiencies that can be achieved. See the discussion of cases recognizing these efficiencies at p. 600, *supra*. The courts, therefore, are confronted with a difficult trade-off between anticompetitive foreclosure on the one hand and redeeming business justifications on the other. Here, the evidence is overwhelming that there simply were no efficiencies to justify TRU's behavior.

The essential prop to all of TRU's arguments about anti-competitive effect is that a government boycott case must fail if the government does not discharge a burden of demonstrating that, as a result of the boycott, market-wide prices increased or market-wide output diminished. (Reply Br. at 52.) This very issue was addressed and settled by the Supreme Court in *Indiana Fed'n of Dentists*, 476 U.S. at 461-62, where a group of dentists conspired to prevent member dentists from submitting x-rays to dental health insurers so that the insurers could check the validity of requests for payment of benefits. The Court elected a rule of reason, rather than *per se*, approach, in part because the boycott involving x-rays was obviously not intended to harm a competitor -- a purpose that *is present* here. *Id.* at 458-59. In applying a full rule of reason, the Supreme Court addressed the argument that there had been no finding that "the alleged restraint on competition among dentists had actually resulted in higher dental costs to

patients and insurers." *Id.* at 447. The Court explained that a showing of higher prices was not essential to establish the illegality of the restraint:

A concerted and effective effort to withhold (or make more costly) information desired by consumers for the purpose of determining whether a particular purchase is cost justified is likely enough to disrupt the proper functioning of the price-setting mechanism of the market that it may be condemned *even absent proof that it resulted in higher prices or, as here, the purchase of higher priced services, than would occur in its absence.*

Id. at 461-62 (emphasis added).⁶⁹

The case for finding a violation is all the more powerful here where the boycott is not an indirect attempt to interfere with price-setting (through withholding of information), but a direct effort by one retailer to organize a boycott designed to impair the ability of its lowest-priced rivals to continue to offer products and services that consumers desire.

2. The anticompetitive effects far outweigh the claimed justification.

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 *post hoc* rationalization for a policy with an anticompetitive purpose and effect. The balance under a full rule of reason tips decidedly toward condemnation.

F. Considered Alone, the Vertical Restraints Are Unreasonable Under § 1 of the Sherman Act.

The evidence is clear that TRU, a dominant toy retailer, significantly diminished the ability of the clubs to compete by inducing a substantial number of toy manufacturers to agree to do business with TRU's club rivals only on discriminatory terms. It accomplished its purpose by approaching each of the toy manufacturers *seriatim* and inducing or coercing each to agree to join in its anticompetitive mission. *See supra* pp.541-48 & notes 23, 24. TRU's purpose was to avoid significant price competition from rivals and to deny consumers a form of distribution they prefer. *See supra* p. 591-92. The effect of these joint actions was to injure a group of rivals in the marketplace. *See supra* pp.609-14.

We conclude therefore that each agreement in the series of vertical agreements, standing alone, even without the evidence of horizontal agreement among many of the toy manufacturers, violates § 1 of the Sherman Act upon a full rule of reason review.

⁶⁹ The Court had previously articulated this point in *Associated Gen. Contractors, Inc. v. California State Council of Carpenters*, 459 U.S. 519, 528 (1983) ("Coercive activity that prevents its victims from making free choices between market alternatives is inherently destructive of competitive conditions and may be condemned even without proof of its actual market effect."). *Accord* *Wilk*, 895 F.2d at 360.

A vertical agreement between a retailer (even one as powerful as TRU) and an individual manufacturer, whereby the manufacturer agrees to deal only on discriminatory terms with a competitor of the retailer, would not be treated as illegal *per se*. It is not vertical price-fixing because no specific price, or price level, was agreed to, *see Sharp*, 485 U.S. 717, 731, and each individual vertical agreement is not *per se* illegal as a boycott.

On the other hand, an examination limited to each individual agreement in isolation (TRU agrees with Mattel, TRU agrees with Hasbro, TRU agrees with Tyco, etc.) would blind us to the true anticompetitive nature and effect of TRU's course of conduct. As the Supreme Court instructed in *Continental Ore Co. v. Union Carbide & Carbon Corp.*, 370 U.S. 690 (1962):

plaintiffs should be given the full benefit of their proof without tightly compartmentalizing the various factual components and wiping the slate clean after scrutiny of each. " * * * (T)he character and effect of a conspiracy are not to be judged by dismembering it and viewing its separate parts, but only by looking at it as a whole. *United States v. Patten*, 226 U. S. 525, 544 * * *; and in a case like the one before us, the duty of the jury was to look at the whole picture and not merely at the individual figures in it." *American Tobacco Co. v. United States*, 147 F.2d 93, 106 (C. A. 6th Cir.). *See Montague & Co. v. Lowry*, 193 U. S. 38, 45-46.

Id. at 698-99. Along the same lines, the Supreme Court in *Standard Stations*, 337 U.S. 293, found individual, exclusive dealing contracts illegal because of the "widespread adoption of such contracts" in the market. *Id.* at 314.

In the present case, each vertical agreement was entered into against a background in which other agreements were solicited and either achieved or were about to be achieved. The large number of agreements ultimately obtained, and the size and importance of the toy firms that joined them, were essential to the success of the agreements and to the accomplishment of TRU's overall scheme. The collection of separate vertical agreements -- together excluding the clubs from the leading manufacturers of toys, accounting for roughly 40% of U.S. output -- had a profound anticompetitive effect, *see supra* pp. 609-14; the collection of parties entering into separate agreements had substantial market power, *see supra* pp. 592-600; and there was no plausible business justification or efficiency, *see supra* pp. 601-08. Under a full rule of reason, we find that *each agreement* in the series of agreements -- anticompetitive in purpose and effect and lacking plausible justification -- constitutes a violation of § 1 of the Sherman Act. *See Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 325-29 (1961); *Chicago Bd. of Trade v. United States*, 246 U.S. 231, 238 (1918); *cf. United States v. National Ass'n of Broadcasters*, 536 F. Supp. 149, 157-169

(D.D.C. 1982); *United States v. American Smelting & Ref. Co.*, 182 F. Supp. 834, 861 (S.D.N.Y. 1960).

G. The Order Crafted By the ALJ Is Reasonable, Appropriate and Necessary to Remedy the Anticompetitive Effects of TRU's Conduct.

Having found that TRU violated the antitrust laws by organizing a boycott agreement to discriminate against the clubs, the ALJ entered an order requiring TRU to cease this law violation and to refrain from similar conduct in the future. This order contains five key elements of injunctive relief. See Order ¶¶ II.A-E. Because each provision of the ALJ's order is reasonable, appropriate and necessary to remedy the anticompetitive effects of TRU's conduct, we have decided to make final the order he crafted.

Briefly summarized, the order prohibits TRU 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. See ¶ II.A. The order also prohibits TRU from facilitating, or attempting to facilitate, an agreement between or among its suppliers relating to the sale of toys to any retailer. See ¶ II.D. Additionally, TRU is enjoined from requesting information from suppliers about their sales to any toy discounter, and from urging or coercing suppliers to restrict sales to any toy discounter. See ¶¶ II.B, C. These four elements of relief are narrowly tailored to stop, and prevent the repetition of, TRU's illegal conduct.

TRU challenges the final provision of the order, see ¶ II.E, arguing that it would prohibit TRU "from exercising its *Colgate* rights." Paragraph II.E requires TRU, for a period of five years, to cease and desist from:

- 1) announcing or communicating that respondent will or may discontinue purchasing or refuse to purchase toys and related products from any supplier because that supplier intends to sell or sells toys and related products to any toy discounter, or
- 2) refusing to purchase toys and related products from a supplier because, in whole or in part, that supplier offered to sell or sold toys and related products to any toy discounter.

TRU contends that these provisions would force it to buy products it could not sell and to operate at a loss.

Colgate "rights" merely describe the boundary between concerted conduct that may violate the antitrust laws and unilateral conduct that the law does not forbid. As we have explained, TRU has crossed that boundary repeatedly and in several different ways. See *supra* pp.569-74. It is well settled that once a respondent engages in illegal conduct, the Commission's order need not prohibit merely unlawful conduct, but may "close all roads to the prohibited goal, so that its order may not be by-passed with impunity." *FTC v. Ruberoid Co.*, 343 U.S. 470, 473 (1952). The order may also include such additional provisions as are necessary to "preclude the revival of the illegal practices." *FTC v. National Lead Co.*, 352 U.S. 419,

430 (1957). Indeed, "those caught violating the Act must expect some fencing in." *Id.* at 431.

Paragraph II.E of the order is necessary to prohibit illegal conduct that TRU engaged in under the guise of the Court's decision in *Colgate*. The sorts of communications and the sales restrictions prohibited by ¶ II.E are the means used by TRU to implement and police the illegal restraints of trade. The paragraph is also necessary to correct the effects of the illegal conduct. Although TRU argues that ¶ II.E would require it to operate at a loss, to buy products it does not believe it can sell, or to carry all items stocked by discounters, it does none of these things. TRU will remain free to reject items that it does not believe it can sell profitably, *so long as it makes that decision independent of whether the item is offered to or sold by a discounter*. Similarly, TRU is free to communicate with manufacturers, *so long as the communications do not concern the sale of items to discounters*.

Finally, the order restricts TRU from communicating with manufacturers about sales not only to warehouse clubs, but to all discounters. The practices employed by TRU to restrict sales to clubs could have been applied to restrict sales to other discounters. Such fencing-in is wholly appropriate.

H. TRU's Procedural Objections Lack Merit.

TRU challenges the ALJ's decision to exclude TRU employees (but not its outside counsel) from those portions of the trial at which *in camera* material submitted by TRU's competitors and suppliers was presented. TRU argues that this decision violated its rights under §555(b) of the Administrative Procedure Act ("APA"), which, TRU contends, embodies the Due Process and Confrontation Clauses of the United States Constitution. TRU also argues that the decision conflicts with the Commission's Rules of Practice ("Rules"). Finally, TRU asserts that the ALJ erred by affording *in camera* treatment to certain documents. We review *de novo* the legal issues raised by TRU. We will not reverse the ALJ's decision regarding the *in camera* status of documents unless we find an abuse of discretion. *See General Foods Corp.*, 96 FTC 168, 170 (1980). We find that the ALJ's decision did not violate the APA, the Constitution, or the Commission's Rules. We also find that the ALJ's decision to provide *in camera* treatment to certain material did not constitute an abuse of his discretion.

Neither the Constitution nor §555(b) of the APA mandates the presence of TRU employees during the presentation at trial of *in camera* information. "Whatever else §555(b) guarantees to parties to an administrative proceeding ..., it does not mandate disclosure of significant confidential information to in-house counsel and corporate executives of

a business competitor -- where that information is fully available to outside counsel." *Akzo N.V. v. United States Int'l Trade Comm'n*, 808 F.2d 1471, 1484 (Fed. Cir. 1986). Thus, §555(b), which entitles a party "to appear in person or by or with counsel or other duly qualified representative in an agency proceeding, ... is not blindly absolute." *Id.* (quoting 5 U.S.C. § 555(b)). Although TRU has a strong interest in having its employees present during the trial, that interest may be outweighed by the submitter's need to protect the confidentiality of the information, and by the Commission's interest in assuring that, in the future, parties will be willing to disclose confidential information. *See A. Hirsch, Inc. v. United States*, 657 F. Supp. 1297, 1302 (Ct. Int'l Trade 1987). The ALJ's order properly balanced these competing interests. Thus, the ALJ's decision did not infringe TRU's rights under the APA or under the Due Process Clause of the Constitution. *See Akzo*, 808 F.2d at 1483 (implying that the right to due process does not guarantee in-house counsel access to confidential information).⁷⁰

TRU also asserts that its rights under the Confrontation Clause have been violated. The Confrontation Clause of the Sixth Amendment applies only to criminal proceedings. *Hannah v. Larche*, 363 U.S. 420, 440 n.16 (1960). Accordingly, it has no relevance here.

TRU argues that the Commission's Rules of Practice guarantee its employees the right to be present when *in camera* material is offered at trial. It claims that because "Section 3.45 provides: 'only respondents, their counsel, authorized commission personnel, and court personnel concerned with judicial review may have access' to *in camera* material . . . there was no basis for precluding Toys "R" Us from being present during the trial" (App. Br. at 88-89 (emphasis in original).) However, the language of Rule 3.45 is not mandatory -- it merely indicates who *may* have access to *in camera* material. We have never interpreted Rule 3.45 to require that respondents *must* have access to *in camera* material. *See Papercraft Corp.*, 78 FTC 1352, 1408 (1971), *aff'd*, 472 F. 2d 927 (7th Cir. 1973); *see also FTC v. United States Pipe and Foundry Co.*, 304 F. Supp. 1254, 1260 (D.D.C. 1969)(order providing for disclosure of documents only to respondent's counsel is consistent with Rule 3.45).

Finally, TRU fails to demonstrate an abuse of discretion in any of the ALJ's evidentiary decisions. TRU does not object to any specific decision made by the ALJ. Instead, it objects to the number of occasions on which

⁷⁰ TRU argues that *United States v. Lever Bros. Co.*, 193 F. Supp. 254, 258 (S.D.N.Y. 1961), mandates disclosure to corporate personnel. However, the order entered by the court in *Lever Brothers* did not mandate disclosure "except insofar as it may be necessary for consultation with counsel for Lever in order to prepare for and assist in the defense of the action." *Id.* Similarly, the ALJ's order here did not preclude disclosure to TRU employees if TRU made a showing that its defense was being harmed. *See Order Re In Camera Issue*, March 5, 1997.

its employees were excluded, and to the fact that its employees were excluded during portions of the testimony given by executives of toy manufacturers.

Because TRU does not challenge any specific *in camera* decision made by the ALJ, we examine the standard that the ALJ applied in reaching his decisions. We conclude that the ALJ applied the appropriate test in evaluating TRU's requests for access to *in camera* information. He balanced TRU's "need for direct access to the confidential financial and business information to adequately prepare its case, the harm disclosure would cause to the parties submitting this information, and the forum's interest in maintaining the confidentiality of the information." Order Re Respondent Seeing *In Camera* Information, May 24, 1997. Further, the ALJ offered to permit TRU's in-house counsel to attend the portions of the trial during which *in camera* information was presented, and further offered to permit TRU to retain an outside expert in order to assist it in evaluating the *in camera* documents. TRU availed itself of neither of these offers. The ALJ also gave TRU's outside counsel the opportunity to interrupt the trial in order to consult with TRU employees (without showing them any *in camera* documents). By presenting TRU with these options, the ALJ amply balanced TRU's interests against the interests of the submitters and of the Commission. Thus, the ALJ applied the appropriate test, and TRU has not identified any abuse of discretion by the ALJ. Accordingly, we decline to reverse any of the ALJ's decisions regarding the treatment of *in camera* documents.

TRU also argues that the Commission should reconsider its decision to issue the complaint, which was allegedly "tainted" 1) because a staff member had an undisclosed conflict of interest, and 2) because Commission staff allegedly leaked information about the investigation to the press. Neither of TRU's arguments gives us reason to do so. First, TRU presents nothing that gives us any reason to doubt any staff member's impartiality. Second, we see no reason why leaks to the press by the staff would affect a Commission determination that there was reason to believe a violation had occurred or that a Commission proceeding was in the public interest. See, e.g., *TRW, Inc.*, 88 FTC 544 (1976). In any event, there is no evidence as to the source of information in press reports that appeared at the time of the issuance of the complaint in this matter. Because Commission investigations frequently necessitate contacts with persons outside the Commission, there usually are many possible sources for press reports. Moreover, it is bare speculation--and nothing more--that the alleged leak had any impact on the Commission's decision to issue the complaint. We have considered TRU's two arguments and find them meritless.

CONCLUSION.

The Commission, for the reasons stated in this opinion, has determined to deny the appeal of respondent TRU and to make final the attached order, which is identical to the order entered by the ALJ.

FINAL ORDER

I.

A. "*Respondent*" means Toys "R" Us, its directors, officers, employees, agents and representatives, predecessors, successors and assigns; its subsidiaries, divisions, and groups, and affiliates controlled by Toys "R" Us, and the respective directors, officers, employees, agents and representatives, successors, and assigns of each.

B. "*Toy discounter*" means any retailer of toys, including but not limited to membership retail outlets such as Price-Costco, Sam's Club, and BJ's Wholesale Club, that sells toys at discounted prices.

C. "*Toys and related products*" means any product that is sold by respondent.

D. "*Commission*" means the Federal Trade Commission.

II.

It is ordered, That respondent, directly or indirectly, through any corporation, subsidiary, division or other device, in connection with the actual or potential purchase or distribution of toys and related products, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, forthwith cease and desist from:

A. Continuing, maintaining, entering into, and attempting to enter into any agreement or understanding with any supplier to limit supply or to refuse to sell toys and related products to any toy discounter.

B. Urging, inducing, coercing, or pressuring, or attempting to urge, induce, coerce, or pressure, any supplier to limit supply or to refuse to sell toys and related products to any toy discounter.

C. Requiring, soliciting, requesting or encouraging any supplier to furnish information to respondent relating to any supplier's sales or actual or intended shipments to any toy discounter.

D. Facilitating or attempting to facilitate agreements or understandings between or among suppliers relating to limiting the sale of toys and related products to any retailer(s) by, among other things,

transmitting or convey-ing complaints, intentions, plans, actions, or other similar information from one supplier to another supplier relating to sales to such retailer(s).

E. For a period of five years, (1) announcing or communicating that respondent will or may discontinue purchasing or refuse to purchase toys and related products from any supplier because that supplier intends to sell or sells toys and related products to any toy discounter, or (2) refusing to purchase toys and related products from a supplier because, in whole or in part, that supplier offered to sell or sold toys and related products to any toy discounter.

Provided, however, that nothing in this order shall prevent respondent from seeking or entering into exclusive arrangements with suppliers with respect to particular toys.

III.

It is further ordered, That respondent shall:

A. Within thirty (30) days after the date on which this order becomes final, mail to each of its suppliers and employees who have purchasing responsibilities a copy of the Commission's complaint and order in this matter, along with a letter from respondent's chief executive officer stating that its suppliers can sell whatever products they wish to retailers, and that respondent will not take any adverse action for selling toys and related products to retailers in whole or in part due to the retailer's retail prices or price policies;

B. Within ten (10) days after the date on which any person becomes an employee of respondent with purchasing responsibilities for toys and related products, or a director, officer, or management employee of respondent, or a new supplier of respondent, provide a copy of this complaint and order to such person; and

C. Require each employee, director, or officer to whom a copy of this complaint and order is furnished pursuant to subparagraphs III. A and B of this order to sign and submit to Toys "R" Us, Inc., within thirty (30) days of the receipt thereof a statement that: (1) acknowledges receipt of the complaint and order, (2) represents that the undersigned has read and understands the complaint and order, and (3) acknowledges that the undersigned has been advised and understands that non-compliance with the order may subject Toys "R" Us, Inc. to penalties for violation of the order.

IV.

It is further ordered, That respondent shall:

A. Within sixty (60) days after the date on which this order become final, and annually thereafter on the anniversary of the date this order becomes final, and at such times as the Commission may by written notice to the respondent require, file with the Commission a verified written report setting forth in detail the manner and form in which respondent has compiled and is complying with this order;

B. Maintain and make available to the staff of the Federal Trade Commission for inspection and copying, upon reasonable notice, all records of communications with suppliers of respondent relating to any aspect of actual or potential purchase or distribution of toys and related products, and records pertaining to any action taken in connection with any activity covered by paragraphs II and III of this order: and

C. Notify the Commission at least thirty (30) days prior to any change in respondent such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries, or any other change in the corporation that may affect compliance obligations arising out of this order.

V.

It is further ordered, That this order shall terminate twenty (20) years after the date on which this order becomes final.

Commissioner Swindle concurring in part and dissenting in part.

OPINION OF COMMISSIONER ORSON SWINDLE,
CONCURRING IN PART AND DISSENTING IN PART

I concur in the Commission majority's determination that respondent Toys "R" Us, Inc. ("TRU"), entered into a series of anticompetitive *vertical* agreements with various toy manufacturers, and I join in the portions of the Commission's order aimed at proscribing the vertical restraints. In my view, however, the evidence does not support the majority's finding that some toy manufacturers entered into an anticompetitive *horizontal* agreement, and thus I dissent from my colleagues' conclusion that TRU orchestrated such a horizontal combination.

The evidence shows that club stores loomed as a small but growing threat to TRU's status and self-image as the leader in discount toy retailing. By dint of its powerful position as the indispensable retail outlet, TRU

induced a number of key manufacturers to accede to its plan to choke off the supply of desirable toys to the clubs. Pursuant to TRU's vertical agreements with Mattel, Hasbro, Fisher Price, and others, certain manufacturers began to make toys unavailable to the clubs -- or available to them only on economically disadvantageous terms -- and the clubs' once-growing share of toy retailing began to shrink. A new channel of toy distribution that promised deep discounts for consumers was imperiled in its infancy, and TRU was spared downward pricing pressure from the clubs. The evidence suffices to establish that the series of vertical agreements between TRU and certain manufacturers had a significant adverse effect on competition, and I agree with my colleagues that TRU has not presented persuasive business justifications to the contrary.

The argument for a horizontal combination, on the other hand, lacks a firm foundation. As the majority makes clear, each manufacturer that entered into one of the vertical undertakings bowed to TRU's power in the market for toys. The majority opinion, true to the evidence in this case, casts TRU in the unmistakable role of the nation's preeminent year-round, full-line toy retailer--the one customer whose patronage many manufacturers considered essential to survival. It is entirely plausible that particular manufacturers would react to pressure from TRU by deciding -- *on their own* -- to disfavor the club stores. No inference of horizontal agreement is necessary to make sense of the manufacturers' actions.

Ironically, it is precisely the plausibility of the vertical theory and the strength of the evidence underpinning that theory that undercut the majority's finding of a horizontal conspiracy among toy manufacturers. There is strong, clear evidence that TRU entered into a series of vertical understandings with toy manufacturers to cut off supply to the clubs. There is a paucity of evidence -- direct or circumstantial -- that the manufacturers developed among themselves a scheme to boycott the clubs.

In laying out the evidence of a horizontal agreement,¹ my colleagues portray TRU as the communications hub of a conspiracy involving multiple manufacturers. These manufacturers purportedly used TRU to signal to one another their views and intentions about whether -- and under what conditions -- they would sell to the clubs. The majority infers from the record that the manufacturers used their direct *individual* communications with TRU as a mechanism to reach a common plan to boycott the clubs. Pursuant to this supposed scheme, TRU shuttled the manufacturers' fears and concerns back and forth until a horizontal consensus emerged.

¹ Slip op. at 29 *et seq.*

The majority's view would be more plausible if we had stronger direct evidence² showing a meeting of the minds among the manufacturers. But virtually all of the evidence on which my colleagues base a finding of horizontal agreement comes from the mouths of *TRU executives*. With only one inconclusive paragraph of their opinion³ devoted to evidence of direct manufacturer-to-manufacturer communications, the majority's finding of a horizontal agreement rests precariously on evidence that certain manufacturers asked TRU for assurances that other manufacturers would not renege on a commitment that they had made, not to one another, but to TRU.

Given the tension between the vertical and horizontal theories in this case, it is not surprising that the proof of the horizontal case is weak. Consider the vertical story: TRU was the toy retailing leviathan without whose business many manufacturers could not survive. TRU's very indispensability gave each toy manufacturer every incentive--every *unilateral* incentive--to knuckle under to TRU's demands regarding the clubs.⁴

On the other hand, consider the thrust of the horizontal case: that TRU coordinated an agreement among the toy manufacturers to restrict their supply of toys to the clubs. Without convincing evidence of an agreement among the manufacturers, the majority opinion relies on the premise that such an agreement was necessary to execute TRU's scheme. This conclusion disregards the ample reasons that each capitulating manufacturer, *acting on its own*, had to obey TRU. TRU's hammerlock on the manufacturers made a horizontal agreement among the manufacturers simply unnecessary.⁵

The majority places considerable weight on individual manufacturers' efforts to learn from TRU what their competitors might do about TRU's club policy. It seems natural, however, for any manufacturer contemplating a commitment to TRU -- *i.e.*, a vertical agreement -- to want to know its competitors' likely responses to TRU's demands. It seems equally reasonable to expect TRU to try to soothe an apprehensive manufacturer with reassurances about what other manufacturers will do. TRU's efforts to reassure manufacturers that they were on "a level playing field"⁶ are

² I recognize, of course, that direct evidence to prove a boycott can be hard to come by, and the law permits us to establish an unlawful horizontal agreement circumstantially.

³ Slip op. at 33.

⁴ See *id.* at 6, 70 *et seq.* for the majority's discussion of TRU's importance as a purchaser from the major toy manufacturers.

⁵ My colleagues also assert that TRU's "club policy" was squarely *contrary* to the independently determined business interests of the toy manufacturers." *Id.* at 57. That is true only if one disregards the great pressure that TRU brought to bear on the manufacturers -- pressure that derived from any rational manufacturer's weighing of the clubs' tiny position in the market against TRU's overwhelming presence. Once the club policy was in place, TRU's formidable power in the toy market clearly made compliance with the policy in each manufacturer's *individual* self-interest.

⁶ *Id.* at 31.

consistent with a purely vertical interpretation -- that TRU was trying to coax reluctant manufacturers into agreements *with it*. TRU had to offer "bait" to induce a manufacturer to agree *with TRU* about the club policy, and that "bait" was a comfort level about what other manufacturers would do. The opinion does not convincingly reject the vertical explanation for what occurred.⁷

The majority also says that "the record shows that a uniform, joint reaction to TRU's policy was a necessary element of each manufacturer's decision to restrict sales to the clubs. Each was simply unwilling to go forward with the proposed policy alone."⁸ But in the context of this case, a manufacturer's unwillingness to go forward alone simply indicates its need -- before entering a vertical agreement with TRU -- to ascertain whether TRU planned to apply the same policy to other manufacturers. It does not necessarily show that that manufacturer reached any horizontal understanding with its competitors.

Moreover, the majority implies that each conspiring manufacturer was intent on achieving a uniform response *among all manufacturers*, rather than just among its direct competitors. A toy train probably does not compete with a Barbie doll, and a Barbie probably does not compete with toys for two-year-olds. As my colleagues seem to recognize,⁹ a manufacturer of infants' and toddlers' toys is likely to be largely indifferent to whether a manufacturer of older children's toys abides by TRU's policy, and thus a manufacturer is unlikely to care whether toy producers in general arrive at "a uniform, joint reaction to TRU's policy." It taxes credulity to assert that "a uniform, joint reaction" was vital from each manufacturer's perspective.

Other evidence further undermines the theory of a horizontal boycott involving the manufacturers. For instance, when certain manufacturers went back on their commitment to TRU and sold product to the clubs

⁷ Other portions of the majority opinion suffer from similar problems. A Mattel document [] does not necessarily prove that Mattel entered into an agreement with any of its competitors. The quoted statement could just as well simply mean that Mattel conditioned acceding to TRU's demands on an understanding that Mattel's competitors would not sell to clubs. Further discussion in the text (*id.* at 31 *et seq.*) shows that TRU ably played manufacturers off against one another but does not necessarily prove that the manufacturers agreed among themselves on a course of action. [] Footnote 30 discusses various manufacturers' efforts to monitor what their competitors were doing about the clubs -- efforts that one would expect the manufacturers to undertake in contemplation of bowing to TRU's pressure, irrespective of whether they formed a horizontal agreement.

The opinion's observation that "the toy manufacturers did not adopt the 'club policy' until they knew or had been assured of the others' responses" (*id.* at 62) shows consciously parallel, but not necessarily collusive, behavior. If a manufacturer, *acting alone*, wants the comfort of knowing that TRU is applying the same rule to all manufacturers, then naturally the manufacturer will balk at adopting the club policy until TRU gives it the desired reassurance.

⁸ *Id.* at 29.

⁹ *Id.* at 2-3.

behind TRU's back, TRU tried to bring these wayward firms back into line with the club policy. If there really was a horizontal agreement to boycott the clubs, why was so much prodding and cajoling on TRU's part necessary to secure obedience? The answer is that the commitments all ran vertically, not horizontally. The glue that held TRU's scheme together was each manufacturer's individual decision not to cross its most important customer's interests.

A recent appellate decision helps illustrate the problems with the majority's finding of a horizontal conspiracy. In *Rossi v. Standard Roofing, Inc.*, No. 97-5185, 1998 U.S. App. LEXIS 21911 (3d Cir. Sept. 9, 1998) -- cited at several points in my colleagues' opinion -- the court of appeals considered plaintiff roofing distributor's allegations that it was the victim of a boycott organized by its direct competitors (and including certain manufacturers of roofing materials). The court of appeals determined that Rossi had presented sufficient evidence against two of its horizontal competitors (Standard Roofing and Arzee Roofing Supply) and against manufacturer GAF Corporation to survive those defendants' motions for summary judgment.

The evidence of horizontal conspiracy in *Rossi* stands in stark contrast to the evidence in the present case. Rossi was a price-cutting distributor who earned the enmity of its direct competitors, including Standard and Arzee. Standard and Arzee instigated and orchestrated the boycott, including persuading key supplier GAF to withhold product from Rossi. The court of appeals describes in detail the substantial proof that Standard and Arzee agreed *between themselves* to design a plan that would remove Rossi as a threat to their pricing equilibrium and prevailed upon GAF to go along with their plan.

In contrast, the evidence against TRU and the toy manufacturers on the horizontal issue is much less substantial. The prime mover behind any plot against the club stores was unmistakably TRU *acting alone*, rather than (as in *Rossi*) the victims' direct competitors acting in concert. *Rossi* would be a good model for finding a horizontal agreement in the present case if, for example, we had evidence that TRU conspired with Wal-Mart, Target, or other retailers to deprive the clubs of desirable toys. But that is not this case. Instead, we have good evidence that toy manufacturers capitulated one-by-one to TRU's threats and pressure, and we have essentially no evidence that the manufacturers reached an agreement among themselves. The inquiries and reassurances between TRU and the toy manufacturers, on which so much of the majority's horizontal conclusion rests, do not suffice to plug this evidentiary gap.

In summary, I agree with my colleagues' condemnation of the vertical restraints in this case. Further, I do not take issue with the principal thrust of the majority's legal analysis. I am simply unable to find a horizontal

415

Opinion

boycott on the basis of this evidence. The gaps and ambiguities in the record require that I dissent from the conclusion that TRU orchestrated an anticompetitive horizontal agreement.

Complaint

126 F.T.C.

IN THE MATTER OF

FAIR ALLOCATION SYSTEM, INC.

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF
SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT*Docket C-3832. Complaint, Oct. 22, 1998--Decision, Oct. 22, 1998*

This consent order prohibits, among other things, the Montana-based association of franchised automobile dealerships from participating in, suggesting, encouraging, or assisting any boycott or threatened boycott of, or refusal to deal with, any automobile manufacturer or consumer. In addition, the consent order requires the respondent to amend its by-laws to incorporate the provisions of this order and to distribute copies of the amended by-laws to each of its members.

Participants

For the Commission: *Shane Woods, Charles Harwood, William Baer, William Layher, and Jonathan Baker.*

For the respondent: *R. J. Sewell, Smith Law Firm, Helena, MT.*

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act, as amended, 15 U.S.C. 41, *et seq.*, and by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that Fair Allocation System, Inc. (hereafter "respondent") has violated the provisions of Section 5 of the Federal Trade Commission Act, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues this complaint, stating its charges as follows:

PARAGRAPH 1. Respondent Fair Allocation System, Inc. is an incorporated association of franchised automobile dealerships (primarily Chrysler, Plymouth, Dodge, Jeep and Eagle), existing and doing business under and by virtue of the laws of the State of Montana, with a mailing address at P.O. Box 1691, Helena, Montana.

PAR. 2. Respondent was formed by its member dealers as an entity through which its members could communicate with Chrysler Corp. ("Chrysler") concerning Chrysler policies and how those policies might affect respondent's members. Respondent's members were initially concerned about the practices of a competing dealer