

Complaint

IN THE MATTER OF

VALASSIS COMMUNICATIONS, INC.

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

Docket C-4160; File No. 0510008
Complaint, April 19, 2006--Decision, April 19, 2006

This consent order relates to allegations that Valassis Communications, Inc., a publisher of co-operative free-standing inserts commonly found in Sunday newspapers, invited its only competitor to collude in ceasing to compete for customers, which would enable the firms to raise prices within their respective uncontested domains and to end the price war between them. The order prohibits Valassis from inviting collusion and from actually entering into or implementing a collusive scheme to divide markets, to allocate customers, or to fix prices. The order does not interfere with Valassis' efforts to negotiate prices with prospective customers, and it would permit Valassis to provide investors with considerable information about company strategy. The order also includes a safe harbor provision permitting Valassis to communicate publicly any information the public disclosure of which is required by the federal securities laws.

Participants

For the Commission: *David Conn, Sean Gates, Geoffrey M. Green, and Geoffrey Oliver.*

For the Respondent: *Robert Pitofsky, Arnold & Porter LLP; Raymond A. Jacobsen, Nicholas R. Koberstein, and Mark Thoman, McDermott, Will & Emery LLP; and Brian L. Sullivan, Winston & Strawn LLP.*

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 ("Commission"), having reason to believe that Valassis Communications, Inc., a corporation, has violated Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, and it appearing to

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the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues this Complaint stating its charges in that respect as follows:

PRELIMINARY ALLEGATIONS

1. Respondent Valassis Communications, Inc. (“Valassis” or “respondent”) is a corporation organized, existing and doing business under and by virtue of the laws of the State of Delaware, with its office and principal place of business located at 19975 Victor Parkway, Livonia, Michigan 48152.

2. The line of commerce relevant to assessing respondent’s anticompetitive conduct is the production and distribution in the United States of cooperative free-standing inserts (“FSI’s”). FSI’s are multi-page booklets containing discount coupons for the products of various firms; these booklets are inserted into newspapers for distribution to consumers. For manufacturers of consumer packaged goods and others, FSI’s are a uniquely efficient means of distributing coupons on a mass scale. Entry into the relevant market is difficult and is not likely to deter or counteract the competitive harm described below.

3. For over a decade, there have been only two U.S. publishers of FSI’s: Valassis and News America Marketing (“News America”). On a typical Sunday, both the Valassis FSI and the News America FSI are distributed by hundreds of newspapers to over 50 million households.

4. Valassis is a publicly traded corporation, and holds a conference call with securities analysts on a quarterly basis. Any person may listen to the call live over the internet, or obtain a transcript of the call from the Valassis website. During these “earnings conference calls,” Valassis executives provide information and answer questions about recent business developments.

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5. As detailed below, during the course of an earnings conference call in July 2004, Valassis invited its competitor, News America, to join with Valassis in a scheme to allocate FSI customers and to fix FSI prices. Valassis intended thereby to bring an end to the price war being waged in the FSI industry.

THE FSI PRICE WAR

6. Between 1998 and 2001, Valassis and News America each published approximately fifty percent of FSI industry pages. Valassis' minimum price or "floor price" during this period was \$6 per full page per thousand booklets.

7. In June 2001, Valassis notified its clients of a five percent price increase. On all future contracts, Valassis' FSI floor price would be \$6.30 for a full page. Valassis anticipated that News America would follow its FSI price increase.

8. News America did not follow the Valassis price move. As a result, News America captured additional customers and built up a substantial market share lead.

9. Valassis largely adhered to its \$6.30 floor price for eight months. In February 2002, Valassis determined that the company had waited as long as it could for a favorable signal from News America, and rolled back the price increase.

10. Over a three year period (2001-2004), FSI prices fell by nearly 20 percent due to competition between Valassis and News America. By 2004, FSI prices were below \$5 per full page. Valassis' strategic objective, announced publicly on numerous occasions, was to regain a 50 percent share of the FSI market.

VALASSIS INVITES ITS COMPETITOR TO COLLUDE

11. In mid-2004, Valassis determined that its aggressive pursuit of greater market share was no longer serving the company's interests. Company executives developed a new strategy. Valassis

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would communicate to News America its readiness to cease challenging for News America customers, provided that News America ceased competing for Valassis customers. This would enable each firm to raise FSI prices within its uncontested domain.

12. Valassis held its second quarter 2004 earnings conference call on July 22, 2004. Valassis executives were aware that News America representatives would be monitoring the call. A complete transcript of the earnings conference call is annexed hereto as Exhibit A.

13. The President and Chief Executive Officer of Valassis, Alan Schultz, opened the earnings conference call by detailing the company's new strategy for increasing FSI prices. Specifically, the following program was announced:

- a. Valassis will abandon its 50 percent market share goal. The company will be content to maintain its current share (mid-40s). "[W]e can achieve our 2005 target for pages produced with no further shifts in co-op FSI market share." Exhibit A at 3.
- b. As necessary, Valassis will aggressively defend its existing customers and its existing market share. "[W]e will defend our customers and market share and use whatever pricing is necessary to protect our share." *Id.* at 4.
- c. But with regard to customers with expiring contracts with News America, Valassis will submit bids at a level substantially above current prices. Effective July 26, 2004, "we will quote all News America first right of refusal customers at the floor price which was effective in May of 2001; hence our net price after ancillary price discounts, rebates, et cetera, will not go below \$6 [per thousand] for a full page and \$3.90 [per thousand] for a half page." *Id.* at 3-4.

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- d. With regard to the small number of customers that divide their FSI business between Valassis and News America, Valassis will seek to retain its current share of each customer's business, but not to encroach upon News America's position. "For Valassis/News America shared accounts we'll price our share at whatever price is necessary to retain our share of the business. If the client wants us to take more than our previous year's share, we will quote the new floor price [\$6 per thousand] on that portion of the business." *Id.* at 4.
- e. For a limited time, Valassis will continue to honor its outstanding bids to News America customers at market prices. "We have proposals currently outstanding to four News America customers where we have previously quoted lower than the 6 and 3.90 floor. We will notify these four clients that the price quotes in these previously delivered proposals will expire on August 1, 2004. Thereafter, after August 1, 2004, all News America customers or market share will be quoted at our new floor price." *Id.* at 4.
- f. Finally, Valassis will monitor News America's response to this overture. If News America competes for Valassis customers, then the price war will resume. "In the recent past News America has been quick to make their intentions known. We don't expect to read the tea leaves. We expect that concrete evidence of News America's intentions will be available in the marketplace in short order. If News continues to pursue our customers and market share then we will go back to our previous strategy." *Id.* at 4.

14. Valassis acted with the intent to facilitate collusion and without a legitimate business purpose.

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15. Valassis' invitation to collude, if accepted by News America, would likely have resulted in higher FSI prices and reduced output.

16. The acts and practices of Valassis, including the acts and practices alleged herein, are in commerce or affect commerce, as "commerce" is defined in Section 4 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 44.

VIOLATION ALLEGED

17. As set forth in Paragraphs 11 through 16 above, Valassis invited its competitor to collude with Valassis in violation of Section 5 of the Federal Trade Commission Act, as amended.

18. The acts and practices of respondent, as alleged herein, constitute unfair methods of competition in or affecting commerce in violation of Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45. Such acts and practices will continue or recur in the absence of appropriate relief.

WHEREFORE, THE PREMISES CONSIDERED, the Federal Trade Commission on this nineteenth day of April, 2006, issues its complaint against respondent.

By the Commission.

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VALASSIS COMMUNICATIONS #566835

July 22, 2004, 11:00 a.m., ET

Chairperson: Alan Schultz

Second Quarter 2004 Earnings

Operator

Good morning, ladies and gentlemen, and welcome to the Valassis Communications Second Quarter 2004 Earnings conference call. At this time all participants are in a listen-only mode. Following today's presentation instructions will be given for the question and answer session. If anyone needs assistance at any time during the conference, please press the star followed by the zero. As a reminder, this conference is being recorded on Thursday, July 22, 2004. Please refer to the Safe Harbor language on the earnings document released this morning. This call will be governed by the language stated thereon.

I would now like to turn the conference over to Mr. Alan Schultz, Chairman, President and Chief Executive Officer of Valassis Communications. Please go ahead, sir.

A. Schultz

Good morning. I'm here with Bob Recchia, our Chief Financial Officer, and Sherry Lauderbach, our Director of Investor Relations.

Today's agenda will include the following: a review of our record quarterly revenue, a discussion of business segments or specific products. I'll elaborate on the opportunity to improve co-op FSI industry pricing mentioned in the press release. I'd like to share some highlights from our continuously improving balance sheet and then of course as always we'll answer any questions that you may have.

Our quarterly revenue of \$257 million is the best in company history. We were pleased with 5.6% revenue growth, particularly when you consider it's on top of 20% revenue growth achieved in the second quarter of 2003, so we had a difficult comp.

As we have expanded our product portfolio it has created additional levers to drive both revenue and profitability. In addition, the broadening of our customer base has created a fertile platform to cultivate this expanded product and services portfolio.

We now do business with 79% of the top 100 advertisers in the United States. In short, I find our diversified product portfolio a tremendous luxury and we are fortunate to have the support of so many outstanding advertisers who participate in a wide variety of industries.

Our one-to-one business performed exceptionally well in the second quarter

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with a 77% increase in revenue. Most importantly this segment crossed the bridge to profitability in the second quarter and the quarterly profit was significant enough to make the one-to-one segment profitable through the first six months of 2004.

I'm really proud of what this team has accomplished and there are a number of people and teams worthy of recognition. Sue Griffin, Ron Goulsby and Todd Wisely have done an outstanding job of getting our three previously autonomous one-to-one business units to work together to meet customer needs. The level of collaboration has been exemplary.

Drew Bennett and his team have played a critical role in using our best of breed frequent shopper management technology to drive other parts of our one-to-one business and to forge stronger relationships with our retail partners.

Lou Zanko and his retail sales team have done an outstanding job of presenting creative concepts to our retail partners in order to help them accomplish their goals and objectives.

Robin Marco and the Direct Mail Operations Group have worked unbelievably hard to support the volume increases associated with our 77% revenue growth.

Gary Youst and the Targeting and Analytics Team have overcome numerous challenges.

Aaron Trager and his Anderson Printing Division have stepped up to not only handle the increased volume but to do so with substantial improvements in efficiency levels.

Last but not least, Rex Bootright and our Creative Teams in both Lavonia and Boston have produced high quality creative to assure substantial consumer response.

After achieving profitability on a stand-alone basis I'm extremely excited about the future prospects of our one-to-one segment.

Switching to our cluster targeted segment. As I previously indicated, the primary focus of our cluster targeted segment was to improve profitability. I told you we were going to trade out low margin business.

As we drove revenue growth in other product lines that was beyond our expectations we accelerated the divestiture of less profitable cluster targeted business. As a result gross profit dollars were up 3.1% in the second quarter even though revenues were down just over 12%.

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Through the first half of 2004 gross profit dollars were up 27% on virtually flat revenue. Since this segment continues to focus primarily on profitability we are revising our revenue growth assumption from the low end of 10% to 15% to less than 10%.

Keep in mind that last year we focused primarily on revenue growth and achieved a 26.3% increase so the revenue comparisons this year are challenging. Also keep in mind that this business by nature does not track consistently on a quarterly basis year against year.

Now switching to the international and services segment, we executed an on-plan performance. Strong performances in Canada, Spain, Italy and the United Kingdom offset softness in France. We delivered promotional media tests in Germany and Italy and we are currently selling in a second test in Germany. In addition we are attempting to sell clients into new concepts in Spain and France which we hope to execute this fall.

I recently visited Italy and Spain and was encouraged by the level of customer interest in and receptiveness to new promotional concepts.

Moving onto the math segment. Let's start with our ROP business where we broker space on the pages of the newspapers in our database. We encourage you to focus on gross margin dollars in this business. In 2004 our goal is to increase margin dollars by 10% to 15%. We have exceeded that goal through the first half of 2004 and the reported revenue increases are consistent with our original assumption of over 80%.

Now I'd like to discuss the co-op FSI industry. When we developed our 2004 guidance we assumed the co-op FSI industry unit growth would be low single digits. Unit growth has continued to exceed our expectations and the industry drove its eighth consecutive quarter of year-over-year unit growth. As a result, our co-op FSI revenue was up 1% for the first six months of this year. In essence we have been able to achieve our page volume objectives with less than a 50% market share due to industry strength.

In addition some clients, who have long term agreements with us, recently indicated they plan to run more FSI pages with us in 2005. When you combine this knowledge with the fact that 80% of all co-op FSI pages for 2005 are now covered by corporate contracts which average 30 months in duration, we believe we can achieve our 2005 target for pages produced with no further shifts in co-op FSI market share.

Based on these conditions we believe that now is the time to create a low risk opportunity to change the long term pricing trends in the co-op FSI industry. Therefore effective Monday, July 26th we will quote all *News America* first

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right of refusal customers at the floor price which was in effect in May of 2001; hence our net price after ancillary product discounts, rebates, etc., will not go below \$6 for a full page and \$3.90 for a half page.

The reason I said this is a low risk opportunity is that we will defend our customers and market share and use whatever pricing is necessary to protect our share. For Valassis/News America shared accounts, we will price our share at whatever price is necessary to retain our share of the business. If the client wants us to take more than our previous year's share, we will quote the new floor price on that portion of the business.

This strategy differs greatly from the price increase we attempted in June of 2001 where we were willing to walk away from business in order to demonstrate our resolve to improve industry pricing and our willingness to reduce our share down to historical levels. In the current situation we will not walk away from our existing customers or market share. We have proposals currently outstanding at four *News America* customers where we have previously quoted at prices lower than the \$6 and \$3.90 floor. We will notify these four clients that the price quotes in these previously delivered proposals will expire on August 1, 2004. Therefore, after August 1, 2004, all *News America* customers or market share will be quoted at our new floor price.

In the recent past *News America* has been quick to make their intentions known. We don't expect the need to read the tea leaves. We expect that concrete evidence of *News America's* intentions will be available in the marketplace in short order.

If *News* continues to pursue our customers and market share, then we will go back to our previous strategy. Our objective has always been to give customers a high quality product that provides them with an exceptional return on investment and while doing that, to foster an industry that maximizes our profitability and creates a platform for long term profit enhancement on an annual basis. We believe the pricing approach I just described has the potential to accomplish all those objectives.

As we have mentioned previously, we believe that an exceptionally strong balance sheet is an important attribute to maintain in this highly competitive co-op FSI environment. I want to review major changes in our cash balance during the quarter and a transaction to swap \$50 million in fixed debt for floating debt.

As of March 31, 2004 we had \$214 million in cash. We made two tax payments in the second quarter which totaled \$28 million. On June 6th we repurchased \$39 million of our convertible bond due in 2021 and spent an additional \$8 million in the quarter against our authorized share repurchase program. That nets cash down to \$139 million, but as of June 30, 2004 we

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had \$164 million in cash meaning we generated roughly \$25 million in cash from operations during the quarter without going into all the ins and outs.

From a financial perspective we also swapped \$50 million of the \$100 million issue of our 6-3/8th percent fixed rate debt due in 2009 to a floating rate on June 29, 2004.

Now we'd like to entertain your questions. Thank you.

Operator

Thank you, sir. Ladies and gentlemen, at this time we will begin the question and answer session. If you have a question, please press the star followed by the one on your pushbutton phone. If you would like to decline from the polling process, please press the star followed by the two. You will hear a three-tone prompt acknowledging your selection. Your questions will be polled in the order they are received. If you are using speaker equipment you will need to lift the handset before pressing the numbers. One moment, please, for our first question.

Our first question comes from Lauren Fine with Merrill Lynch. Please go ahead with your question, ma'am.

L. Fine

Thank you. I have two questions. The first just to go back to the quarter for a second. On the FSI business I think you had one extra publishing date and I'm wondering if you could then help us because of that making it more difficult to assess, what was the industry unit growth in the quarter and/or what is your page increase year-over-year? Then related to that, where are we on a reported basis in terms of whether your pricing has toughed yet?

Then could you refresh our memory on what your market share goals were for this year and whether that's changed and what they are for next year? Then I'll come back with my next question.

A. Schultz

Lauren, we'll check my memory here now.

L. Fine

Breaking down FSI into the components is what I'm really trying to get at in the second quarter.

A. Schultz

The number of dates, we did have one additional date in the second quarter versus what we had last year. So last year we had 10 dates, this year we have 11 dates. From a custom co-op standpoint, last year we had three and this year we also had three, so it's just really the one date difference.

From a unit growth standpoint we once again saw unit growth north of 6%. Obviously we had anticipated low single digits and we did significantly better than that.

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From a page standpoint, particularly on a pages sold basis, full price business, we saw high single digit growth in pages sold and then we had a slight increase in the number of direct response pages. That's how that broke out.

From a pricing standpoint right now as we look through the balance of this year, we had built the model that accounted for some reductions in price as we got into the second half of this year. I don't really think anything has changed in that model. You may remember in the fourth quarter of last year we got into a situation where we had under-estimated the impact of declining prices and we didn't want to repeat that so we built our model this year more in line with what we had experienced last year.

I can't tell you that pricing has bottomed out yet at this point. It's going to be interesting to see obviously what happens with our new pricing approach in terms of the impact that has on the industry in terms of pricing.

From a market share goal standpoint, we're pretty comfortable with where our share stands today and what we have in the way of business locked up out in the future for the back half of this year and what we have secured for 2005.

Where we currently stand we don't really see any need to change market share from what it already looks like today for the balance of 2004 and 2005. The industry looks to be very strong and the supply/demand economics are clearly working in our favor and those supply/demand economics should create some pricing leverage in the industry.

L. Fine Just to refine that, where is your share now? Then on the pricing improvement that you're trying to put in place, it sounds like that is a goal to stabilize pricing from where you've got some contract bids out right now. Would you care to share what you think *Newscorp* will do in response?

A. Schultz I certainly can't speak for *Newscorp* so I certainly don't know what they're going to do in response. The approach we're taking I view as more than stabilization though. I think it is a strategy which is designed to return prices at least to the floor level that was in place back in May of 2001.

Now keep in mind at that particular point in time we were actually selling at prices that were well above that floor price so this is really designed to try to return pricing to the old floor level which would be a step in the right direction and create a longer term trend line of improved pricing and therefore improve the profit picture on a going forward basis.

L. Fine And your current share?

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A. Schultz Our current share is pretty much on plan for what we had anticipated. The way we measure our shares, we look at all the co-op volume when we measure shares so we include our regular co-op and our custom co-ops in share. We're in the mid-40s right now and look like we're up on plan for increasing share as we had indicated in 2004 for 2004.

L. Fine Great. Thank you very much.

Operator Our next question comes from Steven Barlow with Prudential Equity Group. Please go ahead with your question, sir.

S. Barlow Thank you. Could you break out what was going on in cluster targeted in terms of was it VIP that was up or sampling was down? Just trying to get a handle on the pieces there.

Bob, it looks like you have reclassified the \$13.6 million of debt back to long term, so I guess there's no thought of that being paid out because not everyone went for the offer that you had. I just wanted to clarify what the thoughts are on that.

Then, Al, you made a comment that flat revenue on the international, etc., section was on plan. Is that your plan for the third and fourth quarter for that revenue in that group to be flat? Thanks.

A. Schultz The cluster targeted business when you break it out in its components in the quarter, we actually saw a mid-single digit decline in preprints which is the biggest component. In the polybag sampling and advertising, we were down a larger percentage of that, a double-digit decline there.

Again, that is very consistent with what I instructed this group to do which was try to filter out some of the lower margin business, as I had mentioned. Last year we grew revenue in that segment by 26%. In doing that we picked up some customers that were at unacceptable margins. And based on what we see going on in the printing industry in general where it looks like volumes are picking up, margins are picking up, we feel as if conditions are right to focus more on profitability.

With all that said, I think it's important to note that this business tends to have some pretty wild swings on a quarterly basis year against year. In fact, if you look back at the last few years you'll see swings from one quarter to the next where revenues were down 12%, 14%, 15% and then come back and increase by over 40%. So this isn't unusual and they're really doing at this point in time what I'm asking them to do.

From a debt perspective on the \$13 million, that debt does not have an opportunity to be put to us for another two years so therefore it would be into

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long term classification and at this point in time we have no current desire or no plans I should say to pursue that debt to bring it back in.

Flat revenue for our international and services as far as subsequent quarters go, the answer to that is no. We expect that we're going to have revenue growth in our international and services sector in the second half of this year. In fact, some of the test programs that we're delivering that will generate some test revenue will fall into the third and fourth quarters which should improve the revenue picture there.

If you remember, overall if you discount the extra month and a half of revenue from NCH, we expected low to mid-single digit revenue growth. We think we're still on plan to deliver that. There's really no change in our assumption there.

S. Barlow Just to clarify on the one-to-one, is that a gross profit that they were in the positive territory?

A. Schultz No, that is a net pretax profit and that is on a stand-alone basis. As you know in the past we had felt as if our one-to-one unit was in fact profitable because when we looked at other business from other product lines that we were able to secure from customers that we were able to attract because of our one-to-one capability, we thought when we looked at it from that standpoint the business had crossed the line into profitability last year. But now we're looking at it totally on a stand-alone basis, not looking at any of the other ancillary benefits associated with those customers and we are talking about a net profit after all SG&A.

I think it's a very, very important milestone for the business that was achieved in the second quarter. Again, just to reiterate, it was a significant enough profit that it offset the loss from the first quarter so that we're now looking at a net pretax profit through the first six months of the year that's north of a half million dollars.

S. Barlow Thanks very much.

Operator Thank you. Our next question comes from Fred Searby with JP Morgan. Please go ahead with your question.

F. Searby Good morning, everybody. One or two questions, Alan. It sounds historically you've said to me and you're strategizing and I think you've said that it really is up to the market share leader to make price moves and you expected *News America* to raise prices and then we had this circ increase which you all were somewhat skeptical of.

What's the reversal here in that thought? You're trying to actually raise prices

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now. Obviously *News America's* not budging. Then on your existing accounts, have there been any major account losses? The market share ... you say you're in line with guidance, and my assumption was in the past that you thought you'd get back to 50% and it sounds like you're going to be still in the 40s next year.

A. Schultz

From an existing account standpoint there really haven't been a lot of changes from a market share standpoint. From a historical standpoint the answer to your question is yes; historically the market share leader has always been the price leader. With that said I think as a management team and as a company it's important that you're always alert to new possibilities. It's always important that you're creative to consider new ideas, new concepts and that you're agile enough and flexible enough to take advantage of opportunities that may present themselves in the marketplace.

We clearly believe that based on what's going on from an overall industry growth standpoint, it has created somewhat of a unique opportunity for us. We feel as if the pricing approach that I laid out is a very creative and unusual strategy that has never been attempted or implemented in the past.

Again, that's our job to take on that responsibility that and we have a duty to look for ways to improve the long term pricing trend in the FSI industry.

As far as our 50% market share goal, I think when you really get to the underlying goal, our goal, has always been to create a long term, more profitable FSI industry to create a long term, more profitable Valassis. We feel that's in the best interest of all the stakeholders involved in the FSI industry, certainly including our customers. We feel the current market conditions have created a better alternative to achieve that goal.

We are merely being alert in recognizing the opportunities that exist and flexible in adjusting our strategy to best accomplish our goal. We believe our goal can best be accomplished with no further changes in market share from where we're at today.

F. Searby

Speaking of creative, on the circ issue when they raised their circ and you said it was somewhat dubious and would fall flat on its face, how has that done for them because it was a de facto price increase, right?

A. Schultz

From the measurements we've done so far, what we tend to look at is what is the average full run circulation for Valassis and what is the average full run circulation for our competitor. What we've seen is that there are really no differences between us and them in terms of what clients are buying in terms of their full run circulation.

F. Searby

Again, congratulations on some results in light of the challenging conditions.

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A. Schultz: Thanks, Fred, appreciate that.

Operator: Our next question comes from Alexia Quadrani with Bear Stearns. Please go ahead with your question, ma'am.

J. Choy: This is Julian Choy. I have some questions on behalf of Alexia. A couple of questions here. Just wondering how your pricing is on contracts today compared on average to pricing on contracts signed last year. And I also wanted to know how paper prices are trending for the full year.

A. Schultz: Julia, we haven't really given any guidance in terms of what's going on on a day-to-day standpoint in terms of contract pricing so I can't really comment on that.

As far as paper prices, we had anticipated that paper would increase in terms of pricing during the year and based on what we currently see today paper prices are increasing as we had anticipated that they would increase.

J. Choy: Is that the 8% to 9% increase?

A. Schultz: There's really nothing here that is surprising us. When you look at paper in terms of what we had built into our models for the year we had assumed that we'd have a mid to high single digit price increase as a result of the contracts that we have in place through 2005 particularly in the FSI business that have caps and powers in them, cap quarterly increases and then cap annual increases.

Right now it's pretty much on plan and then because of some of the increased volumes that we've talked about, some of which we had anticipated and some of which we had not anticipated, that increased volume has helped us from a media cost standpoint and helped us from a production cost standpoint.

I also want to make note that from a production cost standpoint or a printing standpoint, clearly our manufacturing teams have done a very nice job, had a very good quarter in the second quarter. Then some of the capital additions we've made on the Man Roland presses have also been highly efficient presses. As a result of that, the combination of media and printing costs have really offset that price increase in paper to basically give us a flat cost of goods sold in the co-op FSI.

J. Choy: Given your better than expected share repurchase activity this quarter, I think it's about twice the amount that you purchased last quarter, are you comfortable with current levels?

A. Schultz: Comfortable with what levels, Julia?

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J. Choy With the current amount of shares that you're repurchasing?

A. Schultz We've taken the approach that says that we want to be opportunistic from a share repurchase standpoint, we want to try to buy as many shares as we possibly can for the money. We do have the ability per our Board to spend 75% of our free cash flow on share repurchase if we elect to do that. We haven't elected to do that but I would describe our strategy as it relates to share repurchase as being very flexible, kind of dependent on market conditions.

J. Choy Thank you.

Operator Thank you. Our next question comes from Troy Mastin with William Blair and Company. Please go ahead with your question, sir.

T. Mastin Good morning. Being this far into the 2004 contracting season and with what I think are now longer contracts at 30 months, correct me if I'm wrong there, when might this attempted price increase begin to have a meaningful impact on prices? When could we start to see your effective prices on the FSI going up in aggregate if this price increase works?

A. Schultz The way to look at it, Troy, is that there's about 15% of the business that really never gets covered by a corporate contract. That's what we describe as the bid business. In theory that 15% of the business could start to be priced at higher levels in a relatively short period of time. It has the potential, those prices, to gravitate up near the floor.

Then when you assume the length of contracts which you are correct, that is longer than what we've had previously in terms of length of contracts. I think you have to assume that somewhere between 30% to 40% of the business in any given year, the contract is likely to expire and then the prices on those contracts would step up over time as contracts expire. So I think that's the way you have to look at it.

Then probably the one other factor to be considered is that this is a category, exclusive medium, which means that there are times where business cannot be placed with the company that has the contract because of category blockage problems and then that business ultimately goes to the non-contracted company, typically at higher prices. So in this case from our perspective that would be our floor price.

Today that's a relatively small percentage of the business based on current industry practice but if the supply/demand equation continues to work in our favor and we continue to see strong increases in demand with really insignificant increases of supply or days and a change in business practice, a

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larger percentage of the business could go to the non-contracted company and I would assume that if this were to all come to fruition that it would be at those floor prices.

If you took all of those factors into consideration, Troy, that would be the way to look at it.

T. Mastin Can you give an idea in a reasonable or maybe even a best case scenario when you might finally start to enjoy average FSI prices increasing?

A. Schultz At this point in time we're going to continue to look for some type of concrete evidence in the marketplace. As I had mentioned earlier, we've seen our competitor make their intentions known relatively quickly and we're going to monitor that situation on a daily basis.

T. Mastin Onto the one-to-one business, is there any temporary benefit at this business as a result of competitors that have de-emphasized or shut down their operations that might not be recurring or would you characterize the growth in one-to-one as purely fundamental or maybe industry organic?

A. Schultz Troy, you've got a little bit of everything going on here. There is no doubt that there is organic growth taking place in the one-to-one business. That's being driven by a number of factors, one of which is the macro trends that we have talked about.

You've got the do not call registry where you've got a huge amount of dollars that are shifting from telemarketing into other promotional media vehicles. You've got the consumer evasiveness issue, the satellite radio, the TV fragmentation, the TiVo, the desire on clients, to link their marketing spend to revenue generation and ROI. All those things create a very positive picture for our entire product portfolio and certainly the direct mail business.

There's no doubt that we are seeing organic growth taking place there. Clearly we're benefiting as a result of our competitors in the marketplace changing strategies and their future being somewhat in question from a share standpoint. But there's no doubt that we're seeing growth there and from a consumer package goods industry standpoint, consumer package goods companies seem to be very committed to direct mail being part of their overall marketing mix.

Of course our overall strategy as a company is to be the only company that offers mass delivered promotional products, cluster targeted or neighborhood targeted products and one-to-one targeted products and the only company that has the ability to integrate all those into a single solution.

T. Mastin Then finally one more question. Have you seen any negative impact as a

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result of the circulation issues that have come up in a few newspapers? I know they might not be too relevant to your circulation but more specifically do you sense that advertisers are less interested in using the freestanding insert? Have you had any conversations along those lines despite the strong volume trends you've been seeing?

A. Schultz

The answer to that is no. We have not heard a lot of clients, in fact we have heard very little if any client discussion on the subject of what's going on at these three newspapers, *The Sun Times*, *Long Island Newsday* and *Hoy* [inaudible] in New York.

I want to assure you also that as I've discussed before we've always believed in a high quality market list. We only provide newspapers with the number of inserts that we're comfortable they can distribute and that will ultimately get into the hands of the consumer.

We also give the newspapers an order of distribution. An example would be we say first we want you to cover the paid home delivered circulation within the MSA, then we want you to cover paid home delivered circulation outside the MSA, then go into the paid box within the MSA, then out of the MSA and then our last choice would be to go into TMC programs. Based on everything we know today, we believe that all of our inserts ultimately have reached consumers in the order that we have specified.

I would also point out that we have a division called Promotion Watch which does promotion security consulting. That group does random audits of our newspapers and they have done over 20 random audits this year and based on what we learn as a result of this situation with the newspapers, they will revise their audit procedures to make sure we're looking for some of the problems that materialize at these three newspapers. These three newspapers will not be audited in the future on a random basis but on a specific basis. So we're pretty comfortable with this issue.

T. Mastin

Thanks a lot.

Operator

Our next question comes from Mark Bacurin with Robert W. Baird. Please go ahead with your question, sir.

M. Bacurin

Good morning. Alan, I'm hoping I can dig in on this new pricing strategy a little bit. First I wanted to follow up on a comment you made in response to Troy's question. You said you have seen your competitor make their indications known on this new pricing strategy and you're going to continue to monitor it. Am I to read into that you've already tried this and you've actually seen *News America* make some sort of response?

A. Schultz

No. When I said that we expect *News America* to react relatively quickly

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what I mean is from what we've seen over the last two years we've seen *News America* make their intentions known relatively quickly. We would assume, we don't know for sure but we would assume at this point that their track record of the last two years would continue.

M. Bacurin I understand. Then as I understand the strategy you will not be pushing forward the new pricing floor on renewals with existing clients but only on business that you currently do not have. Is that correct?

A. Schultz That is correct, yes.

M. Bacurin What about renewals for more volume? Would you implement the new floor on incremental volume from those same clients?

A. Schultz If it was a first right of refusal customer with Valassis the answer to that is no, not at this point in time. But if it was a client that was shared between Valassis and *News America* then the answer to that question is yes. If they wanted us to take on incremental market share, incremental volume beyond our share percentage then the answer to that is yes, we would implement the floor.

M. Bacurin As I understand this strategy then this will not necessarily move pricing up for you; the only place you would see a price increase is if you took a competitive win against *News America* and then vice versa, if they respond with a similar increase to the price floor they theoretically shouldn't be taking any clients from you at a higher price point unless it's at a higher price point?

A. Schultz Yes, that is correct. I think there's another side of this that you probably need to consider which is if it's a *News America* renewal and we're quoting the floor price and they currently have a contract which is less than the floor price, then they would certainly have an opportunity to move their pricing up also. It's hard to say what the impact of that will be.

M. Bacurin I understand. Assuming that strategy works to your benefit and pricing moves up on these renewals, as you said, I guess most of the contracts are locked in for '05 except for some spot type business that you might achieve. So we would actually expect those benefits to start accruing more in the '06 timeframe?

A. Schultz Yes. You'd see benefit in the spot business and then as I have mentioned in the conversation, I believe it was with Troy, where there is some business that moves back and forth between the companies if one of the companies is blocked from a category standpoint, that business would also go up. That's currently a relatively small percentage based on practice but the answer to the question is you're correct. The bulk of the opportunity would materialize in '06.

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M. Becurin

Assuming there has been some elasticity of demand with the lower pricing, are you concerned that if prices do move back up that the volumes you're assuming that you might be able to achieve at this lower market share level might actually decline with the higher price point such that you're back in a position where you're not necessarily getting the same kind of profitability out of each book that you would hope?

A. Schultz

As I had mentioned, again I think it was in the conversation with Troy, I think there're some macro trends that are really moving dollars in our favor and that is the desire by clients to link marketing spend to revenue generation.

The FSI has by far the best return on investment bar none. It's an outstanding vehicle for a return on investment standpoint. Even at the floor pricing it's an outstanding return on investment versus where we're pricing at today. Then there's of course these issues with television that we are all well aware of with TTVO and the personal recording devices and the popularity of satellite Internet radio which is commercial free.

Consumers these days want to be in charge of when they receive messages and what messages they receive. The bottom line is that consumers invest time these days, they want value for that time and our products typically provide some type of value.

Then we've got a number of clients that have had tremendous success in the industry and in their business by using our products and I think that has a positive impact on other products.

We need to also keep in mind that we experienced strong unit growth in this industry for the last eight quarters and when you go back in time, that's when prices were relatively stable. When prices were higher than what they are today, when you look at the possibility of returning this industry to the floor pricing that existed back in May of 2001, please keep in mind that we were selling at that time at prices that were significantly higher than the floor. That was still providing clients with a great return on investment and at that time we really didn't have clients that were complaining about the price level.

I think that there is some price elasticity in our industry and some of the growth we have seen as a result of price but I clearly don't think that returning to our floor price with all these other macro trends taking place will dampen demand in a significant way.

M. Becurin

Then, Al, in terms of how you see the response from *News America*, is it a function of whatever contracts are up right now you go out with a new floor price. If it's a *News America* client and then you learn back from that client

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what the pricing actually was done with *News America* assuming they keep it, but at a higher price point? Is that how it works or what is the feedback you get?

A. Schultz: We try to monitor the market in a number of different ways. We will use every means at our disposal to try to monitor the situation. What you just described is certainly one way to determine what's taking place in the marketplace but there are a number of different ways that we would monitor the market.

M. Bacurin: Great. Thanks a lot.

Operator: Our next question comes from Edward Atorino with Fulcrum. Please go ahead with your question.

E. Atorino: My question's been basically answered about seven times so I won't try to go over it again. One other question, on the refinancing, what does that do to your interest expense going forward? I presume it takes it down a notch or two?

A. Schultz: Ed, the first thing I want to do is correct the name. It's Ed Atorino.

E. Atorino: Close enough.

A. Schultz: I just want to make sure everybody's clear about that. With that said I'm going to let Bob give you the answer in terms of interest expense and the impact that the swap will have on an anticipated basis for the back half of this year.

B. Recchia: Ed, it will take down our overall interest expense obviously depending upon what rates do going forward. But immediately it reduces our interest expense from the 6-5/8ths down by a couple of percentage points plus.

E. Atorino: It should be under 3 then for the balance of the year?

B. Recchia: Percent?

E. Atorino: Dollars, millions. You were \$3 million in the second, \$3.1 was it? \$3 million for the second quarter.

B. Recchia: It should come under \$3 million for the next two quarters, that's correct.

E. Atorino: Thanks. I'll talk to Sherry offline and go through some more stuff. Thanks.

A. Schultz: Thanks, Ed.

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Operator Our next question comes from Richard Diamond with Inwood Capital. Please go ahead with your question, sir.

R. Diamond Hi, Al. What happens if *Newscorp* decides to continue to be irrational in the co-op advertising business? The reason I mention this is that the price war has been irrational from the start. What's the downside case and how does that play out?

A. Schultz When you consider the increased client demand for co-op FSI pages and you couple that with really no significant increase in date supply, we think we're at a point where we believe both FSI companies can achieve significant volume with their current market share positions.

 Generally this type of supply/demand equation typically leads to increased pricing power and logic would suggest that this condition provides an opportunity to create a positive long term pricing trend. So clearly that pricing trend could lead to increased profitability.

 Clearly as we assess the situation we think it makes sense. If it doesn't work, we will continue to look for creative ideas and opportunities to improve our profitability. We'll try to do so sooner as opposed to later.

 We believe today's market is very fluid and dynamic and this type of market presents opportunities but you've got to be constantly alert and you've got to quickly identify the opportunities and then of course you need to be agile enough to develop and execute a strategy in the marketplace. I think our objective's clear - how do we create an FSI industry that will improve our profitability. That's our ongoing responsibility not only in the FSI industry but it's our ongoing responsibility in every business we participate in.

R. Diamond Thank you very much, Al.

Operator Our next question comes from Jim Kostell with Cuyahoga Capital. Please go ahead with your question.

J. Kostell Hi. It's Jim Kostell. A couple of questions. First of all I may have this statistically incorrect because it's been a long day and my typing isn't so good but it appears that the accounts receivable relative to days sales have gone up here a bit. Is that correct and could you address why that is?

A. Schultz I'm going to let Bob handle the accounts receivable question.

B. Reechie It's up at about \$258 million at the end of the quarter and once again it's mostly timing. We had a couple of major programs where monies came in the first week of July and that threw us up higher. When you look at actual days sales and receivables it hasn't moved all that much.

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The other part of it is some increased volume at NCH that we're seeing drive up the receivables number as well.

Once again it's mainly a timing issue. There's no real major trends or problems with collectability. It has a lot to do with the volume of business we're taking through in the ROP business and the volume we're taking through at NCH as well.

J. Kostell Is my addition here of 90 days versus 66 correct?

B. Reechia Well, if you take a simple point in time and measure it you can get that but we measure it on a rolling basis and unfortunately when you just grab the end of the month it can look really good and really bad. What I would tell you that the numbers are up slightly because of the type of businesses that we've ventured into and the receivable dynamics in getting paid but nowhere near 90 days.

J. Kostell Secondly, it's been so long since May of '01 I can't even remember where I worked then. Could you tell me, the \$6 and the \$3.90, that's up about 20% from where prices are now?

B. Reechia I can't get into that with you, Jim.

J. Kostell Can you make any comment as to the general level of the pricing over that period of time?

A. Schultz What we can say is that we've been in a declining price environment since basically June of 2001. I guess it was relatively stable at that period and then we went through a period of decline and clearly this is an attempt to change that trend line and create a positive trend line in terms of pricing and reverse that negative trend line.

J. Kostell I was sitting here trying to think about how a customer would feel about this in a sense that if I've got a contract with you and I come to you and say I'd like to do some more volume with you and you say okay but it's up an awful lot in terms of price ... have you gone and talked to any of your customers about this and felt them out ahead of just implementing this?

A. Schultz We have talked to customers on an ongoing basis and have told them that we feel like the current pricing environment is not a realistic pricing environment and that prices will need to ultimately at some point return to more historical levels. I don't think there's any clients that I've come across that would disagree with that. Certainly clients appreciate the lower prices, certainly clients want to take advantage of the lower prices as anyone would but we've been trying to do a good job on an ongoing basis to educate our clients that

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this is a snapshot in time, an opportunity in time for them to take advantage of lower prices and at some point in the future that window's going to close and that opportunity is no longer going to exist. Certainly every client I've talked to understands that.

J. Kostell In terms of your comment about you'll see the response pretty quick, is pretty quick generally speaking defined in days, weeks, a month? What does the word pretty quick mean?

A. Schultz I would think in this situation we're talking about weeks.

J. Kostell Thank you very much.

Operator Management, at this time we have no questions. Please continue with any further remarks or closing comments that you would like to make.

A. Schultz Thank you. Just in closing I'd like to point out the fact that our first half performance was strong and as a result of that strong performance in the first half, it's allowed us to tighten up our annual earnings guidance and we have updated our 2004 earnings per share range which was \$1.65 to \$1.85 to \$1.73 to \$1.85.

It is our sense that the strengthening economy has resulted in growing marketing budgets and increased demand for our products. We clearly believe these conditions create an opportunity to improve margins across our entire product portfolio while at the same time encouraging customers to consider our integrated solutions for which we have already sold 25 this year.

We're encouraged by what we've seen through the first six months of this year. We're at the halfway point, we clearly have a lot of work to do but we are optimistic about the future.

I'd like to thank you for your time, your questions and your interest and have a great day.

Operator Ladies and gentlemen, this concludes the Valassis Communications Second Quarter 2004 Earnings conference call. If you would like to listen to a replay of today's conference please dial in to 1-800-405-2236 or 303-590-3000 and use the access code of 566835.

We thank you for your participation. You may now disconnect and thank you for using ACT Teleconferencing.

Decision and Order

DECISION AND ORDER

The Federal Trade Commission having initiated an investigation of certain acts and practices of Valassis Communications, Inc. (hereinafter referred to as “Respondent”), and Respondent having been furnished thereafter with a copy of the draft of Complaint that the Bureau of Competition proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge Respondent with violations of Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45; and

Respondent, its attorneys, and counsel for the Commission having thereafter executed an Agreement Containing Consent Order (“Consent Agreement”), containing an admission by Respondent of all the jurisdictional facts set forth in the aforesaid draft of Complaint, a statement that the signing of said Consent Agreement is for settlement purposes only and does not constitute an admission by Respondent that the law has been violated as alleged in such Complaint, or that the facts as alleged in such Complaint, other than jurisdictional facts, are true, and waivers and other provisions as required by the Commission’s Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that Respondent has violated the said Act, and that a Complaint should issue stating its charges in that respect, and having accepted the executed Consent Agreement and placed such Consent Agreement on the public record for a period of thirty (30) days for the receipt and consideration of public comments, now in further conformity with the procedure described in Commission Rule 2.34, 16 C.F.R. § 2.34, the Commission hereby makes the following jurisdictional findings and issues the following Order:

1. Proposed Respondent Valassis Communications, Inc. is a corporation organized, existing, and doing business under and by virtue of the laws of the State of Delaware,

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with its office and principal place of business located at 19975 Victor Parkway, Livonia, Michigan 48152.

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the Respondent, and the proceeding is in the public interest.

ORDER**I.**

IT IS ORDERED that, as used in this Decision and Order, the following definitions shall apply:

- A. “Valassis” or “Respondent” means Valassis Communications, Inc., its directors, officers, employees, agents, representatives, successors, and assigns; its subsidiaries, divisions, groups, and affiliates controlled, directly or indirectly, by Valassis Communications, Inc.; and the respective directors, officers, employees, agents, representatives, successors, and assigns of each.
- B. “News America” means News America Marketing and The News Corporation Limited, their directors, officers, employees, agents, representatives, successors, and assigns; their subsidiaries, divisions, groups, and affiliates controlled, directly or indirectly, by either News America Marketing or The News Corporation Limited; and the respective directors, officers, employees, agents, representatives, successors, and assigns of each.
- C. “Commission” means the Federal Trade Commission.
- D. “Competitor” means News America and any other person engaged in the business of publishing, producing, distributing, or selling FSI’s.

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- E. “Consultant” means any person retained by Valassis to provide advice or assistance to Valassis relating to its pricing or marketing strategy.
- F. “Designated Employees” means each employee of Valassis with direct or supervisory responsibility for investor relations, sales, or marketing.
- G. “Federal Securities Laws” means the securities laws as that term is defined in § 3(a)(47) of the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(47), and any regulation or order of the Securities and Exchange Commission issued under such laws.
- H. “FSI” means free-standing insert, and includes any multi-page booklet or other publication containing coupons or advertisements that is inserted into a newspaper for distribution to consumers.
- I. “Insider” means a Consultant, officer, director, employee, agent, or attorney of Valassis; *provided, however*, that a Competitor shall not be considered to be an “Insider.”
- J. “Person” means both natural persons and artificial persons, including, but not limited to, corporations, partnerships, and unincorporated entities.

II.

IT IS FURTHER ORDERED that in connection with the publication, production, distribution, offering for sale, or sale of any FSI in or affecting commerce, as “commerce” is defined by the Federal Trade Commission Act, Respondent shall cease and desist from, either directly or indirectly, or through any corporate or other device:

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- A. Communicating, publicly or privately, to any Person who is not an Insider, that Respondent is ready or willing:
1. to forbear from competing for any customer, contract, sale, or business opportunity, conditional upon a Competitor also forbearing from competing for any customer, contract, sale, or business opportunity; or
 2. to raise, fix, maintain, or stabilize prices or price levels, conditional upon a Competitor also raising, fixing, maintaining, or stabilizing prices or price levels.
- B. Entering into, participating in, implementing, continuing, or otherwise facilitating any combination, agreement, or understanding, either express or implied, with any Competitor:
1. to allocate or divide markets, customers, contracts, lines of commerce, or territories; or
 2. to raise, fix, maintain, or stabilize prices or price levels, or to engage in any other pricing action.

Provided, however, that it shall not, of itself, constitute a violation of Paragraph II of this Decision and Order for Respondent: (1) to communicate to any actual or prospective FSI customer Respondent's price for that customer and/or that Respondent is ready or willing to lower its price in response to a Competitor's price; or (2) publicly to disclose any information where and at such time as the public disclosure of this information by Respondent is required by the Federal Securities Laws.

Decision and Order

III.**IT IS FURTHER ORDERED** that:

- A. Within sixty (60) days after the date this Decision and Order becomes final, Respondent shall submit to the Commission a verified written report setting forth in detail the manner and form in which that Respondent has complied and is complying with this Order.
- B. One (1) year after the date this Decision and Order becomes final, annually for the next four (4) years on the anniversary of the date this Decision and Order becomes final, and at other times as the Commission may require, Respondent shall file with the Commission a verified written report setting forth in detail the manner and form in which it has complied and is complying with this Decision and Order.

IV.

IT IS FURTHER ORDERED that Respondent shall notify the Commission at least thirty (30) days prior to:

- A. Any proposed dissolution of Respondent,
- B. Any proposed acquisition, merger, or consolidation of Respondent, or
- C. Any other change in Respondent that may affect compliance obligations arising out of this Order, including but not limited to assignment, the creation or dissolution of subsidiaries, or any other change in Respondent.

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V.

IT IS FURTHER ORDERED that, for the purpose of determining or securing compliance with this order, upon written request, Respondent shall permit any duly authorized representative of the Commission:

- A. Access, during office hours and in the presence of counsel, to all facilities and access to inspect and copy all books, ledgers, accounts, correspondence, memoranda and other records and documents in the possession or under the control of Respondent relating to any matters contained in this Decision and Order; and
- B. Upon five (5) days' notice to Respondent and without restraint or interference from it, to interview officers, directors, or employees of Respondent.

VI.

IT IS FURTHER ORDERED that Respondent shall:

- A. Within thirty (30) days after the date on which this Decision and Order becomes final, send a copy of this Decision and Order by first class mail to each of its directors, officers, and Designated Employees.
- B. Mail a copy of this Decision and Order by first class mail to each person who becomes a director, officer, or Designated Employee, no later than (30) days after the commencement of such person's employment or affiliation with Respondent.
- C. Require each person to whom a copy of this Decision and Order is furnished pursuant to subparagraphs VI.A and VI.B of this Decision and Order to sign and submit to Respondent within thirty (30) days of the receipt thereof a statement that: (1) acknowledges receipt of the

Decision and Order

Decision and Order; (2) represents that the undersigned has read and understands the Decision and Order; and (3) acknowledges that the undersigned had been advised and understands that non-compliance with the Decision and Order may subject Valassis to penalties for violation of the Decision and Order.

VII.

IT IS FURTHER ORDERED that this Decision and Order shall terminate twenty (20) years from the date the Decision and Order is issued.

By the Commission.

Analysis to Aid Public Comment

Analysis of Agreement Containing Consent Order to Aid Public Comment

The Federal Trade Commission has accepted, subject to final approval, an agreement containing a proposed consent order with Valassis Communications, Inc. (“Valassis” or “Respondent”), a publisher of co-operative free-standing inserts (“FSIs”) with its principal place of business located at 19975 Victor Parkway, Livonia, Michigan 48152. The agreement settles charges that Valassis violated Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, by inviting its only FSI rival to collude so as to eliminate competition. The proposed consent order has been placed on the public record for 30 days to receive comments from interested persons. Comments received during this period will become part of the public record. After 30 days, the Commission will review the agreement and the comments received, and will decide whether it should withdraw from the agreement or make the proposed order final.

The purpose of this analysis is to facilitate comment on the proposed order. The analysis does not constitute an official interpretation of the agreement and proposed order, and does not modify their terms in any way. Further, the proposed consent order has been entered into for settlement purposes only, and does not constitute an admission by Respondent that it violated the law or that the facts alleged in the complaint (other than jurisdictional facts) are true.

I. The Complaint

The allegations of the complaint are summarized below:

FSIs are multi-page coupon booklets commonly found in Sunday newspapers across the country. FSIs are an efficient means for consumer packaged goods manufacturers and other firms to distribute coupons on a mass scale. For more than a decade, there have been only two U.S. publishers of FSIs: Valassis and News America Marketing (“News America”). On a typical Sunday, both

Analysis to Aid Public Comment

Valassis FSIs and News America FSIs are distributed by hundreds of newspapers to over 50 million households.

A. The FSI Price War

Between 1998 and 2001, Valassis and News America each published approximately 50 percent of FSI pages. In June 2001, Valassis notified its clients of a five percent price increase, bringing Valassis' floor price from \$6.00 for a full page per thousand inserts to \$6.30. News America did not follow the Valassis price move. As a result, News America captured additional customers and built a substantial market share lead. In February 2002, Valassis abandoned its efforts to increase prices and sought to regain a 50 percent share of FSI pages, leading to FSI prices falling below \$5.00 per page by 2004.

B. Valassis Invites its Competitor to Collude

In mid-2004, Valassis determined that its aggressive pursuit of greater market share was no longer serving the company's interests. Company executives developed a new strategy. Valassis decided to communicate to News America an offer to cease competing for News America customers, provided that News America ceased competing for Valassis customers. Valassis intended this offer to enable the firms to raise FSI prices within their respective uncontested domains and to end the FSI price war.

As a publicly traded corporation, Valassis holds a conference call with securities analysts on a quarterly basis. Any person may listen to the call live over the Internet or obtain a transcript of the call from the Valassis website. Valassis held its second quarter analyst call on July 22, 2004¹. Valassis executives were aware that News America representatives would be monitoring the call, and they determined to use this conference call as the vehicle to

¹ A transcript of the earnings conference call is annexed to the complaint as Exhibit A.

Analysis to Aid Public Comment

communicate Valassis' offer to News America. To ensure that News America clearly understood the terms of the Valassis offer, including what Valassis expected in return from News America, the President and Chief Executive Officer of Valassis, Alan Schultz, opened the earnings conference call by proposing the following:

1. Valassis would abandon its 50 percent market share goal. The company would be content to maintain the share (mid-40s percent) that it then held.
2. Valassis would aggressively defend its existing customers and price at whatever level was necessary to retain its existing market share.
3. With regard to customers with expiring contracts with News America, effective July 26, 2004, Valassis would observe a floor price of \$6.00 per page and \$3.90 per half page. This was the floor price that had been in effect prior to the price war. That meant that for News America's historical customers, Valassis would submit bids at a level substantially above prevailing market prices.
4. With regard to the small number of customers that divide their FSI business between Valassis and News America, Valassis would price its share at whatever level was necessary to retain its historical share of that customer's business. If the customer wanted Valassis to take more than its historical share, however, Valassis would price that portion of the business at the new (\$6.00) price floor.
5. As to four bids that Valassis already had outstanding to News America customers, Valassis would honor those bids only until August 1, 2004, and thereafter all News America customers would be quoted at the new higher price.
6. Finally, Valassis would monitor News America's response to this invitation, looking for "concrete evidence" of reciprocity in "short order." If News America continued to

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compete for Valassis customers and market share, then Valassis would return to its previous pricing strategy, and the price war would resume.

According to the allegations of the complaint, Valassis made the foregoing proposal with the intent to facilitate collusion and without a legitimate business purpose. Although the proposal was made in the context of an analyst call, Valassis' statements provided information that would not ordinarily have been disclosed to the securities community, and the company would not have made the statements except in the expectation that its sole competitor would be listening. Far from being normal guidance to its investors or the marketplace with respect to the company's future business plans, Valassis' statements described with precision the terms of its invitation to collude to News America. If the invitation had been accepted by News America, the result likely would have been higher FSI prices and reduced output².

II. Legal Analysis of Invitations to Collude

Invitations to collude have been judged unlawful under Section 2 of the Sherman Act as acts of attempted monopolization,³ as well as under the federal wire and mail fraud statutes⁴. In addition, the Commission has entered into consent agreements in several cases

² Evidence reviewed in the course of the Commission's investigation did not support a charge that the anticompetitive agreement proposed by Valassis was consummated.

³ *United States v. American Airlines*, 743 F.2d 1114 (5th Cir. 1984), *cert. dismissed*, 474 U.S. 1001 (1985).

⁴ *United States v. Ames Sintering Co.*, 927 F.2d 232 (6th Cir. 1990).

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alleging that an invitation to collude – though unaccepted by the competitor – violated Section 5 of the FTC Act.⁵

The preceding line of authority rejects the proposition that competition would be adequately protected if antitrust enforcement were directed only at consummated cartel agreements. Several legal and economic justifications support the imposition of liability upon firms that communicate an invitation to collude where acceptance cannot be proven. First, it may be difficult to determine whether a particular solicitation has or has not been accepted. Second, even an unaccepted solicitation may facilitate coordinated interaction by disclosing the solicitor's intentions or preferences. Third, the anti-solicitation doctrine serves as a useful deterrent against conduct that is potentially harmful and that serves no legitimate business purpose.⁶

Previous FTC actions challenging invitations to collude generally have addressed private conversations between the respondent and its competitor⁷. The complaint here alleges that Valassis chose to communicate its offer through a public means. The Commission has concluded that the fact of public communication should not, without more, constitute a defense to an invitation to collude, particularly where market conditions suggest that collusion, if attempted, likely would be successful (here, a durable duopoly). Private negotiation – in a proverbial smoke-filled room – may well

⁵ MacDermid, Inc., ___ F.T.C. ___ (C-3911) (1999); Stone Container Corp., 125 F.T.C. 853 (1998); Precision Moulding Co., 122 F.T.C. 104 (1996); YKK (USA) Inc., 116 F.T.C. 628 (1993); A.E. Clevite, Inc., 116 F.T.C. 389 (1993); Quality Trailer Products Corp., 115 F.T.C. 944 (1992).

⁶ See generally P. Areeda & H. Hovenkamp, VI ANTITRUST LAW ¶1419 (2003).

⁷ In *Stone Container Corp.*, 125 F.T.C. 853 (1998), the Commission alleged that an invitation to collude consisting of both public and private communications was illegal.

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be the most efficient route for would-be cartelists wishing to reach an accommodation. But it is clear that anticompetitive coordination also can be arranged through public signals and public communications, including speeches, press releases, trade association meetings and the like⁸. Given the obligation under the securities laws not to make false and misleading statements with regard to material facts, Valassis' invitation to collude, made in the context of a conference call with analysts, may have been viewed by News America as even more credible than a private communication. If such public invitations to collude were per se lawful, then covert invitations to collude would be unnecessary.

In evaluating cartels, antitrust law does not afford immunity to agreements that are brokered in public; courts recognize that a public venue does not necessarily mitigate the threat to competition⁹. The same approach should govern invitations to collude. Liability should depend upon the substance and context of the communication, including issues of intent, likely effect, and business justification, and should not turn solely on the arena in which the communication occurs.

In its earnings call, Valassis communicated to rival News America proposed terms of coordination for the FSI market, a longstanding duopoly, and did so with extraordinary specificity: Valassis would cease competing for News America customers, provided that News America likewise ceased competing for Valassis customers. In addition, Valassis proposed that prices should be restored by both firms to the pre-price war level of \$6.00 per page

⁸ See, e.g., David F. Lean, Jonathan D. Ogur, and Robert P. Rogers, *Does Collusion Pay . . . Does Antitrust Work?*, 51 SOUTHERN JOURNAL OF ECONOMICS 828, 839 (1985).

⁹ See *FTC v. Superior Court Trial Lawyers Ass'n*, 493 U.S. 411 (1990); *In re Petroleum Products Antitrust Litig.*, 906 F.2d 432 (9th Cir. 1990); *San Juan Racing Assoc. v. Asociacion de Jinetes, Inc.*, 590 F.2d 31, 32 (1st Cir. 1979).

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and \$3.90 per half page per thousand booklets and described how business with shared customers and outstanding bids to News America's customers would be handled. Much of this information would not have been publicly communicated, even to investors and analysts interested in Valassis' business strategy, but for Valassis' effort to induce collusion. Under such limited circumstances, the Commission may challenge an invitation to collude under Section 5 of the FTC Act even where the conduct did not result in competitive harm.

Corporations have many obvious and important reasons for discussing business strategies and financial results with shareholders, securities analysts, and others. For this reason, the Commission is extremely sensitive to the fact that antitrust intervention involving a corporation's public communications must take great care not to unduly chill legitimate speech¹⁰.

In this case, the public statements made by Valassis went far beyond a legitimate business disclosure and presented substantial danger of competitive harm. The Commission's complaint alleges that Valassis made a strategic decision to use and did use its analyst call to communicate to News America information that was essential for News America to understand how Valassis proposed to divide up the market and how it proposed to transition from competition to coordination. For example, Valassis specified how it proposed to split the business of those customers it shared with News America and explained what its pricing would be with regard to pending bids to four News America customers. Valassis historically had not provided information of this type to the securities community, analysts had no need for the information and did not report it, and

¹⁰ For example, the Commission would likely not interfere with a public communication that is required by the securities laws. Here, the Commission has been cited to no other instance where a corporation disclosed publicly in securities filings or other fora the detailed descriptions of its future pricing plans and business strategies alleged in this complaint.

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Valassis had no legitimate business justification to disclose the information. Valassis would not have disclosed the detailed information except in the expectation that News America would be monitoring the call and except for the purpose of conveying its proposal to News America.

III. The Proposed Consent Order

Valassis has signed a consent agreement containing the proposed consent order. The proposed consent order enjoins Valassis from inviting collusion and from actually entering into or implementing a collusive scheme.

More specifically, Valassis would be enjoined from inviting an FSI competitor to divide markets, to allocate customers, or to fix prices. The proposed consent order also prohibits Valassis from entering into, participating in, implementing, or otherwise facilitating an agreement with any FSI competitor to divide markets, to allocate customers, or to fix prices.

The proposed order would not interfere with Valassis' efforts to negotiate prices with prospective customers, and it would permit Valassis to provide investors with considerable information about company strategy. The proposed order also includes a safe harbor provision permitting Valassis to communicate publicly any information the public disclosure of which is required by the federal securities laws.

The proposed order will expire in 20 years.

Complaint

IN THE MATTER OF
DYNAMIC HEALTH OF FLORIDA, LLC

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

Docket D-9317; File No. 0423002
Complaint, June 15, 2004--Decision, May 15, 2006

This consent order addresses the respondents' marketing of a purported children's weight loss product called "Pedia Loss" and a purported female libido enhancer called "Fabulously Feminine." The order requires that the respondents possess and rely on competent and reliable scientific evidence to support representations that Pedia Loss or any other covered product causes weight loss, suppresses appetite, increases fat burning, or slows carbohydrate absorption in overweight children ages 6 and over. Similarly, the order requires that the respondents possess and rely on competent and reliable scientific evidence to support representations that Fabulously Feminine or any other covered product increases a woman's libido, sexual desire, or sexual satisfaction. The order prohibits the respondents from misrepresenting the existence, contents, validity, results, conclusions, or interpretations of any test or studies, but permits them to make certain claims for food or drugs that are permitted in labeling under laws and/or regulations administered by the U.S. Food and Drug Administration. Additional provisions are requirements that respondents maintain copies of advertising making representations covered by the order and any materials relied upon in disseminating these representations; distribute copies of the order to certain company officials; notify the Commission of changes in corporate structure or changes in the individual respondent's business or employment; and file one or more reports detailing their compliance with the order.

Participants

For the Commission: *Richard Cleland, Mary K. Engle, Janet M. Evans, and Sydney Knight.*

For the Respondents: *Max Kravitz, Kravitz & Kravitz; and Debra Bass and Tony Martinez, Martinez and Bass.*

COMPLAINT

The Federal Trade Commission, having reason to believe that Dynamic Health of Florida, LLC, Chhabra Group, LLC, DBS