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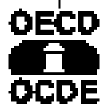

Organisation de Coopération et de Développement Economiques
Organisation for Economic Co-operation and Development

OLIS : 22-Oct-1998
Dist. : 27-Oct-1998

English text only

DIRECTORATE FOR FINANCIAL, FISCAL AND ENTERPRISE AFFAIRS
COMMITTEE ON COMPETITION LAW AND POLICY

DAFFE/CLP/WD(98)52
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ROUNDTABLE ON BUYING POWER

-- Note by the United States --

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

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

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

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

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

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

I. Joint Buyer Conduct - Cooperative Buying Groups

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

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

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

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

II. Complaints Regarding a Competing Discounter

9. Unilateral buyer conduct, even more so than joint conduct, is likely to judged under a rule of reason analysis. Thus, while an agreement between a buyer and seller on prices or price levels (so-called resale price maintenance agreements) is illegal *per se*, the recurring fact pattern in which a manufacturer

occasion Esprit refused to fill Burlington's most recent orders and informed Burlington that it would no longer sell to it. One month earlier, the chairman of Federated had made a speech on off-price retailing at

dominant buyer of toys. The Commission issued its administrative complaint against Toys "R" Us in May

20. Toys "R" Us did not just announce its policy but also met with each of its suppliers, seeking and receiving from at least ten toy manufacturers explicit oral commitments that they understood the policy and agreed to go along. The Commission found "an abundance of evidence of promises, negotiations, compromises and cooperative conduct with respect to the development, adoption and enforcement of the club policy."[19] For example, some suppliers presented proposed club products to Toys "R" Us for its

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

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

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

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

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

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

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

33. The Commission further found that standing alone, even without the evidence of the horizontal agreement among many toy manufacturers, each agreement in the series of vertical agreements that Toys

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

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

35. Commissioner Swindle concurred in the majority's determination that Toys "R" Us entered into

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

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

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

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

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

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

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

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

b. The Robinson-Patman Act and Slotting Allowances

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

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

51. There are no Commission or federal court decisions ruling directly on the legality of slotting allowances. It could be argued that the use of slotting allowances could violate the Robinson-Patman Act.[49] If the payment is for access to the store itself, slotting allowances arguably may constitute a

NOTES

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

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

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

4. 472 U.S. 284 (1985)

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

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

7. See, e.g.

17. Id. at 909.

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

19. Final Decision at 22.

20. Id. at 50.

21. Id. at 60.

22. Id. at 82.

23. Id. at 68.

24. Id. at 69.

25. Id. at 70.

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

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

28. Id. at 87.

29. Id. at 84.

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

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

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

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

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

41. See