

**OPINION OF THE COMMISSION
[PUBLIC RECORD VERSION]**

By Pitofsky, Chairman:

INTRODUCTION.

Boiled down to essentials, this case is about how Toys “R” Us (“TRU”), the largest toy retailer in the United States, responded to a new type of competition in toy retailing posed by wholesale clubs (“clubs”), an innovative class of discount retailers. Instead of meeting this new competition in the market place, TRU communicated with all the toy manufacturers that supplied both TRU and the clubs, and induced many suppliers to agree -- with TRU and each other -- either that they would not sell to the clubs at all, or more usually that they would sell on disadvantageous terms and conditions. TRU’s goal was to prevent consumers from comparing the price and quality of products in the clubs to the price and quality of the same toys displayed and sold at TRU, and thereby to reduce the effectiveness of the clubs as competitors.

We find that TRU’s conduct violates Section 5 of the FTC Act.¹ In doing so, we do not intrude on the right of a trader *unilaterally* to announce terms on which it will deal with suppliers, even if those terms disadvantage a rival. That is a company’s long-recognized right under *United States v. Colgate & Co.*, 250 U.S. 300 (1919), reaffirmed by the Supreme Court in 1984 in *Monsanto Co. v. Spray-Rite Servs. Co.*

¹15 U.S.C. § 45.

supply by exercising market power against suppliers -- then TRU, itself an innovative marketer resented by larger and less dynamic incumbents a generation ago, could have been denied an opportunity to compete on the merits and win in the market place.

I. DISCUSSION OF FACT.

A. THE TOY INDUSTRY.

Hundreds of companies around the world make thousands of different toys. Overall concentration among toy manufacturers is low: the top ten firms in 1993 produced about half of the industry's output. RX 215 at 4.² Smaller firms come and go, while the big toy makers, such as Mattel and Hasbro, introduce many new products every year. Toy manufacturing is a fashion industry, driven by hit products, and characterized by rapid change among the top-selling toys. Toy sales are seasonal, with the industry's production schedule geared toward the year-end, holiday season. New products are introduced at the industry's annual "Toy Fair"³ in February and

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

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

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

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

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

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

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

IDF Initial Decision Findings, referenced by finding number;

App. Br. TRU's Appeal Brief;

Answering Br. Complaint Counsel's Brief;

Reply Br. TRU's Reply Brief.

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

and among companies offering products that are close substitutes for one another. For example, many Mattel products compete with Hasbro toys; Little Tikes' closest rival is Today's Kids, another maker of large plastic toys; and Fisher Price is a close rival of Hasbro's Playskool division.

Most toy manufacturers' revenue is generated by a handful of top-selling items. RX 877 (Carlton) ¶ 40. A successful product can turn a small company into an overnight success, but a few large firms lead industry sales year in and year out. Hasbro and Mattel are the largest toy manufacturers, each selling in recent years four times as many toys as the next largest traditional toy⁴ makers. RX 877 (Carlton) Ex. 4. Little Tikes and Tyco (before it was acquired by Mattel in 1997) occupied spots three and four. These top firms purchase by far the most television toy advertising. CX 1822 (Scherer) ¶ 53.

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

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

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

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

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

ALL TRADITIONAL TOYS

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

ALL TOYS INCLUDING VIDEO GAMES

<u>Manufacturer</u>	<u>1995</u>	<u>1994</u>	<u>1993</u>	<u>1992</u>
Hasbro	10.0%	10.6%	12.6%	11.6%
Mattel	13.3	12.1	8.4	7.7

⁸Fisher Price was acquired by Mattel in 1993.

B. TOY RETAILING.

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

TRU offers an assortment of about 11,000 individual toy items throughout the year. No

⁹TRU's estimate of its share fell between 35 and 49% in these cities: Bakersfield, California 45.47%; Bowling Green, Kentucky 36.59%; Chicago, Illinois 41.98%; Detroit, Michigan 44.40%; Elmira, New York 48.78%; Harrisburg, Pennsylvania 36.21%; Hartford, (continued...)

the largest urban areas in the United States, including Los Angeles, Chicago, and New York. Complaint Counsel's expert economist testified that the appropriate antitrust market is likely to be smaller than the entire metropolitan area in many large cities, so TRU's estimates may actually understate its market power with respect to sales to consumers in these areas. CX 1822 (Scherer) ¶ 24.

TRU buys about 30% or more of the large, traditional toy companies' total output, and is usually their most important customer.¹⁰ As the ALJ found, toy manufacturers would have great difficulty replacing TRU. IDF 433. A Tiger Electronics Vice President of Sales wrote in 1994 that he was worried about his company's future business because of "TRU dictating to Tiger and becoming even a bigger percentage of our business" CX 813. Even the very largest traditional toy manufacturers, which were the most important of TRU's suppliers, felt a regrettable but growing dependence on TRU. Hasbro was worried about "increasingly powerful retailers." IDF 444 (citing CX 136-G). A Hasbro executive testified that Hasbro could not find other retailers to replace TRU. Owen 1151/3-10. Mattel's CEO explained that "[TRU] is 30 percent of our business, so that would be a very big number to put [in]to other accounts that are already committed to what they [feel] is correct" Amerman 3618. Even TRU recognized the large degree to which its suppliers had become dependent upon TRU. In a speech delivered in preparation for the 1990 Toy Fair, a TRU executive explained: "The key to increased profitability [for TRU's suppliers] in the 90's will be doing more business with Toys R Us since most of the expansion in the toy industry, at retail, will be taking place in Toys R Us stores in the U.S. and throughout the world." CX 1650-E.

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

Retail margins enjoyed by different types of retailers vary widely. Department stores and other "traditional" toy stores sell toys for about 40% to 50% above their cost. TRU's average margins are close to 30% above cost, but there is significant variation across the range of products sold. Wal-Mart and the other similar discounters, such as K-Mart and Target, mark-up

⁹(...continued)

Connecticut 35.01%; Los Angeles, California 41.01%; Lubbock, Texas 35.31%; New York, New York 43.88%; Philadelphia, Pennsylvania 39.57%; Reno, Nevada 41.84%; Richmond, Virginia 35.09%; Sacramento, California 48.28%; San Diego, California 44.74%; San Francisco, California 46.41%; Washington, D.C. 43.35%; Youngstown, Ohio 35.55%.

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

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

toys and other products by about 22% over cost. IDF 6; CX 1822 (Scherer) ¶ 5, 7. The clubs sell at mark-ups as low as 9% at Costco and as high as 14%, the highest margin at Pace. IDF 38. As a group, the clubs sell product at average gross margins -- the difference between the cost of merchandise and its selling price -- of between 9 and 12%. IDF 16.

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

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

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

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

C. THE WAREHOUSE CLUBS.

Warehouse clubs are a recent retail innovation. The first warehouse club was founded in 1976. By 1992 the warehouse club chains, Sam's Club, Pace, Price Club, Costco, and BJ's, operated about 600 individual club stores. IDF 17. Subsequent acquisitions have reduced the major club chains to three: Price/Costco, Sam's, and BJ's. *Id.* In June of 1992, TRU estimated that 238 of its 497 then-existing stores in the United States were within five miles of a club. CX 912-A; IDF 391. Clubs, moreover, were within or near the regional ADIs of almost all of TRU's 1992 stores -- 486 of 497. CX 1823. This is not surprising since ADIs, which are designed to be the same size as the circulation area of local newspapers, such as the *Los Angeles Times*, are often significantly larger than five miles. In other words, if TRU lowered its prices on newspaper-

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

register, and customers pack their own purchases. Zarkin 4806/24-4807/16; RX 894 (Buzzell) at 14-15.

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

The first club stores sold only to small business customers, such as restaurants, but by the late 1980s, sales to individuals had become common. RX 894 (Buzzell) at 8-9. While the mix of business and individual members varies among the warehouse club chains, Zarkin 4791/15-4792/17, by 1992 individual customers accounted for at least half of all club sales. CX 178-C; CX 96-D. As the clubs attracted more individual customers, they began to carry a wider variety of products and compete with a larger range of retail outlets. Sinegal 207/25-208/11; Zarkin 4789/22-24. In addition to toys, the clubs carry food products, electronics, appliances, jewelry, cameras, video and audio recordings, books, hardware, housewares, sporting goods, automotive parts, office supplies, health and beauty aids, apparel, and seasonal goods. Sinegal 147/13-21; Zarkin 4789/11-15. Although some manufacturers have restricted the merchandise they offer to clubs, or refused to sell to clubs at all, these suppliers, as the ALJ found, usually "choose not to distribute in any discount or mass merchant channel, not merely warehouse clubs." IDF 25.

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

D. TOY SALES AT THE CLUBS.

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

During the late 1980s and early 1990s, warehouse clubs could select and purchase from the toy manufacturers' full array of products. Clubs bought both the ordinary merchandise that was sold to all classes of retailers and customized products that were specially designed for the club class of trade. IDF 34; Halverson 357/3-359/12; Moen 606/8-22. Warehouse clubs sometimes worked with toy manufacturers to develop certain specially-packaged products that were intended to meet the clubs' business objectives of offering unique products that consumers wanted and recognized as valuable. For example, warehouse clubs purchased combination (or "combo") packs containing multiple inexpensive toys, such as Matchbox or Hot Wheels cars, Moen 606/23-608/22; Halverson 358/2-22, or complementary products, such as a radio-controlled car with a battery. IDF 34; Hilson 4575/11-20.

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

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

Like all large retailers, clubs attempted to purchase toy items that they believed would sell well. Hilson 4580/14-23; Jette 1003/2-20. As the ALJ found, however, the clubs did not carry primarily best-sellers, even before TRU implemented its policy. Of the 310 toy products sold by clubs in 1991, only 11% were among the top 100 selling products and only 27% were among the

top 500. IDF 37; Ingene 9078-79/20. The ALJ also found that, in deciding whether products are likely to sell well, club toy buyers relied on their own assessments of a product's characteristics, the strength of the product brand, and the manufacturer

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

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

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

A: Sure they could hurt us. Yeah.

Q: How so?

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

* * *

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

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

Q: What do you mean your reputation?

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

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

¹⁵During this period -- in 1992 -- TRU acknowledged that club price competition was affecting its business and took steps to respond. TRU created a complete listing of stores that competed with warehouse clubs, specifically noting the number of TRU stores located within a five-mile radius of warehouse club. CX 912-A. This document was circulated, on June 4, 1992, to TRU's top officers, including Chairman Lazarus, CEO Goldstein, President Nakasone, and Goddu. CX 912-A. Also during 1992, TRU lowered its prices for several high-profile products by as much as 20% to match club prices and avoid "damaging perhaps [TRU's] price image with the customer." IDF 56. TRU also lowered its expectations for the performance of TRU stores that competed directly with a club outlet. IDF 57. TRU regularly calculates an index rating the level of competition faced by each of its stores. CX 1822 (Scherer) ¶ 27b. This index allows TRU to evaluate the performance of its store managers without unfairly punishing those who operate stores in more competitive areas. Among other things, end-of-the-year performance bonuses were based on the competition index. *Id.* In December of 1992, TRU included clubs

¹⁶By late summer of 1992, the clubs recognized that the toy orders they had placed earlier in the year were not being filled. In about August of 1992, Costco, BJ's and Pace sent letters to Mattel and other toy manufacturers complaining about the claimed "shortages" and threatening litigation. CX 1688 (Pace); CX 1330 (BJ's); CX 748 (Costco). Mattel responded by creating a "task force" to address the club issue. CX 553-B; Amerman 3693/6-13. In its memorandum establishing the task force, Mattel acknowledged that its "marketing independence was compromised in 1992 by uninvited communications from Toys R Us." CX 553-A. In late December 1992, Mattel's general counsel promulgated the formal club policy, which essentially stated the terms of the agreement Mattel had entered with TRU earlier in the year, *i.e.*, Mattel will offer only differentiated product to the clubs. RX 476; CX 688; Okun 2800/3-6. Mattel has followed this policy ever since. IDF 163; Okun 2805/7-11; Barad 7917/22-7918/16. Likewise,

F. EVIDENCE OF VERTICAL AGREEMENT.

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

For ease of exposition, we have organized the evidence of vertical agreement into four categories, which proceed in roughly chronological order. First, TRU asked for and received an initial verbal commitment from its suppliers; second, at TRU's request, many suppliers presented proposed club products to TRU for its prior approval, or otherwise negotiated with TRU about the appearance or content of club offerings; third, TRU engaged in extended negotiations with its

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

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

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

suppliers over compliance with the club policy and often reached new points of agreement with them as the policy was implemented; and fourth, testimony and industry documents contain many examples of promissory language, indicating that the toy suppliers and TRU believed that they were bound by their commitments to one another. In our discussion, we use the term “commitment” to mean a forward-looking statement about or guaranty of future conduct similar to a promise. Commitments are most easily distinguished from mere statements of fact when, as here, they are made by parties negotiating a change in their course of conduct.

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

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

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

A: Absolutely.

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

A: Yes.

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

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

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

A: Oh, absolutely.

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

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

Mattel first promised TRU that Mattel would try to sell the clubs more customized

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

WAREHOUSE CLUBS

This is one of the fastest growing channels of distribution in the country. As a public company we owe it to our shareholders to maintain our business by selling this class of trade . . . Two years ago we committed to Toys R Us that we would do our best not to sell them regular line goods. We have reached a point where we are selling them approximately 50% of our volume on a customized basis. We will continue to move in this direction and promise to increase the percentage sold on a customized basis. CX 530-B (emphasis in original). The commitment referred to in this memorandum was made at Toy Fair in February 1990. IDF 120.

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

only exclusive[items to the clubs].” Goddu 6891/13-6892/14. By either account, Mattel’s CEO *committed to* TRU’s top officer that Mattel would comply with TRU’s club policy.

Hasbro also *committed to* TRU that Hasbro would not sell promoted products to the clubs. On several occasions between late-1991 and mid-1992, TRU met with Hasbro to explain TRU’s club policy and to complain about finding particular Playskool toys in the clubs. Owen 1106/5-1108/5. Executives from Hasbro’s Playskool division were particularly concerned about the cost of restricting Hasbro’s club sales. In preparation for one of the meetings with TRU, a Playskool executive wrote a memo to superiors at Hasbro suggesting that Hasbro “achieve some major concessions [from TRU] if we are to dramatically change the way we approach the Warehouse Clubs.” CX 78. At the meeting, which occurred prior to the Toy Fair in 1992, TRU raised the subject of Hasbro’s club sales, and Hasbro sought certain benefits from TRU (such as increased shelf space and a limitation on TRU’s sale of imitations of Hasbro products). IDF 177-80. Hasbro’s President of U.S. Sales and Marketing does not dispute that the meeting involved “some meeting of the minds” and calls it an example of “how we [Hasbro and TRU] do business together.” Owen 1121/13-1123/10. During these negotiations, TRU sought a response from Hasbro regarding club sales, CX 1657 (Goddu) at 130/20-25, and Hasbro responded that it would refuse to sell promoted toys to the clubs. Owen 1114/23-1115/5, 1117/6-9. Soon after Toy Fair 1992, TRU grew dissatisfied with Hasbro’s commitment not to sell promoted products and wanted Hasbro to adopt a “no identical items” policy like the other manufacturers. Towards this end, TRU kept asking Hasbro officials questions such as “what is your policy going to be, how are you going to deal with this [Hasbro products in the clubs] . . . ?” Verrecchia 1502/16-1504/19, 1524/2-9. Hasbro changed its policy, as TRU wished, after checking with TRU about the proposed modification. Owen 1136/20-1141/14, 1143/2-1144/23.

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

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

²¹Tyco announced it would sell only to customers that purchase a minimum order of \$20,000, and that the order must include at least 25 different products from the Tyco line. In

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

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

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

After committing to TRU’s policy, the toy companies, as TRU had asked them to do, presented examples of their specially-developed “club products” for TRU’s preview and clearance before offering them to the clubs. On other occasions, TRU and its suppliers negotiated over the

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addition, to prevent customers from ordering small quantities of some items, Tyco required that the smallest quantity of any item ordered must be at least 20% of the unit count of the highest quantity ordered. CX 1418. As described below, the policy was selectively enforced, so that in practice it applied only to the clubs’ purchases of regular products. Other retailers were exempted from the policy, and the clubs could buy combo or special packs without regard to the policy.

²²A memorandum prepared by a Mattel manager explained: “[O]ur agreement with TRU is that all of these [club] items will be offered to them as well so we must plan for a presentation to TRU.” CX 540.

TRU representative Peter Spencer, who screened the club specials of Mattel's Arco subdivision, testified (on cross-examination by TRU) that this was not a conventional right of first refusal, but really a chance for TRU to supervise its suppliers' sales to the clubs:

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

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

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

2283/24-2284/23, 2288/2-7; Goddu 6715/15-6716/9. The two companies agreed that Little Tikes would sell only custom product and near-discontinued toys to the clubs. IDF 273-277.

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

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

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

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

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

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

1. Mattel.

Initial commitment: CX 529, Okun 2671/25- 2673/14 (At Toy Fair 1990, “TRU threatened to ‘review’ their support of those manufacturers that overly supported the warehouse clubs.”); CX 530-B (Mattel committed to “do [its] best not to sell [the clubs] regular line goods.”); CX 532-A; Okun 2684/4 - 2690/4; Barad 7843/18 - 7844/1; Goddu 6663/6-22 (In October 1991, Mattel “said we [Mattel] would not sell the clubs the same items we were selling to them [TRU].”); CX 1658 (Goddu) 271/10-18; CX 1659 (Goldstein) at 87/17-88/7 (TRU’s response to Mattel’s commitment was “[T]hat’s fine. We don’t have anything else to talk about.”).

Preview and clearance of club products: CX 540; CX 624 (Mattel agreed to show TRU club products before they were sold to the clubs.); Leighton 3267/21- 3268/6, 3269/3-3271/2, 3272/8-18, 3291/2-3295/14; CX 597; CX 626; Spencer 1860/3-1862/17, 1960/22-1961/14 (Mattel made several presentations of its proposed club specials to TRU before offering them to the clubs for the purpose of allowing TRU to regulate what was sold to the clubs.); Spencer 1862/20-23 (A TRU representative charged with previewing club products testified that this practice was unprecedented in his experience.).

Negotiation and new points of agreement: Goddu 6887/17-6888/15; CX 1658 (Goddu) at 282/13-284/12; Barad 7894/7-7897/20; CX 1659 (Goldstein) at 100/17-101/17; Goldstein

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8266/25-8268/22 (After the October 3, 1991 meeting, Mattel told TRU's Goddu that Mattel would get back to TRU to "work this thing out." Mattel and TRU's Goldstein then agreed that Mattel would sell only special products to the clubs.); Goddu 6670/13-6671/7; Goddu 6891/13-6892/14 (Following the October 3, 1991 meeting, there were "constant questions" from Mattel, and Mattel later "committed [to sell] only exclusive[items to the clubs]."); Okun 2735/24-2739/6; CX 541 (At a February 27, 1992 meeting, Mattel affirmed to TRU that Mattel would not sell "hot product[s]" to the clubs and that TRU would have a right to preview club products.); Amerman 3802/10-3804/14 (In July 1992, Mattel's CEO Amerman assured TRU's Chairman that Mattel was not shipping first line merchandise to the clubs.); Weinberg 7692-93/6, 7697-7706; CX 1808; CX 1810 (TRU withheld payment for a product that Mattel had sold to the clubs in violation of promises to TRU, and then agreed to a settlement of the disputed debt in which TRU and Mattel split the cost of the markdown).

Promissory language: CX 530-B (Mattel "committed to [TRU] that we [Mattel] would do our best to sell [the clubs] regular line goods."); CX 540 (Mattel's "agreement with TRU is that all of these items will be offered to them as well . . ."); CX 541 (Mattel "[a]greed to show TRU all specials /exclusives"); CX 550-B (if Mattel were to "ship . . . our air hockey game to a club then arguably we [Mattel] are violating the spirit of our agreement [with TRU]."); Okun 2725/19-2726/5 ("TRU . . . came away thinking that there was an agreement . . .").

2. Hasbro.

Initial commitment: CX 78 (In January of 1992, Playskool advised that Hasbro should "achieve some major concessions [from TRU] if we are to dramatically change the way we approach the Warehouse Clubs."); Owen 1122/4-1123/10 (TRU and Hasbro discussed the clubs and other topics at a meeting during or about Toy Fair 1992. A Hasbro officer said that the meeting involved "some meeting of the minds" and was an example of how two companies "do business together."); CX 1657 (Goddu) at 130/20-25; Owen 1112/15-1115/5, 1117/6-9; Inano 3335/15-20; Butler 5535/5-9 (TRU sought a response from Hasbro regarding club sales, and Hasbro responded that it would refuse to sell promoted toys to the clubs).

Negotiation and new points of agreement: Verrecchia 1502/16-1504/19 ("During 1992, TRU kept asking Hasbro officials questions such as "what is your policy going to be, how are you going to deal with this [Hasbro products in the clubs] . . . ?"); Owen 1136/20-1144/23 (Starting in 1993, Hasbro changed its policy as TRU wished after checking with TRU to see if the proposed change was acceptable to TRU.).

Promissory language: CX 913-F ("We [Hasbro and TRU] have reached a corporate agreement on the sale of this item to the club stores.").

3. Fisher Price.

Initial commitment: Cohen 7992/10-19; Weinberg 7732/8-7733/19; CX 1662 (Weinberg) at 97/1-5 (In 1990 or 1991, TRU stated its policy and asked Fisher Price "how are you going to deal" with the clubs.); CX 1657 (Goddu) at 206/12-207/20 (Prior to Toy Fair (February) 1992,

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Goddu told Fisher Price that specially-configured products could be sold to the clubs.); Inano 3334/21-3335/5; Owens 1132/6-1135/8; Verrecchia 1393/5-1394/4 (At Toy Fair 1992, TRU informed Hasbro that Fisher Price had agreed not to sell promoted product to the clubs.); RX 256 (Fisher Price began to sell only specialized products to the clubs in 1993 and thereafter).

Preview and clearance of club products: Chase 1678, 1680/5-6 (At Toy Fair 1993, Fisher Price executives stopped the sale of a club combo pack, which was insufficiently differentiated from the similar regular product, because the product was a “sensitive item” for TRU.)

Negotiation and new points of agreement: Chase 1660/15-1661/5 (In September 1991, TRU sent to Fisher Price’s Vice President for Sales a copy of a TRU shopping report showing Fisher Price products found in Price Club. The words “Byron [the Vice President], you promised this wouldn’t happen” were written on the report.); Chase 1661/6-8 (After this event, Fisher Price imposed an extra level of review on products to be sold to the clubs and limited its sales to special and combination packs.); CX 913-E; Cohen 7970-74, 7997-98 (When a Fisher Price employee, in violation of the club policy, sold a regular product to a club in order to meet a sales volume target, TRU complained to Fisher Price. A TRU record of Fisher Price’s response to its employee’s error states that Fisher Price “agreed to stop selling this item to the clubs.”).

Promissory language: Chase 1660/16-1661/5 (“Byron, you promised this wouldn’t happen.”); CX 913-E (“agreed to stop selling this item to the clubs.”).

4. Tyco.

Initial commitment: CX 1657 (Goddu) at 176-177/17; Goddu 6677/6-8; Grey 2996/9-2997/9 (TRU told Tyco that club sales were not in Tyco’s or TRU’s best interest, and Tyco’s CEO Dick Grey responded that he would think about what TRU had said, promising “we’ll get back to you.” In a subsequent meeting, Tyco told TRU about its 25-item policy.).

Preview and clearance of club products: Weinberg 7716/22-7724/9; CX 1662 (Weinberg) at 169/10-172-16, 177/18-178/4 (In 1993, TRU complained to Tyco’s Playtime division after it found a top-selling toy in the clubs. At a subsequent meeting, Playtime sought TRU’s approval of a repackaged version of that toy for sale to the clubs. After viewing the newly repackaged toy, TRU said it would continue to buy the original version of the toy.).

Negotiation and new points of agreement: CX 1657 (Goddu) at 238/19-24; CX 808; Hilson 4505/5-4507/13; Weinberg 7738/8-7739/4 (Tyco reported to TRU an order from the club BJ’s, which complied with Tyco’s 25-item policy. Tyco told TRU that Tyco believed the BJ’s order was a test of whether Tyco intended to ship any regular products to a club under the 25-item policy.); Moen 651/17-652/9 (TRU put pressure on Tyco to sell combination packs to the warehouse clubs.); CX 913-D; Weinberg 7719/7-22 (In April 1992, TRU contacted Tyco’s Playtime division in order to “remind” them of TRU’s policy after its products were found in the clubs. Playtime responded that the products that offended TRU’s policy had been shipped to the clubs prior to the start of Tyco’s policy, and that, in the future, Playtime would ship only special products to the clubs.).

Promissory language: CX 914-A (From a letter to TRU: “To confirm the meeting we had,

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Playtime will not offer any merchandise to Warehouse Clubs that is bought by Toys R Us. This will make our policy exactly the same as Tyco's.")

5. Little Tikes.

Initial commitment: DePersia 2145/15-2146/9, 2151/13-23; CX 1510 (When asked by TRU's Goddu, Little Tikes told TRU that it would only sell the clubs combination packs or nearly discontinued items. Little Tikes repeated this commitment in conversations thereafter.)

Preview and clearance of club products: CX 1658 (Goddu) at 310/18-311/6 (Goddu told Little Tikes to sell only discontinued items to the clubs, because combination packs would not work for Little Tikes' large and expensive products.).

Negotiation and new points of agreement: CX 1510; DePersia 2159/9-2164/10; Schmitt 2283/24-2284/23, 2288/2-7, 2291/16-2297/18; Goddu 6715/15-6717/1; CX 1516; CX 1514-B, C; CX 1521 (Baughman file memo); CX 1519 (Schmitt handwritten notes) (Little Tikes' President asked TRU's Goddu for "help" in dealing with Little Tikes' parent company, Rubbermaid, which resisted the adoption of any restrictive policy with respect to the clubs. In April of 1993, representatives of the three companies met and reached agreement on key aspects of the club issue. Little Tikes agreed to sell only value packs, discontinued and near-discontinued items to the clubs.); DePersia 2180/15-2181/3; Hilson 4494/3-9 (During the balance of 1993, Little Tikes limited the products available to the clubs consistent with the "value packs, discontinued and near-discontinued [items]" distribution strategy discussed with TRU at the April 1993 meeting.).

Promissory language: CX 1519 ("Discussion + Understanding(s) - LT will offer value packs first to TRU.").

6. Today's Kids.

Initial commitment: Goddu 6729/9-22, 6733/23-6734/3, 6738/5-22, 6739/15; Butler 5524/6-5525. (In the course of several meetings during 1992 and 1993, Today's Kids informed TRU that it would cease club sales, but also asked whether, if it did so, TRU would increase its purchases from Today's Kids.); Goddu 6739/4-7; CX 891, CX 892 (TRU canceled its order for a Today's Kids product, which was selling well at TRU, because the product had also been sold to the clubs.); CX 913-D (In about June of 1992, Today's Kids told TRU that Today's Kids would sell to the clubs "special items going forward.").

Preview and clearance of club products: Stephens 5960-63 (Goddu told Today's Kids that changing the name of product is insufficient differentiation.).

Negotiation and new points of agreement: Goddu 6739/4-7; CX 1657 (Goddu) at 167/11-168/12 (TRU continued to pressure Today's Kids to further restrict its sales to the clubs, and Today's Kids asked TRU "if we could have more time."); CX 1657 (Goddu) at 167/15-168/12; Goddu 6739/4-11 (Goddu said "you must get back to us because we're not going to let this ... sit the way it is."); CX 1657 (Goddu) at 168/19-170/22; Goddu 6729/9-22; Butler 5526/7-10, 5551/2-7; CX 902 (Later in 1993, Today's Kids replied to TRU, explaining Today's Kids intention of not selling
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to the clubs at all. Today's Kids also asked again whether TRU would increase its purchases from Today's Kids. TRU increased its business with Today's Kids by 40%).

7. Tiger Electronics.

Initial commitment: CX 809; Shiffman 2008/3-14 (Goddu told Tiger's Vice President that TRU would not buy any products Tiger sold to a club. Tiger's Vice President asked whether the policy also applied to BJ's, and Goddu responded that it applied to any club. The Vice President then wrote an internal memorandum saying Tiger would have to "face up to Pace and not ship them . . .").

Preview and clearance of club products: CX 811, 814 (When Tiger Electronics asked TRU what type of packaging would meet its concerns, Goddu replied that selling to the clubs five year old product in "multipack[s] with high price points" would not hurt Tiger's sales with TRU.); CX 814; Shiffman 2044/21-2045/9 (Goddu invited Tiger to review Tiger's club strategies with him and get approval in advance, even for specific individual products and packaging.)

Negotiation and new points of agreement: CX 814; Shiffman 2033/12-2045/9 (In January 1994, Tiger's Vice President met TRU's Goddu to get more information on TRU's club policy and to learn what products Tiger could sell to the clubs without jeopardizing its sales to TRU. Goddu told Tiger that he would let Tiger "off the hook" by permitting Tiger to sell a five-year-old product called Skip-It, as well as hand-held games "in multipack with high price point" to the clubs. This agreement was less restrictive than one previously discussed.)

Promissory language: CX 811 ("I understand that with regard to hot new product, television items, high profile items, etc., the only way these can be sold to the clubs is through very 'creative' packaging.")

8. VTech.

Initial commitment: CX 1318; O'Brien 2426-32/19; Goddu 6866/17-23 (VTech "promised" TRU at Toy Fair 1992 that it would not sell to the clubs.)

9. Binney & Smith.

Initial commitment: CX 1662 (Weinberg) at 148/19-149/18; CX 913-C; Weinberg 7614/8-7617/8 (TRU's Weinberg contacted Binney & Smith's Vice President of Sales after TRU found regular Binney & Smith product in a club.); CX-913-C; Weinberg 7666/15-7667/21 (A contemporaneous TRU memorandum noted with reference to this meeting: "Per [the Vice President], understood our concern. Going forward they will offer special packs only for '93. Commitments already made for '92.").

Preview and clearance of club products: Blaine 6421/1-6423/17; CX 1662 (Weinberg) at 162/1-164/5 (In December 1992, TRU previewed a series of prototype samples of warehouse club products, and informed Binney & Smith that its plans were acceptable to TRU.)

Negotiation and new points of agreement: CX 2 (Binney & Smith wrote to TRU on December 21, 1992: "Our intent is to differentiate our product offering to Membership Clubs from that sold
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through our traditional retail trade channels. We will do this with larger sets and multi-packs that move the clubs to higher price points. In addition, we will alter contents to present the club customer with a non-comparable value.”); Blaine 6436/16-6438/14 (TRU called a third meeting with Binney & Smith in October of 1993. Just as in the prior meeting, Binney & Smith brought samples of its club products, however TRU apologized, saying someone on its staff had made a mistake and that TRU had no problem with Binney & Smith's warehouse club offerings.)

Promissory language: CX 913-C (“Per [Binney & Smith’s Vice President of Sales], understood our [TRU’s] concern. Going forward they will offer special packs only.”).

10. Sega.

Initial commitment: CX 754; Kalinske 2475/3-9, 2476/11-23, 2540/17-20; CX 1658 (Goddu) at 387/1-388/6. (In a fall 1991 meeting, TRU’s Lazarus asked Sega’s CEO what Sega’s policy was with respect to selling its Genesis products to the clubs. Sega initially explained to Lazarus that it was not selling any Genesis product to the club Sam’s, but when he learned this was incorrect, the CEO of Sega wrote to Lazarus apologizing and assuring TRU that “Sam’s Wholesale Club will have old Genesis software bundled with Hardware this fall.”); CX 1658(Goddu) at 389/2-11 (Sega told TRU it only sells old product to the clubs.).

Negotiation and new points of agreement: CX 1657 (Goddu) at 229/7-15 (Goddu repeatedly spoke to Sega about product in the clubs that was identical to the product carried by TRU.) CX 1660 (Lazarus) at 123/21-124/2. (Sega complained to TRU that Nintendo’s products were in the clubs.); CX 1659 (Goldstein) at 57/18-593-9er [ôke

do the same. Several were particularly concerned about their closest competitors; all were concerned about the behavior of competitors generally. With the cooperation of the toy manufacturers, TRU also monitored and policed the horizontal agreement after it was in place.

When TRU raised its club policy with the toy companies in late 1991 and 1992, the policy met with resistance. Lazarus testified that the manufacturers were not happy about it:

Q: Did any of the manufacturers, when you were presenting your policy, you said the responses were varied, did any of them express unhappiness to you concerning the policies?

A: Yeah, I think they wanted to do all the business they could do. Right.

* * * *

Q: I think you also mentioned that some others, correct me if I am wrong, did not seem happy about it.

A: I don't think any of them were happy. I think I can characterize no one as being happy.

Lazarus (CX 1660) at 72/9-14, 181/24-82/3.

The toy companies were afraid of yielding a potentially important new channel of distribution to their competitors. Small changes in sales volumes have a significant effect on toy manufacturers' overall profits, CX 1822 (Scherer) ¶ 17, 18, and no retail channel other than the clubs offered similar opportunities for rapid growth. For example, Mattel's sales volume to the clubs increased by 87% between 1989 and 1991. CX 574; Okun 2652/22- 2653/19. Much of this growth was a result of Sam's emergence as a toy buyer, but sales to BJ's, Costco and Pace also increased at a rapid rate. By comparison, Mattel's overall sales grew by approximately 10% during this period. CX 530-E; Okun 2634/20-2636/4. A 1991 Lego memorandum said "clubs may be the most important new format development in retailing in the past century." CX 487-B. A Fisher Price report called the "opportunity for growth . . . phenomenal." CX 698-B. Based on this and other evidence, the ALJ found that toy suppliers in the late 1980s and early 1990s saw the clubs as a new outlet of potentially great importance. IDF 64, 65.

When TRU introduced its club policy, the toy industry was looking to expand -- not restrict -- the number of major retail toy outlets. As already mentioned, Child's World and Lionel Leisure had recently fallen into bankruptcy. The few remaining national retailers comprised a large and growing share of the toy manufacturers'

summarized his view of Mattel's place in this quickly changing retail environment: "The constriction in the number of traditional retail outlets that carry toys is going to become a bigger and bigger problem as time passes." CX 523. Noting the clubs' rapid growth rate, Amerman told his staff that he wanted to be much more aggressive in pursuing the club channel of distribution so Mattel would not be as dependent on TRU and the other traditional retail outlets. CX 523; Okun 2624/19-2625/14. Mattel's Vice President of Sales testified that "our hope was that we could figure out a way to have them [the clubs] expand their business and become more like a traditional toy account. . . ." Okun 2652/1-4.

The club policy that TRU wanted to enforce ran squarely against the independent business strategies of its suppliers. TRU asserts that each toy manufacturer cared about competitor responses only to be sure that its competitors were subject to the same rule or policy. (Reply Br. at 17.) To the contrary, the record shows that a uniform, joint reaction to TRU's policy was a necessary element of each manufacturer's decision to restrict sales to the clubs. Each was simply unwilling to go forward with the proposed policy alone. Indeed, Goddu testified that it was "frustrating to [TRU] that [its suppliers] would always talk about . . . their competition" and resisted making "*a decision on their own independent of what their competition did.*" Goddu 6877/4-13 (emphasis added).

1. TRU built a horizontal agreement among its suppliers to overcome their reluctance.

Toy manufacturers were unwilling to limit sales to the clubs without assurances their competitors would do the same. IDF 68, 75. Discrimination against the clubs simply would not

²⁵As discussed below, this promise itself was based on the fact that the competition would do the same. CX 532.

Goddu's words, TRU, during its meetings and conversations with the manufacturers, communicated the message "I'll stop if they stop"

(Goddu) at 278 (emphasis added).²⁶ Goddu also said: “We may have indicated to one supplier that his competitor is going to do nothing but warehouse club packs, and, you know, ‘You should do the same.’” *Id.* at 279. As the ALJ found, “Goddu understood each of the major manufacturers when they said that they were only selling to the clubs because their competition was selling to the clubs, and that they would get out of the clubs if their competition got out.” IDF 83.

As we will now discuss, the specific evidence of TRU’s discussions with the large toy manufacturers corroborates the accuracy of Goddu’s description. Conversations about the adoption of the club policy between TRU and its suppliers were frequent and constant. They were conducted by other top-level executives at TRU in addition to Goddu. CX 1659 (Goldstein) at 59/13-17; IDF 77 (discussing Lazarus’ testimony that he told TRU’s suppliers that TRU was talking to each of them, so they would know they were on “a level playing field”).²⁷ Overall, documents and testimony connect at least seven firms -- Mattel, Hasbro, Fisher Price, Tyco, Little Tikes, Today’s Kids, and Tiger Electronics -- to these conversations in which TRU discussed rivals’ conduct with respect to TRU’s club policy.²⁸ In light of Goddu’s broad admission that TRU intentionally employed this method of bargaining with all of its “key suppliers,” there is reason to conclude that the discussions were more widespread than the direct evidence indicates. As the ALJ found, the toy manufacturers “were aware that TRU was communicating its policy to the other manufacturers and that without unanimity, regular line product sales to the clubs would recommence.” IDF 80.

A Mattel memorandum summarized the October 3, 1991 meeting at which Mattel’s CEO promised Lazarus that Mattel would comply with TRU’s policy: “I believe we said we would not sell the clubs the same items we were selling to [TRU]. *This was based on the fact that*

²⁶Little Tikes General Manager summarized for his files the contents of a telephone conversation with Goddu in 1993, noting among other things: “I asked why Roger [Goddu] had raised the warehouse club issue so strongly at our Toy Fair meeting? He said they were discussing it with everyone.” CX 1510.

²⁷Mattel’s Okun mentioned Van Butler, Melody Young, and Peter Spencer as other people at TRU who may have complained to Mattel when its products were found in the clubs. Okun 2784/7-9.

²⁸TRU aggressively used this kind of back-and-forth bargaining in its efforts to get Sega and Nintendo to agree to cease entirely distributing their product through the clubs. TRU’s efforts with Nintendo were not successful, since Nintendo never adopted any kind of restricted distribution policy with respect to the clubs. Sega met TRU halfway by agreeing to adopt the same “special packs only” policy as the traditional toy companies. TRU did not think that club combo packs, which generally included video games and video game players, differed sufficiently from similar electronic game products sold at TRU. TRU’s efforts to bring Sega and Nintendo into agreement illustrate the pattern of conduct described herein. IDF 340, 345.

competition would do the same.” CX 532-A (emphasis added). Having obtained this guarantee from Mattel, TRU used it to induce others to join the conspiracy.

Hasbro’s Director of Account Development testified that he recalls his supervisor telling him that at or just before Toy Fair in February 1992, TRU had met with Hasbro’s competitors, including Mattel and Fisher Price. The Hasbro executive said: “because our competitors had agreed not to sell loaded [i.e., promoted] product to the clubs, that we would . . . go along with this, that he didn’t believe that it would stick, meaning that . . . somebody would break and sell promoted product to the clubs, at which time the door would be open to us.” IDF 177; Inano 3334/2-3335/20. The executive further testified that TRU told him the other major manufacturers were going along with the policy, IDF 179, and that he had been assured by TRU that Hasbro would not be singled out. Verrecchia 1376/13-20. Hasbro’s President of Sales and Marketing, Owen, similarly testified that in or about 1992 Goddu told him Tyco, Little Tikes, Mattel, and Fisher Price were all taking a similar position with respect to sales to the clubs. Owen 1128/5-1133/3. These statements were all made in the course of TRU’s negotiations over Hasbro’s policy toward the clubs. Owen admitted that these other companies’ policies were of interest to Hasbro, at least in part, because Hasbro did not want others to gain sales volume that was unavailable to Hasbro. Owen 1131/3-15. As already mentioned, Fisher Price told TRU that Fisher Price would have to “pay attention” to the club “channel” if rivals did so. CX 1658 (Goddu) at 328/18-329/2. Finally, Little Tikes’ Vice President of Sales for North America testified that, when he asked if his close competitor, Today’s Kids, was selling to the clubs, Goddu told him that Today’s Kids would be getting out of the clubs as well. The Little Tikes Vice President understood this as an assurance. DePersia 2147/7-2148/6, 2150/25-2151/3.

Notwithstanding Tyco’s “25-item policy” (which actually functioned to prevent sales to the clubs, *see supra* note 21), TRU also encouraged Tyco to develop combination packs for the clubs to bring it in line with the other toy companies. Costco buyer Michelle Moen testified that TRU urged Tyco to develop special packs for sale to the clubs like the other toy manufacturers were doing, and told other manufacturers that Tyco would sell special packs to the clubs. Moen specifically mentioned Mattel and Hasbro. Moen 651/17-652/9. Tyco’s CEO Grey acknowledged that after the development of combination packs in mid-1993, the “approach in the [Tyco club] line is similar to that which other major toy companies have.” CX 1412-B; Grey 3027/22-3029/12. Tyco sold the special club packs without regard to the 25-item policy previously announced. TRU’s conduct in this instance illustrates that substantial uniformity of club policies across the toy industry was key to the continued success of the plan.

Direct communications between representatives of different toy companies about TRU’s policy also demonstrate the toy manufacturers’ anxiety over having to respond to TRU without knowledge of what their competitors would do. The CEOs of Hasbro and Tyco discussed their respective club policies early in 1992. IDF 189. Tyco’s CEO explained his company’s 25-item policy, and Hasbro’s CEO said that Hasbro was still working on a company-wide response. *Id.* According to Fisher Price records, a Hasbro division representative told Fisher Price that Hasbro was “adamant that they would not be shipping key [items] to the [c]lubs, at least not yet.” IDF

224. And, a Fisher Price representative asked a Little Tikes regional manager if he had experienced any repercussions from TRU for selling products to the clubs. IDF 227.

2. After the initial boycott agreement was in place, TRU organized a related agreement to enforce the boycott.

When asked if TRU ever indicated to a supplier that other, specific companies were going along, Goddu explained:

A. We may have indicated to one supplier that his competitor is going to do nothing but warehouse club packs and, you know, “You should do the same.”

Q. Who was that?

A. I can’t recall which one. I mean *we might use that as a ploy or a tactic to encourage them* to, you know, develop an intelligent distribution policy, but more or less, to get off the dime, you know. “You really ought to do these combo packs.” *I mean we’re talking to everybody and we’re being told in a general sense that, you know, that’s the way so and so’s going.* Not necessarily any one special vendor. I wouldn’t have ruled out that we did that.

CX 1658 (Goddu) at 279 (emphasis added). This “ploy or tactic” illustrates another reason the boycott agreement helped TRU to get its suppliers to adopt a distribution policy squarely contrary to the business strategy they favored only a year earlier. The horizontal agreement not only allowed TRU to overcome its suppliers’ reluctance to restrict sales to the clubs, but TRU turned their apprehensions to its own advantage. As the ALJ found, for fear of reprisals from TRU, the toy companies did not want to be caught selling to the clubs when their competitors were abstaining. IDF 77.

TRU requested and then passed complaints about breaches of the boycott agreement from one supplier to another when regular product was found in the clubs. TRU’s President testified: “I would get phone calls all the time from Mattel saying Hasbro has this in the clubs or Fisher Price has that in the clubs So that occurred all the time.” CX 1659 (Goldstein) at 59. Goddu explained that, on the many occasions he received these calls, he would “always thank them and tell them we would follow up” Goddu 6929-6930. Lazarus also admitted that these conversations took place. IDF 193; Lazarus 5452/12-18. TRU would speak to the offending firm and even assure the complainant that the offending firm would be brought into line. IDF 226. Violations of TRU’s club policy were thus detected and punished, serving to enforce the horizontal agreement. IDF 91, 95. The toy companies participated in this exchange of complaints, which was frequent and continued over lengthy periods, effectively making their competitors’ compliance a part of their agreements with TRU.

In the summer of 1992, TRU made a forceful presentation of Hasbro's complaints to Mattel. IDF 148. Hasbro told TRU about various Mattel regular products that Hasbro found in the clubs. These sales violated TRU's club policy and Mattel's promise not to sell the same products to the clubs that Mattel was selling to TRU. On July 17, 1992, TRU's Lazarus and Mattel's CEO Amerman met, and TRU communicated reports from Hasbro and other competitors of Mattel that Mattel was selling product to the clubs. CX 1772; Amerman 3795/9-3796/20, 3800/7-3801/25, 3806/24-3808/4. Amerman assured Lazarus that Mattel was not shipping "first line" merchandise to the clubs. Lazarus confirmed that he "could have" mentioned Hasbro as one of Mattel's competitors who had complained to TRU at the meeting. Lazarus 5451/4-5452/18. Mattel thereafter ceased filling orders from the clubs that it had accepted earlier in the year. Later on the same day (July 17), Lazarus met with Hasbro's CEO Allan Hassenfeld. CX 1772, 1773-B; Lazarus 5448/13-16.²⁹

Mattel also passed on to TRU complaints about Hasbro products sold in the clubs. TRU's Goldstein testified that either Mattel's Girls' Division President Barad or CEO Amerman complained to him "probably" more than once that Mattel had found some Hasbro products in the clubs. CX 1659 (Goldstein) at 59/10-17, 61/17-22.

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

Another example concerns Fisher Price and Hasbro's Playskool division. John Chase, the Key Account Manager for Fisher Price, and his supervisor saw Playskool products in a club in November of 1992. Chase recalls his supervisor placed a telephone call to TRU, and the supervisor reported to Chase that Playskool was not "going to get away with it, that Toys "R" Us is going to take care of it." Chase 1666/14-1667/1. Playskool was the subject of many complaints in the fall of 1992. In August, Goddu had warned Playskool Vice President for Sales George Miller to cease club sales or TRU "wouldn't still buy [Playskool's] basic product." IDF 200. Later in the year and after hearing from Fisher Price, TRU called Miller to TRU's main

²⁹There is other testimony and documentary evidence of TRU facilitating communications between Hasbro and Mattel. Following the July 17 meeting with Hasbro, TRU received confidential, internal Hasbro memoranda dated from June 30 to July 31, 1992, which reported information about Mattel's, Hasbro's, and other competitors' sales to the clubs. CX 1633.

On August 10, Goddu transmitted this information to TRU's CEO and other top executives. The same day, some of these TRU officials met with Mattel to review the products Mattel planned to ship to the clubs. CX 1633; Goddu 6689/13-6690/10; Leighton 3291/2-3294/24. And just two days later, on August 12, Goddu had a conversation with a Hasbro division president during which Goddu passed on to Hasbro a conversation he had with Mattel executives, including Amerman, concerning the warehouse clubs. CX 1612.

³⁰In addition to the testimony from TRU's officers, particularly persuasive since TRU was the communications hub and initiator of the boycott strategy, that (1) the toy manufacturers were unhappy about TRU's club policy, (2) that they resisted any restrictions on their sales to clubs,

³⁰(...continued)

clubs, Hasbro said it would not do so, but when another company sold promoted product to the clubs "the door would be open for us."); CX 1658 (Goddu) at 273 (Hasbro made it clear to TRU that Hasbro would not "sit by idly" if its competitors sold product to the clubs.); Verrecchia 1385/7-25, 1376/16-1377/12 (Hasbro wanted to ensure that TRU's policy was being applied to Hasbro's competitors.); Verrecchia 1485/19-1486/4; Owen 1128/5-1131/2 (TRU assured Hasbro that it was talking to the major manufacturers about the clubs and that it was establishing a policy that it was going to apply to all of TRU's vendors.); CX 180, 309, 363, 47-50, 336; Verrecchia 1366/6-1367/21, 1374/13-1376/20, 1489/13-23; Lazarus 5451/14-5452/18; CX 1660 (Lazarus) at 141/4-8; Amerman 3795/9-3796/20, 3800/7-3801/25, 3806/24-3808/4; CX 1659 (Goldstein) at 62-63 (Hasbro monitored its competitors' sales to the clubs, and aggressively and frequently complained to TRU when it found violations.); CX 1658 (Goddu) at 329/23-24, 276/12-277/25; Goddu 6701/13-18 (Goddu testified that Hasbro complained more about its competition selling in the clubs than other manufacturers.); Grey 3011/12-3013/4 (In May of 1992, Hasbro's CEO discussed with Tyco's CEO what each company was doing or not doing with respect to the clubs.); CX 1772; 1773-B; Lazarus 5448/13-16; CX 1774 (TRU met separately with Mattel and Hasbro on July 17 1992.); CX 1633 (Following the July 17, 1992, meeting with Hasbro, TRU received confidential internal Hasbro memoranda dated from June 30 to July 31, 1992, reporting sales to the clubs by Mattel and other Hasbro competitors.); CX 1612 (On August 12, 1992, Goddu had a conversation with a Hasbro Division President during which Goddu passed on to Hasbro a conversation he had with Mattel executives, including CEO Amerman, concerning the warehouse clubs.); Moen 651/17-652/9 (When Tyco developed special club packs, this was communicated by TRU to Mattel and Hasbro.); CX 684-B; Cohen 8015/3-23 (A Fisher Price record shows that a Hasbro Division Representative told Fisher Price that Hasbro was "adamant they would not be shipping key [items] to the clubs, at least not yet.").

3. Fisher Price.

CX 1658 (Goddu) at 328/18- 329/29 (Goddu testified that Fisher Price was concerned because "if their competitors are going to exploit the club channel of distribution, then they [Fisher Price] have to pay attention to it."); Weinberg 7628/15- 7629/1 (TRU's Vice President Weinberg testified that Fisher Price complained to him about Playskool [Hasbro] products that Fisher Price found in the clubs.); TRU's Response to Complaint Counsel's Proposed Finding of Fact 278 (TRU admits that Fisher Price complained from time to time and that its particular concern was Hasbro's Playskool Division.); CX 563 (A Fisher Price representative spoke to a Little Tikes' regional manager to find out if Little Tikes had experienced any repercussions from TRU about products it offered to the clubs.); CX 684-B; Cohen 8015/3-23 (Fisher Price notes from Toy Fair 1992 state that Hasbro's Kenner and Playskool representatives told Fisher Price that their company was "adamant that they would not be shipping key skus to the Clubs, at least not yet.").

4. Tyco.

CX 1658 (Goddu) at 271/23-272/22, 273/24-274/3; Goddu 6876/20-6877/13 (TRU's Goddu
(continued...))

³⁰(...continued)

testified that Tyco had an ongoing concern about “having to be in the clubs because their competition was there.”); Inano 3345/2-3347/4; CX 532; CX 553 (Tyco knew of Mattel’s club policy before it was formally announced.); Moen 651/17-652/9 (TRU urged Tyco to adopt the same policy as the other large toy makers by developing special club packs, and told other manufacturers that Tyco would sell such packs to the clubs.); CX 1412-B; Grey 3027/22-3029/12 (Tyco’s CEO acknowledged, in 1993, that Tyco had adopted the same policy as its competitors.); Grey 3011/12-3013/4 (In May 1992, Tyco’s CEO and Hasbro’s CEO discussed their companies’ policies regarding sales to clubs.).

5, 6. Little Tikes and Today’s Kids.

DePersia 2146/10-2147/6, 2148/7-22 (When confronted by TRU about stopping or restricting sales to the clubs, Little Tikes executives asked about other manufacturers’ sales to the clubs and asked specifically whether TRU’s policy also would be applied to Today’s Kids.); DePersia 2214/23-2215/3 (Little Tikes was concerned that Today’s Kids might take away market share from Little Tikes.); DePersia 2147/7-14, 2150/3-12 (Goddu responded that Today’s Kids would be “getting out of the business” of selling to the clubs.); DePersia 2147/18-24, 2150/25-2151/4 (A Little Tikes Sales Vice-President understood that Goddu had spoken with Today’s Kids and that the response was a reassurance of Little Tikes’ concerns.); Goddu 6726/2-11, 6727/8-12, 6730/20-6732/2, 6738/5-6739/25 (Goddu had spoken to Today’s Kids about TRU’s policy, and Today’s Kids had told Goddu it would slow or discontinue sales to the clubs.); CX 874 (A Today’s Kids memorandum lists several Mattel and Tyco-Playtime products sold by clubs, and states that Today’s Kids knew that TRU was taking these items from its shelves. The memo is dated a week before TRU met with Tyco regarding these products.).

7. Tiger Electronics.

Shiffman 2016/18-2017/1 (Tiger’s Executive Vice-President got the “impression”

and among the toy companies not to sell any of the same products to the clubs that the toy manufacturers sold to TRU. Thus, the focus on hot products was dropped in favor of a uniform policy of offering the clubs only goods that were significantly differentiated from those carried at TRU. Toy companies like Tyco also agreed to develop a special line of differentiated products for the clubs if they had not already done so. These special lines were comprised of combination packs, but in a few instances individually packaged toys were redesigned to make them visually distinct from the items sold at TRU and other traditional retailers. As discussed above, TRU supervised the policy by reviewing and approving many club products before they were offered to the clubs.

The no-identical products policy met TRU's goals. TRU wanted to prevent toy manufacturers from competing with each other to sell products to the clubs, CX 1658 (Goddu) at 276/23-277/25; Kalinske 2488/20-2489/3, 2491/19-2492/6, to prevent consumers from making direct price comparisons between products sold by TRU and products sold by the clubs, Butler 5560/13-24; Goddu 6635/7-21, and to prevent the clubs from competing with TRU. Okun 2684/15-2685/6.

TRU approved of the sale of special packs to the clubs because special packs make it difficult for customers to compare the prices at different retail outlets. Asked whether a customer could compare the price of an individual toy with that of a club pack, TRU's Goddu answered:

the objective was that the consumer not be able to do it easily. And if, can I give you an example on that? If Sunshine Barbie individual doll is found everywhere at \$9.99 and then the warehouse clubs sell Sunshine Barbie and two little friends with it and the warehouse clubs sell that for \$14.99 or \$16.99, the customer doesn't really know the value of the little dolls. I mean, it's hard to say is that worth -- are the other retailers competitive or not competitive at \$9.99 relative to that version being \$14.99? Will you get more product? So those were the objectives, you know, so that they'

³¹(...continued)

said, but that Mattel could not stop selling everything to the clubs because Mattel already had outstanding commitments to them and what Mattel really wanted to do was to sell special packs to the clubs. . . . During this phone call, Goldstein also indicated to Barad that selling special packs to the clubs was acceptable to TRU.”).

for a lower price at a club than any one of the items sold alone at other retailers. IDF 394, 395. A 1993 Mattel memorandum describing problems with the Barbie Gift Sets developed for the clubs illustrates the point:

The biggest complaint the clubs have is that there is no perceived value to the Barbie gift sets. They attempt to sell the gift sets at \$14-\$18, while the traditional retailers sell the regular line feature Barbie for \$11-\$16. Their [the clubs'] customer sees only the doll and sees them as being higher priced. This also creates a problem for their entire department which a consumer could view as being higher priced.

CX 592. The memorandum also says that "putting costumes with a doll and calling it a gift set does not work. They sell costumes for as little as 75 [cents] each . . . and we're charging them \$2-\$4. No value." *Id.* While not all combination packs fared as poorly as these Barbie Gift Sets, the problem they created was pervasive.

The ALJ correctly found that TRU halted a pattern of rapid growth of toy sales at the clubs. IDF 368, 375. In just the year before the boycott, clubs' share of all toy sales in the United States grew from 1.5% in 1991 to 1.9% in 1992. But, toy sales by the clubs fell steadily to 1.4% by 1995 after the boycott took hold.³² CX 1822 (Scherer) Ex. 4a.

The boycott hobbled individual clubs' toy business. Costco's experience is illustrative. While its overall growth on sales of all products during the period 1991 to 1993 was 25%, Costco's toy sales increased during the same period by 51%. IDF 385; CX 1745-Z-9. But, after the boycott took hold in 1993, Costco's toy sales *decreased* by 1.6% despite total sales growth of 19.5%. *Id.* While there is no assurance that Costco's toy business would have continued to grow at an annual rate of 25% or more, TRU's policy clearly took the wind out of Costco's sails. This change reflects the sudden loss of supply of key toy products. In 1989, over 90% of Mattel toys purchased by Costco and the other clubs were regular items, but this number fell to zero in 1993. CX 1822 (Scherer) ¶ 51. The clubs' share of the 100 most popular toys from all manufacturers dropped by more than half between 1992 and 1995. Most of Costco's 1995 sales were video products, so the reduction in popular traditional toys was even greater. CX 1822 (Scherer) Ex. 5, 6a.

The reversal of the clubs' success as toy retailers can also be seen by examining toy manufacturers' sales to the clubs. For example, the sales volume of Fisher Price to Price Club dropped from around \$6 million in the late 1980s to approximately \$220,000 in 1993. Chase 1775/14-1776/6. Sales to the clubs by Hasbro, including its Playskool, Playskool Baby, and

³²The clubs's overall sales of all goods grew at an annual rate of 26.4% in 1991, 22.8% in 1992, 10.8% in 1993, 3.9% in 1994, and 5% in 1995. CX 1824. Professor Buzzell, a marketing expert called by TRU, testified that the sales volume of all clubs grew at an average annual rate of 48 % from 1985 to 1988 and of 24.3 % from 1988 to 1992, before slowing to an annual rate of 6.5 % from 1992 to 1995. RX 894 (Buzzell) at 21-22.

Kenner divisions, declined from \$9.5 million in 1991 to \$3.2 million in 1993. IDF 212; CX 448; CX 447A-E; Owen 1294/2-5. Mattel's sales to all clubs, which grew at about 50% annually in both 1989 and 1990, dropped from over \$23 million in 1991 to \$7.5 million in 1993.³³ IDF 165. From 1991 to 1993, Tiger Electronics sold the clubs regular products, and its sales to the clubs climbed from \$273,000 to \$3.5 million, at which time clubs accounted for 2.5% of Tiger's sales. IDF 301; CX 1756-C. But after Tiger adopted TRU's policy in 1994, club sales dropped to less than \$32,000. IDF 309.

Most significantly, competition would have driven TRU to lower its prices had TRU not taken action to stifle the competitive threat posed by the clubs.³⁴ In turn, if TRU lowered its prices, other retailers would have been forced to do so as well. IDF 392. Several industry witnesses expressed this view. Goddu thought that the clubs were going to force down toy prices at all retailers, in the same way that Wal-Mart had done. Goddu 6616/19-23. A Binney & Smith executive believed that the prices charged by the warehouse clubs would become the prevailing market price. Blaine 6372/12-16. The ALJ also found that, because clubs carry many less popular items at prices substantially lower than TRU's, TRU would have lowered prices for toys beyond the top 100 to 250 best-selling items to protect its price image. IDF 405.

If TRU had matched the clubs' prices by reducing its average margin on its five hundred best-selling products from 20.5% (TRU's average margin on the top 500 toys) to 9% (Costco's average margin), its customers would have saved \$55 million per year.³⁵ CX 1822 (Scherer) ¶ 58. By the same token, TRU's policy raised the costs of toys at the clubs, obstructing their advantage as the lowest price outlet. This too weakened their effectiveness as competitors to the advantage of TRU and the injury of consumers.³⁶

³³Mattel's sales of regular product to clubs dropped from about \$17 million in 1991 to zero in 1993, and during the same period sales of custom product grew from \$6.7 to \$7.5 million. IDF 165.

³⁴Indeed, TRU *did* lower its prices for several items when clubs were able to sell the *same* items at a substantially lower price. *See supra* p. 21.

³⁵Of course, if TRU lowered the prices on fewer than five hundred items to meet club competition -- which in fact it was more likely to do -- this number would be lowered accordingly.

³⁶In an effort to show that TRU's pricing is already constrained in local markets by competition from Wal-Mart and the other national discounters, TRU's economist, Professor Carlton, performed a regression equation comparing the number of local competitors to the prices charged for *all* of the toys at TRU stores and found a very small (1-2%) relationship between the number of local competitors and prices charged by TRU. Complaint Counsel's expert, Professor Scherer, responded that Carlton erred in using the average price of all toy items, because TRU only adjusts its prices on the top several hundred items to meet price competition from other

(continued...)

I. EVIDENCE OF “FREE-RIDING.”

TRU provides several services that might be important to consumers. These include advertising, carrying an inventory of goods early in the year, and supporting a full line of products. But the evidence indicates that the manufacturers compensate TRU for advertising toys, storing toys made early in the year, and stocking a broad line of each maker’s toys under one roof. Given TRU’s hard bargaining with the toy companies over prices and other terms of sale, and due to the industry’s desire to support TRU, TRU has consistently been able to extract subsidies, discounts, and other concessions from the toy companies that enable TRU to provide the services the toy industry wants.

TRU does not purchase “image advertising” designed to boost the demand for toy products generally. Television advertising, for example, is paid for entirely by the toy companies. IDF 470; CX 1822 (Scherer) ¶ 60. TRU advertises in local newspapers, and via catalogs, to promote the availability and prices of products in TRU stores. IDF 471. There is no reason to believe that the small amount of local advertising by TRU boosts sales at nearby club stores. IDF 480. To the contrary, Professor Scherer convincingly demonstrated that, if anything, TRU’s local advertisements lower toy sales at its competitor stores in the same area. CX 1831 (Scherer) ¶¶ 1-10.

Toy manufacturers also pay TRU for its local ads. A 1993 TRU memorandum states that advertising is vendor-funded and calls it “essentially free.” CX 967-C.³⁷ TRU’s cost calculations confirm this statement. TRU’s calculations do not indicate the amount of advertising expenditures in 1993, but do show advertising allowances of more than \$183 million from toy manufacturers. CX 1012. In 1994, TRU spent \$199 million on advertising-related expenses and received compensation in excess of \$198 million. *Id.* TRU’s net cost of advertising was \$750,000, or 0.02% of total sales. In 1995, TRU’s calculations show that it spent about \$263 million on advertising and was paid a bit more than \$225 million, roughly 90% of its costs. TRU projected that 1996 payments would cover 95% of advertising costs. CX 1009. Advertising, in short, was a service the *toy manufacturers* provided for TRU and not the other way around.

³⁶(...continued)
discounters. Reinterpreted to measure not average price, but only the prices of the top 100 to 250 items, Carlton’s analysis shows pricing differences of between 5.08 and 7.08% for top-selling items at locations where TRU stores compete with Target, Wal-mart or other discounters. If allowed to continue, head-to-head price competition with the clubs was likely to lower toy prices further in the 238 or more areas where TRU stores compete with club outlets. CX 1830 (Scherer) ¶¶ 10, 11.

³⁷According to Spencer, a TRU toy buyer, TRU’s Senior Vice President of Advertising repeatedly explained that TRU received more in advertising allowances than it spent on advertising. Spencer 1867/7-14.

Manufacturers also compensate TRU for storing the goods that it buys before the Christmas selling season. Most often compensation is made by extremely favorable “dating,” meaning delay in the date payment is due for goods received over the year. TRU’s Chairman Lazarus explained dating:

it’s financed in large part by the manufacturers who build extra margin into the price and then give “dating.” You buy now; you pay later. Because you don’t sell evenly throughout the year. That was and is the premise. They [the toy companies] build the price margin into it so they can produce 12 months a year. Without this dating, I never would have been able to afford the inventory.

CX 1611-C (emphasis in original). TRU is the only toy retailer that pays for all of its Mattel inventory on [redacted], even if products are purchased in January of that year. [citation redacted]. By comparison, Wal-Mart is required to pay within 90 days of shipment. *Id.* Mattel documents describe this late payment deadline as compensation for storage services. CX 686-B. When Playskool shipped an order of products unexpectedly early (late June), Playskool agreed to lower the price of the shipment by an amount equal to four months’ storage costs. CX 1730. TRU’s records show that manufacturers routinely paid TRU credits for warehousing services. CX 1012.

TRU is compensated for supporting the toy companies’ full line of products. TRU receives a disproportionately large supply of hit products in short supply. In 1992, for example, TRU got 40 to 50% of Mattel’s “hot” products while it sold only 29% of Mattel’s total output. CX 530-D. A 1990 letter from Mattel to TRU explained, TRU “is receiving a disproportionate share of our quotas. . . . [W]e will continue to provide the maximum possible support to insure a great sell-through.” CX 533-A. “Great sell-through” means that TRU, by stocking hit product unavailable at other toy retailers, is able to sell additional toy items to the customers who come to TRU stores to purchase the hit products. In other words, even though TRU’s margins are lower for “hit” products, TRU is able to profit from its access to hits by also selling some less popular products to the customers who come to its stores to purchase hits. CX 1822 (Scherer) ¶ 20. Thus, liberal access to scarce products compensates TRU for its full-line stocking service to the toy industry. A 1990 Tonka (Hasbro) memorandum reports: “Tonka has fulfilled its obligation to provide ‘more than a fair share’ of hot product to TRU (including the 8,000 . . . Wrestling Buddies that [were] bound for other retailers).” CX 5.

The toy companies also give TRU post-sale discounts (“markdowns”) on the prices paid for slow-moving products. In this way, if TRU is burdened by an unsuccessful product it carries, the manufacturer pays a large part of the cost. A Kenner (Hasbro) document states that TRU “murdered us” on Kenner-funded markdowns on products that flop. CX 10 A, B. Many documents in the record memorialize discounts extended to TRU when products did not sell as well as expected: for example, a 1992 Mattel memorandum titled “Toys ‘R’ Us -- Special Pricing” records granting TRU well over \$1 million in free goods in compensation for “special discounts” on slow-moving items; and a 1994 memorandum suggests that Mattel, as “done in the

past,” should fund discount coupons for twenty-eight items overstocked at TRU. CX 556, 584-A; IDF 507 (listing documents). TRU’s standard purchase contract includes a most favored nation clause to guarantee that it pays no more than the lowest price in the industry. CX 1030-F.

There is no evidence that club competition without comparable services threatened to drive TRU’s services out of the market or harm consumers. TRU’s *only* illustration of its claim that it was forced to change (or even considered changing) its marketing policy as a result of purported free-riding involves a decision in 1996 to cut back the average inventory in TRU stores from approximately 16,000 to 18,000 units to about 11,000 units. Goddu 6574/22-25. Based on the record, it is difficult to connect this TRU marketing change to “free-riding” or even competition by the clubs. TRU’s executive in charge of these changes testified that the reduction in the number of units in its inventory was an effort to create a cleaner looking shopping floor. Goddu 6576. Studies undertaken by the company prior to the decision to cut back on inventory all related that decision to consumer preferences for a less crowded store, not to free-riding issues. Goddu 6574-75.³⁸

No contemporaneous document suggests that TRU was concerned about “free-riding” when it developed its club policy.

J. BEFORE TRU’S POLICY WAS IMPLEMENTED, ALMOST ALL THE TOY COMPANIES SOLD TO ALL RETAIL OUTLETS INCLUDING WAREHOUSE CLUBS.

Most toy companies are saturation retailers, meaning that they seek sales whenever and wherever possible. Toys are sold at supermarkets, pharmacies and convenience store gas stations.

³⁸Competition with Wal-Mart caused TRU to lower prices and “to give the customer a better in-store shopping experience.” Goddu 6523-24. TRU decided to reduce the number of products in its inventory in an effort to create a cleaner looking shopping floor. Goddu 6574/16-25. Three studies were undertaken to find the optimal number of items for TRU; all recommended 9,000, as additional items do not register in the eyes of consumers. Goddu decided to cut his inventory to about 10,000 and ended up with an inventory of a little less than 11,000. Goddu testified that any greater inventory reduction would cause TRU to lose its distinct edge. He speculated that if TRU attempted any inventory cut greater than the one he made TRU would “close [its] doors.” Goddu 6578. TRU documents echo Goddu’s conclusion, “[o]ur broad selection continues to be a strong competitive defense versus virtually all of our competitors. We must leverage this as much as possible.” CX 1586-B. And, “[m]ost competitive stores that you go into, you often can’t find what you want, which gives us an enormous marketing opportunity particularly in the current environment.” CX 1611-F. Professor Scherer concurred with Goddu’s evaluation: “I don’t think that [a \$55 million] loss in profit would lead to a significant change [in TRU’s stocking policy] because for Toys “R” Us not to pursue the policy it has pursued with such great success would be to undermine the basis of its success.” Scherer 4919/3-7. Scherer also observed that TRU lost money on the 6,000 or so slow-moving items that it cut from its inventory in 1996, but that the remaining stock is profitable for TRU. Scherer 4921/9-22.

To the extent that the toy industry needed costly services from any of its retail outlets, it traditionally has chosen to pay for these services itself through one of the several methods described earlier. There is no evidence that a toy company, prior to TRU's policy announcement, ever restricted the distribution of its toy products in an effort to preserve or enhance the quality of its retailers' services. Two small companies, Little Tikes and Lego, restricted the clubs to custom or discontinued products prior to 1992 (when the TRU policy was announced). IDF 262, 330. There is no indication why Lego in the late 1980s limited the clubs to old products, but Lego began to sell regular products to BJ's in the early 1990s. Little Tikes was motivated by product prestige. IDF 262-65. Little Tikes' founder believed his company's image would be eroded if products were sold at steep discounts in clubs and similar outlets, and therefore declined to sell to the clubs. *Id.* All other toy companies (and eventually Little Tikes, after it was purchased by Rubbermaid) courted the clubs and other new channels of distribution.

No toy company document before 1992 even hints that "free-riding" by one toy retailer on the efforts of another could be a problem in the industry. On the contrary, before 1992 all the big toy companies (Mattel, Hasbro, Fisher Price, Tyco, etc.) actively searched for new low-cost distributors and aggressively sought to expand toy sales to and through the clubs.³⁹

³⁹Several toy manufacturer witnesses testified that they *did* view the clubs as free-riders, even before they were confronted by TRU. The ALJ did not credit this testimony, in some instances expressly dismissing these witnesses as not credible. IDF 296 (Today's Kids executive's testimony not credible), 316 (VTech executive's testimony includes "much post hoc rationalization"). Other testimony of this kind was inconsistent with specific evidence in the rest of the record. For example, Fisher Price's Senior Vice President of Sales gave several reasons why Fisher-Price decided to restrict club sales in 1990 prior to any request from TRU, including the desire to protect the margins of its core retail customers. Cohen 7955, 7960-61. But these statements were contradicted by a 1990 memorandum showing that Fisher-Price planned to sell both regular product and special packs to the clubs that year. RX 280. TRU attempted to rely on a 1993 document, RX 256, for corroboration of the Fisher Price executive's testimony. Cohen 7948/8-22. Obviously a 1993 document is not as reliable as contemporaneous documents with respect to a decision purportedly made in 1990. TRU's reliance on this 1993 document underscores the weakness of TRU's contemporary evidence on this point. *Cf. United States v. U.S. Gypsum, Co.*, 333 U.S. 364, 396 (1948) (where antitrust defendants' trial "testimony is in conflict with contemporary documents, we can give it little weight.").

All of the manufacturers' testimony giving independent reasons why they decided to discriminate against the clubs is also contradicted by the consistent testimony from TRU's own officials that the club policy was difficult to implement. As quoted above, TRU's Chairman Lazarus said that *none* of the toy manufacturers was happy about TRU's club policy.

We thus agree with the ALJ's decision to reject this line of testimony, which was self-serving, unsupported, and directly inconsistent with the rest of the evidence showing that virtually all toy manufacturers viewed the clubs' emergence as toy retailers as a *positive* development for the industry which was thwarted by uninvited pressure from TRU.

II. DISCUSSION OF LAW.

Set out below is a discussion of fact and law demonstrating, first, the existence of vertical agreements between TRU and at least ten toy manufacturers, and second, the existence of horizontal agreements among at least seven toy manufacturers. We then turn to an application of substantive legal standards to these agreements.

The boycott organized by TRU and the toy manufacturers could be declared illegal *per se* under the Supreme Court's decision in

16-19; second, it engaged in extended negotiations with companies that were reluctant to adopt the restraint, and worked out agreed-upon compromise solutions, *see supra* pp. 20-21; third, it asked to, and in fact did, preview and clear products developed for the clubs to assure that they were sufficiently differentiated from its own, *see supra* pp. 19-20; fourth, on at least one occasion, a supplier agreed to split the cost of a discount that TRU offered after a toy company breached the policy by selling a product to a club, and TRU elected to meet the club's lower price, *see supra* p. 21; fifth, on other occasions, TRU invited toy manufacturers to police compliance by competitors and, when toy companies complained about competitors' sales to the clubs, TRU called meetings with the firms violating the agreement to demand again that they cease club sales, *see supra* pp. 33-35. On the last point, the fact that toy manufacturers asked for enforcement of TRU's policy perhaps would not be enough, without more, to form an agreement. *See Parkway Gallery Furniture, Inc. v. Kittinger/Pennsylvania House Group, Inc.*, 878 F.2d 801 (4th Cir. 1989). We need not resolve that issue because the systematic give-and-take of negotiations between TRU and the various manufacturers went well beyond the simple announcement of a policy followed by terminations if that policy was not followed.

The parties constantly described their arrangements as "agreements," "promises," "understandings" and like terms, *see supra* pp. 21-22 & note 23, -- all indicating a conscious commitment to a common plan or scheme.

Recent case law interpreting *Colgate* demonstrates why TRU's conduct and the toy suppliers' responses evidence agreements. The *Colgate* doctrine was discussed at length in *Monsanto*. 465 U.S. at 761-63. In *Monsanto*, the Court addressed the question of the type of evidence that a plaintiff must present to create an issue for the trier of fact in an action for vertical price fixing. *Id.* at 760-64. The Court rejected the proposition that complaints by one party in the distribution network to another (most often the manufacturer) about a price cutter, followed by termination of the price cutter, could alone amount to adequate evidence of an agreement. *Id.* The proper test, the Court concluded, was that a plaintiff must produce "direct or circumstantial evidence that reasonably tends to prove that the manufacturers and the others 'had a conscious commitment to a common scheme designed to achieve an unlawful objective.'" *Id.* at 764 (quoting *Edward J. Sweeney & Sons, Inc. v. Texaco, Inc.*, 637 F.2d 105, 111 (3d Cir. 1980)). This test was alternatively stated with a focus on the refutation of independent business justification: "There must be evidence that tends to exclude the possibility that the manufacturer and the nonterminated distributors were acting independently." *Id.* In this case, there is no question that complaint counsel presented evidence tending to exclude the possibility of independent action under the standard of *Monsanto*.

In *Monsanto*, the Court found "substantial direct evidence of [an unlawful agreement] to maintain prices" where Monsanto advised a discounting dealer other than the one terminated that it would not receive adequate supplies if it continued discounting; Monsanto, frustrated by the dealer's continued discounting, complained to the dealer's parent company, which then instructed

⁴⁰The Court also found more ambiguous, but nonetheless adequate evidence of a vertical agreement to create a question for the trier-of-fact in the following newsletter sent by a Monsanto distributor to its retail clients:

In other words, we are assured that Monsanto's company-owned outlets will not retail at less than their suggested retail price to the trade as a whole. Furthermore, those of us on the distributor level are not likely to deviate downward on price to anyone as the idea is implied that doing this possibly could discolor the outlook for continuity as one of the approved distributors during the future upcoming seasons. So, none interested in the retention of this arrangement is likely to risk being deleted from this customer service opportunity. Also, so far as the national accounts are concerned, they are sure to recognize the desirability of retaining Monsanto's favor on a continuing basis by respecting the wisdom of participating in the suggested program in a manner assuring order on the retail level "playground" throughout the entire country. It is elementary that harmony can only come from following the rules of the game and that in case of dispute, the decision of the umpire is final.

Monsanto, 465 U.S. at 766.

⁴¹TRU's behavior in holding up payment for a shipment from Mattel, followed by Mattel's compliance with the scheme to discriminate against the clubs, *see supra*

brought a Sherman Act section 1 action alleging an illegal price maintenance agreement. Isaksen prevailed with the jury, but the district court set aside the verdict.

The Seventh Circuit found sufficient proof of vertical agreement to create a jury question based on (1) the manufacturer's threat that orders would be "mix[ed] up" if the discount dealer did not raise its prices and (2) the dealer's subsequent price increase. *sa*

⁴¹(...continued)
conduct.

⁴²The Court's analysis is quoted at p. 52, *infra*.

manufacturer about a rival price cutter and, following those complaints, the price cutter was terminated. But TRU's conduct went beyond simple complaints to toy manufacturers about low prices at the clubs and each manufacturer's simple response that it was no longer dealing with the clubs. Rather, TRU negotiated with suppliers about the terms on which they would sell to the clubs, reviewed and agreed to assortments of products that could be sold to the clubs on terms acceptable to TRU, and then negotiated about and policed compliance by companies caught in violation of its policy. The decisions TRU cites lack such additional proof of conspiracy that is present here, which as in *Parke, Davis* goes "far beyond" the manufacturer's communication of its policy to its dealers in response to complaints, and subsequent cut-off.

TRU also relies on *H. L. Hayden Co. v. Siemens Medical Sys., Inc.*, 879 F.2d 1005 (2d Cir. 1989), and particularly that portion of the opinion in which the Second Circuit found that Siemens did not overstep its *Colgate* rights when it said to a group of complaining full service dealers that it was "working on the problem" presented by a discount mail-order dealer. It was undisputed that the full service dealers had complained about free-riding by the mail-order outlet and also clear that the mail-order outlet really was a free-rider, providing none of the presale, point-of-sale and post-sale services that the manufacturer desired from its distributors. The court of appeals emphasized that the "correct standard" requires evidence that tends to exclude the possibility of independent action by the manufacturer in response to distributor complaints. *Id.* at 1014. Except for the complaints, there was no evidence of agreements between the manufacturer and dealers, and there was also clear evidence of a "negative impact" upon Siemens' reputation and its ability to protect its distribution system arising from the mail-order outlet's "free-ride" on services. *Id.* The single comment by Siemens -- that it was "working on" the mail-order problem -- was insufficient to persuade the court that termination of the mail-order price cutter was not an independent decision by the manufacturer. *Id.* at 1016. Similarly, if each toy manufacturer had responded to TRU's complaints by saying only that it was "working on the problem," and later cut-off or discriminated against the clubs, we would not conclude that there was a "conscious commitment" to a common plan between TRU and each manufacturer.

This case does not present a similarly close call. We do not see how extended negotiations to change distribution policies, requests for and the granting of assurances of compliance, splitting the cost of a discount TRU offered to meet a competitor's low price, or presenting products for preview and agreed-upon clearance by TRU can in any way be understood as unilateral decision making by the toy manufacturers.⁴³

⁴³There is no question that parties, though reluctant, may be pressured into antitrust agreements against their will or better judgment. See *Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U.S. 134, 139-40 (1968); *In re Brand Name Prescription Drugs Antitrust Litig.*, 123 F.3d 599, 614 (7th Cir. 1997); *MCM Partners, Inc. v. Andrews-Bartlett & Assocs., Inc.*, 62 F.3d 967, 972-73 (7th Cir. 1995) (citing cases); *Kohler Co. v. Briggs & Stratton Corp.*, 1986-1 Trade Cas. (CCH) ¶ 67,047, at 62,416-17 (E.D. Wis. 1986). See also 6 Phillip E. Areeda, *Antitrust Law* ¶ 1408, at 39 (1986). Cf. *Lorain Journal Co. v. United States*, 342 U.S.

(continued...)

B. TRU ORGANIZED A HORIZONTAL AGREEMENT AMONG THE TOY MANUFACTURERS.

The record demonstrates that TRU organized and enforced a horizontal agreement among its various suppliers. Despite TRU's considerable market power, key toy manufacturers were unwilling to refuse to sell to or discriminate against the clubs unless they were assured that their competitors would do the same, *see supra* pp. 28-29. To overcome that resistance, TRU gave initial assurances that rival toy manufacturers would commit to comparable sales programs, *see supra* pp. 29-33; TRU representatives then acted as the central player in the middle of what might be called a hub-and-spoke conspiracy, shuttling commitments back and forth between toy manufacturers and helping to hammer out points of shared understanding, *see supra* pp. 32-35; toy manufacturers' commitments were carefully conditioned on comparable behavior by rivals, *see supra* pp. 32-35; and, after the discriminatory program was in place, TRU and the toy manufacturers worked out a program to detect, bring back into line, and sometimes discipline, manufacturers that sold to the clubs, *see supra* pp. 33-35.

TRU's witnesses (principally Lazarus and Goddu) testified that *all* toy manufacturers resisted TRU's proposed sales policies and insisted on assurances that rivals would fall into line.

⁴³(...continued)

143, 152 (1951) (discussing unwilling compliance in the context of § 2 of the Sherman Act). TRU has not advanced any argument that the toy companies' hesitation prevents a legal conclusion that agreements were reached.

In *Parke, Davis*, the government challenged vertical price fixing agreements between *Parke, Davis*

⁴⁴The Supreme Court in *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 735 (1988), removed any doubt that *Parke, Davis* found both vertical price fixing agreements and a separate and related horizontal conspiracy to refrain from price advertising by characterizing the latter agreement as horizontal.

Just as TRU's conduct was almost identical to the conduct condemned as a vertical agreement in *Parke, Davis*, TRU's conduct was also similar to Parke, Davis' behavior in orchestrating a horizontal agreement not to advertise prices. TRU's actions of shuttling commitments between toy manufacturers allowed the manufacturers to come into an agreement with each other. The manufacturers did not have to meet to hammer out a horizontal agreement. Their conscious commitment was extracted and then communicated each to each by TRU.

TRU was not content to rely on its suppliers' assessment of their individual business interests when it asked them to adopt restrictions on distribution through the clubs. Just as Parke, Davis used Dart's willingness "as a lever to gain [its competitors'] acquiescence in the program," 362 U.S. at 46, TRU used Mattel's promise -- itself "based on the fact that the competition would do the same" -- to gain a commitment from Hasbro and then others. There is similar evidence of *express*, interdependent commitments among at least seven major toy manufacturers. See *supra* pp. 29-35 & note 30. Their subsequent decisions to enter the proposed boycott were made despite the fact that it might have been a competitively foolish thing to do as an individual matter, or that others might gain if it was -- or proved to be -- a mistake. As in *Parke, Davis*, the boycott was presented to TRU's suppliers in "competition-free wrapping." *Id.* at 47. Due to this, the agreement ultimately obtained was in all likelihood different from, and more stable than, any agreements TRU would have obtained had it negotiated separately with each supplier, and had each not requested and received assurances about the behavior of its rivals. TRU would not have gone to the trouble of conducting these negotiations and working out the horizontal agreements if it believed it could have enforced its will without them.

b. Interstate Circuit.

A sensible reading of *Interstate Circuit*, 306 U.S. 208, an important Supreme Court case on proof of horizontal agreement, supports our analysis here. *Interstate Circuit*⁴⁵ wrote identical letters to eight competing film distributors, naming all the distributors as addressees in each letter. As a condition for the exhibition of movies in its first-run theaters at an evening price of at least 40 cents, *Interstate Circuit* asked the distributors to impose two restrictions in their contracts for the exhibition of such films: (1) subsequent-run evening exhibitions of "A" movies must be at an admission price of at least 25 cents, and (2) first-run, evening exhibitions of "A" movies may not be part of a double feature. 306 U.S. 216-17 & n.3. There was no evidence of direct communication among the distributors, but each met separately with representatives of *Interstate Circuit* to discuss the demands made in its letter. *Id.* at 218. Each distributor eventually acceded to *Interstate Circuit*'s request, except that each declined to adopt the restrictions in Austin, Galveston and the Rio Grande Valley. *Id.* at 219. No witnesses from the distributor defendants testified to offer explanations as to why these "far-reaching changes" were introduced with such

⁴⁵*Interstate Circuit* was one of two affiliated chains of Texas movie theaters under common management. Both chains, and the individuals who served as their President and General Manager, were named as defendants. For convenience, we refer to all movie exhibitor defendants as "*Interstate Circuit*."

uniformity. *Id.* at 223. The Supreme Court affirmed the district court's finding that Interstate Circuit and the national movie distributors had violated section 1 of the Sherman Act, and upheld the injunction against enforcing their illegal agreement or continuing their conspiracy.

In a famous passage, the Court concluded that there was horizontal agreement between the national film distributors as well as agreement with Interstate Circuit:

Each was aware that all were in active competition and that without substantially unanimous action with respect to the restrictions for any given territory there was risk of a substantial loss of the business and good will of the subsequent-run and independent exhibitors

There was risk, too, that without agreement diversity of action would follow.

Id. at 222.

We agree with Professor Areeda's analysis that it would be a mistake to give the Court's sweeping language in *Interstate Circuit* the broadest construction it could support. 6 Areeda, *supra* note 43, ¶ 1426b, at 162. Not every unanimous action taken in response to an invitation -- even where a uniform response is sought or preferred -- constitutes an agreement. If that were the law, a simple price increase, followed by parallel price increases by competitors, could be characterized as a horizontal agreement. Subsequent cases make clear that parallel conduct alone does not constitute antitrust agreement. *See, e.g., Theatre Enters. v. Paramount Film Distrib. Corp.*, 346 U.S. 537, 541 (1954); *Modern Home Inst., Inc. v. Hartford Acc. & Indem. Co.*, 513 F.2d 102, 108-10 (2d Cir. 1975). This may be true even where, as with oligopoly pricing, there is some indication that success in raising price requires a uniform response. *See, e.g., Pevely Dairy Co. v. United States*, 178 F.2d 363, 369 (8th Cir. 1949). However, we also agree with Professor Areeda that, on a full examination of the facts and analysis of *Interstate Circuit*, the finding of horizontal agreement was entirely justified there, and note that the same logic requires a similar finding here.

The Court in *Interstate Circuit* discussed a host of factors before concluding that, viewed in context, the evidence supported the district court's finding that the national film distributors had entered into agreement with one another. 306 U.S. at 221-27. By its letter, Interstate Circuit literally addressed its invitation to all of the film distributors. *Id.* at 222. Each knew that the others were asked to make the same choice. Their later course of conduct was a dramatic change that was not only far-reaching and complex, but also difficult and costly to undo because prices were set at 25 cents by contracts lasting for a year or more. *Id.* at 224. This change lacked any convincing explanation or business justification because the high-level officials, who would have been in a position to explain the distributors' actions, did not testify to explain the reasons for their companies' change of course. *Id.* at 223. Finally, the distributors' decisions to accede to Interstate Circuit's requests were "interdependent" in nature, that is they made economic sense only if each had reason to believe the others would go along. *Id.* at 224-25. Thus, in the passage just quoted, the Court explained that "[e]ach was aware . . . that without substantially unanimous

action with respect to the restrictions . . . there was risk of a substantial loss of the business and good will” *Id.* at 222. Together these facts and circumstances suggested to the Court that -- more likely than not -- the movie distributors responded to Interstate Circuit’s request in a concerted fashion. Subsequent cases, following scholars and other lower court judges,⁴⁶ have emphasized that interdependence is crucial if an antitrust agreement is to be inferred from circumstantial evidence.

A similar, and in some respects stronger, set of facts is present here, and the same inference of conspiracy is appropriate. As in *Interstate Circuit*, there was an invitation clearly addressed to all of the participants in the proposed conspiracy. Like the listing of all the film distributors as addressees in the letter sent by Interstate Circuit, TRU, in *Goddu*

⁴⁶*See, e.g., Bogosian v. Gulf Oil Corp.*, 561 F.2d 434, 446-47 (3d Cir. 1977); *Ambook Enters. v. Time, Inc.*, 612 F.2d 604 (2d Cir. 1979); Donald F. Turner, *The Definition of Agreement under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 Harv. L. Rev. 655, 663 (1962).

⁴⁷As discussed below, we do not have to infer “that such assurances took place” as the Court did in *Interstate Circuit*, because there is *direct* evidence that assurances were solicited and given.

done. Here, TRU and some toy company executives testified about “free-rider” problems, and the toy companies hinted at such problems after the clubs threatened to sue them in 1992. But no toy company mentioned a free-rider problem before TRU extended its unwelcome invitation to boycott the clubs. As we discuss in detail below, *see infra* pp. 76-82, the free-rider explanation for discrimination against the clubs is simply a pretext. *Cf. Rossi v. Standard Roofing Inc.*, No. 97-5185, 1998 U.S. App. LEXIS 21911, *81-85 (3d Cir. September 9, 1998) (holding that reliance on pretextual excuses to justify boycott of a price-cutting retailer, combined with other circumstantial evidence, supports inference of agreement).

Professor Areeda noted that the parallel behavior of the national movie distributors in adopting both of Interstate Circuit’s requests in four cities but rejecting them in Austin, Galveston, and the Rio Grand Valley was highly suspicious. 6 Areeda, *supra* note 43, ¶ 1426, at 159. The Court naturally questioned how a simple request for terms of sale across Texas could have been converted into a common policy everywhere but Austin, Galveston, and the Rio Grande Valley without the movie distributors discussing the matter among themselves or through Interstate Circuit. If the record required us to draw inferences, we might likewise find it “highly suspicious” that an initial promise from Mattel not to support the clubs changed to a commitment identical to that of Hasbro and Fisher Price not to sell “hot” or advertised products to the clubs, and then changed again to a policy that “no identical product” will be sold to the clubs, at which point all of the major toy companies developed special lines of similarly highly-differentiated products for sale to the clubs. It is difficult to imagine this course of events taking place without direct communications among the toy manufacturers or indirect communications through TRU. But in this case, it is not necessary to draw an inference of conspiracy from entirely circumstantial evidence, because there is testimony, which is supported by significant documentary evidence, that these communications *did* occur and that TRU in fact acted as the “hub” in a conspiracy to disadvantage the clubs by inducing all the key suppliers of toys to adopt parallel restrictions on club sales.

Finally, just as the facts and broader context of *Interstate Circuit* indicated that the decision to adopt Interstate Circuit’s suggestions was interdependent -- *i.e.*, that uniformity was necessary for all to profit -- there is likewise every reason to think that the boycott here was the result of such interdependence. Recent cases have reaffirmed the requirement of interdependence for any finding of antitrust agreement particularly when based on circumstantial evidence. *See, e.g., Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586, 589-97 (1986); *Bogosian*, 561 F.2d at 447. It has been alternatively described as a “motivation to conspire” or an apparent “benefit from the agreement.” *See First Nat’l Bank of Arizona v. Cities Serv. Co.*, 391 U.S. 253, 278-80 & n.16 (1968).

In *Interstate Circuit*, the existence of agreement was the best explanation for what

of market power *and* without a strong assurance that rivals will do the same. The eight film distributors that did just this in four Texas cities collectively distributed about 75% of all of the "A" movies in the United States. Thus, in the passage we have quoted the Court commented: "each [movie distributor] was aware . . . that without substantially unanimous action with respect to the restrictions . . . there was risk of a substantial loss of the business and good will" 306 U.S. at 222.

The success of the club boycott similarly depended on having a substantial and significant number of participants. If only one company -- or even several companies collectively selling a small share of all toys -- had joined, the boycott would not have worked. Instead, the toy manufacturers that agreed to the boycott would have lost sales, while their rivals that continued to sell all of their products to the clubs would have gained this business to their own benefit. This risk attended any toy company that decided unilaterally to cut off the clubs. And for this reason, they all clearly told TRU that they were unwilling to make a decision on their own.

TRU offers some theoretical speculation as to why interdependence was not present, *i.e.*, that a toy manufacturer might be pleased to see a competitor ignore TRU's demands and threats because the manufacturer could gain favor with TRU. There is little doubt that, after the boycott was in place, efforts to curry favor at the expense of a rival helped TRU to police and maintain the initial agreement. But TRU's speculation that this was a motive for the adoption of the boycott agreement in the first place is refuted by the evidence. TRU'

discount when they placed the ad through an advertising agency. *Id.* at 607-09. Plaintiffs claimed that the dual rate card system (and specifically the uniform 15% discount) was the consequence of an illegal agreement under section 1 of the Sherman Act. *Id.*

The Second Circuit concluded that a jury could have found that the uniform policy adopted by the media with respect to price was the result of agreement. *Id.* at 614-18. It emphasized two points relevant here: first, there was no evidence to show what legitimate business reason would have led the media to discriminate in favor of ads placed through advertising agencies; and second, there was evidence that the ad agencies had placed pressure on the media not to give discounts when the ad agencies were bypassed. *Id.* The appellate court found that a reasonable fact-finder could conclude that the uniform program of discriminating against ads that were placed directly was not the result of individual decisions but rather of an agreement that publishers went along with "only because of sloth or fear of reprisal." *Id.* at 618.

The evidence of agreement in the present case is stronger because we *know* -- and need not infer -- that the toy manufacturers initially thought discrimination against the clubs was not in their own independent interests, that combo packs and other discriminatory devices made no independent business sense, and that the manufacturers were pressured or coerced into adopting roughly uniform policies. We appreciate that the toy manufacturers' discriminatory policies were not *identical* (as in *Ambook*), but they were sufficiently uniform to serve TRU's anticompetitive purpose.

Given all these factors, we agree with the ALJ that the record demonstrates that there was a horizontal agreement among the identified toy companies, orchestrated by TRU, to deal with the clubs in a discriminatory fashion.

2. TRU also organized a horizontal agreement to enforce the boycott.

As we saw earlier, TRU, with the cooperation of various toy manufacturers, acted as a clearinghouse of information about firms not abiding by the terms of the horizontal agreement, and TRU also acted as the enforcement arm of the boycott. *See supra* pp. 29-35. This collateral enforcement agreement, which could be considered either as part of, or separately from, the boycott agreement itself, is similar to conduct declared illegal in *United States v. General Motors Corp.*, 384 U.S. 127, 140-41 (1966). In *General Motors*, the government challenged a group boycott that included General Motors ("GM") and several trade associations of its car dealers in the Los Angeles area. The Government established that GM had reached agreements with all of its dealers not to resell GM cars to a group of automobile discounters. GM then invited its dealers to survey each other's compliance with these agreements. The dealers' trade associations created a joint investigating committee and hired automobile "shoppers" to test whether resold GM cars still were being offered by the discounters. The dealers' associations then "supplied [this] information to General Motors for use by it in bringing wayward dealers into line." *Id.* at 140-41. Several dealers were persuaded by GM and the dealers' associations to repurchase at a loss cars that they had sold to discounters in violation of their promises to GM. *Id.*

Observing that the agreement to enforce the boycott of the automobile discounters was very similar to the agreement in *Parke, Davis*, the Court commented on the obvious interdependence of the dealers' collective efforts to police their group boycott:

As Parke Davis had done, General Motors sought to elicit from all the dealers agreements, substantially interrelated and interdependent, that none of them would do business with the discounters. These agreements were hammered out in meetings between nonconforming dealers and officials of General Motors' Chevrolet Division, and in telephone conversations with other dealers. It was acknowledged from the beginning that substantial unanimity would be essential if the agreements were to be forthcoming. And once the agreements were secured, General Motors both solicited and employed the assistance of its alleged co-conspirators in helping to police them. What resulted was a fabric interwoven by many strands of joint action to eliminate the discounters from participation in the market, to inhibit the free choice of franchised dealers to select their own methods of trade and to provide multilateral surveillance and enforcement. This process for achieving and enforcing the desired objective can by no stretch of the imagination be described as "unilateral" or merely "parallel."

General Motors, 384 U.S. at 144-45.

While the toy companies did not band together and jointly hire professional shoppers to enforce the club boycott, there is no question that TRU "both solicited and employed the assistance of its" suppliers "in helping to police" each other. "What resulted was a fabric interwoven by many strands of joint action to eliminate the discounters [the clubs] from participation in the market, to inhibit the free choice of [toy manufacturers] to select their own methods of trade and to provide multilateral surveillance and enforcement." *Id.* at 144.⁴⁸

3. Under the general principles used to evaluate allegations of hub-and-spoke conspiracy, TRU's suppliers entered an agreement.

The relationship between TRU and its suppliers is an example of a hub-and-spoke conspiracy. See *Blumenthal v. United States*, 332 U.S. 539 (1947); cf. *Kotteakos v. United States*, 328 U.S. 750 (1946). In such conspiracies, a "hub" firm has separate relationships with individual or separate groups of other firms and these "spoke" relationships (often vertical conspiracies in their own right) are connected into a horizontal conspiracy by a unifying "rim." *Blumenthal* concerned a conspiracy to sell whiskey at prices in excess of those set pursuant to the

⁴⁸See also the Third Circuit's decision in *Rossi*, 1998 U.S. App. LEXIS 2191, at *53-61, *70-75, *77-81, which concluded that there was sufficient evidence of vertical and horizontal antitrust agreements to avoid summary judgment because, among other evidence, defendant retailers (1) pressured or threatened manufacturers not to deal with a price-cutting competitor, (2) set up a monitoring system, and (3) reported detected breaches of the boycott to a key manufacturer.

Emergency Price Control Act. The Supreme Court reasoned that even though several conspirators lacked knowledge of the identity of a key co-conspirator, the proof was still sufficient to find action in accordance with a criminal conspiracy to evade price controls:

All knew of and joined in the overriding scheme. All intended to aid the owner [of the whiskey] . . . to sell the whiskey unlawfully, though the two groups of defendants differed on the proof in knowledge and belief concerning the owner's identity. All by reason of their knowledge of the plan's general scope, if not its exact limits, sought a common end, to aid in disposing of the whiskey. True, each salesman aided in selling only his part. But he knew the lot to be sold was larger and thus that he was aiding in a larger plan. He thus became a party to it

Blumenthal, 332 U.S. at 559.

Although *Blumenthal* and *Kotteakos* are criminal cases, the concept of hub and spoke conspiracy is also accepted in civil antitrust. *Interstate Circuit*, which we have discussed at length, is perhaps the most prominent example, but there are many lower court decisions as well. E.g., *Impro Prods., Inc. v. John B. Herrick*, 715 F.2d 1267, 1279 (8th Cir. 1983); *Elder-Beerman Stores Corp. v. Federated Dep't Stores, Inc.*, 459 F.2d 138, 146-47 (6th Cir. 1972); cf. *Mylan*

⁴⁹TRU argues, for example, that the manufacturers did not benefit from the alleged agreement. While the boycott primarily advanced the economic interest of TRU, the manufacturers did benefit from the horizontal boycott agreement by not having to respond unilaterally to TRU's proposal. While most -- if not all -- of the toy companies disliked having to choose between what they saw as two bad options -- (1) sell to TRU and restrict club sales, or (2) sell to the clubs and risk retaliation from TRU -- the decision was made easier by the horizontal agreement which took the sting out of reducing sales to the clubs. From the manufacturers' point of view, the boycott was the second-best alternative, but that does not mean the toy manufacturers did not benefit from the agreement.

TRU also argues that there is no direct evidence of horizontal conspiracy. By that, TRU means there is no evidence of *direct* horizontal conspiracy, because, as in *Parke, Davis and Interstate Circuit*, the agreement was initiated and organized by TRU as the hub and facilitator. There is direct evidence of an agreement -- through TRU as organizer and coordinator -- which makes this case stronger than *Interstate Circuit*

Several of TRU's other arguments are similarly based on theories that are inconsistent with the record. First, TRU claims that this analysis "ignore[s] the choice posed by TRU." (Reply Br. at 14.) TRU argues that the allegation of horizontal conspiracy is "based on the fallacy that toy manufacturers were able to enjoy unrestrained sales of their product to both [TRU] and the warehouse clubs." *Id.* (emphasis in original). It further argues that when the toy companies were forced to make a choice, it was "entirely logical" to pick TRU. *Id.* TRU was the most important customer, and the clubs were comparatively small fish. A manufacturer might even

⁵⁰*Monsanto* and *Sharp* hold, *inter alia*, that dealer complaints about another dealer's prices followed by termination is not sufficient evidence of a vertical price-fixing conspiracy to give the case to a jury. *See Sharp*, 485 U.S. at 722, 731; *Monsanto*, 465 U.S. at 763-64.

If TRU merely had complained to the toy companies about the clubs' low prices -- thereby drawing their attention to a threat (perceived by TRU) to the toy distribution system -- these complaints would have been similar to those in *Sharp* and *Monsanto*. Even if TRU only told each of its suppliers that it also was complaining to the others, it would be more difficult to infer that their later adoption of a restrictive policy was concerted. But TRU did more. TRU told each of its suppliers what *their* rivals (not its own as in *Sharp* or *Monsanto*) were doing, suggested they do the same and, on that basis, extracted mutual commitments from many of them.

The toy suppliers committed to TRU's policy (gave in, really) only after they were assured others would do the same. There is, therefore, no reason to think the toy suppliers were using information gathered by TRU to evaluate their distribution practices in view of their own best interest. We do not think the Supreme Court's solicitude for communications up and down the supply chain of a manufacturer of a single brand of products can be stretched to cover negotiations between interbrand competitors conducted by their shared distributor for the purpose of obtaining a horizontal agreement among them. This pattern of conduct is also different from the common situation in which a dealer bargains with several suppliers to achieve the lowest price, or other favorable terms of sale. There, the dealer is playing one supplier against the other to gain a lower price, but here, the dealer is bringing the two together to obtain an outcome that would be impossible in a competitive market of firms making independent decisions.

⁵¹Little Tikes, for example, sold to Costco on several occasions despite Little Tikes' commitment to TRU, and some of the smaller companies like Lego restricted their sales to the clubs for only a short period.

Davis-Watkins Co., 686 F. 2d 1190, presents a pattern of facts very similar to that in *H.L. Hayden Co.* Amana was a manufacturer of microwave ovens accounting for 11 to 18% of that market. *Id.* at 1193. From the outset, Amana insisted that its distributors provide substantial pre-sale, point of sale, and post-sale services including advertisements, in-store demonstrations by sales staff, explanations and warranty service. *Id.* at 1195. Plaintiff SMC was a showroom catalog business that provided few, if any, of those services. *Id.* Competing dealers complained to Amana, which refused to sell to SMC and also took steps to prevent other dealers from transshipping to it. *Id.* at 1194-95. But SMC was a true free-rider. Moreover, the court found no evidence that the dealer complaints were coordinated, or that Amana adopted transshipping restrictions for reasons other than to serve its own, independent marketing strategy. *Id.* at 1199. There was, unlike this case, no evidence that any party was coerced into discriminating against SMC, or that any party sought to coordinate behavior vertically or horizontally. Many cases similarly decline to find non-price vertical or horizontal restrictions where all parties pursue their own legitimate business interests. See discussion and cases cited *supra* pp. 54-58; see also *Michelman v. Clark-Schwebel Fiber Glass Corp.*, 534 F.2d 1036, 1043 (2d Cir. 1976) (finding a pattern of denials of credit explained by independent interest of defendants to minimize losses from default); *Solomon v. Houston Corrugated Box Co.*, 526 F.2d 389, 395 (5th Cir. 1976) (finding that independent self-interest explained rivals' similar decisions to replace the plaintiff with a customer offering them more favorable terms).

In conclusion, none of TRU's objections dissuades us from our conclusion that, in addition to entering vertical agreements with ten or more toy companies, TRU also organized a horizontal agreement among at least seven key toy manufacturers. Direct evidence indicates that these seven toy companies joined the conspiracy with the knowledge and assurance that the others would go along. Although other toy manufacturers similarly discriminated against the clubs, they may have done so only because of their agreements with TRU -- not with each other. Finally, TRU and the seven toy manufacturers entered a horizontal agreement to enforce the boycott agreement.

C. THE AGREEMENTS COULD BE CONSIDERED *PER SE* ILLEGAL UNDER THE *KLOR'S* RULE.

In *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959), the Supreme Court held that Klor's, an independent appliance distributor, had successfully pled a *per se* violation of section 1 when it alleged that a rival distributor enlisted several suppliers to boycott Klor's. *Id.* at 212-13. *Klor's* came to the Supreme Court following the grant of a motion for summary judgment for the defendant. *Id.* at 210. The Court reversed, based primarily on the allegations of the complaint. *Id.*

Klor's had alleged that Broadway-Hale, a department store chain, orchestrated an agreement with and among ten appliance manufacturers to sell to Klor's only on highly-unfavorable terms or not to sell to it at all. *Id.* at 209. Klor's was an appliance store in Broadway-Hale's neighborhood. *Id.* at 208. The Court noted that the combination "takes from Klor's its freedom to buy appliances in an open competitive market and drives it out of business

as a dealer in the defendants' products." 359 U.S. at 213. It held that the allegations, if proved at trial, merited *per se* condemnation because Broadway-Hale would have arranged a "wide combination consisting of manufacturers, distributors and a retailer." *Id.* The Court distinguished this from the "case of a single trader refusing to deal with another, or even of a manufacturer and a dealer agreeing to an exclusive distributorship." *Id.* at 212.

This case presents *Klor's*, not on the pleadings but rather after the development of an unusually complete record. The ALJ found that, like Broadway-Hale, TRU entered vertical agreements with each of its key suppliers to disadvantage its rivals, the clubs. He further found that TRU organized a horizontal agreement among key suppliers to the same purpose and effect -- to disadvantage the clubs. Under the Supreme Court's *Klor's* decision, TRU's conduct would be *per se* illegal.

If *Klor's* is still good law -- it is after all a Supreme Court decision that has never been overruled and indeed has been cited with approval in many subsequent decisions⁵² -- it would be dispositive and our analysis would be complete. Nevertheless, we elect not to rely exclusively, or even primarily, on the *Klor's per se* rule.

We are reluctant to apply the *Klor's per se* rule for several reasons. First, the Supreme Court has made it clear that it will not apply *per se* rules mechanically. When there is adequate reason, *per se* rules have been bypassed with respect to price fixing,⁵³ and boycotts,⁵⁴ and have been eased and clarified in connection with tie-in sales.⁵⁵ Some lower courts have speculated that the Supreme Court would not reaffirm a broad interpretation of *Klor's* today.⁵⁶ Also the Supreme Court has recognized that manufacturers can terminate dealers and restrict channels of distribution in order to diminish the adverse impact of "free-riding"⁵⁷ -- a theory that was little

⁵²The Court has cited *Klor's* as authoritative at least four times in recent years. See *Summit Health, Ltd. v. Pinhas*, 500 U.S. 322, 332 (1991); *FTC v. Superior Court Trial Lawyers Ass'n*, 493 U.S. 411, 452 n.9 (1990); *Sharp*, 485 U.S. at 734; *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284, 293, 294 (1985).

⁵³ *Broadcast Music, Inc. v. CBS, Inc.*, 441 U.S. 1, 16-24 (1979).

⁵⁴ *Northwest Wholesale Stationers*, 472 U.S. at 293-98.

⁵⁵ *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 11-18 (1984).

⁵⁶See, e.g., *Betkerur v. Aultman Hosp. Ass'n*, 78 F.3d 1079, 1089-90 (6th Cir. 1996); *United States Trotting Ass'n v. Chicago Downs Ass'n, Inc.*, 665 F.2d 781, 788 (7th Cir. 1981).

⁵⁷*Sharp*, 485 U.S. at 724-25; *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 55 (1977).

known when the Supreme Court in *Klor's* found a violation without according any opportunity to the defendants to explain their business behavior.

Finally, in *Northwest Wholesale Stationers*, a boycott case decided 26 years after *Klor's*, the Supreme Court observed that the question of which types of "group boycotts" merit *per se* treatment is "far from certain" and that "care" is necessary in defining the category of concerted refusals to deal that mandate *per se* condemnation. 472 U.S. at 294. The Court offered a list of factors that must be taken into account before "group boycotts" can justifiably be treated under the *per se* doctrine. *Id.* It is to that mode of analysis and those factors that we now turn.

D. "GROUP BOYCOTTS" THAT MERIT SUMMARY CONDEMNATION: THE *NORTHWEST WHOLESALE STATIONERS* APPROACH.

The Court in *Northwest Wholesale Stationers* looked to *Klor's* and other cases to provide guidance as to which collective refusals to deal constitute *per se* unlawful group boycotts, and found that they generally displayed four common factors. *Id.* As the Court described them:

Cases to which this Court has applied the *per se* approach have generally involved joint efforts by a firm or firms to disadvantage competitors by "either directly denying or persuading or coercing suppliers or customers to deny relationships the competitors need in the competitive struggle." Sullivan, *supra*, at 261-262. See, e. g., *Silver, supra* (denial of necessary access to exchange members); *Radiant Burners, Inc. v. Peoples Gas Light & Coke Co.*, 364 U. S. 656 (1961) (denial of necessary certification of product); *Associated Press v. United States*, 326 U. S. 1 (1945) (denial of important sources of news); *Klor's, Inc., supra* (denial of wholesale supplies). In these cases, the boycott often cut off access to a supply, facility, or market necessary to enable the boycotted firm to compete, *Silver, supra*; *Radiant Burners, Inc., supra*, and frequently the boycotting firms possessed a dominant position in the relevant market. E. g., *Silver, supra*; *Associated Press, supra*; *Fashion Originators' Guild of America, Inc. v. FTC*, 312 U. S. 457 (1941). See generally Brodley, Joint Ventures and Antitrust Policy, 95 Harv. L. Rev. 1523, 1533, 1563-1565 (1982). In addition, the practices were generally not justified by plausible arguments that they were intended to enhance overall efficiency and make markets more competitive. Under such circumstances the likelihood of anticompetitive effects is clear and the possibility of countervailing procompetitive effects is remote.

Northwest Wholesale Stationers, 472 U.S. at 294. We conclude from the evidence in this case that each of the factors suggested by this passage is present. The same approach to boycott analysis was followed by the Third Circuit in *Rossi v. Standard Roofing Inc.*, No. 97-5185, 1998 U.S. App. LEXIS 21911, *28-33 (3d Cir. September 9, 1998). The purpose of the group boycott agreement was anticompetitive, in that it was designed to disadvantage competitors of one of the participants; the firms involved were dominant in their markets; the boycott cut off

lastly, the practice was not justified by plausible arguments that it enhanced overall efficiency. We consider each of these factors in turn below.

1. Intent: Purpose of disadvantaging competitors.

The primary (if not the only) purpose of the agreements that TRU obtained with and between its suppliers was to disadvantage a group of new entrants in the toy retailing market. Those new entrants -- the warehouse clubs -- were obviously competitors of TRU and thus in a “horizontal” economic relationship to it. The agreed-upon practices reduced direct price competition between the clubs and all other toy outlets, including TRU. The toy manufacturers committed to TRU to sell only highly differentiated products to the clubs, which in turn would usually be resold by the clubs at retail prices higher than the closest comparable toy at TRU. As TRU’s Goddu explained, what made special packs and other custom products acceptable to TRU was that customized products could not readily be compared with the products sold at TRU and other retailers. *See supra* p. 39. TRU’s suppliers understood that this was the purpose of the policy to which they subscribed.

Customized products also tended to raise the cost of toys to the clubs and the prices of toys to consumers who bought toys at the clubs. This too redounded to the benefit of TRU (and other traditional discounters), which no longer had to worry that their reputation as “the” or “a” low-price toy retailer might be eroded. The savings generated by the clubs’ innovative method of retailing would not be recognized by the market if their average cost of goods was both higher than that of other retailers and greater than the value that customers placed on the products available at the clubs. Putting the point plainly, TRU wanted the clubs to run the race carrying extra weight.

2. Market dominance.

Preliminarily, we note that it may not be necessary to demonstrate market power under the *Northwest Wholesale Stationers* approach, which examines behavior from several perspectives before deciding whether it is appropriate to attach a *per se* label. Ordinarily, market power is a proxy for competitive effects. Where evidence of actual competitive injury is available and there is no plausible justification, it may not be necessary to demonstrate market power. As the Supreme Court observed:

Since the purpose of the inquiries into market definition and market power is to determine whether an arrangement has the potential for genuine adverse effects on competition, “proof of actual detrimental effects, such as reduction of output,” can obviate the need for an inquiry into market power, which is but a “surrogate for detrimental effects.”

⁵⁸*Accord Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 477 (1992) (holding that “[i]t is clearly reasonable to infer that Kodak has market power to raise prices and

The record supports the conclusion that the relevant product market is all traditional toys. Under that interpretation, electronic toys would be excluded, largely because they tend to sell in a different and higher price range, have different characteristics, are used with special complementary products, and tend to be sold in a wider variety of outlets than traditional toys. IDF 346 (discussing Sega's ability to find other outlets for its products). We do not linger on the point because inclusion or exclusion of electronic toys makes little or no difference to the result in this case.⁶⁰

Barriers to entry into toy manufacturing are moderate, although there does appear to be a trend toward concentration among the makers of the most well-known branded toys. Brand name recognition, existing manufacturing facilities, and economies of scale mean that, while many entrepreneurs can and do introduce a single successful toy, none is able to enter the market on the same scale and with the same scope of products as Mattel or Hasbro. Barriers to entry into toy retailing -- at least at the level of a national chain like TRU, Wal-Mart, Target, or K-Mart -- are high. IDF 464; CX 1830-G (Scherer) ¶ 14 (testifying that timely entry on a meaningful scale is unlikely). Among discount retailers selling toys exclusively, moreover, the pronounced trend is toward exit rather than entry into the market.

⁵⁹(...continued)

n.38.) The complaint in *Staples* addressed *only* the likely effects of the proposed merger on the combined entity's local market power as a seller of office supplies. The power of Staples and Office Depot as *buyers* of office supplies was not an issue. By contrast, TRU's power on *both* the buying and the selling side is relevant to the antitrust analysis of the boycott allegation in the Commission's Complaint. The allegation of market power was therefore stated more generally. The significance of both local and national markets was understood by the parties and their experts since both kinds of power were vigorously litigated below.

⁶⁰When possible, we have included market share statistics for both traditional toys and the broader all toys (including electronic toys) market.

a. TRU's dominance as a buyer and seller of toys.

TRU's market share is extraordinarily high for a retailer and, due to several other distinctive factors discussed below, this large percentage share understates TRU's actual market power. While not a monopolist or a monopsonist, TRU enjoys a dominant position in buying and selling toys.

As noted in our discussion of fact, *see supra* pp. 5-6, TRU is the largest retail buyer of toys in the United States and in the world. At the time it orchestrated its program of inducing toy manufacturers to discriminate against the clubs, it purchased about 20% of toys sold at wholesale in the United States. That percentage share is deceptive because it includes areas of the United States where TRU is not present. In just the localities that it serves (and where toy manufacturers depend on it for distribution), TRU buys and resells 32% of all toys sold. In many local areas (where retail competition is focused) its market share is much higher. In 18 metropolitan areas, it accounts for 35% to 49%, and in eight other cities plus Puerto Rico, its share was greater than 50%. Cities where its market share exceeds 40% include Los Angeles, Chicago, and New York. TRU is invariably the largest customer for traditional toy companies' output. As we have discussed, toy company executives describe TRU as irreplaceable. *See supra* p. 6.

TRU's extraordinarily high market shares for the retail sector in fact understate its true dominance as a purchaser and seller of toys for a number of reasons. First, TRU purchases such a great share of all toys and of each toy manufacturer's output that no other retailer could make up for lost sales volume should TRU decide to terminate its relationship with the supplier. *See supra* pp. 5-6. Second, TRU maintains a uniquely broad inventory. No other discount retailer carries nearly as many toys. For many toy manufacturers, TRU is the only large buyer of some of their older or low volume toy products. These toys significantly affect the manufacturer's overall profitability. Third, TRU, which operates 300 stores in 20 countries outside the United States, is by far the largest United States toy retailer operating in overseas markets. This is an important ingredient in TRU's influence over manufacturers. For example, half of Mattel's and Hasbro's revenues are derived from foreign sales. CX 1822 (Scherer) ¶ 16. Fourth, without TRU's support, many toy manufacturers will not pay for an effective marketing campaign, because the manufacturers believe they cannot attain the necessary volume of sales if products are not sold at TRU.⁶¹

Last, and of great importance in explaining why TRU was so successful in organizing its boycott, is that TRU, as a very large multi-brand retailer, has the ability to amplify its own market

⁶¹TRU's importance as a retailer is so great that it often could squelch an item before the item made it to the market. This power is aptly illustrated by an incident involving Just Toys. Just Toys introduced what it believed was a promising new toy. When TRU found the item for sale at several BJ's club stores in the New York City area, TRU canceled its order for the product. Just Toys thereafter canceled its advertising plans for the product, despite its belief that the item could have been a successful product. Without TRU's support, Just Toys was unwilling to risk the expense of an advertising campaign. IDF 360.

power by playing favorites -- or even threatening to play favorites -- among its suppliers. This is a source of market power that is not available to single-brand retailers (

suppliers to take similar steps in Canada where traditional toy outlets similar to those in the United States also met new club competition. A reasonable conclusion is that the successful boycott in the United States was a result of a powerful dealer's ability to negotiate with suppliers that had nowhere else to turn, because in Canada, where they could turn to Zeller's, no restraint was imposed. See 8 Areeda, *supra* note 43, ¶ 1648(E), at 539 (suggesting that "selective" adoption of a restraint in only certain markets may help prove that the restriction was a result of

⁶²TRU explains the failure to implement a similar boycott in Canada by noting that "[i]n Canada, unlike the United States, product shortages are rare and popular toys need not be rationed." (App. Br. at 79 n.37.) There are several problems with this expedient explanation: (1) the club policy does not address the issue of shortages, IDF 60; CX 1681; CX 1651(Goddu) at 49/5-13 (stating that shortages were not the reason for the club policy); (2) the free-riding justification advanced by TRU, if valid, applies whether or not shortages are a problem; and (3) according to the witness from Costco Canada, toy products sometimes *are* in short supply in Canada. Nickel 964/8-20.

⁶³Professor Areeda remarks:

Dealers cannot force an unwilling manufacturer to restrict intrabrand competition to their advantage unless they possess some power over him. Of course, there is no better demonstration of power than its exercise. Suppose, for example, that a manufacturer explicitly declared that distribution restraints would be inefficient but nevertheless adopted them after dealers threatened, "Restrain intrabrand competition or we cease handling your product." The resulting restraint could then readily be attributed to dealer power and fairly judged unreasonable. Few cases will be so clear.

8 Areeda, *supra* note 43, ¶ 1604 (g), at 65-66 (footnote omitted). This is precisely what happened here.

and principal television advertisers, they accounted for a far larger proportion of the "hit" toy products that lead consumers to shop at a particular outlet.

Another way to look at TRU's and its suppliers' market power is to examine the effect of the boycott on the clubs. As noted earlier, the clubs' combined market shares increased steadily until 1992, and reliable observers predicted that the increase would continue. *See supra* pp. 11-12. Club sales reached a high of 1.9% of the toy market in 1992 and then, after TRU introduced its policy, steadily declined to 1.4% of the market by 1995. We will address more fully the effect of TRU's policies on the clubs and on the marketplace at pp. 83-87, *infra*. The significant point here is that the participants in the boycott clearly had enough market power to retard the clubs' ability to continue to compete.

TRU challenges the ALJ's conclusion that TRU and the toy manufacturers had market power by arguing that there is no evidence that TRU had the power generally to curtail output and raise price in the marketplace, or evidence that overall output actually was curtailed and overall prices raised. There are several problems with this argument. First, there is little question that the boycott of the warehouse clubs that TRU organized *could* and *did* lower output by avoiding a decrease in toy prices by TRU and TRU's non-club competitors. *See infra* pp. 38-41. TRU, which lowered prices in 1992 to meet club prices, found that those price cuts were no longer necessary after the boycott limited club access to toy products. Second, in pressing its argument, TRU confuses the concept of *monopoly* power (which except in extraordinary circumstances does not exist at market share levels below 60% or 70%) with *market* power under the rule of reason (which may occur at lower percentage levels). Thus, TRU's argument ignores the clear directive in *Northwest Stationers* that courts should examine whether the boycotting firms possess "a dominant position," language that traditionally has required market shares in the 30% range, not the 60 or 70% range. A requirement that a boycott violation could be found only where the boycotting firms hold 60% or more of the market and all by themselves can curtail output and raise price, in effect would read section 1 out of the Sherman Act. Only monopolization or conspiracies to monopolize would be actionable. *See Eastman Kodak*, 504 U.S. at 481 ("Monopoly power under § 2 requires, of course, something greater than market power under § 1."); *Reazin v. Blue Cross and Blue Shield*, 899 F.2d 951, 967 (10th Cir. 1990) ("Market and monopoly power only differ in degree -- monopoly power is commonly thought of as 'substantial' market power.") Many rule of reason cases find "market power" at less than the monopoly level. *See, e.g., Twin City Sportservice, Inc. v. Charles O. Finley & Co.*, 676 F.2d 1291, 1301, 1303-05 (9th Cir 1982). *See also Rossi*, 1998 U.S. App. LEXIS 21911, at *17-18 (reversing summary judgment for defendants and remanding for trial where defendant manufacturer, who along with retailers allegedly was part of a boycott of a price-cutting retailer, accounted for 38% of sales in a local geographic market); *Valley Liquors, Inc. v. Renfield Importers, Ltd.*, 822 F.2d 656, 667 (7th Cir. 1987) ("Without a showing of special market conditions or other compelling evidence of market power, the lowest possible market share legally sufficient to sustain a finding of monopolization [or substantial market power] is between 17% and 25%.") (citation omitted); *United States v. Realty Multi-List, Inc.*, 629 F.2d 1351, 1373 (5th Cir. 1980) ("When the cooperating group possesses sufficient market power that a nonmember

⁶⁴*Roland Mach. Co. v. Dresser Indus., Inc.*, 749 F.2d 380 (7th Cir. 1984), a decision of

Exclusive dealing and other non-price vertical cases, moreover, are easily distinguished from the boycott orchestrated by TRU. For example, many of the exclusive dealing cases involved short term contracts, usually a year or less in duration and often terminable at will. The boycott orchestrated by TRU was not limited in duration and, if effective, would go on indefinitely. More important, there are substantial efficiencies, consistently recognized by the Supreme Court, flowing from exclusive dealing and other non-price vertical restrictions. As Justice Frankfurter explained in the majority opinion in *Standard Oil Co. v. United States*, 337 U.S. 293, 306-07 (1949) (“*Standard Stations*”), exclusive distribution arrangements remove substantial uncertainties, aid planning and reduce costs, permitting investments that might not otherwise occur. See also *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 12 (1984) (discussing business justifications for tie-in sales); *id.* at 40-42 (O’Connor, J., concurring); *Sylvania*, 433 U.S. at 54-55 (discussing business justifications for territorial and customer allocation).

But as we will show in our discussion of TRU’s justification or defense, there are no efficiencies to the boycott orchestrated by TRU.

3. Terminating access to a necessary supply or relationship.

TRU does not really contest the proposition that its "club policy" was designed to and had the effect of denying the clubs “a supply . . . necessary to enable [the clubs] to compete.” *Northwest Wholesale Stationers*, 472 U.S. at 294. The whole point of its club policy was to deny the clubs product, or at least product in a form capable of being compared to TRU’s products, in order to eliminate price competition. The sharp decline in club toy sales, and consequent decline in price pressure on TRU, demonstrates that TRU did not miscalculate.

The clubs’ competitive advantage over other retailers is their low prices, and TRU’s policy denied the clubs toy products necessary to engage in price competition. As club executives testified, see *supra* p. 9, clubs seek to carry branded products that their customers will recognize. Their objective is to offer well-defined values, and this is most easily achieved if customers know the value of the product and its price at other retail outlets. TRU’s policy denied the clubs access to precisely that class of toy products.

TRU’s club policy also imposed costs on the clubs and unavoidably added to shoppers’ perceptions that warehouse club inventory tends to be irregular and limited, or characterized by cumbersome and over-sized products. Finally, the policy led to a denial of the clubs’ preferences (as buyers from the manufacturers) and of consumers’ preferences (as shoppers at the clubs) for a kind of service they preferred and that would have been provided but for TRU’s intervention. See *Indiana Fed’n of Dentists*, 476 U.S. at 462 (“The Federation is not entitled to pre-empt the working of the market by deciding for itself that its customers do not need that which they demand.”); cf. *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 606 (1985) (“[T]he evidence supports a conclusion that consumers were adversely affected by the elimination of the 4-area ticket. . . . [S]kiers demonstrably preferred four mountains to three.”).

The drop in toy sales by the clubs demonstrates the importance of full and non-discriminatory access to toy products. As discussed above, *see pp. 38-41*, TRU's boycott halted a pattern of rapid growth of toy sales at the clubs. While the clubs' share of all toy sales in the United States was growing rapidly before the boycott, toy sales at clubs fell steadily from 1.9% of all U.S. toy sales in 1992 to 1.4% in 1995. Equally important, many (if not most) of the toys that continued to be sold by clubs did not threaten TRU's own prices.

4. The boycott lacked a business justification.

TRU has offered only one business justification for its conduct. It claims that the clubs were "free-riders" that took advantage of services provided by TRU, and that the continued presence of these "free-riders" would have the long term adverse effect of driving these services out of the marketplace. It argues that it therefore was justified in urging toy manufacturers to curtail the ability of the clubs to compete with TRU.

Free-rider concerns arise where there are two classes of competing distributors; one group provides services valued by some consumers, while the other does not but usually charges lower prices. It is now well-recognized in antitrust jurisprudence that a manufacturer can take steps to eliminate free-riding when it is likely to drive services valuable to the manufacturer and consumers out of the marketplace and reduce overall consumer welfare. It is also well accepted that a retailer providing services may urge a manufacturer to eliminate free-riding by terminating the free-riding retailer or taking other action to curtail the problem. *See Sharp*, 485 U.S. at 731; *Sylvania*, 433 U.S. at 54-55.

The simple fact that two sets of distributors elect to adopt different sales formats -- one high-service and the other no-frills discounting -- is insufficient to establish free-rider concerns. As pointed out by Judge Easterbrook, one of the scholars most responsible for calling attention to the validity of a free-rider defense, "[w]hat gives this the name *free-riding* is the lack of charge. When payment is possible, free-riding is not a problem because the 'ride' is not free." *Chicago Prof'l Sports*, 961 F.2d at 675.

a. Dealer compensation cures any free-rider problems.

As we will discuss below, several of the services that TRU points to do not really raise free-rider concerns because they are services that provide advantages only to the toy manufacturers, not to the clubs or any other retailers. But even if they do, the concerns evaporate because TRU is compensated for the services, and there is no threat that the services will be driven from the market. In the words of Professor Scherer, "[s]ufficiency of incentive [to

There are at least three ways a distributor can be compensated for valuable services that it provides. First, the consumer may pay separately for the service. That is feasible, for example, when an automobile dealership provides excellent post-sales servicing at a separate price from purchase of the car, thereby leaving the customer with a good opinion of the dealer and the manufacturer of the car. But consumer compensation is often not feasible. For example, it is not practical to charge customers separately for access to a showroom or pre-sale advertising. *General Leaseways, Inc. v. National Truck Leasing Ass'n*, 744 F.2d 588, 592 (7th Cir. 1984) (“[V]irtually no one will pay to consume advertising.”). A second, theoretically elegant possibility is for a group of dealers who do not supply the service to pay full service dealers roughly the amount the first group benefits from the services. See *White Motor Co. v. United States*, 372 U.S. 253, 270-72 (Brennan, J. concurring) (discussing use of pass-over payments between distributors as an alternative to exclusive territories). Pass-over payments from one set of dealers to another are possible but often extremely difficult to negotiate. Neither of these techniques was used to compensate TRU in connection with the services it claims to provide.

A third technique for compensating dealers for their investments in services that advance consumer welfare is much more common and practical. The manufacturer might decide that the services are important to its long-term market success, but prefer to keep both types of dealers. It may therefore elect to pay the high service dealers an amount roughly equal to their investment. In effect the manufacturer, once it recognizes that the services are valuable to consumers and therefore to its reputation, has a choice. It can either cut off or discriminate against those distributors that fail to provide the service, or continue to do business with those dealers because it believes it is in its interest to do so, but ensure that others continue to provide the service by paying for it. Cooperative advertising programs, whereby manufacturers of trademarked goods pay all or part of the expenses of dealer programs for advertising the manufacturer’s product, are the most common example.

The fact that compensation to the high service retailer eliminates free-rider problems was emphasized by Judge Easterbrook in *Chicago Prof'l Sports*, 961 F.2d at 675, and by Judge Posner in *General Leaseways*, 744 F. 2d at 592. *General Leaseways* challenged the exclusive, territorial divisions imposed by an association of full service, over the road, commercial truck leasing firms. 744 F. 2d at 590. Members of the association provided each other’s trucks with repair services at a reasonable rate, allowing them to receive repair services over a geographic scope comparable to that of a national company. *Id.* at 589-90. The association defended the exclusive territories as a restraint on would-be free-riders who might try to take advantage of the association’s reasonable rates. *Id.* at 592. However, the court rejected this defense as too speculative, noting that the association’s “members . . . charge each other for emergency repair service[s]” they provide -- a kind of compensation by barter. *Id.* The Court did not stop to examine whether the compensation from dealer to dealer was exactly the right amount. It was sufficient that it ensured the continuation of the beneficial activity.

Chicago Prof'l Sports concerned a challenge to the NBA’s rule that so-called television “superstations

⁶⁵Both *Chicago Sports and General Leaseways* dealt with fact situations in which the compensation could be paid (

what they want when they come to the store. TRU does not dispute that it provides no customer services such as product demonstration or installation assistance. There are few if any sales people in a TRU store available to guide or advise shoppers. There was no evidence in the record that anyone sought demonstration or explanation of a toy product at TRU and then purchased the product at a club.

c. TRU was compensated for any services it provides.

Turning now to TRU's specific contentions, it argues that it provides three important and costly services that are not provided by the clubs but that advance the club's interests: (1) TRU advertises products in catalogs and newspaper inserts (called rotos) regularly over the year; (2) it provides a year-round, full-line, industry showroom, which generates sales information and marketing guidance for the toy industry; and (3) it accepts inventory early and regularly over the course of the year, saving the toy manufacturers warehousing costs and permitting steady, less costly production schedules. The record indicates, however, that TRU's services largely benefit the manufacturers and that TRU is compensated generously for any costs incurred in providing these services.

Advertising can raise legitimate free-rider problems if one group of distributors commits resources to promotional efforts and another group, spending no resources, enjoys some of the benefits. *See* discussion of *General Leaseways*, *supra* pp. 77-78. But it is the toy manufacturers who finance advertising in this market. Television advertising is paid for entirely by the toy manufacturers. *See supra* p. 42. As to catalogs and newspaper inserts, the bulk of these expenses -- over 99% in one year and more than 90% in several other years under review -- was paid by the toy manufacturers. A 1993 TRU memorandum called advertising •

important point is that there is no reason to expect that TRU will cease carrying hit products in its unusually broad year-round inventory because the same products are carried by the clubs with a narrower range of offerings.

The marketing surveys that TRU prepares before the annual Toy Fair may, as TRU claims, help manufacturers identify probable hits and plan advertising expenditures. But TRU overlooks the facts that the toy companies create the products and pay for the advertising that helps a promising product become a hit. TRU can be compensated for any market research it does for its suppliers, and the evidence shows that it is compensated by several of the methods just mentioned. In other words, "reimbursed" market research for a manufacturer by a dealer is not the kind of service that has been recognized as creating free-rider problems by other dealers that justify exclusionary restraints.

As to TRU's claim that it accepts inventory early in the course of the year, permitting toy manufacturers to save warehousing costs, the evidence again clearly shows that TRU is paid for this service. Warehousing, moreover, is far from the type of dealer services at issue in the case law on free-riding. It is largely the toy manufacturers and TRU, not the clubs or any other rival of TRU, that benefit from the use of TRU's warehouse space. TRU is allowed to pay later for the delivery of goods (described by several toy manufacturers as compensation for storage services), and receives a disproportionately large share of hit products and generous post-sale discounts for slow-moving inventory. *See supra* pp. 42-43.

Even assuming that the various services provided by TRU were valuable to manufacturers and consumers, there is no evidence that the clubs' failure to provide those services (or Wal-Mart's and K-Mart's for that matter) had, or was likely to have, the effect of driving those services from the market. TRU did argue that "free-riding" by Wal-Mart had forced TRU to reduce the number of items it carried and, if competition from the clubs were not curtailed, that inventory reduction might have to occur again. (Reply Br. at 74-75.) But the claim that inventory reduction was a consequence of no-frills price competition by the clubs and therefore was a justification for organizing a boycott against the clubs does not hold up. The decision to cut back on inventory did not occur until 1996 -- a full four years after the clubs' market share peaked and TRU introduced its club policy. According to Goddu, the TRU executive in charge of the policy change, the inventory reduction resulted primarily from competition from Wal-Mart, not from free-riding by Wal-Mart. Goddu testified that the purpose of the reduction was to create a cleaner looking shopping floor and less cluttered stores. *See supra* note 38.

TRU argues that services remained in the market only because of its policy of inducing toy manufacturers to restrict sales to the clubs. (Reply Br. at 75.) That argument would be far more persuasive if there was any indication, prior to the time TRU's policy was implemented, that any services were on the decline. There is also no indication in the documents -- either those produced by the toy manufacturers or TRU -- that any party had the slightest concern, before the

clubs threatened to sue TRU under the antitrust laws, that the clubs were free-riders that endangered the continued availability of any services that consumers valued.⁶⁶

d. Significantly less restrictive alternatives were available.

Another reason why TRU's policies do not qualify under *Northwest Stationers* is that TRU could have achieved its purported objectives through policies and conduct that restricted competition far less than a boycott among suppliers of its club rivals. Consequently, the boycott cannot be "justified by plausible arguments that they were intended to enhance overall efficiency and make markets more competitive." 472 U.S. at 294.

TRU's essential argument is that its advertising, other forms of promotion, and large year-round inventory, "created" hit products. According to TRU, the clubs observed TRU's activities and then elected to carry only those hit products in the Christmas season. Other services pointed to by TRU involved the accumulation of market data which was communicated to the toy manufacturers so that they could predict proper levels of production for the last part of the year.

TRU could have adopted policies, however, that fell well short of orchestrating arrangements whereby products identical to those carried by TRU would not be provided to the clubs. If TRU's concern was that club purchases would prevent TRU from receiving all the "hit" products it needed during the Christmas season, it could have asked for assurances that it would receive an adequate supply of "hit products." This would protect TRU's alleged position as the industry hit-maker without eliminating clubs as effective competitors on the vast majority of toys. Instead, TRU adopted a policy that all products -- new and old, hit and non-hit products -- could be sold to the clubs as long as they were part of a combination pack that could not be compared easily to TRU product prices. This disconnect between purpose and policy indicates that elimination of effective price competition was TRU's true motivating concern. TRU claims that compensation for the services provided -- advertising, inventory, marketing data -- was not adequate in light of its investment in those services. But TRU, as the largest toy retailer in the United States, could have bargained harder with toy manufacturers for compensation instead of organizing a boycott of the clubs. To the extent the adequacy of compensation is addressed in this record, the evidence is overwhelming that TRU was an exceptionally capable and aggressive bargainer and that TRU received compensation that equaled or exceeded its investment.

e. TRU's free-riding claims are a pretext.

Before TRU introduced its policy of curtailing toy manufacturers' sales to clubs, there is no indication in the documents that any toy manufacturer declined to do business with the clubs

⁶⁶*Cf. Eastman Kodak*, 504 U.S. at 485 n.33 (rejecting a free-riding defense when there is no evidence that manufacturer-imposed restrictions are necessary to induce competent and aggressive retailers to make the investment of capital and labor necessary to distribute the product).

because of possible free-riding. Indeed, TRU's suppliers' adoption of the club policy was an abrupt departure from the toy companies' longstanding distribution policies. Few toy manufacturers avoided doing business with discounters, or even with retailers that provided a narrow range of services, nor did they require distributors to carry their full line. The few who did avoid sales to the clubs did so for reasons unrelated to "free-riding." *See supra* pp. 44-45.

Similarly, there is absolutely no evidence -- certainly no contemporaneous document -- that TRU developed and implemented its policy with respect to competition by the clubs because of a free-riding concern. Indeed, the first mention of free-riding within TRU was in the late summer of 1992, when the clubs threatened to sue TRU and its suppliers for discriminatory sales policies. Also, TRU never asked the toy manufacturers to discipline Wal-Mart, Target, K-Mart or other established discounters -- even though they, like the clubs, did not provide services such as early purchasing of inventory, stocking a large number of toy products, and advertising. The difference was that the clubs offered a form of extreme price competition that TRU came to believe it could not tolerate. Although concerns about free-riding often will be difficult to distinguish from generic concerns about "unfair" price cutting, the lack of any more specific,

that evidence of such effects “can obviate the need for an inquiry into market power which is but a ‘surrogate for detrimental effects.’” *Id.* at 460-61 (quoting 7 Areeda, *supra* note 43, ¶ 1511, at 429. *See also Wilk v. AMA*, 895 F.2d 352, 360-62 (7th Cir. 1990) (holding that a showing of actual adverse competitive effects obviates the need to present detailed evidence of the market definition and market power) (citing and discussing *Indiana Fed’n of Dentists*). That is particularly clear where the boycott prevents economic activity that the market would otherwise produce, *see id.* at 360, and there are no countervailing procompetitive virtues such as the creation of efficiencies in the operation of the market or the provision of goods and services. *Id.* at 361.

That is exactly the situation we have here. There were clear anticompetitive effects, *see infra* pp. 83-87, and no plausible business justification. TRU and its reluctant collaborators set out to eliminate from the marketplace a form of price competition and a style of service that increasing numbers of consumers preferred.

In conclusion, we note that all elements required by *Northwest Wholesale Stationers* to justify application of a *per se* rule are present; even if market power were not present, a violation would nevertheless be found.

E. THE GROUP BOYCOTT ORGANIZED BY TRU IS ALSO ILLEGAL UNDER A FULL RULE OF REASON ANALYSIS.

Even if TRU’s conduct is analyzed under the full rule of reason, its behavior must still be found illegal. The principal additional factors that must be examined under a full rule of reason -- as opposed to *Northwest Wholesale Stationers*’ modified *per se* approach -- are, first, whether TRU’s behavior had a significant anticompetitive effect, and, second, whether any such effect is outweighed by legitimate business justifications.

1. The boycott produced anticompetitive effects.

The boycott TRU orchestrated had harmful effects for the clubs, for competition, and for consumers. TRU prevented a decrease in the price paid by many consumers for many toy items, reduced the options available to consumers, and weakened both intrabrand and interbrand competition in the retail toy market.

TRU argues that Complaint Counsel has failed to demonstrate anticompetitive effects. TRU’s arguments reduce to an assertion that, because the clubs were small -- accounting for no more than an estimated 1.9%⁶⁷ of the United States toy market when TRU’s policy went into

⁶⁷Mattel estimated the clubs’ total share of the retail toys sold in the United States in 1992 at 2.3%. CX 695-L. Although we have no reason to think this estimate is any less accurate than the lower statistic offered by the NPD Group, we have given TRU the benefit of the doubt by
(continued...)

effect -- TRU was privileged to organize a boycott designed to disadvantage and impose extra costs on them without being accountable for having caused harm cognizable under the antitrust laws. The clubs, according to TRU, were too small to matter. (App. Br. at 69-72; Reply Br. at 64 (“A ‘restraint’ that leads to 1% of the market being excluded from toys making up 40% of industry sales is barely foreclosure at all. . . .”)) When a similar argument was advanced in *Klor’s*, the Supreme Court commented:

It [the boycott allegation] clearly has, by its “nature” and “character,” a “monopolistic tendency.” As such it is not to be tolerated merely because the victim is just one merchant whose business is so small that his destruction makes little difference to the economy. Monopoly can as surely thrive by the elimination of such small businessmen, one at a time, as it can by driving them out in large groups.

Klor’s, 359 U.S. at 213 (footnote omitted).

This remark applies with even greater force to the boycott orchestrated by TRU. Far from a single small business, the clubs were growing chains of retailers operating hundreds of outlets nationally and employing a distinctly new and efficient method of distribution. Because the boycott injured the clubs, it also harmed competition, and because competition was harmed, consumer welfare was reduced. Although the antitrust laws protect competition and not competitors, there can be no competition without able competitors. A policy that selectively eliminates effective competitors (or the ones most threatening to incumbent firms) harms the competitive process even though individual firms are the targets. Our discussion of effects looks first at the harm caused to the clubs’ toy sales and then at the repercussions of this for consumers.

As noted previously, *see supra* p. 40, club toy sales reached a high of 1.9% of total U.S. sales in 1992, and business observers expected toy sales to continue to grow rapidly. Although club sales generally continued to increase in the next several years, club toy sales declined steadily

⁶⁷(...continued)
picking the lower number for this discussion.

customers would have saved \$55 million per year.⁶⁸ And of course the boycott raised the costs of toys at the clubs, obstructing their advantage as the lowest price outlet to the advantage of TRU and the injury of consumers.

The boycott orchestrated by TRU reduced the range of choices available to consumers and eliminated forms of competition that consumers desired and would have been ilaGTf8 ” Tc

⁶⁸*Cf. FTC v Staples, Inc.*, 970 F. Supp. 1066, 1082 n.14 (D.D.C. 1997) (recognizing an averted price decrease as an anticompetitive effect).

these efficiencies at p. 75, *supra*. The courts, therefore, are confronted with a difficult trade-off between anticompetitive foreclosure on the one hand and redeeming business justifications on the other. Here, the evidence is overwhelming that there simply were no efficiencies to justify TRU's behavior.

The essential prop to all of TRU's arguments about anticompetitive effect is that a government boycott case must fail if the government does not discharge a burden of demonstrating that, as a result of the boycott, market-wide prices increased or market-wide output diminished. (Reply Br. at 52.) This very issue was addressed and settled by the Supreme Court in *Indiana Fed'n of Dentists*, 476 U.S. at 461-62, where a group of dentists conspired to prevent member dentists from submitting x-rays to dental health insurers so that the insurers could check the validity of requests for payment of benefits. The Court elected a rule of reason, rather than *per se*, approach, in part because the boycott involving x-rays was obviously not intended to harm a competitor -- a purpose that *is present* here. *Id.* at 458-59. In applying a full rule of reason, the Supreme Court addressed the argument that there had been no finding that "the alleged restraint on competition among dentists had actually resulted in higher dental costs to patients and insurers." *Id.* at 447. The Court explained that a showing of higher prices was not essential to establish the illegality of the restraint:

A concerted and effective effort to withhold (or make more costly) information desired by consumers for the purpose of determining whether a particular purchase is cost justified is likely enough to disrupt the proper functioning of the price-setting mechanism of the market that it may be condemned *even absent proof that it resulted in higher prices or, as here, the purchase of higher priced services, than would occur in its absence.*

Id. at 461-62 (emphasis added).⁶⁹

The case for finding a violation is all the more powerful here where the boycott is not an indirect attempt to interfere with price-setting (through withholding of information), but a direct effort by one retailer to organize a boycott designed to impair the ability of its lowest-priced rivals to continue to offer products and services that consumers desire.

2. The anticompetitive effects far outweigh the claimed justification.

There was no business justification for a boycott that had a pronounced anticompetitive effect. The single justification offered -- the prevention of free-riding -- was a *post hoc*

⁶⁹The Court had previously articulated this point in *Associated Gen. Contractors, Inc. v. California State Council of Carpenters*, 459 U.S. 519, 528 (1983) ("Coercive activity that prevents its victims from making free choices between market alternatives is inherently destructive of competitive conditions and may be condemned even without proof of its actual market effect."). *Accord Wilk*, 895 F.2d at 360.

rationalization for a policy with an anticompetitive purpose and effect. The balance under a full rule of reason tips decidedly toward condemnation.

F. CONSIDERED ALONE, THE VERTICAL RESTRAINTS ARE UNREASONABLE UNDER § 1 OF THE SHERMAN ACT.

The evidence is clear that TRU, a dominant toy retailer, significantly diminished the ability of the clubs to compete by inducing a substantial number of toy manufacturers to agree to do business with TRU's club rivals only on discriminatory terms. It accomplished its purpose by approaching each of the toy manufacturers *seriatim* and inducing or coercing each to agree to join in its anticompetitive mission. *See supra* pp. 15-22 & notes 23, 24. TRU's purpose was to avoid significant price competition from rivals and to deny consumers a form of distribution they prefer. *See supra* p. 67. The effect of these joint actions was to injure a group of rivals in the marketplace. *See supra* pp. 83-87.

We conclude therefore that each agreement in the series of vertical agreements, standing alone, even without the evidence of horizontal agreement among many of the toy manufacturers, violates § 1 of the Sherman Act upon a full rule of reason review.

A vertical agreement between a retailer (even one as powerful as TRU) and an individual manufacturer, whereby the manufacturer agrees to deal only on discriminatory terms with a competitor of the retailer, would not be treated as illegal *per se*. It is not vertical price-fixing because no specific price, or price level, was agreed to, *see Sharp*, 485 U.S. 717, 731, and each individual vertical agreement is not *per se* illegal as a boycott.

On the other hand, an examination limited to each individual agreement in isolation (TRU agrees with Mattel, TRU agrees with Hasbro, TRU agrees with Tyco, etc.) would blind us to the true anticompetitive nature and effect of TRU's course of conduct. As the Supreme Court instructed in *Continental Ore Co. v. Union Carbide & Carbon Corp*, 370 U.S. 690 (1962):

plaintiffs should be given the full benefit of their proof without tightly compartmentalizing the various factual components and wiping the slate clean after scrutiny of each. " * * * (T)he character and effect of a conspiracy are not to be judged by dismembering it and viewing its separate parts, but only by looking at it as a whole. *United States v. Patten*, 226 U. S. 525, 544 * * *; and in a case like the one before us, the duty of the jury was to look at the whole picture and not merely at the individual figures in it." *American Tobacco Co. v. United States*, 147 F.2d 93, 106 (C. A. 6th Cir.). *See Montague & Co. v. Lowry*, 193 U. S. 38, 45-46.

Id. at 698-99. Along the same lines, the Supreme Court in *Standard Stations*, 337 U.S. 293, found individual, exclusive dealing contracts illegal because of the "widespread adoption of such contracts" in the market. *Id.* at 314.

In the present case, each vertical agreement was entered into against a background in which other agreements were solicited and either achieved or were about to be achieved. The large number of agreements ultimately obtained, and the size and importance of the toy firms that joined them, were essential to the success of the agreements and to the accomplishment of TRU's overall scheme. The collection of separate vertical agreements -- together excluding the clubs from the leading manufacturers of toys, accounting for roughly 40% of U.S. output -- had a profound anticompetitive effect, *see supra* pp. 83-87; the collection of parties entering into separate agreements had substantial market power, *see supra* pp. 67-75; and there was no plausible business justification or efficiency, *see supra* pp. 76-82. Under a full rule of reason, we find that *each agreement* in the series of agreements -- anticompetitive in purpose and effect and lacking plausible justification -- constitutes a violation of § 1 of the Sherman Act. *See Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 325-29 (1961); *Chicago Bd. of Trade v. United States*, 246 U.S. 231, 238 (1918); *cf. United States v. National Ass'n of Broadcasters*, 536 F. Supp. 149, 157-169 (D.D.C. 1982); *United States v. American Smelting & Ref. Co.*, 182 F. Supp. 834, 861 (S.D.N.Y. 1960).

G. THE ORDER CRAFTED BY THE ALJ IS REASONABLE, APPROPRIATE AND NECESSARY TO REMEDY THE ANTICOMPETITIVE EFFECTS OF TRU'S CONDUCT.

Having found that TRU violated the antitrust laws by organizing a boycott agreement to discriminate against the clubs, the ALJ entered an order requiring TRU to cease this law violation and to refrain from similar conduct in the future. This order contains five key elements of injunctive relief. *See* Order ¶¶ II.A-E. Because each provision of the ALJ's order is reasonable, appropriate and necessary to remedy the anticompetitive effects of TRU's conduct, we have decided to make final the order he crafted.

Briefly summarized, the order prohibits TRU from continuing, entering into, or attempting to enter into, vertical agreements with its suppliers to limit the supply of, or refuse to sell, toys to a toy discounter. *See* ¶ II.A. The order also prohibits TRU from facilitating, or attempting to facilitate, an agreement between or among its suppliers relating to the sale of toys to any retailer. *See* ¶ II.D. Additionally, TRU is enjoined from requesting information from suppliers about their

because, in whole or in part, that supplier offered to sell or sold toys and related products to any toy discounter.

TRU contends that these provisions would force it to buy products it could not sell and to operate at a loss.

Colgate "rights" merely describe the boundary between concerted conduct that may violate the antitrust laws and unilateral conduct that the law does not forbid. As we have explained, TRU has crossed that boundary repeatedly and in several different ways. *See supra* pp. 46-50. It is well settled that once a respondent engages in illegal conduct, the Commission's order need not prohibit merely unlawful conduct, but may "close all roads to the prohibited goal, so that its order may not be by-passed with impunity." *FTC v. Ruberoid Co.*, 343 U.S. 470, 473 (1952). The order may also include such additional provisions as are necessary to "preclude the revival of the illegal practices." *FTC v. National Lead Co.*, 352 U.S. 419, 430 (1957). Indeed, "those caught violating the Act must expect some fencing in." *Id.* at 431.

Paragraph II.E of the order is necessary to prohibit illegal conduct that TRU engaged in under the guise of the Court's decision in *Colgate*. The sorts of communications and the sales restrictions prohibited by ¶ II.E are the means used by TRU to implement and police the illegal restraints of trade. The paragraph is also necessary to correct the effects of the illegal conduct. Although TRU argues that ¶ II.E would require it to operate at a loss, to buy products it does not believe it can sell, or to carry all items stocked by discounters, it does none of these things. TRU will remain free to reject items that it does not believe it can sell profitably, *so long as it makes that decision independent of whether the item is offered to or sold by a discounter*. Similarly, TRU is free to communicate with manufacturers, *so long as the communications do not concern the sale of items to discounters*.

Finally, the order restricts TRU from communicating with manufacturers about sales not only to warehouse clubs, but to all discounters. The practices employed by TRU to restrict sales to clubs could have been applied to restrict sales to other discounters. Such fencing-in is wholly appropriate.

H. TRU'S PROCEDURAL OBJECTIONS LACK MERIT.

TRU challenges the ALJ's decision to exclude TRU employees (but not its outside counsel) from those portions of the trial at which *in camera* material submitted by TRU's competitors and suppliers was presented. TRU argues that this decision violated its rights under § 555(b) of the Administrative Procedure Act ("APA"), which, TRU contends, embodies the Due Process and Confrontation Clauses of the United States Constitution. TRU also argues that the decision conflicts with the Commission's Rules of Practice ("Rules"). Finally, TRU asserts that the ALJ erred by affording *in camera* treatment to certain documents. We review *de novo* the legal issues raised by TRU. We will not reverse the ALJ's decision regarding the *in camera* status of documents unless we find an abuse of discretion. See *General Foods Corp.*, 96 F.T.C. 168, 170 (1980). We find that the ALJ's decision did not violate the APA, the Constitution, or the Commission's Rules. We also find that the ALJ's decision to provide *in camera* treatment to certain material did not constitute an abuse of his discretion.

Neither the Constitution nor § 555(b) of the APA mandates the presence of TRU employees during the presentation at trial of *in camera* information. "Whatever else § 555(b) guarantees to parties to an administrative proceeding . . . , it does not mandate disclosure of significant confidential information to in-house counsel and corporate executives of a business competitor -- where that information is fully available to outside counsel." *Akzo N.V. v. United States Int'l Trade Comm'n*, 808 F.2d 1471, 1484 (Fed. Cir. 1986). Thus, § 555(b), which entitles a party "to appear in person or by or with counsel or other duly qualified representative in an agency proceeding, . . . is not blindly absolute." *Id.* (quoting 5 U.S.C. § 555(b)). Although TRU has a strong interest in having its employees present during the trial, that interest may be outweighed by the submitter's need to protect the confidentiality of the information, and by the Commission's interest in assuring that, in the future, parties will be willing to disclose confidential information. See *A. Hirsch, Inc. v. United States*, 657 F. Supp. 1297, 1302 (Ct. Int'l Trade 1987). The ALJ's order properly balanced these competing interests. Thus, the ALJ's decision did not infringe TRU's rights under the APA or under the Due Process Clause of the Constitution. See *Akzo*, 808 F.2d at 1483 (implying that the right to due process does not guarantee in-house counsel access to confidential information).⁷⁰

TRU also asserts that its rights under the Confrontation Clause have been violated. The Confrontation Clause of the Sixth Amendment applies only to criminal proceedings. *Hannah v. Larche*, 363 U.S. 420, 440 n.16 (1960). Accordingly, it has no relevance here.

⁷⁰TRU argues that *United States v. Lever Bros. Co.*, 193 F. Supp. 254, 258 (S.D.N.Y. 1961), mandates disclosure to corporate personnel. However, the order entered by the court in *Lever Brothers* did not mandate disclosure "except insofar as it may be necessary for consultation with counsel for Lever in order to prepare for and assist in the defense of the action." *Id.* Similarly, the ALJ's order here did not preclude disclosure to TRU employees if TRU made a showing that its defense was being harmed. See Order Re In Camera Issue, March 5, 1997.

TRU argues that the Commission's Rules of Practice guarantee its employees the right to be present when *in camera* material is offered at trial. It claims that because "Section 3.45 provides: 'only respondents, their counsel, authorized commission personnel, and court personnel concerned with judicial review may have access' to in camera material . . . there was no basis for precluding Toys "R" Us from being present during the trial . . ." (App. Br. at 88-89 (emphasis in original).) However, the language of Rule 3.45 is not mandatory -- it merely indicates who *may* have access to *in camera* material. We have never interpreted Rule 3.45 to require that respondents *must* have access to *in camera* material. See *Papercraft Corp.*, 78 F.T.C. 1352, 1408 (1971), *aff'd*, 472 F. 2d 927 (7th Cir. 1973); see also *FTC v. United States Pipe and Foundry Co.*, 304 F. Supp. 1254, 1260 (D.D.C. 1969) (order providing for disclosure of documents only to respondent's counsel is consistent with Rule 3.45).

Finally, TRU fails to demonstrate an abuse of discretion in any of the ALJ's evidentiary decisions. TRU does not object to any specific decision made by the ALJ. Instead, it objects to the number of occasions on which its employees were excluded, and to the fact that its employees were excluded during portions of the testimony given by executives of toy manufacturers.

Because TRU does not challenge any specific *in camera* decision made by the ALJ, we examine the standard that the ALJ applied in reaching his decisions. We conclude that the ALJ applied the appropriate test in evaluating TRU's requests for access to *in camera* information. He balanced TRU's "need for direct access to the confidential financial and business information to adequately prepare its case, the harm disclosure would cause to the parties submitting this information, and the forum's interest in maintaining the confidentiality of the information." Order Re Respondent Seeing In Camera Information, May 24, 1997. Further, the ALJ offered to permit TRU's in-house counsel to attend the portions of the trial during which *in camera* information was presented, and further offered to permit TRU to retain an outside expert in order to assist it in evaluating the *in camera* documents. TRU availed itself of neither of these offers. The ALJ also gave TRU's outside counsel the opportunity to interrupt the trial in order to consult with TRU employees (without showing them any *in camera* documents). By presenting TRU with these options, the ALJ amply balanced TRU's interests against the interests of the submitters and of the Commission. Thus, the ALJ applied the appropriate test, and TRU has not identified any abuse of discretion by the ALJ. Accordingly, we decline to reverse any of the ALJ's decisions regarding the treatment of *in camera* documents.

TRU also argues that the Commission should reconsider its decision to issue the complaint, which was allegedly "tainted" 1) because a staff member had an undisclosed conflict of interest, and 2) because Commission staff allegedly leaked information about the investigation to the press. Neither of TRU's arguments gives us reason to do so. First, TRU presents nothing that gives us any reason to doubt any staff member's impartiality. Second, we see no reason why leaks to the press by the staff would affect a Commission determination that there was reason to believe a violation had occurred or that a Commission proceeding was in the public interest. See, e.g., *TRW, Inc.*, 88 F.T.C. 544 (1976). In any event, there is no evidence as to the source of information in press reports that appeared at the time of the issuance of the complaint in this

matter. Because Commission investigations frequently necessitate contacts with persons outside the Commission, there usually are many possible sources for press reports. Moreover, it is bare speculation -- and nothing more -- that the alleged leak had any impact on the Commission's decision to issue the complaint. We have considered TRU's two arguments and find them meritless.

CONCLUSION.

The Commission, for the reasons stated in this opinion, has determined to deny the appeal of respondent TRU and to make final the attached order, which is identical to the order entered by the ALJ.