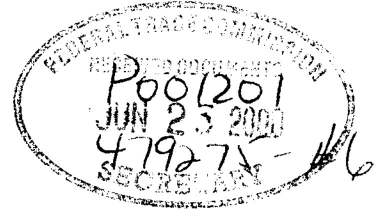
Comments Regarding Slotting Allowances
and Other Grocery Marketing Practices



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Introduction

I would first like to express my appreciation to the Federal Trade Commission for the opportunity to be heard on the issue of slotting allowances.

Slotting allowances – fees charged to defray the costs of new product introductions – arise because of an economic reality: there are more new products introduced each year than supermarket store space. The widespread use of slotting allowances in the retail food industry has developed over more than thirty years because of the real economic costs of stocking new products and the limits on available retail shelf space.

New products impose two types of costs on supermarkets and other retailers: a) shelving and promotion expenses for the product; and b) the opportunity costs versus a store's current product offerings and against other new products the supermarket could carry. Examples of the former include the cost of setting the product up in warehouses, accounting for it in inventory, bar-coding it, re-doing plan-o-grams to reflect the changes in store shelf configurations, and eventually stocking the shelves with it.

New grocery product innovations have exploded since the 1980s, numbering 10,000 to 15,000 new product introductions or product line extensions each year. While individual supermarkets generally carry between 30,000 and 50,000 SKUs and many chains carry more SKUs throughout their chain – an obviously dizzying variety of products – supermarkets and other retailers must make choices. Supermarkets do not expand shelf space when new products are proposed; they must make choices about which current products to displace.

New products are quite risky. Despite the number of SKUs stocked by supermarkets and the number of new products stocked every year, the failure rate for new grocery products has been estimated to be nearly 90%. This high failure rate is likely due to the fact that few of these new products are test-marketed by manufacturers before they are introduced to the consuming public. While successful product innovations in the grocery business benefit consumers by offering them preferred products, such new products do not generally encourage consumers to

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[1] The views expressed herein are entirely my own. My views do not necessarily reflect the views of White & Case LLP, our clients, or my colleagues.

spend a greater portion of their budgets on food purchases. Consequently, successful product innovations in the grocery industry largely displace sales of existing products.

Supermarkets have no bias against smaller manufacturers. Indeed, supermarkets are the champion of smaller, regional and offbeat manufacturers. A hallmark of the supermarket format has been the offering of greater selection than other food retailers, such as mass merchants and club stores, while also providing consumers with local products.

In many cases, particularly where the manufacturer is a small company, there has been little or no advertising of the product, and therefore, no sense of consumer demand for the product. To create consumer demand and to drive sales, the retail grocer must also incur the cost of advertising the product in some way, offer in-store coupons, or other promotions.

Unlike manufacturer profit margins, which generally are in double-digits, net profit margins at grocery stores hover at very narrow levels of one to two percent of sales. Thus, added costs associated with the addition of new product lines has a large impact on store profitability. Slotting fees can help defray the costs retailers face from the risk of new product introduction. Accordingly, slotting allowances efficiently allocate a scarce resource – retail shelf space owned by the retailer – and tend to increase new product innovation. Manufacturers can use slotting allowances to get products on the retail shelves quicker and cheaper than other means, such as waiting for a national advertising campaign to generate sufficient demand for new products that stores are only then willing to stock. It is undisputed that consumers are better off if they have more choices, and supermarket slotting fees guarantee that consumers will have more choices.

Finally, it is all but conceded by others in the slotting fee debate that there is nothing inherent in charging a slotting allowance that would necessarily make it an antitrust violation. Slotting allowances do not constitute a per se violation of any American antitrust law. At the same time, any lawful activity can be abused in certain rare situations; outrageous conduct that is anticompetitive is amply covered by current antitrust laws.

Government guidelines attempting to regulate, curtail or eliminate slotting fees would be disastrous for the entire food retailing industry and for consumers. Slotting fees work to promote new product innovation and to encourage retailers to introduce those new products to consumers. Guidelines could only penalize efficient manufacturers and retailers and would likely result in fewer product innovations and higher prices.

A. Background for the Role of Slotting Fees

1. Retailers Increasingly Perform Test-Marketing for Manufacturers

Manufacturers in recent years have reduced the resources and time devoted to test-marketing new products. This has increased the risk of new product failures. As a result, supermarkets and other retailers now bear the burden of test-marketing new products from manufacturers. For example, many supermarket chains will add a new product just in a single

store or in a small group of stores. Although it is costly to add SKUs that are not carried chain-wide, this can give small manufacturers an opportunity to test new products.

2. Supermarkets Are Not the Sole Path to Manufacturer Success

New products are introduced in a variety of retail formats. Manufacturers today can and do choose from warehouse clubs, mass merchants, chain supermarkets, independent supermarkets, drug stores, convenience stores, "mom and pop" stores, vending machines, and the world wide web to introduce and promote new products.[2] For example, the majority of many products are sold outside the supermarket channel.[3]

Many of today's blockbuster new products were first introduced in deli shops and independent convenience stores, when the manufacturer was operating out of a garage. Snapple was started by three friends in Brooklyn, New York who began selling fruit drinks to health food stores in Greenwich Village.[4] Similarly, Nantucket Nectars first distributed its product off the back of a sailboat to independent sandwich shops, on college campuses, and in convenience stores.[5] The product caught the attention of regional supermarket retailers who worked with the firm's founders to expand manufacturing capacity. Today, less than a decade after the company was founded, the product is widely distributed with sales in excess of $75 million, and it is the number one selling fruit juice in Boston.[6]

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2 Jeremy's Microbatch Ice Creams, Inc., a Nasdaq listed manufacturer, sells its limited edition pints of ice cream through "grocery stores, convenience stores, gourmet food shops, and through its website, www.microbatch.com." "Jeremy's MicroBatch Ice Creams is Making Ice Cream Cool Again," Business Wire, March 15, 2000. On the importance of vending machines, see "Cape Cod Potato Chip of Hyannis to be Sold a Second Time," Boston Globe, April 17, 1999, p.F1, describing the acquisition in 1999 of Cape Cod chips by Lance, which helped develop additional distribution by making 65,000 vending machines available to that manufacturer.

3 For example, 80% of Snapple sales are conducted through the convenience store channel. "New Owner is Whipping Snapple Back into Shape," USA Today, March 9, 1998, p1B.

4 "Former Snapple Executive Joins South Beach Beverage," Fairfield County Business Journal, Oct. 6, 1997, p.2.

5 "Looking for . . . a few good distributors," Beverage World, May 1999, p.52 (describing how Harvard Business School teaches Nantucket Nectars as a case study in beginning with mom and pop distribution before being carried in supermarkets).

6 "Nantucket Nectars Will Tie Up in Denver," Rocky Mountain News, Feb. 14, 1999, p.11G.

3. Supermarkets Encourage Small and Disadvantaged Manufacturers

Supermarkets have a stake in seeing manufacturers succeed in meeting consumer demand. First, supermarkets work very hard to be able to present themselves as highly attuned to local tastes. For this reason, merchants from supermarkets review products carried in small mom and pop stores to pick up new trends or new products.

There are countless instances of the dogged, garage start-up entrepreneur making an initial modest sale to a small convenience store, grocery or supermarket chain to get its break. Persistence and creativity are often the hallmark of success. For example, Honest Tea is a new start-up, low-calorie naturally sweetened tea, created in late 1997. It gained supermarket distribution with a modest $15,000 order from Fresh Fields, after the buyer sampled a thermos of tea brought to the store by the company's owner.[7] It is now carried in over 800 supermarkets nationwide.

Second, it should be obvious that no supermarket or other food retailer has an incentive in seeing a product fail or in barring the next blockbuster product from its shelves. Indeed, retailers have every incentive to work to locate successful new products and introduce them.

Third, supermarkets have a very long history in working with small manufacturers and small farmers. Many supermarkets buy produce from individual farmers. In many instances, a farmer may produce only enough for a single store. Despite the cost involved in working with such small scale purchases, supermarkets – whether chain or independent – continue to carry local produce because they value the ability to support local farmers and advertise such local purchasing in advertising and in-store displays. Consumers in turn have rewarded these merchants with their purchasing dollars.

Similarly, supermarkets have worked with micro-brands to add diversity to the store shelves. When Cape Cod chips ceased production due to the Anheuser-Busch exit from snack foods,[8] supermarket chains helped the founder re-introduce Cape Cod chips to their stores. In other words, supermarket chains have relaxed or forgiven slotting allowances where necessary to put or keep a unique product on store shelves.

Fourth, supermarket chains increasingly pursue disadvantaged manufacturers as an untapped source of product diversity and a new means of reaching consumer demand. The Stop & Shop Supermarket Company has been a leader in this regard. Its CEO, William Grize, hosted the first summit for disadvantaged/minority entrepreneurs in 1999. As a result, a number of start-

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7 "Maryland Company Takes on Iced Tea Giants," AP Business Wire, May 18, 1999.

8 "Chipping the American Dream," CNNfN Transcript, May 7, 1999 (available on Lexis/Nexis).

up minority manufacturers were put in touch with Stop & Shop's minority vendor liaison and with the Stop & Shop merchants for the relevant store categories. Many of the products have reached multi-store rollouts. The most successful products that prove themselves with consumers will be introduced chain-wide.

Indeed, being introduced by Stop & Shop to the marketplace has had a ripple effect on other supermarket chains. As an example, there is a product that Stop & Shop purchased chain-wide, which created warehouse demand for the product at C&S Wholesale. That made the product available to Big Y and other New England supermarket chains, which today carry the product as well.

4. Supermarkets Foster Broad Product Assortments

Supermarkets today sell variety as one dimension of their customer offering. Price, service, and quality are also very important. Other retail formats may emphasize different aspects of the shopping experience.

Supermarket chains carry an impressive array of SKU's. A modern chain may carry up to 50,000 SKU's in its largest stores and have multiple assortments for different neighborhoods. Because a supermarket merchant will want to tailor its assortment to the community, the supermarket may also carry a number of ethnic products. As a result, a supermarket chain operating in many neighborhoods may be carrying as many as 70,000 SKU's in its system. Obviously, a 70,000 SKU retailer will have more expenses than a 20,000 SKU or 6,000 SKU retailer.

Slotting allowances have arisen in the retail format that encourages broad and diverse product lines. To compare supermarkets with mass merchants or club stores that do not typically feature this product depth, is to compare apples and oranges. From the retail format that has product depth, slotting allowances developed as a means of defraying the real costs of introducing new products. While the FTC would be advised to review other retail formats, particularly if retail concentration is a part of its policy consideration, it is not a coincidence that the slotting allowance developed in the format with the greatest depth of SKU coverage.

5. Manufacturers Who Create Superior Brands or Superior Products Will Do Better than Those Who Do Not

The debate over slotting allowances and fees obscures the reality that all manufacturers are not equal. Manufacturers of the same product differentiate that product based on the strength of their promotional efforts and based on the product's strength itself. Some manufacturers invest decades of time, research, development and promotional dollars into developing well-known brands. They must continue to advertise and create reinforcing images of their products to keep ahead of the competition. As long as they continue to promote their brand and products, they will out-sell manufacturers who put less money into product promotion. Supermarkets, convenience stores, mass merchants, and drug stores know that branded products supported by strong manufacturer advertising and promotion will tend to outsell unknown or lesser-promoted brands.

Similarly, manufacturers who innovate and create new products will do better than those who do not. Baby diapers, for example, are a product with an almost unimaginable level of manufacturer R&D behind it (unless you are a parent). Proctor & Gamble (Pampers) and Kimberly-Clark (Huggies) each hold scores if not hundreds of patents and licenses for every element of the diaper system and have dedicated R&D teams working on a better diaper. This R&D has resulted in diapers that are in great demand by today's parents.

There will always be some manufacturer who is less successful than another. Government cannot re-balance the playing field without acting to the detriment of consumers.

6. Store Shelving Decisions Are Highly Complex

The decisions involved in allocating in-store shelf displays are highly complex. Merchants balance a number of considerations in working through plan-o-grams.

It is consumers that determine how much shelf space a product will enjoy. Popular, well-promoted, familiar products will always receive the greatest shelf space. This is a response to consumer demand, not a nefarious plot by retailers. Retailers devote the largest number of facings to high-demand products because retailers want to avoid out-of-stock shelves. As an example, Hellman's mayonnaise will always receive many more facings (*i.e.*, more jars on display laterally on the store shelf) than Uncle Bill Gidley's mayonnaise (a hypothetical brand) will because of the strong consumer demand for Hellman's mayonnaise. Consumers have developed a taste for branded, well-promoted existing products such as Hellman's mayonnaise and are attracted to it. Retailers try to stock fast-moving products in sufficient case quantities such that consumers are not disappointed by finding a beloved product out-of-stock.

Physical shelving limits also play a role. A retailer will work very hard to avoid dead air on its shelf — that is a distinct inefficiency. Both shelving design and the height of other products have an effect on store plan-o-grams.

There are trade-offs inherent in any supermarket decision to carry a novel, regional or start-up product. As an example, how many ranch-style salad dressings should a supermarket carry? Should it stick to only the highly promoted brands (*e.g.*, Hidden Valley, Newman's Own, Kraft, Wishbone)? Should the supermarket or other food retailer carry a (sadly hypothetical) Uncle Bill Gidley's Ranch Dressing? One supermarket might make the calculus that serving local tastes and the addition of this offbeat brand would be of value to consumers. In fact, even shoppers who refuse to buy Uncle Bill Gidley's Ranch Dressing might appreciate that their grocery store so values a broad SKU selection that it has such products throughout the store. This appreciation may manifest itself through return trips to the store, despite not ever purchasing that particular SKU.

SKU diversity can be an intangible of the shopping experience for customers. Carrying this or that offbeat micro-brand might distinguish the store from its other retail competitors. Another competitor might devote the same store shelf area to another facing of a premium brand of salad dressing and make more money. Neither retailer's decision is correct or incorrect, as a matter of sound antitrust law (or indeed public policy). Still another retailer might eschew

branded products substituting its own private-label brand, such as the Trader Joe's business model for supermarkets or Sears Roebuck & Company's approach to white good appliances before Sears Brand Central. As a matter of public policy, there is no "right" answer to store format or shelving decisions. There is no exact economic formula for balancing the two because the human shopper behavior variable involves many intangibles and simply cannot be quantified.

7. Prices and Fees are Appropriate Means for Allocating Costs and Scarcity

There are other examples of scarce space leading to fees. Cable channels are scarce. There are often only 120 channels available, but more than 200 exist. Thus, the cable channel producers pay access fees to the system.[9] Online services allocate their limited "shelf space" by access fees to online merchants. Merchants pay the largest online services and Internet portals a flat fee in advance for a multi-year affiliation deal.

Some critics of slotting allowances claim that mergers in the supermarket industry have intensified slotting fees. Slotting fees have existed for at least thirty years in New England, and slotting fees are widely reported to have been charged more than 20 years throughout most of the country. This was a quarter century before any significant supermarket merger activity occurred. Moreover, slotting allowances and fees are charged by small and independent supermarkets. Small chains of 10 to 20 stores will charge a slotting allowance for accepting a new store product because the costs of new product introduction are real. There is no evidence that supermarket mergers have accelerated the use of slotting fees.

B. Procompetitive Functions Served by Slotting Fees

There are highly procompetitive, efficiency-based explanations for slotting fees: they transmit information about the manufacturer's product to the retailer regarding the likelihood of the new product's success; they absorb some of the cost and risk to the retailer if the product fails; and they tend to increase new product innovation by getting more products on the grocery store shelves quicker and cheaper than other means.

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[9] "Oxygen Media," *Red Herring*, June 2000, p.370 ("Part of that challenge stems from the company's unorthodox distribution strategy: rather than paying cable operators to pay for distribution, it asks operators to pay for its content. One problem with this method is the shortage of space available on cable systems. . . 'There are something like 200 channels trying to get carriage,' says Mr. Arlen [of Arlen Communications], 'and there's just not room.'"). Of course, to complete the analogy it must be recognized that the local cable business is almost always a government-franchised and -guaranteed monopoly. Retailers face no such insulation from competition.

1. Demonstration of the Level of a Manufacturer's Support for a New Product

Communicating information is central to the production and marketing of new products. A manufacturer that has developed a new product must convince grocery retailers that its innovation will be preferred by consumers over existing products and that adopting the new product will be in the retailers' interests. Therefore, the manufacturer must make a convincing case based upon available information, like test marketing. In addition, the manufacturer is competing against other manufacturers, each of which is presenting information to retailers in support of its innovations.

Slotting allowances can serve as a sign to grocery retailers of the manufacturers' confidence about the likely success of its new product. Manufacturers are always engaging in innovative efforts to develop new products, as evidenced by the sheer number of new product innovations annually. Some of these products will be successes, which provide consumers better value than the products they displace, and will be profitable to both retailers and manufacturers. Other new products will be failures – products that are not better values to consumers than existing products.

While manufacturers may not know before completing a particular research and development project whether the new product will be a success, they gain confidence that it will be successful when the project is completed and before it is introduced. Retailers, by contrast, cannot determine whether the product will be a success without putting the product on their shelves and offering it to consumers. The slotting allowance offers a means for manufacturers to distinguish success from failures in the eyes of retailers. Because successful products are re-ordered by retailers, successful products obviously will be sold longer than will failures. Manufacturers will be able to recoup the slotting payments made at product introduction for successful products from product re-orders; however, they will be unable to recoup these slotting payments for failures.

Because a slotting allowance is a fixed payment made at the time of product introduction, it represents a decreasing percentage of the manufacturer's total selling cost as the product's life span increases. The manufacturer's willingness to pay a slotting allowance for a new product tells retailers that the manufacturer has sufficient confidence in its product's success and that it is willing to absorb the retailers' non-recurring costs of placing the new product in inventory and promoting the new product. The more optimistic the manufacturer is about the new product's potential success, the more willing it will be to pay slotting allowances. This willingness communicates the manufacturer's assessment of the new product to the retailer and serves as a guarantee of that assessment. Offers to pay slotting allowances can be used by a retailer to infer differences between manufacturers regarding their beliefs about their new products.

Accordingly, payment of a slotting allowance can be seen as a performance bond for the new product. It is a way for the manufacturer to guarantee to the retailer that the manufacturer will not make a profit on the new product unless the retailer is also able to make a profit.

2. New-Product-Introduction Risk Allocation

Retailers experience product failure at a high rate and take steps to minimize this failure. Slotting allowances, by shifting product innovation costs from retailers back to manufacturers, also shift the risks and costs of unsuccessful product innovations from retailers back to manufacturers.

Retailers face at least two costs in opting to stock a new product. First, retailers face the real costs of stocking the product in their warehouses and allocating store shelf space by re-designing the plan-o-gram . Retailers face costs associated with adding the new product to inventory and point-of-sale systems. Incumbent products are already fully part of the retailers systems and warehouse plans. It should be axiomatic that new products require expensive set up.

Second, retailers face very real opportunity costs in devoting shelf space to a new product. When considering whether to sell a new brand, the retailer must consider the opportunity costs of that decision – displacing of incumbent products risks the profits from such products. Existing products are far less risky to retailers. The sales patterns of existing products are known. The replenishment needs for the product are known. The profit margin dollars, if any, are known. For many retailers, the least risky product assortment is the current assortment.

A new product, however, is a risky proposition. A new product has no track record. Its sales history is unknown. Its effect on other product sales is unknown. The potential profit or loss is unknown. The consumer demand, if any, is unknown. If the product is a slow mover or a "no mover," the product can have a markedly negative effect on the retailer's return.

The retailer can reduce, and perhaps eliminate, its risk – or at least transfer some of it back to the producer – by charging a fee that, essentially, provides indemnification from lost profits that would arise if the new product fails to sell well.

Reallocating the risk from retailers back to manufacturers has important procompetitive incentive effects. Both manufacturers and retailers can produce information about the likely success of a new product. Test-marketing can reduce the uncertainty that firms face in the innovation process. Market forces will allocate risk to those with the lowest cost of reducing uncertainty. Risk shifting can also affect actions that both retailers and manufacturers can take to influence the success of the product, including the research and development effort that went into producing it and the promotional support that each gives the new product after introduction.

3. Increased Innovation

Slotting fees provide a strong incentive for the retailer to stock a new product on its shelves quicker than it might without the slotting fee – the fee covers costs of stocking the new product and helps allocate the risk of failure back to the manufacturer. This process allows a retailer to take on more variety of new products and to offer consumers a wider range of choices.

By contrast, without slotting fees and any information about consumer demand for a particular new product, retailers likely will be hesitant to undertake the expense necessary to

remove an incumbent product from their shelves and forego the revenue stream from that product to replace it with a new, unknown and untested product. If retailers do not take new products on to their shelves, manufacturers likely will reduce new product innovations, resulting in fewer and fewer consumer choices.

C. Public Policy Considerations Regarding Slotting Allowances

1. Slotting Fees Evidence a Competitive, Well-Functioning Market

Retailers bear costs when they introduce a new product, particularly when they must substitute one product for another. Slotting fees, by transferring such costs from retailers to manufacturers, make these costs explicit. Transferring costs does not discourage innovation, because while the transfer makes innovation more costly for manufacturers, it also makes product innovations more attractive to retailers.

For example, a grocery chain may offer to shelve a new product for a fee, but the manufacturer claims that such a fee would force the retail price of the product higher and walks away from the offer. Had the chain adopted the new product, it would have incurred certain costs, including the opportunity costs of discontinuing an existing product as well as the opportunity costs of replacing an existing item with a better new product. From the manufacturer's side, the fact that the manufacturer was not able to come to an agreement with the grocer suggests that the cost of producing the product, combined with the cost of introducing it, exceeds its expected value to consumers. That is, the marketplace does not expect this new product to be a success. Slotting fees play an integral role in the retail grocery business and help the marketplace function efficiently.

2. Other Tools Are Available to Get Products on Shelves

New entrants should not be at a competitive disadvantage to incumbent manufacturers in offering slotting fees to retailers. The amount of a slotting allowance is only one factor that a retailer generally will take into account in deciding to adopt a new product. For any product to be adopted by a retailer and placed in inventory, the manufacturer must be able to convince the retailer that the product will be successful, and therefore will offer consumers some value. Manufacturers can do other things, such as product promotion, free case offers or advertising investments, that can serve as substitutes for slotting allowances. For instance, an incumbent manufacturer with an established track record of creating consumer demand for products, such as Proctor & Gamble or Campbell's Soup, would appear to be in a better position to use such promotional and brand-enhancing skills in competition with new entrants. Slotting allowances therefore would be a way for new entrants to compete with incumbents.

Hustle, entrepreneurship and a good product will defeat any slotting fee issue for most, if not all, retailers. Many retailers work closely with new suppliers to develop creative ways to get their new products on the grocery shelves. There are hundreds, if not thousands, of instances where small manufacturers distributed their products to a local or regional store, then were helped by supermarket retailers to get their products into supermarkets. For example, Nantucket Nectars, a Massachusetts-based drink company, selling its products to small stores and delis,

moved to a handful of Stop & Shop stores in Massachusetts, without slotting fees. Nantucket Nectars was started by college drop-outs who were selling peach nectar off a boat. Through savvy promotion and increased consumer demand, the product expanded throughout the entire Stop & Shop chain and further throughout New England and the Mid-Atlantic region.

By the same token, large slotting allowances will not entice a food retailer to carry a product against its better judgment. A slotting fee cannot save an unsuccessful product or a product that is a poor use of store space. At the day's end, the retailer has to make a judgment call about what products it wants to carry and how that product fits its retailing format and strategy.

3. Grocery Stores Cannot Be Required to Grant Shelf Access to Everyone

No one, particularly the government, should take on the role of telling a retailer what types of products should be displayed on the shelves or how that product should get to the shelves. Often overlooked in the slotting fee debate is a simple, yet powerful fact: the shelves belong to the stores. No one has a right to be on a supermarket shelf. As clearly enunciated by the Supreme Court over 80 years ago, supermarkets unilaterally may choose to deal with whomever they want.[10] The freedom to deal or not deal with a particular manufacturer is a hallmark of our free enterprise system. If a retailer only wants to stock one brand of carbonated beverage, it may do so legitimately and legally.

Consumer demand determines what products a supermarket retailer believes it should carry. In an efficiently-run supermarket shelf space is fully allocated; supermarkets must choose what new products to carry and what incumbent products to remove. As part of that decision, supermarkets look at ways in which manufacturers can help defray costs associated with new product introduction and help ensure against product failure. Whether this is accomplished through upfront payments, free cases, advertising programs or other promotional or discount programs, the supermarket should be free to make that determination. It is the supermarket's shelves and the supermarket's business that is at stake with any product choices it must make.

Some retailers do not charge slotting allowances; they offer a limited assortment of products and are able to extract low prices from manufacturers, given their immense buying power, enormous product volume, and large consumer base. These retailers tend not to carry the breadth of SKU's that a typical supermarket carries. While this approach to slotting fees might fit their retail business model, it does not fit within the supermarket business model. Supermarkets distinguish themselves from other retailers and mass merchandisers by offering a vast product array – up to 35,000 or 50,000 SKUs in some stores – along with product quality and service, at a competitive price. To keep prices competitive, slotting fees are necessary to reduce the costs of

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10 *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919).

replacing products and product failure. Limiting or restricting slotting fees is simply favoring one business model over another – something the government should not do.

4. Grocery Retail Margins Are Less Than Those of Manufacturers

While some manufacturers may complain about having to pay slotting allowances, the reality is that grocery product manufacturing net margins are generally much higher than grocery retail margins. Supermarket industry profits last year of 1.03% of sales do not offer much room for product failure.[11] Manufacturers are in a much better financial position than retailers to fund marketing, promotion and other new product introductory costs.

5. Government Intervention Entails Great Risks without Corresponding Benefits

Government should not pick and choose among various retail business models. Some retailers charge slotting allowances. Some retailers eschew product variety and focus on a smaller number of SKUs sold at low prices (*e.g.*, mass merchants such as Wal-Mart, Target, and Big K/Kmart). Some retailers focus on a broader assortment of products in hybrid mega-stores such as the rapidly growing Wal-Mart Supercenter concept. Warehouse club retailers opt for still less variety and feature a relatively "small" number of SKUs (still 6,000 or more) sold at below discount store prices in large quantity packs (*e.g.*, Costco, Sam's, BJ's). Consumers appear to value each of these business models. Government should not punish one business model to force it to behave like another. Consumers will not reward merchants who do not provide at least some elements of strong service, selection, quality, variety and pricing. Retailers will continue to balance which elements of these dimensions they will focus on.

6. Greater Regulation of Retailers Leads to Higher Consumer Prices and Less Consumer Variety

America has chosen not to regulate retailers. Unlike Germany, most states do not ban Sunday sales, and today Sunday is for many chains the busiest or second busiest day in the supermarket, given today's busy two-income households.[12] Unlike Germany, American stores are free to stay open 24 hours,[13] and many retailers have done so, including many supermarkets, Staples, Home Depot, and Wal-Mart. Unlike Germany, there has not been in this country a

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[11] Food Marketing Institute's Annual Financial Review (fiscal year 1998-99).

[12] Wal-Mart Annual Report 2000 at 9 ("German shoppers are hurried by local laws that force early store closings and forbid Sunday sales").

[13] Wal-Mart Annual Report 2000 at 9 ("Wal-Mart has already made a major change in the shopping culture of Germany simply by opening stores two hours earlier than the 9 a.m. standard. German laws allow shopping to begin at 7 a.m., but most shops in the country wait at least two more hours to open.").

prohibition on discounting by retailers. In general, retailing, whether hardware, food, general merchandise or drug stores, is unregulated. Instead, we have opted for the application of the antitrust laws for competition.[14]

This policy choice of antitrust enforcement rather than plenary regulation appears to have been a very sound one. America, not Germany, Japan, France or the United Kingdom, has been the birthplace of such world-class global retail juggernauts as Wal-Mart, Sears Roebuck & Co., Costco, Home Depot, Staples, Office Depot, Eckerd's, and many other chains. Over the past ten years, American consumer level inflation in food and in general merchandise has been very low and is correlated with the rapid growth of these retailers.

By all accounts, the entry of American-style retailing into foreign economies is beginning to reap in those countries the benefits we Americans take for granted in this country. Wal-Mart's entry into retailing in Europe has shaken up many European retailers. Wal-Mart's acquisition of the ASDA supermarket chain has resulted in lower prices at that chain and other retailers have cut prices in response.[15] Wal-Mart's entry into Germany also appears to be lowering prices.

D. Legal Status of Slotting Fees

Slotting allowance critics and FTC officials have largely conceded that slotting allowances are themselves legal practices under the nation's antitrust laws.[16]

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[14] *See United States v. Syufy Enterprises,* 903 F.2d 659, 668 (9th Cir. 1990)("It can't be said enough that the antitrust laws protect competition not competitors.").

[15] Wal-Mart Annual Report 2000 at 9 ("ASDA is the third-largest supermarket chain in the U.K., but that could change with the Wal-Mart merger. In a bold move to build market share, ASDA pledged last year to continue reducing prices, some by five to ten percent, through its ongoing rollback program.").

[16] *See, e.g.*, Testimony of Robert A. Skitol, Drinker, Biddle & Reath LLP, on behalf of the American Antitrust Institute Before the Committee on Small Business, U.S. Senate Hearings on Slotting Fees in the Grocery Industry (Sept. 14, 1999); "Slotting Allowances and the Antitrust Laws," Testimony of the Federal Trade Commission, presented by Willard K. Tom, Deputy Director of the FTC Bureau of Competition, before the Committee on the Judiciary, U.S. House of Representatives (Oct. 20, 1999); "20/20" television program, William J. Baer, Director of FTC Bureau of Competition (Nov. 10, 1995)(slotting fees "are legal in most situations"); "Grocery Store Slotting Allowances," speech by Kevin J. Arquit, Director of FTC Bureau of Competition, to National Grocers Association (Nov. 12. 1991)("An up-front payment from a manufacturer to a retailer for shelf space can be viewed as a discount from the wholesale price the retailer pays for the product. There is nothing inherent in such a transaction that would necessarily make it an antitrust violation.").

However, there are instances when slotting allowances, just as other normally innocuous business conduct, may be part of a violation of the antitrust laws. The FTC's recent action against McCormick & Company is a prime example of how existing antitrust law can be used to address the situation where a dominant supplier is price discriminating by offering competing retailers different aggregate discounts or "deal rates." *See McCormick & Company, Inc.*, FTC File No. 9610050 (Mar. 8, 2000).

Conclusion

Slotting allowances permit supermarket retailers and others to defray the very real costs of new product introductions. Slotting allowances help to compensate both the direct costs of stocking a new SKU and the opportunity cost of displacing proven, incumbent products. Critics of slotting fees do not dispute that these costs are real for supermarket retailers.

While there may be occasions when a dominant manufacturer may violate the antitrust laws through the use of slotting allowances (or through other means), the existing antitrust statutory regime is equal to the task of addressing any issues that may arise. For the rare occasions where the use of slotting fees by manufacturers might be anticompetitive, individual enforcement actions, both public and private, are sufficient to address these concerns.

Guidelines attempting to either regulate slotting fees, eliminate or curtail the use of slotting fees or to change manufacturers' and retailers' behavior will have disastrous and unintended consequences for the entire food retailing industry. For the most part, slotting allowances function well as an integral part of the food retailing industry – fostering new product innovation, moving new products quickly to consumers and compensating retailers for the cost of replacing existing products with new products and insuring them against product failure. Guidelines restricting or curtailing the use of slotting fees will penalize efficient supermarket retailers and manufacturers, and will likely lead to fewer new product introductions and higher prices.

The FTC and other policy makers must consider the ramifications of any guidelines or other policy directives on all aspects of retailing. Certainly, from a concentration standpoint, the supermarket industry is today one of the least concentrated industries in retailing. Assuming that store formats are "product markets," as urged in the *Staples* case, there are 3 office superstore retailers in the U.S. For mass merchants, there are three national chains - Wal-Mart, Kmart and Target - with a small number of regional discount chains remaining. In home centers, there are 2 national chains - Home Depot and Lowe's, with a declining base of regional firms. In warehouse club stores, there are 3 national chains, Sam's (owned by Wal-Mart), Costco and BJ's. By contrast the supermarket industry is highly fragmented; there are well more than 100 major supermarket chains across the U.S. Whatever policy guidance the FTC is considering should apply to all forms of retailing, as the antitrust laws governing those retail formats are the same. All the evidence appears to suggest that the consolidation that has taken place in these retail channels has yielded enormous benefits for consumers in the form of lower prices and better services.

America has chosen antitrust enforcement not plenary regulation of retailers. As a result, American-based retailers are the envy of the world in terms of efficiency, productivity and consumer acceptance. Anticompetitive excesses of the free market system are best addressed in specific instances through the application of the antitrust laws. New regulations or guidelines will impose costs on retailers and raise the price of goods. Any effort to curtail or eliminate slotting allowances will reduce new product introductions and reduce efficiency. The consequence of slotting fee curtailment or regulation will be a reduction in consumer welfare.