

**Report on the  
Federal Trade Commission  
Workshop on Slotting Allowances  
and Other Marketing Practices in the  
Grocery Industry**



**A Report by Federal Trade Commission Staff**

**February 2001**

## FEDERAL TRADE COMMISSION

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Rosemarie Straight	Executive Director

### Policy Planning Contributors

Susan S. DeSanti, Director  
William E. Cohen, Deputy Director

### Bureau of Competition Contributors

David A. Balto, Assistant Director, Policy and Evaluation  
Ernest A. Nagata, Deputy Assistant Director, Policy and Evaluation  
Neil W. Averitt

### Bureau of Economics Contributor

Christopher J. Garmon

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## INTRODUCTION AND EXECUTIVE SUMMARY<sup>1</sup>

Grocery manufacturers and supermarkets deal with each other every day in the roles of supplier and customer. In these roles they bargain over a wide variety of business matters, beginning with the basic elements of price and product quality, but also covering a number of collateral issues that affect the exposure that a particular manufacturer's goods receive on the retailer's shelf. Obtaining good exposure is important to the manufacturer since it can significantly affect sales, and shelf allocation is something for which the retailer may demand special compensation, since it involves customized use of the retailers' most important asset – the store shelves themselves.

“Slotting allowances” are one class of payments that may be made for shelf access. They are lump-sum, up-front payments from a manufacturer or producer (collectively, “manufacturer”) to a retailer to have a new product carried by the retailer and placed on its shelves. The practice is common for certain products in supermarkets, but also occurs in other industries.<sup>2</sup> Some have argued that slotting allowances – and a variant known as “pay-to-stay” fees, paid by manufacturers to keep existing products on retailers' shelves – harm consumers by, among other things, excluding certain manufacturers and thereby impairing competition that otherwise would take place. Defenders of slotting allowances have asserted that, among other things, they cover the cost of introducing new products to the marketplace and thereby tend to foster entry and innovation. Pay-to-stay fees have been justified as efficient means of allocating limited shelf

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<sup>1</sup> This Report was prepared by staff of the Federal Trade Commission. It does not necessarily reflect the views of the Commission or any individual Commissioner.

<sup>2</sup> The operation and competitive significance of slotting allowances and similar practices in other industries is beyond the scope of this Report.

space. Both slotting allowances and pay-to-stay fees have been the subject of congressional hearings<sup>3</sup> and requests for investigation by the Federal Trade Commission. Despite the interest that has developed, there has been relatively little academic research or empirical data collection regarding these practices.<sup>4</sup>

Because of the substantial debate over and the need for greater information regarding slotting allowances and related shelf allocation practices, the FTC conducted a public workshop on May 31 and June 1, 2000, to shed further light on these issues.<sup>5</sup> Organized by the staffs of the Bureau of Competition's Office of Policy and Evaluation and the FTC's Policy Planning office, the workshop brought together approximately forty participants with a variety of perspectives on the grocery industry. They included representatives of large chain retailers; small retailers, wholesalers, and, especially, small manufacturers; and attorneys, economists, marketing academics, and consultants familiar with the industry. As Chairman Pitofsky explained, the workshop was designed without preconceptions to examine a set of practices that in some situations may "make great business sense and contribute to consumer welfare" but in

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<sup>3</sup> "Competitive Issues in Agriculture and the Food Industry," Hearings before the House Committee on the Judiciary, 106<sup>th</sup> Cong. (Oct. 20, 1999); "Slotting: Fair for Small Business and Consumers?," Hearings before the Senate Committee on Small Business, 106<sup>th</sup> Cong. (Sept. 14, 1999); "Slotting Fees: Are Family Farmers Battling to Stay on the Farm and in the Grocery Store?," Hearings before the Senate Committee on Small Business, 106<sup>th</sup> Cong. (Sept. 14, 2000). The views of the FTC were presented at the House Judiciary Committee hearing by Willard K. Tom, Deputy Director, Bureau of Competition, in testimony entitled "Slotting Allowances and the Antitrust Laws" (Oct. 20, 1999).

<sup>4</sup> For a summary of existing research, *see* P. Bloom, G. Gundlach, & J. Cannon, "Slotting Allowances and Fees: Schools of Thought and the Views of Practicing Managers," 64 *J. of Marketing* 92 (2000).

<sup>5</sup> *See* 65 Fed. Reg. 15911 (2000) (notice announcing workshop).

others could present “competitive problems.”<sup>6</sup> The workshop represented one step in an ongoing process to improve the agency’s understanding of those practices.

Although the workshop assisted in accumulating information and developing insights, it could not, and did not, resolve all the questions. Its record was necessarily incomplete. For one thing, the panelists did not represent a complete cross-section of the industry: although the FTC staff invited and would have welcomed broader participation by large manufacturers and retailers, the industry members who actually participated tended to be the smaller firms. Moreover, details of slotting arrangements and other marketing practices are often viewed as competitively sensitive, and an open discussion in a public forum necessarily had to be general. Finally, there was no uniformity of view. Participants voiced diverse viewpoints and offered different assessments of the facts. Thus, the record generated questions and suggested paths for further analysis, but did not provide a basis for definitive answers.

This Staff Report summarizes and synthesizes the information and views presented at the workshop<sup>7</sup> and identifies some of the specific areas where more needs to be learned.<sup>8</sup> The discussion is divided into five parts. Part I describes the shelf space allocation practices that workshop participants identified as the most competitively significant, including slotting

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<sup>6</sup> Pitofsky, Tr. 3. References to the workshop transcript in this report are set out in the form “Tr,” followed by a page number. References to written materials submitted for the record are in the form “Submissions,” followed by a page number. The transcript and written submissions can both be found on the FTC website, [www.ftc.gov/bc/slotting/index.htm](http://www.ftc.gov/bc/slotting/index.htm). Workshop panelists and written submissions are listed in Appendices A and B, respectively.

<sup>7</sup> Staff, of course, does not adopt participants’ viewpoints merely by reporting them.

<sup>8</sup> See Pitofsky, Tr. 4 (one agency role is to “get the facts . . . report to the public and report to Congress”); Senator Bond, Tr. 6-7 (appearing by videotape) (Senate Committee on Small Business will “look forward to receiving recommendations”).

allowances themselves and related practices such as pay-to-stay fees and payments to limit rivals' shelf space, such as exclusive dealing arrangements. Part II describes one antitrust theory under which the competitive effects of these practices might be assessed – a theory of anticompetitive exclusion. Part III examines the implications of two interrelated practices – category management and the use of category captains – that may help retailers better decide how to allocate shelf space, but that may raise competitive questions as well. Part IV reviews the theory that slotting allowances sometimes might be imposed, not by manufacturers seeking favored access to retailers' shelves, but rather by large retailers with market power in their purchasing activities. Finally, Part V summarizes the recommendations that came out of the workshop. **Overview of shelf space allowances.** Slotting allowances have grown larger and more widespread in the last twenty years. While precise figures are not available, speakers at the workshop stated that allowances may now range from \$75 to \$300 per item per store. The allowances may vary geographically, and by section of the store, and perhaps also by the firms' skill in negotiating different terms. One speaker estimated that it would cost approximately \$16.8 million to introduce a small product line of four items in all supermarkets nationwide.

The workshop also discussed two other types of access payments alleged to harm competition. One is the pay-to-stay fee, sometimes required in order for established products to remain on a retailer's shelves. The second is a payment – which could take the form of a slotting allowance or a pay-to-stay fee – made to gain exclusive or preferential access to shelf space, to the disadvantage of rivals; one example of this is an exclusive-dealing contract providing that a particular firm will be the only one of its product class in the retailer's store. Neither of these access payments is necessarily improper, but they both involve issues that require careful

consideration.

Some panelists viewed slotting allowances as a mechanism for excluding rivals because they require large, lump-sum, up-front payments at a time when a product may be producing little or no revenue. The allowances are said to impose disproportionate burdens on companies that are unable to finance those expenditures, such as smaller or newer firms. Critics of slotting allowances asserted that they harm consumers, raising prices, deterring innovation, and reducing variety by restricting the number of competing firms in a product category. Critics also contended that they provide few efficiencies, and that any efficiencies that exist could be achieved through less-burdensome means such as failure fees on products that do not succeed.

Other participants viewed slotting allowances as beneficial. These speakers stated that the allowances compensate retailers for the real costs and risks of taking on unproven new products. According to these speakers, slotting allowances reduce the retailer's financial exposure in trying the product of a new firm, encourage retailers to take such risks, and in this way facilitate rather than exclude new entry at the manufacturer level. Panelists on this side of the debate also stated that a willingness to pay slotting allowances signals the manufacturer's confidence in a product's success and shifts risk back to the party best able to control it. They claimed that firms unable to raise enough capital to meet slotting allowance requirements are often manufacturers of products that contribute relatively little value in terms of additional product variety.

Pay-to-stay fees were generally viewed as potentially more problematic than slotting allowances, since they are assessed on established products and therefore lack the efficiency of compensating for new-product risk. On the other hand, to the extent that pay-to-stay fees are



spread over time and equate in aggregate size to a lump-sum slotting allowance, they may impose less of a burden on small manufacturers. Moreover, pay-to-stay fees may be an efficient device for auctioning shelf space when a retailer wishes to carry the products of only one or a few suppliers. Testimony in this regard was inconclusive.

**Framework for analysis.** Many of the competitive issues presented by these arrangements are issues of exclusion.<sup>9</sup> The concern is that a particular form of access payment may tend to exclude rivals, with adverse effects on competition.

Testimony reflected considerable consensus on a framework for analysis of such matters. It begins with consideration of the extent of disadvantage that rival suppliers likely would experience and of their ability to avoid or mitigate that disadvantage. To show harm to competition, rather than merely to competitors, the analysis then inquires about the likely impact on competition in markets in which the disadvantaged suppliers seek to compete. Finally, if anticompetitive harm is likely, the analysis asks whether the practice produces procompetitive benefits that likely would offset the harm and whether similar benefits could be obtained by practical, significantly less restrictive means. Speakers also advised that care should be taken to consider whether there are special countervailing circumstances that would diminish likelihood of competitive harm on some particular set of facts.

Participants viewed the effects of shelf access payments as dependent on the circumstances of their use. Exclusive-dealing contracts, for example, may lead retailers to

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<sup>9</sup> Access payments can also lead to other issues such as discrimination and collusion, but these were not the focus of the workshop and are covered only briefly in this Report. Particular access payments, *e.g.*, activities amounting to commercial bribery, could raise considerations outside of antitrust law. Such issues were not addressed at the workshop and are beyond the scope of this Report.

become usefully committed to making a particular product a success in the marketplace, and they may not be harmful to competition as long as other retailers remain available for other manufacturers to use in reaching the market. However, there was considerable consensus that exclusive-dealing contracts can be anticompetitive if they tie up so many retailers that other manufacturers cannot reach customers at all, or can do so only at increased costs, and if this results in an impairment of effective competition. Even apart from any direct acquisition of exclusionary rights, both pay-to-stay fees and slotting allowances could raise manufacturers' capital costs in ways harmful to competition; they need to be judged on a case-by-case basis, with attention both to likely competitive harms and to likely procompetitive benefits.

**Category management and category captains.** A separate panel discussed the interrelated topics of "category management" and "category captains." Category management is a business technique for studying consumer demand within a particular category, such as soups, and then allocating shelf space among different products and designing marketing programs to best satisfy that demand as a whole. A category captain is an outside firm, commonly a large supplier, to whom a retailer turns for advice in managing the category. Category management is in some respects a substitute for slotting allowances as a shelf space allocation device.

Panelists agreed that category management can offer important efficiencies, but that the use of category captains can raise competitive questions insofar as it involves a supplier making recommendations about how its competitors should be treated. While these concerns are not so inherently serious as to call into question the entire practice of using category captains, the panel agreed that care should be exercised: (1) that the captain does not improperly receive confidential information about its rivals' plans; (2) that the category captain does not bias its

advice to the retailer in such a way that it effectively excludes or significantly disadvantages its competitors; (3) that the category captain does not orchestrate horizontal collusion among retailers; and (4) that the category captain does not orchestrate horizontal collusion among manufacturers.

**Retailer market power.** One panel considered whether slotting allowances are sometimes imposed by retailers wielding market power. Workshop participants identified and distinguished three possible types of market power: (1) monopsony power, which depends on a reduction in the purchases of inputs to force lower input prices; (2) buyer power, which induces lower input prices without reducing input purchases; and (3) gatekeeper power. Each may require its own, distinct analysis. According to participants, although the exercise of bargaining leverage by retailers with buyer power can, at least in the short run, result in lower wholesale prices and potential benefits for consumers, under some circumstances it can cause market distortions resulting ultimately in lower output and higher prices. The panel expressed a general sense that actual exercise of monopsony power might be unusual in these markets, but some participants emphasized potential concerns in settings where manufacturers of a particular product are limited to selling in a small geographic area and therefore are limited to dealing with just the retailers in that area. In that situation, a high level of local retailer concentration can leave manufacturers with limited options. There was general agreement that the FTC's supermarket merger program should continue to watch for the possible creation of market power exercisable in an anticompetitive manner against suppliers.

**Recommendations.** The workshop concluded with a panel of legal and economic practitioners who had extensive experience counseling on distribution issues. That discussion,

the workshop record as a whole, and the agency's experience with and analysis of these issues lead the FTC staff to offer several recommendations. The first is that the agency pursue empirical studies on topics that will contribute significantly to future enforcement actions or business guidance, beginning with gathering basic data on current practices. This recommendation is one that Congress has endorsed by providing funds for the FTC to use in investigating slotting allowances in the retail grocery industry. Next, staff recommends that the Commission refrain from issuing slotting-allowance guidelines at the present time, when much remains to be learned. In terms of future enforcement, the staff recommends that the agency: (1) carefully review exclusive-dealing contracts to determine whether they threaten a harm to competition; (2) examine slotting allowances and pay-to-stay fees with particular attention to circumstances that could give rise to exclusionary effects; (3) revisit price discrimination issues in the context of appropriate investigations; (4) focus any inquiries into category captains primarily on situations that may involve anticompetitive exclusion or tacit or explicit collusion; and (5) ensure that supermarket merger policy continues to take account of the potential exercise of retail market power in an anticompetitive manner against suppliers.

## PART I

### THE NATURE OF THE PRACTICES

Payments for shelf access are one of a number of practices by which manufacturers and retailers bargain over the availability of shelf space. Workshop participants identified three specific types of shelf-access payments as the ones most likely to raise business and competitive concerns: (1) slotting allowances for new product access; (2) pay-to stay fees; and (3) payments to exclude rivals or to give them disadvantageous shelf space. These practices are described in greater detail below.

#### A. Slotting Allowances

Although the term “slotting allowance” lacks a standard definition,<sup>10</sup> a consensus emerged to use the term to mean a lump-sum fee paid for new product introduction. One supermarket executive described slotting allowances in the following terms: “Slotting is an up-front payment for the introduction of a new item, and that’s the end of the slotting allowances . . . Slotting is a one-time happening.”<sup>11</sup> This Report follows that usage.<sup>12</sup>

#### 1. Characteristics of Slotting Allowances

Manufacturers usually pay slotting allowances in cash, although the up-front payment can

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<sup>10</sup> Silberman Submission, p.2 (the term “has been employed in a manner which exceeds the elastic limit of semantic utility”).

<sup>11</sup> Sussman, Tr. 55-56.

<sup>12</sup> “Pay-to-stay” fees, paid by manufacturers to keep existing products on retailers’ shelves, are discussed separately in Part I.B.

sometimes take other forms, such as free goods.<sup>13</sup> The total size of the allowance commonly varies according to the number of new products to be introduced from a manufacturer and the number of stores operated by a retail chain. To permit comparisons using a common denominator, retailers usually express the allowance in terms of the payment required per item (a “stock-keeping unit” or “SKU”) per store.<sup>14</sup> The allowances do not commit the store operator to any particular level of purchases, but commonly assure the manufacturer a place on the shelf for some reasonable trial period.<sup>15</sup>

Slotting allowances cover an increasing number of products in grocery stores. According to one researcher, both manufacturers and retailers report that retailers have become more likely over the past five years to require slotting fees of all kinds,<sup>16</sup> although their prevalence continues to vary between different sections of the supermarket.<sup>17</sup> Slotting allowances have also grown larger over time,<sup>18</sup> although some workshop participants believe their size has not changed

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<sup>13</sup> Weber, Tr. 54. As discussed later, payment in the form of goods may have somewhat different implications than cash payments, both for consumers and for competing firms. *See infra* text accompanying notes 70 and 71 and note 90.

<sup>14</sup> Hannah, Tr. 76. Each individual item carried by the store is a separate stock-keeping unit. Different sizes or flavors of a product are separate SKUs, and require separate slotting fees. *See* Hannah, Tr. 216.

<sup>15</sup> Sussman, Tr. 83-84 (“we guarantee the manufacturer at least six months to establish the movement”).

<sup>16</sup> Gundlach, Tr. 12.

<sup>17</sup> Gundlach, Tr. 14 (“product categories of heavy use included frozen food, dry grocery and beverages; and those of light use included fresh meat and seafood, produce, and deli”).

<sup>18</sup> *See* Tada, Tr. 159 (in the fresh produce industry slotting allowances have “gotten much more intensive”); Hannah, Tr. 76. Allowances may range from \$75 to \$300 per SKU per store. *Id.* (“It used to be roughly like \$25 on the West Coast . . . We’re up to \$75 to a hundred

significantly in the last five years.<sup>19</sup> Any estimates lack certainty, however, because firms negotiate the allowances in private, and there are no surveys or empirical studies of the amounts.<sup>20</sup>

Some retailers reported that they are willing to negotiate a reduction in the allowances, particularly for small or local suppliers,<sup>21</sup> but that practice does not appear to be universal or even necessarily common. Some smaller suppliers confirmed that they are able to negotiate at least occasionally,<sup>22</sup> but others reported considerable difficulty in negotiating.<sup>23</sup> Suppliers of new brands of commodity items may find it particularly difficult to negotiate because their bargaining power is limited by the ready availability of substitutes for their products.<sup>24</sup>

## 2. Potential Benefits of Slotting Allowances

Slotting allowances may serve some practical business purposes. The most important is that of insuring retailers against the costs and risks of taking on a new product. Slotting

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dollars in the West, and . . . on the east Coast . . . up to \$250 to \$300 per store”).

<sup>19</sup> See Weber, Tr. 53; Sussman, Tr. 54; Campbell, Tr. 54.

<sup>20</sup> See Gundlach, Tr. 12 (allowances are “private” and “often off-invoice”); Food Marketing Institute Backgrounder at 1.

<sup>21</sup> E.g., Ukrop, Tr. 62.

<sup>22</sup> E.g., Nickila, Tr. 70.

<sup>23</sup> Carver, Tr. 172 (retailers that want slotting will generally not negotiate for alternative benefits such as lower wholesale prices); *id.* at 165 (“You wind up with basically the same payout”); Mills, Tr. 166 (rates negotiable “only up”); Hannah, Tr. 76 (“lately they’re not negotiating”).

<sup>24</sup> Stenzel, Tr. 202 (a fresh produce supplier is “easily substitutable,” and when one refuses to pay, “they are moved out the next week, and with very little ability to negotiate”).

allowances may increase a retailer's incentive to take a chance on otherwise untested items and therefore make it more likely that such items are presented to consumers long enough for them to express a marketplace verdict. A manufacturer's willingness to pay slotting allowances can signal its confidence in likely product success or can shift certain costs and risks from the retailer to the manufacturer.<sup>25</sup>

**a. Signaling Likely Product Success**

Some participants stated that a manufacturer's willingness to pay an up-front slotting fee is a tangible, credible statement of confidence in the product's success.<sup>26</sup> They believed that this statement may be persuasive to the retailer, since the manufacturer is the party that has had the best opportunity to study the potential of the new product – for example, as a result of research and test marketing. The slotting payment may convey particularly useful information to the retailer precisely because it is a single, fixed sum made at the time of the product's introduction. This amount “represents a decreasing percentage of the manufacturer's total selling cost as the product's life span increases,” and thus can be said to express concrete confidence that the product will have a long life span.<sup>27</sup>

Not all panelists shared this view, however. While admitting the importance of the signaling function, some questioned whether slotting allowances provide a reliable signal.

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<sup>25</sup> For a discussion of some of the potential benefits flowing from the use of slotting allowances, see M. Sullivan, *Slotting Allowances and the Market for New Products*, 40 J. Law & Econ. 461 (1997).

<sup>26</sup> Ahold USA Submission, p.2 (“Slotting allowances . . . provide some assurance from the manufacturer that the product will sell”); Rao, Tr. 97 (“probably does communicate something” about manufacturer confidence).

<sup>27</sup> Gidley Submission, p.8.



These speakers suggested that other factors, such as the results of trial runs in a few stores, can give the retailer a sounder basis for judging a product's likely success.<sup>28</sup>

**b. Shifting Risk of Product Failure**

The second benefit claimed for slotting allowances is that they require the manufacturer to assume a greater share of the risk of product failure, and, by doing so, make retailers more willing to take on new products. Retailers have been confronted with a rapid proliferation of new products. Suppliers now introduce about 20,000 new items each year, in contrast to the 12-15,000 per year that they introduced a decade ago.<sup>29</sup> About 80 to 90 percent of these new products fail within a relatively short period.<sup>30</sup> Taking on a new product is therefore said to be a difficult, and, in some respects, an unattractive proposition for the retailer.<sup>31</sup>

Slotting allowances help to reduce the retailer's risks by compensating for a number of real, out-of-pocket costs involved in new-product introductions. The principal purchasing executive for Stop & Shop reported that these out-of-pocket costs include those "associated with putting the products on to our store shelves physically, changing our store shelf planograms,

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<sup>28</sup> *E.g.*, Weber, Tr. 65-66 ("I do not believe that slotting allowances signals one iota how the consumer is going to buy a product. You look at advertising, consumer promotion, the quality of the product, the uniqueness of the product, the category the product [is] in."). *Cf.* Steiner Submission, pp.1-2 (truly strong brands have a consumer franchise and often don't have to pay slotting at all).

<sup>29</sup> *See* Gundlach, Tr. 87; Food Marketing Institute Backgrounder at 5.

<sup>30</sup> Gundlach, Tr. 103; *see also* FMI Backgrounder at 2 (70-80 percent failure rate).

<sup>31</sup> Sussman, Tr. 46 ("There's the risk of that new item that we bring on fails. There's no proven track record on new items. There's also the risk involving the item that we discontinue to make place for the new item."); Gundlach, Tr. 16.

putting the new items into our computer systems, and physically into our . . . warehouse.”<sup>32</sup>

Stop & Shop reported that it adjusts its slotting charges so that they will accurately reflect real costs: “We have different slotting guidelines in each of our categories depending on the size of the item, the amount of shelf space it takes, the turnover on the item, the category growth of the item.”<sup>33</sup>

Other panelists disagreed about how frequently slotting allowances are actually based on reasonably precise calculations of out-of-pocket costs.<sup>34</sup> Some testified that slotting fees tend to be uniform throughout a department, without regard to the level of risk,<sup>35</sup> cost of the product, or

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<sup>32</sup> Sussman, Tr. 46. A “planogram” is a chart showing the placement of each item on the shelf of a supermarket department. *See also* Campbell, Tr. 47 (for his wholesale firm it is also primarily “a cost coverage issue”).

<sup>33</sup> Sussman, Tr. 50-51.

<sup>34</sup> *See* Weber, Tr. 51 (some retailers just “try to get as much from the manufacturer as they can”).

<sup>35</sup> According to some of the panelists, risks may vary considerably from product to product. Some entire product categories may be relatively low risk for retailers because they are sold with direct store delivery and a return guarantee. *See* Nickila, Tr. 70 (his firm accepts “quite a bit of cost” to provide direct store delivery). Others are of a general type already familiar to consumers, such as commodity products. *See* Tada, p. 237 (fresh produce products “have been around a long time”). *But see* MacAvoy, Tr. 412 (“you just need to be careful about how you’re defining new [products]. \* \* \* Branded produce [and prepackaged products like salads] has not been around forever”). Other product categories may involve higher risks because of their opportunity costs. *See* Sussman, Tr. 113 (items in dairy case all move well, so discontinuing one of those items is a big risk and “we would look for higher slotting fees in the dairy category for that reason”). Moreover, the risks of taking on a new product may be higher for wholesalers than for retailers, since wholesalers have fewer means of moving the product. *See* Campbell, Tr. 48 (“We do not have the avenue to force [an item] downstream into the retail outlets”).

amount of shelf space required.<sup>36</sup> In addition, some panelists were not convinced that slotting allowances actually reallocate risks to the party who is better able to assess and control them.<sup>37</sup> For example, several speakers suggested that the retailers might sometimes have superior information about product prospects.<sup>38</sup> Some speakers pointed out that the success or failure of a new product depends to some important degree not only on the manufacturer, but also on the support that it receives from the retailer.<sup>39</sup> One speaker suggested that manufacturers already bear a disproportionate share of the risk even without the slotting allowance.<sup>40</sup>

**c. Alternative Means for Achieving Similar Efficiencies**

Some asked whether slotting allowances were necessary to efficiently assess and allocate risk. For example, the use of test stores might enable a retailer to try a new product in a few locations before deciding on a larger commitment. This reduces the retailer's risks if it can better determine a product's customer appeal before making a large investment in it, but without

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<sup>36</sup> See Hannah, Tr. 76 (allowances on West Coast are "roughly" \$75 to \$100 per SKU per store).

<sup>37</sup> Compare Gundlach, Tr. 18 (fees said to shift risks to those "best able to control them") with Weber, Tr. 112 (not clear how one would define risk or differentiate between manufacturers that have done a lot of product testing and those that haven't).

<sup>38</sup> See Sullivan, Tr. 89 (asking if retailers might sometimes have the better information); Rao, Tr. 90-91 (best information on a new product's prospects lies sometimes with the manufacturer and sometimes with the retailer).

<sup>39</sup> See Gundlach, Tr. 104; Rao, Tr. 286.

<sup>40</sup> See Steiner Submission, p.3 ("for every dollar of inventory of a new item in retail stores, the manufacturer may have on the order of \$ 3 in his warehouse").

imposing the capital burdens of a slotting fee.<sup>41</sup>

A per-unit introductory allowance might be a second alternative. This is similar to a slotting allowance in that it is a financial benefit granted to the retailer to offset the risks of a new product, but it is applied on a per-unit basis rather than as a lump sum, up-front payment, potentially reducing burdens on manufacturers.<sup>42</sup> Introductory allowances could be made available in several ways. For example, a supplier might offer “scan-down” allowances on products actually sold, or, in a variant sometimes used in other industries, might provide a special temporary percentage discount on new products.<sup>43</sup> The per-unit discount may be less effective than slotting allowances at the tasks of risk-shifting and confidence-signaling, however, and consequently may not achieve similar efficiencies.

A third alternative is the use of buy-back guarantees or failure fees.<sup>44</sup> Some panelists recommended these mechanisms on grounds that they offer the retailer a credible assurance of

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<sup>41</sup> See Hannah, Tr. 94 (describing how a retailer first accepted his product in a five-store test before taking it on a chain-wide basis).

<sup>42</sup> See Steiner, Tr. 141-42 (small manufacturer can pay a percentage, he can't pay an up-front fee). See generally White, Troy, & Gerlich, *The Role of Slotting Fees and Introductory Allowances in Retail Buyers' New-Product Acceptance Decisions*, 2000 J. Acad. Marketing Science 291 (Spring 2000).

<sup>43</sup> Houck, Tr. 96, 57-8. On the other hand, one speaker doubted that consumer-focused promotions will always be fully effective alternatives to slotting. See Gundlach, Tr. 15 (some manufacturers believe that such “pull” strategies are becoming less effective “due to diminished consumer loyalty, a lack of differentiation of new products, as well as the emphasis on short-term profits”).

<sup>44</sup> One panelist defined failure fees as “fees paid when a product does not meet expected goals.” Gundlach, Tr. 11. Another indicated that variants include slow-moving fees and discontinuance fees. Hannah, Tr. 94.

manufacturer confidence, without requiring payment of up-front money.<sup>45</sup> Others questioned their effectiveness. One suggested that a willingness to pay failure fees is a less accurate signal of product success than a slotting allowance, because there is a complicating risk that the retailer might contribute to any eventual product failure.<sup>46</sup> Another suggested that it might be harder to collect a failure fee after the fact than to charge a slotting allowance up front.<sup>47</sup> Physical buybacks also may impose costs in shipping goods back to the manufacturer, since the product is then moving “in the reverse direction in the distribution system, which it wasn’t built for.”<sup>48</sup>

Finally, some speakers questioned the need for slotting allowances, pointing out that some of the largest and most successful retailers, such as Wal-Mart or Costco, do not charge slotting fees.<sup>49</sup> Wal-Mart reportedly makes a point of avoiding schedules of allowances and discounts and insists instead on receiving the single best price that a supplier can offer.<sup>50</sup> A representative of Costco gave a similar description of his firm’s policy once it has selected an item that it wants to buy: “[W]e really don’t require any fees. We just want the best price that

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<sup>45</sup> Hannah, Tr. 95.

<sup>46</sup> Rao, Tr. 98 (“they will both signal, but the likelihood that the failure fee will fail to signal is higher because of potential abuse”). *See generally* A. Rao & H. Mahi, *The Price of Launching a New Product: Empirical Evidence on the Use of Slotting Allowances* (working paper). It is possible that in some circumstances the consequences of this will run in the opposite direction, however, and a manufacturer’s willingness to pay failure fees in spite of the risks involved will signal an even higher level of confidence.

<sup>47</sup> Sullivan, Tr. 102. *But see* Hannah, Tr. 106 (it may be workable to collect such fees from established firms that continue to have other lines in the store).

<sup>48</sup> Weber, Tr. 98.

<sup>49</sup> *See* De La Cruz, Tr. 231; Steiner, Tr. 141.

<sup>50</sup> *Cf.* Steiner, Tr. 141; Flickinger, Tr. 195.

they can give us.”<sup>51</sup>

### **3. Potential Harms of Slotting Allowances**

Slotting allowances have been criticized on a number of grounds. These criticisms assert that slotting allowances have harmful effects that are separate from – and greatly outweigh – any benefits. The main criticisms include charges that slotting allowances exclude small manufacturers, reduce innovation and product variety, and, by virtue of their fixed, lump-sum nature, increase prices paid by consumers.

#### **a. Exclusion of Small Manufacturers**

A common concern is that slotting allowances raise the cost of entry into an industry, and thus tend to exclude the smaller and more thinly-capitalized competitors.<sup>52</sup> Small manufacturers who appeared at the workshop described slotting fees as “a major stumbling block for us to enter into any large distribution network”<sup>53</sup> and a factor making it “more difficult” for small companies to develop sales.<sup>54</sup> Typical of these concerns was the view expressed by the executive of a

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<sup>51</sup> Eagan, Tr. 194. Mr. Eagan noted that Costco selects products on the basis of a mix of attributes, including quality, uniqueness, reliability of supply, and price. Tr. 193. The firm sometimes seeks out small manufacturers in order to obtain unique products to carry. *Id.* Some speakers suggested that discount houses may be able to eschew slotting fees by limiting their stock to a relatively small number of proven items, rather than new items. *See* Sussman, Tr. 64 (variety); Gidley, Tr. 398 (newness).

<sup>52</sup> Slotting allowances also may serve as the means of payment for contracts directly excluding rivals or limiting their shelf space. Concerns arising from exclusive-dealing contracts are discussed *infra* in Part I.C.

<sup>53</sup> Carver, Tr. 156.

<sup>54</sup> Nickila, Tr. 167.

bottled-water company: “So for us to get into a large supermarket, you’re talking \$50,000 or better up front, which we cannot provide because of the high outlay of capital which we just don’t have.”<sup>55</sup> Another firm explained, “There’s no way that you as a small manufacturer can come in with a few items and charge that slotting allowance against your pro forma.”<sup>56</sup> Similar experiences were reported by suppliers of a broad range of products, including specialty breads,<sup>57</sup> general breads,<sup>58</sup> greeting cards,<sup>59</sup> tortillas,<sup>60</sup> fresh produce,<sup>61</sup> and air fresheners.<sup>62</sup> This concern, as it relates to effects on competition, not merely on competitors, is the principal subject of the antitrust theories discussed in Part II.<sup>63</sup>

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<sup>55</sup> Carver, Tr. 156.

<sup>56</sup> Hannah, Tr. 59. *See generally* “Markets’ Shelf Fees Put Squeeze on Small Firms,” Los Angeles Times (Jan. 29, 2000).

<sup>57</sup> Nickila, Tr. 70 (“these slotting fees are a concern for us because we cannot afford to do this.”)

<sup>58</sup> Pyle, Tr. 284 (“We had a baker who served [a chain of 175 stores]. They were approached by this retailer after an acquisition saying that if they wanted to continue to do business they need to pony up \$1,700 per store to continue to supply bread and rolls and \$1,300 to continue to supply sweet goods”).

<sup>59</sup> McMahan, Tr. 157 (“We ourselves have lost a few pieces of business because we did not give a slotting allowance . . . and yet we would be in the top ten of the publishers . . .”)

<sup>60</sup> Mills, Tr. 158 (“we’re being squeezed off the shelves because the dominant manufacturer pays so much money”); Steinberg, Tr. 239 (“there has been, at least in the tortilla industry, definite exclusion of suppliers who cannot afford to come in with the right product”).

<sup>61</sup> Tada, Tr. 159 (this is a problem for “small growers and shippers who cannot afford to pay or are faced with the hammer” of dealing with a perishable product).

<sup>62</sup> Doppes, Tr. 178 (slotting allowances increase costs).

<sup>63</sup> Indeed, other antitrust authorities have brought enforcement actions challenging slotting allowances because of their exclusionary effect and resulting harm to competition. For example, the Canadian Competition Bureau recently brought a case in the baby food industry

There was little dispute that slotting allowances can increase the capital costs of entering a market, but there was wide disagreement over the practical consequences of those increased capital costs. One panelist estimated that the allowances required per item for nationwide distribution might be \$4.2 million, so that total slotting allowances on a small product line of four items would be \$16.8 million.<sup>64</sup> This was estimated to represent 30 to 50 percent of the total capital cost of bringing the products to market.<sup>65</sup> Another panelist suggested that the usual reality was different. “[S]lotting allowances generally are a very small percentage of the total cost of putting products into a marketplace.”<sup>66</sup> This disagreement may stem in part from the lack of systematic, verifiable data about the true magnitude of slotting allowances and the percentage by which they increase capital costs. It was beyond the scope of this workshop to conduct a scientific survey of the subject.

Assuming that slotting allowances substantially increase capital costs, some workshop participants indicated that this kind of addition to the capital requirements of entry would affect smaller businesses more seriously than large ones, for at least two reasons. First, the fixed slotting fee will be a larger percentage of the otherwise modest introductory costs for a “small

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challenging the use of slotting allowances by a dominant manufacturer. *See* "Heinz Canada Signs Undertaking Regarding Jarred Baby Food and Infant Cereal," (press release) (August 1, 2000) (undertaking resolving concerns that use of slotting and exclusivity prevented baby food manufacturers from entering the market), <http://strategis.ic.gc.ca/SSG/ct01803e.html>, last visited 01/08/00.

<sup>64</sup> Hannah, Tr. 161 (“35,000 supermarkets in the United States, give or take, some say 33,000, at \$150 a store, one item would be \$4.2 million up-front cost”).

<sup>65</sup> *See* Hannah, Tr. 169-70 (30 to 50 percent); Doppes, Tr. 161 (50 percent).

<sup>66</sup> Weber, Tr. 123; *see also id.* at 309.



brand,” which one speaker characterized as one having a few SKUs and a small promotional budget. A product line of that type is not atypical for small companies.<sup>67</sup> Second, a large firm will often be able to pay the cost of any allowance with the help of cash flows generated by established product lines that no longer have to pay slotting fees, whereas a small new entrant is less likely to have this kind of pre-existing revenue base.<sup>68</sup>

Several speakers suggested that the problems were exacerbated by retailers’ demand to receive this payment in the form of up-front cash. They suggested that it would be easier for small firms to provide a per-unit discount of comparable value. “The difference between the two is it’s the huge excessive one time flat payment unrelated to volume that causes the real problem for smaller manufacturers, versus the per unit discount which even smaller manufacturers ought to be able to afford over time.”<sup>69</sup> It may also be easier for small firms to provide an up-front payment that is denominated in terms of free goods. With free goods, “the manufacturer can work off a cost of goods basis and it’s less expensive for them.”<sup>70</sup> Others disagreed, however, and thought the two forms of payment could be equally burdensome.<sup>71</sup>

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<sup>67</sup> See Weber, Tr. 123.

<sup>68</sup> See Hannah, Tr. 59; Steiner Submission, p.2 (“A \$50,000 lump sum payable in advance is a far riskier proposition to a producer with \$5 million in sales than to the dominant firm with \$50 million in sales”).

<sup>69</sup> Skitol, Tr. 414.

<sup>70</sup> Weber, Tr. 54.

<sup>71</sup> See Hannah, Tr. 175 (“it’s still a horse . . . I don’t see the difference”); Specialty Food Distributors and Manufacturers Association Submission, p.2 (stressing burdens imposed by “scan based trading” procedures, under which the manufacturer is not paid until the goods are sold).

In theory, small businesses could turn to the capital markets to finance the costs of slotting allowances for desirable products. Although the workshop developed only anecdotal evidence, its record offered some indications that common forms of capital financing may not be readily available under these circumstances. Participants largely suggested that small firms seeking to supply retail grocery markets may have difficulty tapping sources of equity capital because of their size.<sup>72</sup> Moreover, they suggested, markets for debt capital also may not be responsive. “[B]anks do not finance marketing in any way, shape, or form. They finance machinery, automobiles. They don’t even like to finance your office building.”<sup>73</sup> If the financial markets are in fact reluctant to fund expenditures on intangible assets such as slotting rights, slotting fees could be a particular burden for small firms.

The workshop also considered the practical availability of other means for reducing the up-front impact of slotting requirements, such as a staged roll-out of new products beginning on a smaller scale. Panelists expressed a range of views. Some believed that small companies could minimize up-front costs by growing or rolling out geographically on an incremental basis. One supermarket executive noted that his firm carries a brand of canola oil that was initially made “in the garage and delivered it to ten Stop & Shop stores . . . it’s now in distribution at 204 Stop & Shops.”<sup>74</sup> Some panelists suggested that new products can be introduced through

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<sup>72</sup> Hannah, Tr. 183-84.

<sup>73</sup> Hannah, Tr. 183.

<sup>74</sup> Sussman, Tr. 82 (going on to note that there are “many” such examples). *See also* Flickinger, Tr. 164 (even today successful rollouts still occur, especially with a distinctive product, citing Krispy Kreme, Evian, and Starbucks); Thomas, Tr. 186-87 (“We can buy for one store . . . as a matter of fact, there’s a product called a coffee syrup that you can only sell in Rhode Island”); Thomas, Tr. 188 (Stop & Shop deals with “over a hundred [vendors] that are

alternative retailers, not necessarily conventional supermarket chains, that do not require slotting fees, such as mass merchandisers and specialty stores.<sup>75</sup> However, other industry members suggested that these kinds of incremental roll-out strategies may not always be available as a practical matter. One noted that while chains may sometimes permit limited testing or roll-outs, this is “a rarity,” because “it takes as much of [the retailer’s] manpower and time to set up a test as it does it to do their entire chain.”<sup>76</sup> Another observed that it has become increasingly difficult to start with just a few stores, since retailers have been consolidating and now often buy through large regional warehouses that cannot easily handle small product lines.<sup>77</sup>

**b. Reduced Innovation and Product Variety**

Several panelists suggested that slotting allowances might also harm competition by reducing the range and adversely affecting the mix of desirable products available in the marketplace. These panelists stated that slotting allowances could have this effect by retarding innovation and reducing the number and breadth of existing products that an individual retailer will choose to carry.

Innovation effects might arise because slotting allowances increase the costs of bringing new products to market. Slotting allowances target new products and new product variants, not  

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small suppliers”).

<sup>75</sup> Flickinger, Tr. 195 (rollouts can occur using the mass merchants that don’t charge slotting, such as Costco and Wal-Mart); Campbell, Tr. 124 (“Now you’ve got natural food, ethnic goods, and it’s opened up a whole wide array of opportunity for people to sell goods at”).

<sup>76</sup> Doppes, Tr. 163.

<sup>77</sup> See Hannah, Tr. 77-78; see also Carver, Tr. 165 (“It’s been either an all or nothing, and it’s not only the grocery stores but the convenience store chains unless you go with a small mom and pop chain”).

items already on the retailer's shelves. Several manufacturers reported that they had refrained from introducing new products because of the cost of slotting allowances.<sup>78</sup> On the other hand, some research has found that new product introductions increased during the time that slotting allowances have increased, suggesting that the allowances do not deter innovation.<sup>79</sup>

Even if slotting allowances have no effect on innovation, some believe that they have a tendency to reduce the range of existing products that a retailer will carry. Several participants urged that consumers have lost valuable variety and options as a result of slotting allowances,<sup>80</sup> and some suggested that small or regional supermarkets that are less dependent on slotting allowances offer greater variety.<sup>81</sup> For example, the head of a local supermarket chain opined, "customers should have the right to have some variety they might not otherwise have if we didn't allow the smaller manufacturers to get in the game without paying the slotting allowances, because for some people, there's no way they can afford to do it."<sup>82</sup> Others cautioned against

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<sup>78</sup> Mills, Tr. 216 ("I had a product that I was actually developing, and I have artwork that's sitting there pending . . . but since I'm limited to unlivable space . . . of inches, I don't see the sense of putting the new product in."); Tada, Tr.203; Hannah, Tr.216 (a "very minor change" in processing hash browns "would have required a whole new slotting allowance just to make that change in the same slot, so that's an idea where innovation is killed.")

<sup>79</sup> See Sullivan, *supra* note 25, at 474.

<sup>80</sup> See Hannah, Tr. 216; Mills, Tr. 216; Kirsch Submission, p.2; *see also* G. Shaffer, *Do Slotting Allowances Ensure Socially Optimal Product Variety* (working paper) (U. Mich. 1993).

<sup>81</sup> See Ukrop, Tr. 67. *But see* Sussman, Tr. 63-64 (finding "a correlation between the higher-slotting-charging supermarkets and . . . higher variety").

<sup>82</sup> Ukrop, Tr. 63. The panelist cited an instance in which a small manufacturer had proposed to sell him sweet potato muffins and cookies: "[T]here's no way anybody would give them the time of day if they had to pay slotting allowances." *See also* Hannah, Tr. 216; Mills, Tr. 216.

overstating the importance of variety, because some complaints involve “me-too” products that are not of great importance to consumers.<sup>83</sup> Whether exclusion of a product amounts to competitive harm is likely to depend on factors such as consumer demand for variety, costs that are saved, the degree of variety that remains, the ease with which existing firms can further differentiate their products, and the likelihood of new entry. The workshop record, however, provided little basis to generalize, beyond establishing the point that variety is a factor to be considered, with caution and on a case-by-case basis.

**c. Increased Consumer Prices**

A third concern expressed at the workshop is that slotting allowances may ultimately result in higher consumer prices by channeling benefits to retailers in a form that is less likely than others to be passed through to the ultimate consumer.<sup>84</sup> Under this analysis, slotting allowances are likely to increase the wholesale price of a product, because the manufacturer must raise its price to cover the expense of the allowances.<sup>85</sup> Retailers receive an up-front, lump-

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<sup>83</sup> See Weber, Tr. 236 (me-too products create “cost of duplication”); Reynolds, Tr. 249 (“the manufacturers that we’ve heard from [at the workshop] are relatively small and have relatively weak brand or fungible brand kinds of issues”); Gidley, Tr. 268 (multi-product supermarket is “an inherently less efficient model [than the limited-selection discounter], and the manufacturers are going to have to offer real value”); see also Campbell, Tr. 246 (“no guarantee that anyone has access to the shelf”).

<sup>84</sup> There were also concerns that slotting allowances are a relatively inefficient way of creating consumer demand. Slotting allowances are often perceived as less successful than advertising, discounts, or couponing for serving that purpose. See Campbell, 56-57; Houck, Tr. 57; Weber, Tr. 100. Some manufacturers suggested that consumer demand would be sparked more effectively by payments that require the retailers to take specific promotion actions. Hannah, Tr. 122.

<sup>85</sup> Steinberg, Tr. 271 (“the company that’s paying the allowance has to build it into their own profit margin”); Hannah, Tr. 117.

sum addition to their revenues, but the purchasing costs (costs of goods sold) have increased to the extent of the higher wholesale prices. Although these two effects theoretically may be equal and offsetting as an accounting matter, they are not necessarily equal in their effect on final retail prices. Rather, some contend that the lump-sum slotting payment to the retailer, unrelated to volume, is less likely to be passed on to consumers than the higher wholesale price, which raises the retailer's marginal cost.<sup>86</sup> Professor Greg Shaffer explained: "If you give the retailer . . . up front money, the retailer has no incentive to lower its price to try to sell more. It's got the money . . . There's no marginal effect."<sup>87</sup> As a result, according to this view, consumer prices are likely to rise as a result of slotting allowances.<sup>88</sup> Panelists expressing these concerns, however, did not

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<sup>86</sup> See Steiner, Tr. 142 ("it's not competed away, and if it were a variable cost in the food business, I think it would probably be competed away"); Nickila, Tr. 72; Doppes, Tr. 178; Shaffer, Tr. 180-81.

<sup>87</sup> Shaffer, Tr. 181. For a fuller description of this thesis see G. Shaffer, *Slotting Allowances and Resale Price Maintenance: A Comparison of Facilitating Practices*, 22 Rand J. Econ. 120 (1991). See also Steiner Submission, p.2 (this problem may exist "especially in markets where retail competition is less vigorous").

<sup>88</sup> By virtually the same analysis, some panelists also reasoned that a slotting allowance that substitutes for an equivalent discount on the wholesale price is less likely to result in a lower retail price because it provides the retailer with a lump-sum benefit rather than a reduction of marginal cost. Skitol, Tr. 414 ("the per unit discount is much more likely to end up translating into a downstream lower price to the consumer"). Both variants of the analysis presuppose that the retailer will carry the product. In contrast, if the point of comparison were different, so that the slotting allowance instead induced the retailer to carry a product that otherwise would not be carried, the allowance may be merely a mechanism to compensate retailers for added fixed costs and risks assumed by taking on the new product rather than a discount that one might expect retailers to pass directly through to consumers. See Campbell, Tr. 61 ("somebody bears the cost, and so it's going to be flowing through at some point"). To the extent that the cost-shifting increases efficiency, slotting allowances would reduce total costs in the system. See Sullivan, Tr. 119 ("Just as a matter of theory, if slotting allowances serve some sort of efficient role . . . then maybe a manufacturer's costs really are going up a couple hundred thousands, but maybe somebody else's costs are going down more than a couple hundred thousand dollars somewhere else in the system").

contend that payment of fees tending to raise consumer prices, standing alone, gives rise to an antitrust violation.

A number of other speakers disagreed with the conclusion that slotting leads to increased consumer prices. One speaker argued that “there have been slotting allowances for 20 years, and for 20 years the amount that people are paying supermarkets is actually not going up . . . .”<sup>89</sup> Some suggested that lump-sum slotting allowances would be passed through in particular cases if they were coupled with specific performance requirements that gave retailers an incentive to do so.<sup>90</sup> Others believed that, as long as the retail market remains competitive, all price benefits to supermarkets eventually have to be passed through to consumers.<sup>91</sup> Typical among these speakers, Professor Salop explained: “microeconomic theory predicts that an up-front lump-sum payment, not conditioned on retailer performance, would not be passed on in the short run, but by making retailing more profitable would have a tendency to lead to greater investment in the retail sector which could lead to more variety and ultimately more competition in the long run

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<sup>89</sup> Weitz, Tr. 119.

<sup>90</sup> Salop, Statement p.2 (in this case “lump sum payments can have similar competitive effects to variable payments. Thus, it is more difficult to draw a bright line”). One panelist suggested that when slotting allowances are paid in the form of free goods rather than cash, this involves an implicit performance requirement. He reasoned that the free goods will benefit the retailer only when they are sold, and this may give the retailers an incentive to reduce price in order to move the goods. *See* Shaffer, Tr. 180, 182 (“If you give free cases, the retailer has to move that. That has a potential of lowering prices for consumers, so it may make no difference for you [the manufacturer], but in terms of the consumer it may make a difference”).

<sup>91</sup> Sussman, Tr. 61-62 (“all streams of income help lower cost”). *Cf.* Reynolds, Tr. 301 (chains differ in their willingness to offset revenues against cost of goods, but some do so).

and ultimately to lower prices that way . . . .”<sup>92</sup>

### **B. Pay-to-Stay Fees**

A second form of access payment is the pay-to-stay fee. These payments are made to ensure the continued presence of an existing product on the shelf for some further period, commonly one year. Pay-to-stay fees differ from slotting allowances in that they are charged for existing products rather than for new ones, and the risk-compensating efficiencies associated with them may be more limited. They are similar, however, in the sense that they also involve a lump-sum payment at the beginning of a time period, and may impose burdens on manufacturers that cannot afford to make this payment. Workshop participants differed on the question of how frequently pay-to-stay fees are used. Some observers believe that they are seldom charged,<sup>93</sup> while others claimed that they exist and are substantial.<sup>94</sup>

Some suppliers believe that pay-to-stay fees can be significantly exclusionary. For example, one tortilla manufacturer reported that such fees require “five, six digit numbers for an annual program,” and that, as a result, “[w]e’re being squeezed off the shelves . . . .”<sup>95</sup> This potentially could limit competition on price or variety. On the other hand, other participants

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<sup>92</sup> Salop, Tr. 143. *Cf.* Sullivan, Tr. 119; Egan, Tr. 60-61; Houck, Tr. 117-18; Campbell, Tr. 61.

<sup>93</sup> Weber, Tr. 114 (“I have not seen evidence of pay to stay fees”); Sussman, Tr. 115 (“Stop & Shop and Ahold do not [charge them]”).

<sup>94</sup> Mills, Tr. 158 (do pay-to-stay fees exist? “Oh, yes, annually”) (tortillas); Tada, Tr. 158-59 (produce); Hannah, Tr. 114 (frozen foods); Stenzel, Tr. 168 (produce).

<sup>95</sup> Mills, Tr. 158. *See also* Tada, Tr. 158-59 (in produce business, pay-to-stay “has a tremendous impact on small growers and shippers who cannot afford to pay or are faced with the hammer of smelling their product at the end of the day”).



believed that pay-to-stay fees involve little more than a form of ongoing price competition that is unlikely to reach those extremes, and is thus beneficial for consumers.<sup>96</sup>

Participants held widely divergent views on the efficiencies attributable to pay-to-stay fees. Several contended that these efficiencies are likely to be less than those possible for new product introductions, since there are fewer risks and unknowns for which the retailer needs to be compensated.<sup>97</sup> Similarly, since the product already has a track record, there is less need for a signal from the manufacturer as to whether it is likely to succeed.

Other speakers suggested that pay-to-stay fees might offer other efficiencies by providing a way to rationally allocate limited shelf space. They may serve as devices for retailers to auction their shelf space and efficiently determine its highest-valued use.<sup>98</sup> Others questioned whether this was a sound approach without looking to a broader set of measures of likely consumer satisfaction.<sup>99</sup> One retailer saw no problem with banning pay-to-stay fees.<sup>100</sup>

### **C. Payments to Limit Rivals' Shelf Space**

Some participants charged that certain suppliers make payments that limit or disadvantage a rival's shelf space. These can be outright exclusivity agreements, partial

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<sup>96</sup> See Silberman, Tr. 407.

<sup>97</sup> Warren-Boulton, Tr. 252; Gundlach, Tr. 405; Tada, Tr. 237.

<sup>98</sup> See McMahon, Tr. 217; Reynolds, Tr. 296 (Product 1 is on the shelf; Product 2 offers a big fee to enter; so you offer Product 1 the chance to pay up: "It's a business decision at that point").

<sup>99</sup> See Sussman, Tr. 117 ("[suppliers] have to fight it out on our shelves, but it's not a [shelf payment] issue per se. It's a total package: sales, profits, customer satisfaction").

<sup>100</sup> Sussman, Tr. 306 ("as somebody who doesn't use [pay to stay charges] as a business model, and doesn't see the value in those, I have less problem with [a ban]")

exclusivity agreements, or preferential shelf space arrangements. The exclusivity or preference may be paid for in various ways, including slotting allowances and pay-to-stay fees. For example, a small supplier of canned tomatoes, tomato products, and sauerkraut stated that national brands of canned vegetables pay high slotting fees “just to keep us off the shelf”;<sup>101</sup> an air freshener producer claimed that the dominant producers of automotive air fresheners “will pay large amounts of money to keep everybody else out”;<sup>102</sup> and a small tortilla manufacturer claimed that a dominant supplier had paid to have the smaller firm’s product placed in a disadvantageous shelf location, eventually taking all the shelf space except for “three feet in a corner.”<sup>103</sup>

Contractual arrangements to limit rivals’ shelf space can be formulated in several different ways. The dominant firm may contract for absolute exclusivity, or a stated and relatively high absolute amount of shelf space, or a stated and high proportion of shelf space. One panelist suggested that buying space for oneself was generally less harmful to rivals than paying to have competitors excluded altogether, but that it could still have adverse effects in circumstances where the total amount of space was limited.<sup>104</sup> The exclusivity or preferential position may be attained either through express agreements, or through incentives that indirectly

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<sup>101</sup> See Hirzel Canning Submission, pp.1-2

<sup>102</sup> Doppes, Tr. 199.

<sup>103</sup> Mills, Tr. 176.

<sup>104</sup> Whinston, Tr. 208 (“in general we expect the first type of arrangement to be less effective at securing exclusion . . . In principle the rivals of this laundry detergent manufacturer then are free to, in a sense, buy space away from toilet paper or napkins . . .”); Whinston, Tr. 209 (but there may be circumstances where space is very constrained – *e.g.*, at the checkout counter or in the dairy cases -- so that “if you buy that space there’s no ready substitute”).

lead the retailer to those results.<sup>105</sup>

These arrangements can lock up such a high proportion of space or preferential space, at so many outlets, that rivals' costs are substantially raised. If the disadvantaged rivals were important for maintaining competition in markets for the affected goods, an exclusive or preferential shelf space arrangement could cause anticompetitive harm. *See infra* Part II.

#### **D. Discriminatory Payment of Access Fees**

Although the workshop did not focus extensively on possible discrimination issues in either the payment or receipt of access fees, some participants indicated that both types of discrimination may exist, at least to some degree.<sup>106</sup>

Some panelists stated that larger supermarket chains demand a greater amount of allowances than smaller chains, with harmful effects on retail competition. One independent wholesaler noted that when unwarranted price discrimination exists, "then you are fueling the fire for the bigs to get bigger and the smalls to disappear."<sup>107</sup> Another speaker claimed specifically that the smaller chains and their customers are being damaged: "In general . . . larger retailers get larger allowances and not simply proportionately larger, and there is a damage to the

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<sup>105</sup> *See* W. Tom, D. Balto & N. Averitt, *Anticompetitive Aspects of Market-Share Discounts and Other Incentives to Exclusive Dealing*, 67 *Antitrust L.J.* 615 (2000).

<sup>106</sup> Discrimination in payment of slotting allowances can violate the Robinson-Patman Act. *See* *McCormick & Co.*, Docket No. C-3939 (FTC May 2, 2000) (consent order) (Comm'rs Swindle and Leary dissenting).

<sup>107</sup> Campbell, Tr. 75. One written submission suggested that the Robinson-Patman Act was passed to preserve the social value of having smaller, regional businesses, as well as for economic purposes. Weiss and Romeyn Submission, p.1.

smaller retailer in that they cannot compete.”<sup>108</sup> Another speaker emphasized that manufacturers should be required to give small supermarkets effective notice that allowances are available.<sup>109</sup> On the other hand, at least one panelist suggested that retailers already have ways to minimize the risks of discriminatory allowances.<sup>110</sup>

Discrimination among manufacturers can exist when a retailer charges different slotting fees to competing suppliers. The workshop record provided relatively little information about this issue, but one researcher reported finding “that not all manufacturers were viewed as paying the same for the similar type of SKU.”<sup>111</sup>

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<sup>108</sup> Houck, Tr. 268.

<sup>109</sup> Campbell, Tr. 103.

<sup>110</sup> Weber, Tr. 52 (retail chains could waive slotting allowances “if the offeror signed a letter stating they were getting all possible allowances”).

<sup>111</sup> Gundlach, Tr. 13.

**PART II**

**ANTICOMPETITIVE THEORY:  
EXCLUSION AT THE MANUFACTURING LEVEL**

The most commonly expressed concern regarding slotting allowances is that they may exclude manufacturers that lack the resources to pay these up-front costs from selling to consumers.<sup>112</sup> This section of the Report considers the circumstances under which slotting allowances, pay-to-stay fees, or payments to limit rivals' shelf space may constitute exclusionary conduct that is unlawful under the antitrust laws.

“[E]xclusion of competitors is cause for antitrust concern only if it impairs the health of the competitive process itself.”<sup>113</sup> Exclusion of individual firms is not a competitive concern if

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<sup>112</sup> Other theories have been advanced in the antitrust and economic literature, including a theory of slotting allowances as a facilitating practice, in which the payment or receipt of allowances (or pay-to-stay fees) in combination with higher wholesale prices has the effect of dampening competition among industry rivals, leading to higher consumer prices. *See* G. Shaffer, *supra* note 87, at 121-22. This Report focuses on the manufacturer exclusion theory, however, which is the one emphasized by participants at the workshop.

<sup>113</sup> *Roland Machinery Co. v. Dresser Industries*, 749 F.2d 380, 394 (7<sup>th</sup> Cir. 1984). *See generally* *Entering the 21<sup>st</sup> Century: Competition Policy in the World of B2B Electronic Marketplaces*, A Report by the Federal Trade Commission Staff at Part 3, pp. 18-19 (2000). Cases involving exclusionary conduct generally are brought under Section 1 of the Sherman Act, 15 U.S.C. § 1, which prohibits agreements that unreasonably restrain competition, or Section 2 of the Sherman Act, 15 U.S.C. § 2, which prohibits conduct aimed at monopolizing a market and

the relevant market as a whole remains competitive.<sup>114</sup> This result flows from the principle, often repeated by the Supreme Court, that the antitrust laws are intended to protect “competition” rather than “competitors.”<sup>115</sup>

The following sections first discuss the basic elements of an economic theory of anticompetitive exclusion and then apply this theory in the context of slotting allowances, pay-to-stay fees, and payments to limit rivals’ shelf space.

#### **A. The Core Economic Theory**

The basic elements of an economic theory of anticompetitive exclusion were discussed by Professors Steven Salop and Mike Whinston. Under this theory, the analysis first considers the extent of disadvantage that rival suppliers likely would experience from a given marketing arrangement, including consideration of their ability to avoid or mitigate the disadvantage. To show harm to competition, rather than merely to competitors, the analysis then inquires about the likely impact on competition in markets in which the disadvantaged suppliers seek to

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attempts to monopolize. Exclusionary conduct might also be challenged under Section 3 of the Clayton Act, 15 U.S.C. § 14, or Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, which generally applies Sherman Act standards.

<sup>114</sup> See Salop, Tr. 137 (“if . . . there is adequate competition, then the fact that competitors are harmed does not raise an antitrust question”); Whinston, Tr. 205 (exclusionary conduct should be limited to practices that “reduce competition from rivals”); Silberman, Tr. 407 (“I know there are smaller people that said, Gee, I can’t afford it, but as long as there’s a competitive market functioning, that is not going to be problematic in terms of the big picture”). Market definition is important in these contexts, and the relevant markets may be different at the manufacturer and retail levels. Many products are distributed nationally by manufacturers, while retail markets are often local.

<sup>115</sup> See *Spectrum Sports v. McQuillan*, 506 U.S. 447, 458 (1993); *Cargill, Inc. v. Monfort of Colo.*, 479 U.S. 104, 109-10 (1986); *Brunswick Corp. v. Pueblo Bowl-O-Mat*, 429 U.S. 477, 488 (1977).

compete. Finally, if anticompetitive harm is likely, the analysis asks whether the practice produces procompetitive benefits that likely would offset the harm and whether similar benefits could be obtained by practical, significantly less restrictive means. It may also be important to consider whether special countervailing circumstances make competitive harm unlikely in a particular case.

To develop an exclusion theory, there must first be a likelihood of substantial disadvantage to rivals from the challenged conduct. For example, an exclusive-dealing contract in which a manufacturer obtains the right to be the only supplier of a particular kind of product in an individual retailer's stores obviously excludes all other manufacturers from those outlets. Whether the agreement substantially disadvantages rivals then depends on whether other satisfactory retail outlets are still available to competing manufacturers. If a number of other retail outlets are available, rival manufacturers may still be able to provide effective competition. On the other hand, if the dominant manufacturer or a small group of manufacturers obtains exclusive-dealing contracts with a high percentage of the desirable retailers in a relevant market, or if rivals are excluded from retail outlets with an importance to manufacturers disproportionate to their numerical share of the market,<sup>116</sup> competitive harm might occur.<sup>117</sup>

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<sup>116</sup> Such situations have been identified in other antitrust contexts. In cigarette retailing, for example, payments to limit shelf space have been successfully challenged in the "per-pack" outlets like gas stations and convenience stores, as well as at the bulk "per-carton" outlets. *See R.J. Reynolds Tobacco Co. v. Philip Morris Inc.*, 60 F. Supp. 2d 502 (M.D. N.C. 1999). Similarly, Toys "R" Us ("TRU") recently was found to have an even more significant role in toy retailing than its market share might suggest, since it was substantially larger than any other retailer and was regarded as essential to the introduction of new products. *See Toys "R" Us v. FTC*, 221 F.3d 928, 930 (7<sup>th</sup> Cir. 2000).

<sup>117</sup> In some circumstances, manufacturers may be able to bid to avoid such exclusion. If a dominant firm offers to pay retailers to exclude its rivals from distribution, the rivals could, at

Absolute exclusion of competitors is not the only way a firm might substantially disadvantage its rivals. A firm could decrease competition, and enhance its ability to increase price, simply by raising its rivals' costs and making it more difficult and costly for rivals to compete even if they technically remain as a fringe presence.<sup>118</sup> This might be accomplished by depriving rivals of effective means of distribution.<sup>119</sup> Alternative outlets might be less efficient or too small to enable rival manufacturers to maintain an efficient scale of operation. If rivals' costs are increased by their need to use such distribution methods, they will become less effective constraints on the pricing of the dominant firm.<sup>120</sup>

Some forms of restrictive but non-exclusive arrangements might also raise rivals' costs. For example, if a manufacturer obtained a high percentage of the shelf space for a particular product in all major retailers in a region, rivals might not have enough sales exposure for that product to maintain an efficient level of operation. Alternatively, a dominant firm might use certain kinds of incentive pricing structures to induce retailers to purchase a high percentage of

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least theoretically, make a counter-bid in order not to be excluded. Professor Salop noted, however, that this self-correcting mechanism may not work in all cases: a dominant firm might be expected to bid higher in order to protect its monopoly power than an entrant would be willing to pay in order to achieve a competitive rate of return. Salop, Tr. 130. *See also* Salop, Tr. 132 (“for this reason you cannot count on competition for exclusives, or in the supermarket context competition for shelf space. You can’t count on that to reach the efficient outcome.”).

<sup>118</sup> *See, e.g.*, T. Krattenmaker & S. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs To Achieve Power Over Price*, 96 Yale L.J. 209 (1986); Salop, Tr. 127; *see also* Toys “R” Us, 221 F.3d at 937 (condemning agreements that diminished club stores' ability to compete without absolutely excluding them).

<sup>119</sup> Whinston, Tr. 210-11.

<sup>120</sup> Salop, Tr. 127 (“the dominant manufacturer . . . can gain the power to charge higher wholesale prices”).



their requirements from it, in a way that may have exclusionary effects.<sup>121</sup>

The analysis then shifts to the likely impact of the exclusionary conduct on competition in the markets in which the disadvantaged rivals participate. Whether an exclusion of certain rivals or raising their costs gives rise to anticompetitive effects will depend on whether adequate competition remains.<sup>122</sup> Harm to competition from exclusionary conduct may take a variety of forms, such as increased prices,<sup>123</sup> reduced output, diminished product quality, and decreased innovation, product variety and consumer choice.<sup>124</sup> Some economists noted that effects on variety and consumer choice may be more difficult to evaluate,<sup>125</sup> and that in order to analyze them it would first be necessary to assess the actual importance to consumers of the variety

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<sup>121</sup> See Tom, Balto & Averitt, *supra* note 105, at 622.

<sup>122</sup> Subject to consideration of likely procompetitive benefits, a likelihood of competitive harm may be established from an analysis of market structure and of the market participants' abilities and incentives to behave anticompetitively following the exclusionary conduct. It also might be inferred from evidence that a competitor's constraining influence on the market has been diminished. See Toys "R" Us Inc., Docket 9278, slip op. at 38-41 (F.T.C. Oct. 13, 1998) (Comm'r Swindle concurring in part and dissenting in part), *aff'd*, 221 F.3d 928 (7<sup>th</sup> Cir. 2000) (finding that competition from price clubs would have caused TRU to lower its prices but for a set of agreements in which several toy manufacturers pledged not to sell the same products to the clubs that they sold to TRU).

<sup>123</sup> Salop, Tr. 127 ("if there is insufficient competition among other established brands . . . the dominant manufacturer can gain power over price. It can gain the power to charge higher wholesale prices, which then will be passed on to consumers in the form of higher retail prices").

<sup>124</sup> See Whinston, Tr. 221 (loss of variety "is a significant concern").

<sup>125</sup> See Salop, Tr. 139 ("I would be worried about simply looking at a reduction [in] variety because by definition, if you exclude a rival, variety goes down"). Economic theory suggests further complexity: depending on the circumstances, greater variety can either increase or decrease social welfare. See generally F. M. Scherer & D. Ross, *Industrial Market Structure and Economic Performance* 602-07 (3d ed. 1990); D. Carlton & J. Perloff, *Modern Industrial Organization* 297-303 (2d ed. 1994).

contributed by an additional firm.<sup>126</sup>

If this examination indicates likely anticompetitive harm in a relevant market, the analysis then considers whether the conduct at issue is reasonably necessary to achieve procompetitive benefits that likely would offset the harm.<sup>127</sup> A frequently asserted justification for distributional restraints in general is the prevention of “free riding” by other market participants.<sup>128</sup> One justification for exclusive dealing could be the need to prevent, or to compensate for, such free-riding at the retailer level.<sup>129</sup> Efficiencies do not include, however, simple pecuniary gains resulting from the transfer of wealth from one party to another through the exercise of market power.<sup>130</sup> And efficiencies should not justify anticompetitive exclusion if there are practical and significantly less restrictive ways in which the firm could have achieved

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<sup>126</sup> See Whinston, Tr. 221 (“[i]n principle, we know how to measure welfare effects . . . [t]he difficulty is actually considering what is the welfare loss from the loss of variety”). For an analysis of issues raised in taking account of variety and a call for research and discussion to enhance understanding of its effects, see T. Leary, *The Significance of Variety in Antitrust Analysis*, 68 Antitrust L.J. — (forthcoming 2001).

<sup>127</sup> See Salop, Tr.128 (“potential efficiency benefits . . . need to be taken into account”), Tr. 137 (efficiency issues should be judged under “the usual kind of full Rule of Reason analysis”); cf. Federal Trade Commission and U.S. Department of Justice Antitrust Guidelines for Collaborations Among Competitors (“Competitor Collaboration Guidelines”) at § 3.3 (discussing efficiencies in contexts other than exclusion).

<sup>128</sup> In a typical free-riding situation, rival retailers take advantage of (*i.e.*, “free ride” on) the promotional efforts and services of another retailer while offering little of their own, which enables them to undercut the price of the retailer that incurs the promotional costs. This free riding reduces the incentives to provide these services and thus tends to reduce total output.

<sup>129</sup> Salop, Tr. 129.

<sup>130</sup> See *Chicago Professional Sports v. NBA*, 754 F. Supp. 1336, 1359 (N.D. Ill. 1991), *aff’d*, 961 F.2d 667 (7<sup>th</sup> Cir.), *cert. denied*, 506 U.S. 954 (1992); Salop, Tr.129.

those efficiencies.<sup>131</sup>

Some panelists suggested that instances of exclusion are likely to be rare because retailers usually prefer to have multiple suppliers of a product and therefore are unlikely to go along with a manufacturer's efforts to achieve exclusive standing.<sup>132</sup> Economist panelists agreed that this could limit the frequency of problems, but believed that exclusivity might nonetheless develop in some situations. They suggested that suppliers might share their monopoly profits with some of the retailers and that those retailers would be willing to go along because a portion of the harm from reduced competition would fall on other retailers.<sup>133</sup> As a result, retailers' self-interest might not prevent a dominant supplier from attaining market-wide exclusivity for itself.

Short-run restrictions might be less worrisome than others because they give new entrants frequent opportunities to bid. Economist witnesses cautioned, however, that even

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<sup>131</sup> *Cf.* Competitor Collaboration Guidelines at § 3.36(b); Salop, Tr. 137 (cautioning that “you shouldn't put in such a high ‘less restrictive alternatives’ bar that no one could ever meet them”).

<sup>132</sup> Gidley, Tr. 266 (“In our core categories we [supermarkets] don't tolerate exclusives”). Some panelists suggested that downstream, demand-side pressures may force retailers to carry a variety of familiar brands that their customers desire, making it likely that they will demand multiple suppliers. *See* Reynolds, Tr. 261 (“if [retailers] choose to do business in an inappropriate way [e.g., not enough variety], they're going to be out of business because the consumers have lots of alternatives in almost every case”); Thomas, Tr. 185; Campbell, Tr. 73.

<sup>133</sup> *See* Whinston, Tr. 210 (a retailer's actions in agreeing to an exclusivity provision may not take into account external effects on the level of competition faced by other retailers); Salop, Tr. 135 (“[T]here is a free rider problem, a public goods problem. A single retailer would have a tendency to ignore the effect of his conduct on the success of the entrant overall . . . the monopolistic, dominant manufacturer can pay a number of retailers enough that they're compensated for the loss in competition, and then it can make money on that monopoly that it achieves with respect to others.”); *see also* Address by former Principal Deputy Assistant Attorney General A. Douglas Melamed, “Exclusionary Vertical Agreements” at 5 (Apr. 2, 1998) (“the manufacturer . . . can endeavor to induce the distributors to go along with the exclusionary scheme by sharing with them a portion of the anticipated supracompetitive profits”).

short-run contracts may raise concern if a monopolist is bidding for exclusivity, because the firm that anticipates monopoly returns may be willing to outbid its competitors on each occasion.<sup>134</sup>

Short-term contracts might also be problematic if they interfere with a new entrant's ability to coordinate the opening of outlets and to reach viable scale within a reasonable period of time.<sup>135</sup>

Finally, some panelists suggested that exclusive arrangements are not necessarily harmful in the supermarket context because there will often be times when a retailer prefers to carry only one brand of a particular product, either because multiple brands would take up too much space, or because they involve a commodity product as to which additional brands provide consumers no meaningful additional choice.<sup>136</sup> However, one should distinguish between situations in which a retailer unilaterally decides that it is efficient to carry only a single brand and situations in which a retailer has been induced to carry a single brand by an opportunity to share in monopoly profits, finding competitive concerns in the latter setting.<sup>137</sup>

## **B. Application of the Theory**

There was substantial consensus that marketing practices that would meet the

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<sup>134</sup> Salop, Tr. 130.

<sup>135</sup> See Salop, Tr. 133 (“Even if the exclusives are short-term, and can be undone on demand, the entrant faces a coordination problem. The entrant can’t survive just by being on the shelf of one store”). Cf. Whinston, Tr. 212.

<sup>136</sup> See McMahon, p. 217 (many retailers want only one line of greeting cards); Sussman, Tr. 258-59 (“there’s a big difference between duplication and variety. . . . In most cases we have a national brand [of sugar], then a private label, because sugar is sugar, and we don’t need five of them . . .”).

<sup>137</sup> See Melamed, *supra* note 133, at 5 (“If the supracompetitive profits available to the distributor are large enough, the distributor can be induced to agree to the restraint, even if it is inefficient.”).

requirements of the anticompetitive exclusion theory articulated in the previous section would constitute an appropriate antitrust concern. Rick Warren-Boulton, for example, identified “a real consensus in the economics profession that exclusion is a real concern and a real problem . . . .”<sup>138</sup> This section uses the framework of that theory to focus on the three marketing practices that appeared at the workshop to raise the greatest competitive concerns – slotting allowances, pay-to-stay fees, and payments to limit rivals’ shelf space. These practices may be anticompetitive in some circumstances but not others. Although each can impair the ability of rivals to provide effective competition, the ultimate competitive effects are not always clear, and the offsetting efficiencies may be important.

Payments to exclude rivals or limit their shelf space have the potential for directly disadvantaging rivals. Exclusionary rights can be paid for in a number of ways, including through the mechanisms of slotting allowances and pay-to-stay fees.<sup>139</sup> Rivals may be absolutely excluded, or their shelf space may be limited until, at some point, “it’s not cost effective to take a product to market.”<sup>140</sup> Some panelists, however, suggested that adequate alternatives are often available,<sup>141</sup> with one speaker observing that non-traditional retailing formats can sometimes

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<sup>138</sup> Warren-Boulton, Tr. 465.

<sup>139</sup> Salop, Tr. 127; Whinston, Tr. 206.

<sup>140</sup> Mills, Tr. 177. Firms making products that require direct store delivery may be particularly vulnerable to this tactic because such deliveries presumably have to be made at a relatively high route density in order to be economically viable.

<sup>141</sup> See Campbell, Tr. 248; Gidley Submission, p.3; Food Marketing Institute Backgrounder at 4 (“Even as the supermarket industry continues to consolidate, the types of retailers selling groceries is expanding, including upscale, specialty and ethnic stores, takeout establishments, gas stations and online shopping services.”).

serve more important distribution roles than formerly, thus enabling rivals to maintain a significant competitive presence.<sup>142</sup>

Apart from any direct acquisition of exclusionary rights, there was substantial agreement that slotting allowances and pay-to-stay fees can increase the capital costs of participating in a market,<sup>143</sup> but little consensus as to the implications. As shown by Part I.A.3.a, there are unresolved issues concerning the significance of slotting allowances as a share of the total costs of bringing new products to market; the ability of small manufacturers with desirable products to raise the necessary capital; and the practicality of introducing new products through staged roll-outs or the use of alternative retail outlets that do not charge slotting allowances. As for pay-to-stay fees, they too involve a lump-sum payment at the beginning of a sales period and raise exclusionary potential for upstream suppliers. However, to the extent that pay-to-stay fees are spread out over time and are collected after a product has been in distribution instead of in an equivalent up-front, lump-sum, they may be less burdensome; in those circumstances they would not fall due during the initial period of “no cash flow,” a feature of slotting allowances that was singled out for particular criticism.<sup>144</sup> As described in Part I.B, several panelists nonetheless recounted instances in which pay-to-stay fees may have harmed small manufacturers by raising the capital requirements of remaining in business.

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<sup>142</sup> *Cf.* McMahon, Tr. 217 (outlets aside from traditional card locations enable his firm to remain a competitive presence in the greeting-card market).

<sup>143</sup> *See* Salop, Tr. 142 (“An up-front lump-sum payment goes into the extra cost of entry. It’s just like you need to build a plant or you need to pay something to the contract manufacturer, you need to pay something to the retailer as well, and it raises your capital costs of entry.”).

<sup>144</sup> *Cf.* Hannah, Tr. 161.

Looking to the markets in which the manufacturers seek to compete, if a dominant firm's use of slotting allowances, pay-to-stay fees, or exclusionary contracts reduces the number of competing firms sufficiently or otherwise sufficiently hinders rivals' ability to compete, it can harm competition. The workshop record contains little evidence concerning likely effects in specific relevant markets, and a thorough investigation would require such fact-specific analysis.<sup>145</sup>

The panelists generally agreed that slotting allowances can have real efficiencies -- such as facilitating new entry by signaling likely success and sharing and reallocating risks between manufacturers and retailers -- although their strength and practical significance were debated.<sup>146</sup> As already noted, however, many of those efficiencies are less significant in the pay-to-stay context.<sup>147</sup> Unlike new products, products covered by pay-to-stay arrangements have a proven track record. Consequently, there is less need for signaling, less risk in carrying the products, and less value in methods for sharing that risk. On the other hand, there may be other possible efficiencies in using a market mechanism to allocate available space among products.<sup>148</sup>

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<sup>145</sup> At least one panelist suggested that pay-to-stay arrangements are unlikely to result in harm to competition. “[The] bidding process is going to result in price changes. It’s going to result in all sorts of things. I would not be concerned about that. It sounds to me to be exactly what competition is all about.” Silberman, Tr. 407; *see also* Scher, Tr. 409 (“An auction for scarce shelf space hardly violates the antitrust laws . . .”).

<sup>146</sup> *See supra* Part I.A.2. Indeed, Rick Warren-Boulton recommended that enforcement actions under the exclusion theory be confined to situations involving established products and ongoing payments, *i.e.*, pay-to-stay fees, precisely because of the potential efficiencies of slotting allowances. *See* Warren-Boulton, Tr. 252-53, 410.

<sup>147</sup> *See supra* Part I.B.

<sup>148</sup> Some, however, suggested that consumer interests will be better protected if retailers looked to expressions of actual consumer demand, rather than to proxies based on manufacturer

Exclusive or preferential shelf access arrangements may also give rise to efficiencies and benefit consumers if they create incentives to provide desirable specialized services. For example, an exclusive-dealing arrangement commits the retailer to a single brand of product, and so may induce the retailer to devote greater attention to that brand.<sup>149</sup> An investigation of any of these grocery marketing practices would require consideration of these possible efficiencies, and whether practical, significantly less restrictive alternatives are available.<sup>150</sup>

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payments, which can serve exclusionary rather than procompetitive objectives. *See* Hade, Tr. 339 (“our basis for carrying products is what we think we’ll sell in our marketplace”); Sussman, Tr. 306 (pay-to-stay is “a bad business practice”); *see also* Salop, Tr. 129-33 (urging that a dominant incumbent has incentives to outbid an equally efficient entrant for exclusive access to shelf space); Shaffer, *supra* note 80; *cf.* Weitz, Tr. 342.

<sup>149</sup> *Cf.* Roland Machinery, 749 F.2d at 395; Beltone Electronics Corp., 100 F.T.C. 68, 200-01 (1982).

<sup>150</sup> *See* Salop, Tr. 129 (real efficiencies are limited to things like “elimination of free riders and so on . . . and that’s not inherent in every exclusivity”).



## PART III

### CATEGORY MANAGEMENT AND CAPTAINS

A separate panel considered category management and category captains, which are a linked set of business techniques designed to help a retailer allocate shelf space on the basis of consumer demand patterns. “Category management” is a business technique for studying consumer demand within a particular category, such as soups, and then allocating shelf space among different products and designing marketing programs to best satisfy that demand as a whole. In effect, it is a way of managing a category of products as if it were a free-standing business.<sup>151</sup> The “category captain” is a firm, often a large supplier that is designated to help apply the technique to a particular category of products. Together, the two techniques provide a means for securing information relevant to shelf-space allocation decisions that is, to some degree, an alternative to the use of slotting allowances. However, the practices may also raise potential competitive concerns.

#### A. General Description

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<sup>151</sup> Sussman, Tr. 316 (“we would look at category management as a way of taking our large business, like our grocery business, and breaking it down to smaller business and having ownership of that business by a person or a team. That group then takes responsibility for understanding the customer better – pricing, promotion, all the things that we do with that category”). *See generally* R. Blattberg & E. Fox, “Category Management: Getting Started” (Food Marketing Institute and the Northwestern University Center for Retail Management, 1995).

As the name suggests, category management is an organizational approach in which the management of a retail establishment is broken down into categories of like products. Under category management, decisions about product selection, placement, promotion and pricing are made on a category-by-category basis with an eye to maximizing the profit of the category as a whole.<sup>152</sup>

Before the use of category management, supermarket chains divided management duties by task (*e.g.*, shelf allocation, promotions, replenishment, etc.)<sup>153</sup> or by brand.<sup>154</sup> Consolidating control of all activities for a particular cluster of products allows a more effective coordination of activities (*e.g.*, promotions and the replenishment needed to support a promotion; offering the optimal selection of brands). This coordination can benefit the retailer, the suppliers, and consumers.<sup>155</sup>

Effective category management requires marketing expertise and continual analysis of data. Some speakers opined that even the very largest retailers are less well-informed about

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<sup>152</sup> Many retail trades have employed category management for years, but supermarket chains have only recently adopted it on a wide scale. Weitz, Tr. 318 (“it’s really very unique that this has come late to supermarkets”).

<sup>153</sup> Sussman, Tr. 316-17 (“what you had was a lot of specialists. You had one group of people that just did replenishment, another group of people that just worried about shelf allocations, other people who just did negotiated deals and other people who planned promotions, and what we’ve done is we try to shrink it down and give kind of a cross-functional view to a smaller group of people”).

<sup>154</sup> Weitz, Tr. 318.

<sup>155</sup> See Hade, Tr. 320; Steiner, Tr. 335-36. See also R. Steiner, *Cooperation, Competition, and Collusion Among Firms at Successive Stages* at 20-21, paper presented to European Association of Law and Economics Conference (Oct. 28, 2000) (publication forthcoming), for a survey of the studies that have estimated the efficiencies of category management.

particular product areas than the manufacturers, and thus can benefit from their assistance.<sup>156</sup>

The manufacturer may know things like the times of year when a product will sell best, the kinds of promotions that are most effective in moving the product, or the kinds of complementary goods that might be advantageously displayed in adjacent space. Assistance often comes from a category captain – a leading manufacturer of products in the category who acts as a primary advisor for the retail chain’s management of the category.

The exact function performed by category captains varies widely across firms and product categories. At one end of the spectrum, some retailers, such as Stop & Shop, do not use category captains at all, even though they do rely on category management.<sup>157</sup> A little further along the spectrum, other retailers use the category captain only for advice about the management of the category and check this advice against the recommendations of other manufacturers and their own data. At the other end of the spectrum, some retailers delegate all category management responsibilities to the captain.<sup>158</sup> While it was acknowledged that the latter approach may be optimal for some peripheral categories (e.g., magazines, kitchen gadgets),<sup>159</sup> the general consensus of the panel was that assigning complete control of a category to one manufacturer could lead to biased management, which is not in the retailer’s best

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<sup>156</sup> See, e.g., Steiner, Tr. 337; Steiner, *supra* note 155, at 17.

<sup>157</sup> Sussman, Tr. 326-27.

<sup>158</sup> Weber, Tr. 334.

<sup>159</sup> Even in these categories, the delegation may be made to a wholesaler who represents many lines, rather than to a single manufacturer. See Reynolds, Tr. 343-44 (in those sectors, frequently “a rack jobber . . . comes in and decides what is going to go on the rack and services it”).

interest.<sup>160</sup>

An important part of category management is product selection. Category management typically approaches this task differently from product selection based on slotting allowances. As one panelist stated, category management is a proactive approach to product selection, while the use of slotting allowances is a passive, market-driven approach.<sup>161</sup> However, the two practices are not mutually exclusive. Some retailers base new product selections solely on category management principles but charge slotting allowances to offset the cost of stocking the new product.<sup>162</sup> Other retailers weigh both category management considerations and slotting allowances when deciding which new products to offer.<sup>163</sup>

## **B. Antitrust Issues**

Category management can provide significant benefits to manufacturers, retailers, and consumers. But, as one panel member stated, it can also provide an opportunity for “mischief,” particularly when it is practiced with a heavy reliance on a category captain.<sup>164</sup>

There are four ways in which category management – particularly the use of category

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<sup>160</sup> See Weitz, Tr. 330-31; Weber, Tr. 333 (if retailer delegates decisions to supplier, “they are going to be relatively ineffective and ultimately make the wrong business decisions”).

<sup>161</sup> Weitz, Tr. 342.

<sup>162</sup> Hade, Tr. 339 (his firm’s charges “are pretty small and really are set up to just cover our expenses to make the changes”).

<sup>163</sup> Sussman, Tr. 340-41. See generally V. Rao & E. McLaughlin, *Modeling the Decision to Add New Products by Channel Intermediaries*, 53 J. of Marketing 80 (1989).

<sup>164</sup> Steiner, Tr. 367 (“possibility of mischief” where captain has substantial information from its competitors). The risks of problems can be minimized by a prior awareness of potential antitrust issues, however. See MacAvoy, Tr. 445 (“Where there’s information sharing there is need for antitrust counseling”); see also Steiner, *supra* note 155.

captains – may lessen competition. The category captain might: (1) learn confidential information about rivals’ plans; (2) hinder the expansion of rivals, (3) promote collusion among retailers; or (4) facilitate collusion among manufacturers.

### **1. Learning Information about Rivals’ Plans**

First, a category captain can use its position to obtain sensitive information about other manufacturers’ plans. If this information is sufficiently important, it can thwart the growth of those manufacturers or lessen their incentive to produce innovative plans, to the ultimate detriment of consumers.

Category management inherently requires the sharing of sensitive information between manufacturers and retailers. Among these disclosures, manufacturers may inform retailers about their future promotional plans, including advertising campaigns, schedules of product innovations, and the like.<sup>165</sup> The retailers in turn may make this information available to category captains so that the captains can take it into account in managing and stocking the category. This information could be misused if the category captain takes advantage of it in its role as a competing manufacturer. With advance notice of where its rivals are planning promotional efforts, the captain would be positioned in some instances to compete less aggressively and in others to devise a counter to the rivals’ plans.<sup>166</sup> If rivals’ promotional efforts

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<sup>165</sup> Weber, Tr. 328 (“The supplier has certain information that the retailer doesn’t have – new product introduction plans, advertising plans, is advertising going to increase this year or decrease this next year”).

<sup>166</sup> See Steiner, *supra* note 155, at 18 (“As one would expect, there appears to be a continuing issue over how much data competitors are expected to make available to the Captain. Especially sensitive is information on upcoming promotions and on new product introductions. Yet this information must be forthcoming to construct an intelligent category plan.”).

are counteracted with enough regularity or in matters of enough importance, it might reduce their incentive to devise initiatives that would benefit consumers.

The issues raised by inside information might be solved through the use of managerial firewalls within the category captain. These firewalls would be internal corporate rules, providing that employees who receive information about competitors must not also be involved in the management of the firm's own brands, and that they not communicate information across the barrier to those who are.<sup>167</sup> Such a remedy, of course, would depend on the ability to construct firewalls sufficient in design and actual effect to protect against the potential harm.

## **2. Excluding or Hindering Expansion of Rivals**

A category captain might also gain an anticompetitive advantage over rivals in a second way. A captain that is able to control decisions about product placement and promotions could hinder the entry or expansion of other manufacturers, leading to less variety and possibly higher prices.

Retailers typically select as category captain the manufacturer with the greatest or second-greatest sales in the category.<sup>168</sup> In these circumstances, the captain may have an incentive to recommend that the retailer not carry a rival's product, or it might recommend that the rival's product be placed in a disadvantageous location. This incentive may exist even when the recommendation could hurt the overall sales of the category.

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<sup>167</sup> Information firewalls of this sort have been created as part of past FTC consents. *See* The Boeing Company, C-3992 (FTC Dec. 29, 2000) (consent order); Lockheed Corporation, 119 F.T.C. 618 (1995) (consent order); *see also* R. Parker & D. Balto, *The Merger Wave: Trends in Merger Enforcement and Litigation*, 55 *Business Lawyer* 351, 396 (1999).

<sup>168</sup> *See* Hade, Tr. 325.

Panelists presented a mixed picture of such experiences with category captains. One manufacturer described an instance in which a dominant category captain allegedly left a smaller rival with insufficient shelf space as a result of its recommendations.<sup>169</sup> Another panelist referred to concerns expressed by small manufacturers that the use of category captains can raise entry barriers.<sup>170</sup> A retailer, on the other hand, stated that it makes the final decisions on product placement and does not always follow the recommendation of the category captain.<sup>171</sup> Another panelist stated that exclusion of rivals by a category captain is unlikely as a practical matter: such tactics are not in the best interest of the retailer, and if a category captain behaves in that manner, it will have progressively less influence as an advisor.<sup>172</sup>

### 3. Promoting Collusion among Retailers

A manufacturer that serves as the captain of a category for all or most of the competing retailers in a market could facilitate tacit collusion among the retailers by providing a common point of reference for pricing, promotion, and product placement decisions.<sup>173</sup> The manufacturer, could, for example, make identical recommendations to all of the retailers, and if each retailer were aware of this practice, there would be less incentive for any one of them to deviate from the

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<sup>169</sup> Mills, Tr. 348-49, Tr. 358-6; *see* Tr. 348 (“The competitor was able to reduce my shelf space to I call it unlivable living conditions and unlivable space”).

<sup>170</sup> Steiner, Tr. 367 (small manufacturers say they must “go through the category captain who’s my bigger competitor and who just doesn’t want my stuff out there”); *see also id.* (category management position must be valuable because it is sometimes “auctioned off”).

<sup>171</sup> Hade, Tr. 350-51.

<sup>172</sup> Weitz, Tr. 372-73.

<sup>173</sup> Steiner, Tr. 367-68.

recommendation.

Several panelists stated that any category captain that offered a competitor's proprietary information to another retailer probably would not be a category captain for long.<sup>174</sup> However, sharing of proprietary information is not necessary for a category captain to facilitate tacit collusion among retailers. All that is needed is for several competing retailers to have a category captain in common, and for that captain to make identical recommendations to them. Some believe that retailers may not want to use a captain that also serves a number of competing retailers, because there would be doubts about the captain's commitment to their own interests.<sup>175</sup>

#### **4. Facilitating Collusion among Manufacturers**

Finally, category management has some potential to harm competition by facilitating collusion among manufacturers. That could occur if retailers encourage important manufacturers to confer and agree on a category management recommendation. The result could be fewer promotions and higher prices.

One panelist asserted that such activity is rare because it is not in the strategic interest of a retailer to have its suppliers meet to discuss a category plan.<sup>176</sup> Nonetheless, another panelist suggested that such activity occurs.<sup>177</sup> Some suggested that these instances may have resulted

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<sup>174</sup> See Weber, Tr. 372; Scher, Tr. 375 ("you're not going to want that vendor to be your category manager anymore").

<sup>175</sup> See Weber, Tr. 372.

<sup>176</sup> Weber, Tr. 362 ("that can negate the negotiating leverage the retailer has on one supplier versus the other").

<sup>177</sup> See Mills, Tr. 358-61.



from the inexperience of particular firms in using category management, or from poor training of category managers.<sup>178</sup> In any event, the concerns expressed suggest that category management has at least the potential to facilitate inappropriate contacts among manufacturers.

### **C. Category Management Summary**

The consensus of workshop participants was that category management can produce significant efficiencies that will benefit retailers, manufacturers and consumers. In some cases, category management, in particular the use of category captains, can also provide an opportunity for anticompetitive conduct. While these concerns are not so inherently serious as to call into question the entire practice of using category captains, the panel agreed that care should be exercised: (1) that the captain does not improperly receive confidential information about its rivals' plans; (2) that the category captain does not bias its advice to the retailer in such a way that it effectively excludes or significantly disadvantages its competitors; (3) that the category captain does not orchestrate horizontal collusion among retailers; and (4) that the category captain does not orchestrate horizontal collusion among manufacturers. The potential for anticompetitive conduct is minimized when retailers make their own category management decisions, require category captains to establish firewalls, and limit the competitive information that goes to the category captain.

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<sup>178</sup> See Sussman, Tr. 370 (“You can’t just say, One day you’re a buyer, next day you’re a category manager, because that’s what happens”).

## PART IV

### AN ALTERNATIVE CONCERN: RETAILER MARKET POWER

Some commentators have suggested that slotting allowances and similar practices are attributable to increases in retail market power.<sup>179</sup> In the context of purchasing, market power may be defined as the ability of a firm to influence significantly the terms on which it purchases its supply of inputs, for reasons not related to efficiency considerations but rather to the relative bargaining positions of buyer and supplier.<sup>180</sup> The workshop explored the possible existence of retail market power as a determinant of slotting fee requirements, and the possible competitive consequences of such practices. In general, the workshop sought to identify key issues rather than to develop specific answers.

#### A. Potential Concerns

The workshop identified and distinguished three different potential concerns – monopsony power, buyer power without monopsony, and gatekeeper power.

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<sup>179</sup> One researcher reviewed the results of a survey he had conducted and reported that “manufacturers and retailers agree that slotting fees were associated with the exercise of retail market power.” Gundlach, Tr. 23. *See also* Egan, Tr. 257 (“When it comes to small manufacturers, the retailer probably has all of the power”).

<sup>180</sup> *See, e.g.,* J. Lücking, *Retailer Power in EC Competition Law*, paper presented to the Fordham Corporate Law Institute Twenty-Seventh Annual Conference on International Antitrust Law & Policy (Oct. 2000), at 3-4. To date, retailer market power in purchasing appears to have attracted more intensive analysis in the European Community than in the United States.

Of course, large-scale purchasing may also reduce input prices by enabling the achievement of desirable efficiencies, such as when manufacturers are able to save costs by producing or shipping in bulk.

Monopsony is the buyer's counterpart to monopoly.<sup>181</sup> In a monopsony, a single large buyer (or a group of buyers acting in concert) effectively controls the purchasing side of a market and can reduce the price paid for a product below the competitive level.<sup>182</sup> Under the "classical theory of monopsony," a monopsonist reduces its purchases of a given input in order to lower the price it must pay.<sup>183</sup> Monopsony has adverse effects comparable to those associated with the exercise of market power by sellers, such as restricted output.<sup>184</sup> Workshop participants generally agreed that classic monopsony power probably is unusual in the supermarket industry, although the issue has not been studied in detail.<sup>185</sup>

In some settings, a large purchaser may be able to exercise buyer power without reducing the level of its input purchases because of its importance to sellers in getting their products to market.<sup>186</sup> For example, a buyer may account for a large share of the retail market, such that a

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<sup>181</sup> See *Addamax Corp. v. Open Software Foundation*, 888 F. Supp. 274, 280 n.9 (D. Mass. 1995); see also *Vogel v. American Society of Appraisers*, 744 F.2d 598, 601 (7<sup>th</sup> Cir. 1984) ("[M]onopoly and monopsony are symmetrical distortions of competition from an economic standpoint.").

<sup>182</sup> See P. Areeda, H. Hovenkamp & J. Solow, *IIA ANTITRUST LAW* ¶ 574 (1995); DOJ & FTC Horizontal Merger Guidelines, § 0.1 (April 2, 1992). See generally *Mandeville Island Farms v. American Crystal Sugar Co.*, 334 U.S. 219 (1948); *National Macaroni Mfg. Ass'n v. FTC*, 345 F.2d 421 (7<sup>th</sup> Cir. 1965); *United States v. Rice Growers Ass'n*, 1986-2 Trade Cas. (CCH) ¶ 67, 288 (E.D. Cal. 1986).

<sup>183</sup> See, e.g., R. Blair & J. Harrison, *Antitrust Policy and Monopsony*, 76 *Cornell L. Rev.* 297, 297-98, 301-03 (1991).

<sup>184</sup> *Merger Guidelines* at § 0.1.

<sup>185</sup> See Warren-Boulton, Tr. 254, 256, 298 ("classic monopsony power by a supermarket is a pretty rare event").

<sup>186</sup> For example, a firm with market power could maintain a higher level of purchases than predicted by the classical monopsony model by employing an "all or nothing," "take it or

seller does not have fully equivalent substitute outlets that would enable it to maintain the same scale of operation. In these circumstances there may be a cost asymmetry, enabling the buyer to shift to a different supplier at relatively small cost to itself, but at a greater cost to the supplier. This cost disparity may give the buyer some leverage over price.<sup>187</sup>

Consumers may benefit, at least in the short term, if retailers use their bargaining leverage to negotiate a lower price without reducing the quantity purchased, and then pass the savings on to consumers.<sup>188</sup> The extent of any savings pass-through, however, is likely to be affected by the degree of competition on the selling side of the retail market.<sup>189</sup> Some participants suggested that even if consumers receive some benefits in the short run, they could be adversely affected by the exercise of buyer power in the longer run, if prices to suppliers are reduced below a competitive level and if the suppliers respond by under-investing in innovation or production.<sup>190</sup>

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leave it” strategy, under which the buyer seeks to determine the maximum quantity a seller will deliver at a given price, when the alternative is to sell nothing. *See, e.g., Blair & Harrison, supra* note 183, at 316-17.

<sup>187</sup> *See, e.g., Toys “R” Us, Inc. v. FTC*, 221 F.3d 928, 930 (7<sup>th</sup> Cir. 2000) (finding distribution through TRU essential for an effective marketing campaign).

<sup>188</sup> *Warren-Boulton*, Tr. 401; *see Kartell v. Blue Shield*, 749 F.2d 922, 931 (1<sup>st</sup> Cir. 1984) (courts “should be cautious – reluctant to condemn too speedily – an agreement that, on its face, appears to bring low price benefits to the consumer”).

<sup>189</sup> A retailer may have some buyer power against suppliers, yet face significant competition from other retailers on the selling side. It is therefore important to examine the possible existence of retailer market power on both the purchasing and selling sides

<sup>190</sup> *See Steiner Submission*, p.3 (“if slotting fees have the effect of shifting further costs on manufacturers they will become less willing to undertake investments in R & D, production engineering and in introductory marketing and advertising campaigns, which outlays become sunk costs once the item is in production”); *cf. Rao*, Tr. 286 (quality may decline in response to

Some participants in the workshop suggested that retail market power might also take the form of “gatekeeper” power.<sup>191</sup> In this situation, a retailer is so important a part of the retail market that its refusal to carry a product will, by itself, make it too costly for the supplier to effectively enter.<sup>192</sup> The supplier may be held below minimum efficient scale in manufacturing, or may be unable to advertise efficiently in the mass media. In those circumstances the buyer stands as a gatekeeper to the retail marketplace. The existence of retailers with gatekeeper power might have particular implications for the variety of products available to the consumer, since some of those products will have to pass the decision-making screen of a single dominant retailer.

While not extensively discussed at the workshop, the gatekeeper theory would appear to involve difficult issues of evidence and causation. A product’s inability to gain distribution does not by itself mean that retailers are acting as “gatekeepers” in the power-buyer sense. The product simply might not offer sufficient advantages over existing products to induce retailers to carry it, and thus the seller’s lack of success could be consistent with a competitive outcome.

#### **B. Identification and Assessment of Retailer Market Power**

The notion of retail market power involves the relevant markets in which retailers purchase their products – the procurement markets. As with relevant markets on the selling side,

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a price drop). *See also* Blair & Harrison, *supra* note 183, at 318-20 (sellers may be forced to exit the market).

<sup>191</sup> *See* Savrin, Tr. 388-89; J. Curtin, D. Goldberg & D. Savrin, *The EC’s Rejection of the Kesko/Tuko Merger: Leading the Way to the Application of a “Gatekeeper” Analysis of Retailer Market Power Under U.S. Antitrust Laws*, 40 B.C. L. Rev. 537, 545 (1999).

<sup>192</sup> The excluded firm might still be able to find distribution as a fringe brand, but will not be an effective competitive constraint on the principal brands.

procurement markets have both product and geographic dimensions.<sup>193</sup>

As to the former, the relevant question is, what other types of purchasers can constrain the behavior of the retailer in question? In other words, can a supplier avoid a retailer's demands by turning to alternative types of purchasers?<sup>194</sup> The analysis would need to take account of any special characteristics that might render potential alternatives inadequate substitutes for the purchasers supposedly possessing market power.

Likewise, in assessing the possible exercise of market power by a retailer located in a particular part of the country, could a supplier profitably reject those demands by turning to alternative outlets in other sections of the country? Unlike the selling side of retail grocery markets, which usually are local in geographic scope,<sup>195</sup> procurement markets for many supermarket products may be broader. On the other hand, sellers of goods produced and sold on a local or regional basis, such as certain bakery products, may have fewer alternative purchasers and may face narrower procurement markets.<sup>196</sup> In that situation, a high level of local retailer concentration could leave manufacturers with limited options and could support the exercise of

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<sup>193</sup> For discussion of market definition in the context of buyer power issues, see R. Blair & J. Harrison, *Monopsony: Antitrust Law and Economics* 55-56 (1993).

<sup>194</sup> A supplier might also be able to discourage an exercise of retail market power by shifting production capacity to other products.

<sup>195</sup> E.g., *California v. American Stores, Inc.*, 697 F. Supp. 1125 (C.D. Cal. 1988), *aff'd in part and rev'd as to remedy*, 872 F.2d 837 (9<sup>th</sup> Cir. 1989), *rev'd*, 495 U.S. 271 (1990).

<sup>196</sup> Similarly, in a recent challenge to a proposed merger between two large grain traders, the Antitrust Division alleged that the merged firm would be able to exercise market power to depress prices paid farmers, who were confined by transportation costs to dealing only with purchasers in local geographic markets. 64 Fed. Reg. 44046 (1999). The matter ultimately was resolved by a consent order requiring certain divestitures. See *United States v. Cargill, Inc.*, 2000-2 Trade Cases (CCH) ¶ 72,967 (D.D.C. 2000).

retail market power.

### **C. Evidence Regarding Retail Market Power**

The workshop received relatively little evidence on the existence of retail market power. One recent study found that increased use of slotting allowances is associated with the exercise of retailer power.<sup>197</sup> Other participants, however, apparently citing national statistics, observed that the supermarket industry is still relatively unconcentrated. One noted that “there are well more than 100 major supermarket chains,”<sup>198</sup> and another stated that the share of the market held by the top four firms is still only 42 percent.<sup>199</sup> On the other hand, some testimony suggested that retailer concentration in certain regions of the country may be higher than it is nationally, with three or four supermarket chains sometimes representing about 60 percent of sales.<sup>200</sup> One economist noted that this could lead to market power over suppliers of products that are limited to those regional markets.<sup>201</sup>

Although some panelists indicated that certain chains purchase on a regional basis and

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<sup>197</sup> See Gundlach, Tr. 23. Another speaker cautioned, however, that increased use of slotting allowances was not, by itself, persuasive evidence of market power. He reasoned that “if a merger between supermarkets did create monopsony power, [then] a slotting fee is probably a less efficient way for that to be exercised than through simply driving the price.” Warren-Boulton, Tr. 298.

<sup>198</sup> Gidley Submission, p.14.

<sup>199</sup> Savrin, Tr. 388. While this number is substantial and increasing, as the speaker noted with some concern, it still may not be unusually high by general standards.

<sup>200</sup> Tada, Tr. 282 (this regional concentration level is “not uncommon”).

<sup>201</sup> See Warren-Boulton, Tr. 297. Certain specialized kinds of products – particularly those that require direct-store delivery and service – appear to be limited to relatively small sales territories as a result of the need to maintain route density. See Pyle, Tr. 272 (bread and tortillas). Producers of those products may be vulnerable to regional retailer market power.

therefore may have less market power than might otherwise be expected,<sup>202</sup> others responded that modern data processing systems enable large chains to enjoy the bargaining advantages of centralized purchasing on important products even if their operations are decentralized in other respects.<sup>203</sup> Panelists also diverged on the significance of regional chains as alternatives to national supermarkets. Some speakers emphasized the regional chains' significance, noting that they "have a tendency to actually be more sympathetic to the smaller suppliers";<sup>204</sup> others expressed concern that regional chains were disappearing through acquisitions,<sup>205</sup> leaving excluded manufacturers with just "the mom and pops," who are not enough to ensure effective exposure.<sup>206</sup>

While not a major focus of the workshop, the participants also noted the role of the FTC's merger program in preventing mergers that may harm competition by creating or enhancing retail market power in purchasing. There was general consensus that this was an important issue, but reactions ranged from that of an observer who thought that "the questions [about market power in purchasing] are pertinent questions, and they are being asked,"<sup>207</sup> to the

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<sup>202</sup> See Sussman, Tr. 288 (Ahold buys from the same vendor through five different centers).

<sup>203</sup> See Reynolds, Tr. 280 (notwithstanding organizational decentralization, a big chain has "a much more powerful information base . . . and a more effective buying back toward the vendor community").

<sup>204</sup> Weber, Tr. 80.

<sup>205</sup> Nickila, Tr. 74; Hade, Tr. 222 ("one of the things that's happening in our industry today is that you're seeing the shrinking basically of the independent retailer").

<sup>206</sup> See Carver, Tr. 224.

<sup>207</sup> MacAvoy, Tr. 394.



view that the issue “doesn’t seem to filter into the merger analysis, the buying side of the equation.”<sup>208</sup>

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<sup>208</sup> Bloch, Tr. 395.

**PART V**  
**RECOMMENDATIONS**

The workshop ended with a panel of policy experts, including a number of lawyers and economists with extensive familiarity with supermarket and shelf space access issues. The panel was asked to review the discussion in earlier phases of the workshop and to help formulate concrete policy recommendations. There was substantial diversity of view, and in many areas no consensus emerged. In part, this probably reflects the varied nature of the practices at issue and the circumstances in which they could be applied. In addition, the lack of specific and complete information limited the ability to fully identify problems or formulate solutions. The resulting need to speak from individual experience rather than from a common understanding of industry-wide practices and their likely effects may have contributed to the lack of consensus.

Accordingly, the staff's first recommendations are to continue efforts to enhance understanding of slotting allowances and other grocery marketing practices. Specifically, we recommend that the Commission pursue research in areas identified by the workshop and refrain from issuing slotting-allowance guidelines at the present time.

Although much remains to be learned, the workshop still provided helpful guidance for focusing enforcement efforts. In light of the workshop record and the agency's experience with and analysis of these issues, the staff therefore offers five additional recommendations as to circumstances that may be brought to the attention of the agency: (1) exclusive-dealing contracts should be carefully reviewed to determine whether they threaten a harm to competition; (2) slotting allowances and pay-to-stay fees should be examined with particular attention to

circumstances that could give rise to anticompetitive exclusionary effects; (3) issues of price discrimination should be revisited in the context of appropriate investigations; (4) inquiry into category captains should be primarily focused on situations that may involve anticompetitive exclusion or tacit or explicit collusion; and (5) supermarket merger review should continue to take careful account of any upstream anticompetitive effects.

## **1. Research**

The agency should consider conducting further research in this area. Speakers were aware of, and frustrated by, the scarcity of hard data and empirical findings. The few studies that have been undertaken reflect opinion surveys rather than empirical research.<sup>209</sup> Several speakers emphasized the need to fill some of the gaps.<sup>210</sup> Such research could provide useful support for enforcement programs and perhaps ultimately serve as a foundation for additional business guidance. The workshop produced specific suggestions for research in three broad areas: (1) general information on slotting allowances and grocery retailing; (2) exclusionary grocery marketing practices; and (3) merger-related issues.

*a. General Information on slotting allowances and grocery retailing.* Several speakers suggested research to learn more about the practical business role played by slotting allowances and pay-to-stay fees generally. Such an inquiry would look into matters such as product categories in which allowances and fees are typical; frequency of use in those product categories;

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<sup>209</sup> See Bloom, Gundlach, & Cannon, *supra* note 4; Rao & Mahi, *supra* note 46. See generally Food Marketing Institute Backgrounder at 1 (“Some economists have provided estimates [of total payments] but these are highly speculative, and no generally accepted numbers are available.”).

<sup>210</sup> See, e.g., Silberman, Tr. 454; Bloch, Tr. 457.

amounts of allowances and fees; how the allowances and fees are paid; how they are handled as an accounting matter; and efficiency justifications, including the role of fees in retailers' decisions to accept a new product or retain an established product.<sup>211</sup>

*b. Slotting allowances/pay-to-stay fees and exclusion.* Another suggestion was to look more specifically at how slotting allowances and pay-to-stay fees may have tended to foster anticompetitive exclusion. One speaker proposed that research here might examine the mechanisms of new product acceptance and attempt to determine whether “small manufacturers [are] somehow disadvantaged” in this process.<sup>212</sup> A similar inquiry at the other end of the product life cycle might look to determine “the circumstances under which a retailer decides to take a product off the shelf, and [whether that is] related in some way to fees that were paid by other manufacturers.”<sup>213</sup> The general methodology suggested for studies of this sort was to use the FTC’s compulsory-process authority to require special reports from affected firms.<sup>214</sup>

*c. Merger-related issues.* Finally, an economist suggested a number of research projects that could help resolve the question of whether supermarket chains have in fact acquired

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<sup>211</sup> See Gundlach, Tr. 405 (need to understand “exactly what happens when that fee is paid, where it goes, how it’s accounted for”); Sullivan, Tr. 472 (study decisionmaking process to see “what makes a retailer decide to accept a new product, and how do the fees affect that . . . ?” and see if “fees [are] really important in other stages of the life cycle other than when new products are introduced”).

<sup>212</sup> Sullivan, Tr. 472.

<sup>213</sup> Sullivan, Tr. 472-73.

<sup>214</sup> Skitol, Tr. 451 (“the FTC ought to consider dusting off its broad authority under Section 6(b) . . . and send out special reports to the 25 or 50 largest supermarket chains in the country, and the 25 or 50 largest grocery manufacturers in the country and get the information . . . all of the hard data on exactly what’s going on, write a report and make it public”).

market power over their suppliers. One such study could look at selected supermarket mergers and determine whether, after the merger, there had been a significant increase in the shelf-access payments required for established products.<sup>215</sup> A second study could help to differentiate between monopsony and other manifestations of bargaining leverage by examining supermarket mergers to determine whether the prices of the relevant products had risen or fallen relative to other prices of supermarkets, and whether the output or sales of those products had risen or fallen.<sup>216</sup>

*d. Staff recommendation.* The staff recommends that the Commission initiate one or more research projects to learn about the use of slotting allowances and other shelf-access payments. In order to avoid skewing the results of the study through self-selection by interview subjects and to obtain a more complete picture than was available through the workshop, we recommend that at least part of the inquiry be conducted using compulsory process. We also recommend that compulsory process be focused on industry segments drawn as narrowly as the nature of the inquiry permits, in order to minimize any potential burdens on business. This research would be supported by specific funding that Congress has earmarked to enable the FTC to investigate slotting allowances in the retail grocery industry.

## **2. Guidelines**

The staff recommends that the agency refrain from issuing slotting allowance guidelines at the present time. Such guidelines had been requested in a petition filed by the Independent

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<sup>215</sup> Warren-Boulton, Tr. 299.

<sup>216</sup> Warren-Boulton, Tr. 401.

Bakers Association and two other groups.<sup>217</sup> An advocate of the guidelines noted that they could be useful if they were able to identify some broad areas of legality, some narrow areas that are open to serious question, and perhaps an uncertain middle ground.<sup>218</sup> Others questioned the need for, and the likely benefits of, such guidelines.<sup>219</sup> Some observed that desirable guidance might best be provided in a more flexible format,<sup>220</sup> and the staff believes that publications such as this Report are the most appropriate means for providing guidance at this time, when much remains to be learned about slotting allowances.

### **3. Price and promotional discrimination**

The Commission should remain aware of the ways in which differential payment of slotting allowances and other access fees could result in discrimination among a firm's trading partners. This subject was beyond the scope of the workshop, but it warrants further examination in appropriate investigations.<sup>221</sup>

The record provided a range of views. A number of participants spoke against increased

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<sup>217</sup> Petition to the FTC on Behalf of the Independent Bakers Ass'n, the Tortilla Industry Ass'n, and the National Ass'n of Chewing Gum Manufacturers for the Issuance and Enforcement of Guidelines on Slotting Allowances in the Grocery Industry (Apr. 14, 2000).

<sup>218</sup> Skitol, Tr. 446 *et seq.*

<sup>219</sup> See Bloch, Tr. 456; MacAvoy, Tr. 461; Schmidt, Tr. 467. A further question was raised about whether guidelines could be flexible and "nimble" enough to cover all the business techniques that could function as alternatives to slotting allowances. Steuer, Tr. 460; *see also* Warren-Boulton, Tr. 465.

<sup>220</sup> See Silberman, Tr. 453-54.

<sup>221</sup> See McCormick & Co., *supra* note 106.

enforcement of the price-discrimination statute.<sup>222</sup> Indeed, all panelists seemed agreed that any enforcement or guidance in this area should be framed very carefully to avoid inhibiting individualized bargaining and free competition. On the other hand, there was a widely shared view that there are some enforcement possibilities that warrant further study. One speaker suggested, for example, that current supermarket mergers may be driven by a lack of enforcement of the price-discrimination laws: “If . . . things are consistently supplied and offered to all competitors fairly . . . I don’t think you would have seen the merger and acquisition activity that you have today.”<sup>223</sup>

#### **4. Exclusive-dealing contracts**

Exclusive dealing contracts warrant the closest attention among grocery marketing practices and should be carefully reviewed to determine whether they threaten harm to competition. This class of cases should be flexibly construed to include partial exclusive-dealing contracts, preferential shelf-space arrangements, and other payments made to limit rivals’ distribution. Exclusive dealing may be a particular concern if the disadvantaged rivals compete in a concentrated market and the retailer is induced by slotting allowances or other practices to carry fewer lines than it otherwise desired.

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<sup>222</sup> See MacAvoy, Tr. 438 (a fully level playing field “can’t be delivered by Robinson-Patman or by the FTC under Section 5”); Silberman, Tr. 437 (“There is a level playing field in some sense, but \* \* \* we have recognition of functional differences between firms”); Scher, Tr. 439-40 (“it would be a great mistake for the Commission to . . . start enforcing it [the Robinson-Patman Act] actively again”).

<sup>223</sup> Campbell, Tr. 247. See also Bloch, Tr. 434-35 (“I think the focus on slotting allowances is misplaced. \* \* \* The general agreement that I heard primarily today was on the need for a level playing field, and that . . . came from somebody purporting to represent manufacturers. It came from retailers, large and small. It came from the only wholesaler who was on the panel this morning. \* \* \* Robinson-Patman has to be part of the equation.”).

Several panelists endorsed this focus. They noted that it would concentrate enforcement resources on the forms of conduct that could have the strongest effect of impeding rivals' access to the market. Moreover, by focusing inquiry on markets with few competitors, it would direct attention to settings where exclusion would be most likely to have anticompetitive effects.<sup>224</sup> Some added that problematic exclusionary contracts will most often be manufacturer-initiated,<sup>225</sup> although they need not always be.<sup>226</sup> Some panelists observed that de facto exclusivity may sometimes result from agreements expressed in different terms and urged attention to situations raising that possibility.<sup>227</sup>

##### **5. Slotting allowances, pay-to-stay fees, and other exclusionary conduct**

Antitrust enforcement should not stop with exclusive-dealing contracts. Where appropriate facts are presented, other forms of exclusionary conduct that do not rely on simple foreclosure of outlets should also be investigated.

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<sup>224</sup> See Silberman, Tr. 406 (“the fundamental issue is the situation where dominant manufacturers engage in conduct . . . that’s almost a bribe to raise rival’s costs”; Warren-Boulton, Tr. 255-56 (“The only thing . . . you want to worry about is a situation in which a supermarket may have an incentive to use this gatekeeper role to the detriment of consumers. The only good examples . . . are situations in which a dominant manufacturer essentially . . . makes a supermarket a deal . . . that is going to either increase the cost to their rival manufacturers or reduce the amount that the supermarket is willing to pay for those rivals”); Warren-Boulton, Tr. 410 (same).

<sup>225</sup> See Silberman, Tr. 408-09; Warren-Boulton, Tr. 410. Some slotting allowances are said to be in fact manufacturer-initiated in this way. See Weber, Tr. 51-52.

<sup>226</sup> See Sullivan, Tr. 417.

<sup>227</sup> See Silberman, Tr. 426 (“What begins to bother me is the ancillary activities [like restraints on promotional activities] that very much sound like . . . preventing my competitor from coming up with something that will allow it to market its products”); see also Steuer, Tr. 420 (“in some instances some types of graduated discount schedules can result in exclusion”).



The record was divided on this recommendation. Some panelists urged that enforcement efforts should stop at the point identified in the previous recommendation – at payments for exclusionary rights to particular shelf space. Typical of this group, one economist warned that any broader enforcement in slotting allowances would have “a high false-positive rate”<sup>228</sup> – i.e., a high rate of incorrectly concluding that a slotting allowance was anticompetitive.

Others, however, suggested that the agency should also be aware of the possibility that, in appropriate cases, exclusion could be effectively brought about by means that raise rivals’ costs in other, less-familiar ways, such as through slotting allowances or pay-to-stay fees. One panelist noted that, “if it’s a situation where . . . the amount of the fee is way beyond any conceivable cost justification, then the efficiency story doesn’t apply . . . and the payment is likely to be entry-barrier-raising vis-a-vis small rivals.”<sup>229</sup>

On balance, the record suggests that these additional forms of access payments could give rise to competitive concerns but often will not, so that investigations and enforcement activity should focus selectively on settings that present the most appropriate facts. As the discussion earlier in this Report suggests, antitrust concerns require factual demonstrations of key predicates and careful consideration of potential efficiencies, especially in settings involving new product introductions. But the exclusionary effects traceable to slotting allowances could,

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<sup>228</sup> Warren-Boulton, Tr. 253 (“I think, given the number of efficiency defenses for this, the chance that the FTC wants to get into the business of trying to do something about slotting allowances for new products strikes me as having such a high false positive rate.”); *see also* Silberman, Tr. 406 (“What I would exclude from enforcement activity for all sorts of reasons are the things that are the more classic slotting allowances -- the one time payment demanded by retailers for access . . . the bidding situations.”).

<sup>229</sup> Skitol, Tr. 413; *see also* Warren-Boulton, Tr. 410 (discussing pay-to-stay fees).

in theory, give rise to overall anticompetitive effects, and such concerns will receive serious attention from the Commission staff as circumstances warrant. Pay-to-stay arrangements, which do not involve certain of the efficiency justifications applicable to slotting allowances, may warrant particular scrutiny in settings presenting the appropriate facts.

#### **6. Category management and captains**

Investigations into the use of category management and captains should focus primarily on ways in which the practice may facilitate tacit or explicit collusion or result in anticompetitive exclusion. The record strongly suggests that category management and the use of category captains can produce important efficiencies, and there was agreement that FTC actions should not call these practices into question in any general way.<sup>230</sup> However, speakers also generally agreed that the use of category captains carried the potential for competitively troublesome exchanges of information. In this context, horizontal exchanges of information are the most likely to produce anticompetitive effects, and they warrant close attention.

#### **7. Merger enforcement**

The Commission's review of supermarket mergers should remain alert for possible creation or enhancement of retail market power, exercisable upstream against suppliers, as well as for the more familiar seller power exercisable downstream against consumers. Moreover, the FTC should exercise care in framing and implementing divestiture orders, to ensure that divestitures made to cure downstream competitive problems do not inadvertently create

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<sup>230</sup> See Schmidt, Tr. 444 (“as a general matter, category management is a positive for the industry”); MacAvoy, Tr. 445 (category management “ought to be encouraged and certainly not dampened”).

upstream problems of their own.<sup>231</sup> These subjects already receive attention, but a continuation of that attention is warranted.

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<sup>231</sup> See Bloch, Tr. 395 (arguing that the policy of divesting all stores in a market to a single buyer is counterproductive: “that policy favors inherently strengthening the power buyers that we’ve been talking about. I think that’s kind of an anomalous result. Again it requires some sort of harmonization of the policy toward power buyers and the way the merger process functions.”).

**APPENDIX A:  
WORKSHOP PANELISTS**

<b><u>NAME</u></b>	<b><u>AFFILIATION</u></b>	<b><u>DATE</u></b>
Ronald Bloch	McDermott Will & Emery	6/1/00
Jay Campbell	Associated Grocers of Baton Rouge	5/31/00
Karen Carver	Elan Natural Waters	6/1/00
Peter de la Cruz	Keller and Heckman	5/31/00; 6/1/00
Gus Doppes	California Scents	6/1/00
Mark Denbaly	Economic Research Service, Department of Agriculture	5/31/00
John Eagan	Costco	5/31/00; 6/1/00
J. Mark Gidley	White & Case	6/1/00
Greg Gundlach	Department of Marketing, College of Business Administration, University of Notre Dame	5/31/00; 6/1/00
Scott C. Hannah	Pacific Valley Foods	5/31/00; 6/1/00
Robert Houck	CoAMS	5/31/00; 6/1/00
Christopher MacAvoy	Howrey Simon Arnold & White	6/1/00
Jack McMahon	Gallant Greeting Corp.	6/1/00
Pamela Mills	Tortilla Industry Association	6/1/00
David Nickila	Portland French Bakery	5/31/00; 6/1/00
Nicholas Pyle	Independent Bakers Association	6/1/00
Akshay Rao	Carlson School of Management, University of Minnesota	5/31/00; 6/1/00

<u>NAME</u>	<u>AFFILIATION</u>	<u>DATE</u>
Robert <b>Reynolds</b>	Reynolds Associates	6/1/00
Steven C. <b>Salop</b>	Georgetown University Law Center	5/31/00
Daniel <b>Savrin</b>	Bingham Dana	6/1/00
Jeffrey <b>Schmidt</b>	Pillsbury Madison & Sutro	6/1/00
Irving <b>Scher</b>	Weil, Gotshal & Manges	6/1/00
Greg <b>Shaffer</b>	Simon School of Business, University of Rochester	6/1/00
Alan <b>Silberman</b>	Sonnenschein Nath & Rosenthal	6/1/00
Robert <b>Skitol</b>	Drinker Biddle & Reath	6/1/00
Irwin <b>Steinberg</b>	Tortilla Industry Association	6/1/00
Robert <b>Steiner</b>	consultant	6/1/00
Thomas <b>Stenzel</b>	United Fresh Fruit and Vegetable Association	6/1/00
Richard <b>Steuer</b>	Kay Scholer Fierman Hays & Handler	6/1/00
Mary <b>Sullivan</b>	Antitrust Division of the United States Department of Justice	6/1/00
Donald <b>Sussman</b>	Ahold USA	5/31/00; 6/1/00
Pierre <b>Tada</b>	Limoneira Company	6/1/00
Victor <b>Thomas</b>	Stop & Shop Supermarket Company	6/1/00
Robert <b>Ukrop</b>	Ukrop's Supermarkets	5/31/00
Frederick <b>Warren-Boulton</b>	MiCRA	6/1/00

<u>NAME</u>	<u>AFFILIATION</u>	<u>DATE</u>
Winston <b>Weber</b>	Winston Weber & Associates	5/31/00; 6/1/00
Barton <b>Weitz</b>	Marketing Department, College of Business Administration, University of Florida	5/31/00; 6/1/00
Michael <b>Whinston</b>	Northwestern University	6/1/00

**APPENDIX B:  
WRITTEN STATEMENTS**

<u>NAME</u>	<u>AFFILIATION</u>
<b>Ahold USA, Inc.</b>	Ahold USA, Inc.
J. Mark <b>Gidley</b>	White & Case LLP
<b>Hirzel Canning Co.</b>	Hirzel Canning Co.
Independent Bakers Association, Tortilla Industry Association, and National Association of Chewing Gum Manufacturers	Independent Bakers Association, Tortilla Industry Association, and National Association of Chewing Gum Manufacturers
Paul F. <b>Kirsch</b>	Townsend & Townsend & Crew
Christopher <b>MacAvoy</b>	Howrey Simon Arnold & White
Steven C. <b>Salop</b>	Georgetown University Law Center
Alan <b>Silberman</b>	Sonnenschein Nath & Rosenthal
Specialty Food Distributors and Manufacturers Association	Specialty Food Distributors and Manufacturers Association
Robert L. <b>Steiner</b>	consultant
Jonathan <b>Weiss</b> and Jonathan W. <b>Romeyn</b>	Law Offices of Jonathan Weiss