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FEDERAL TRADE COMMISSION

I N D E X

ORAL ARGUMENT	PAGE :
Mr. Feldberg	4, 79
Mr. Dagen	35

1
2
3
4
5
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8
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11
12
13
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FEDERAL TRADE COMMISSION

In the Matter of:)
TOYS "R" US, INC.)
a corporation) Docket No. 9278

Thursday, February 19, 1998
Room 532
Federal Trade Commission
6th Street and Pennsylvania Ave., NW

The above-entitled matter came on for hearing at 10:00 A.M., before the Commission, Robert Pitofsky, Chairman, and Mozelle W. Thompson, Sheila F. Anthony and Orson Swindle, Commissioners, attending. Commissioner Azcuenaga did not participate because of medical leave.

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1 PROCEEDINGS

2 MR. PITOFISKY: Good morning,
3 everyone. The Commission is meeting today in
4 open session to hear oral argument in the matter
5 of Toys "R" Us, Docket Number 9278, on appeal by
6 the respondent from the decision of the
7 Administrative Law Judge. Each side will have
8 45 minutes to present its arguments, with
9 counsel for the respondent making the first
10 presentation. Respondent is represented by
11 Michael Feldberg, complaint counsel is
12 represented by Rich Dagen.

13 Mr. Feldberg, do you want to reserve
14 some time for rebuttal?

15 MR. FELDBERG: Thank you,
16 Mr. Chairman. I would like to reserve 15
17 minutes to close the argument.

18 MR. PITOFISKY: Very well.

19 All right, if everyone is ready, why
20 don't you proceed?

21 MR. FELDBERG: Thank you.

22 Mr. Chairman, Members of the
23 Commission, my name is Michael Feldberg, and I'm
24 one of the lawyers for Toys "R" Us. In the
25 course of my argument today I'm going to refer

1 to some of the evidence that was presented at
2 the hearing below before the Administrative Law
3 Judge and some of the exhibits, and I would like
4 to hand out to the Commissioners and my adversary a
5 small notebook which contains a few exhibits and
6 excerpts of testimony, so that Members of the
7 Commission can read them as well as listen to me
8 talk about them.

9 I hope to make two critical points to
10 the Members of the Commission: The first
11 relates to the claim in this case that Toys "R"
12 Us organized a horizontal conspiracy among toy
13 manufacturers to boycott the warehouse clubs.

14 And I hope to demonstrate to you
15 today that there is zero, none, no direct
16 evidence of any such horizontal conspiracy. And
17 that there is no circumstantial evidence either.
18 And that in this case, we come nowhere near the
19 standard set by the Supreme Court in the
20 Matsushita case that requires an antitrust
21 plaintiff seeking to prove a claim like this, to
22 demonstrate evidence that tends to exclude the
23 possibility, evidence that tends to exclude the
24 possibility that the alleged conspirators acted
25 independently.

1 We hope to demonstrate to you today,
2 as we have in the briefs, that the evidence
3 shows a diversity of manufacturer conduct, and
4 it shows manufacturers acting in what each of
5 them perceived to be its own unilateral
6 self-interest.

7 The other key point I hope to make to
8 you today pertains to the alleged unreasonable
9 restraint of trade relating to the vertical
10 relationship between Toys "R" Us, the retailer,
11 and various toy manufacturers, the suppliers.

12 In their brief before you counsel
13 supporting the complaint spends most of their
14 time arguing that there were vertical
15 agreements. And we think the evidence does not
16 support that.

17 But even if you find that there were
18 one or two or three vertical agreements between
19 Toys "R" Us and various manufacturers, the
20 evidence shows that there was no unreasonable
21 restraint of trade, because there is zero
22 evidence that Toys "R" Us had market power,
23 which is a threshold requirement in a rule of
24 reason case. And there is zero evidence of
25 substantial foreclosure of the market. And,

1 therefore, zero evidence of any anticompetitive
2 effects, which is another threshold requirement
3 in any rule of reason case.

4 I hope to demonstrate to you, as I
5 hope we have in our briefs, that this case
6 brought by the FTC staff represents a radical
7 assault on established antitrust law.

8 This case concerns Toys "R" Us'
9 Warehouse Club policy. There is no dispute that
10 Toys "R" Us developed this policy unilaterally
11 on its own, not in consultation with any of its
12 competitors, any of its suppliers, anybody else.
13 It's Toys "R" Us' unilateral policy.

14 There is no dispute that Toys "R" Us
15 announced this policy openly in a
16 non-conspiratorial way to various manufacturers
17 primarily in February, 1992 at the annual
18 industry event known as Toy Fair.

19 Toys "R" Us told each manufacturer in
20 substance, do whatever you want. But if you
21 sell a particular item to the Warehouse Club
22 channel of trade, we probably won't buy it. It
23 posed a choice.

24 MR. PITOFSKY: That's not what they
25 said the first time around. Mr. Goddu's memo,

1 is that the way you pronounce it?

2 MR. FELDBERG: Goddu.

3 MR. PITOFSKY: Goddu. His first memo
4 seemed to say not if you sell to them you can't
5 expect to sell to us. Because we want you to
6 sell to them under special conditions, like
7 combination packs, exclusives, and so forth.

8 MR. FELDBERG: Actually, that
9 memorandum does not say that. What the first
10 memorandum, I think bears a date of January
11 29th, '92, and there is no evidence that was
12 ever communicated to anyone; but even if it was,
13 what it says is we won't buy. And the dispute
14 in the evidence is some people remember it that
15 Toys "R" Us said we won't buy the same items that
16 are sold to warehouse clubs. Some people
17 remember it that Toys "R" Us said we may not.
18 Some people remember it as we reserve the right
19 not to. And probably all of those things were
20 said at various times. But those differences,
21 we submit are immaterial.

22 What you're suggesting, Mr. Chairman,
23 relating to the creation of combination packs,
24 there is no dispute in this evidence that the
25 concept of combination packs was developed by

1 some of the manufacturers on their own. That
2 was an idea that the manufacturers came up with,
3 because of basically two reasons: A, a number
4 of the warehouse clubs had always wanted to buy
5 toys in combination packs. One of the unique
6 features, if you will, of the warehouse club
7 channel of distribution, is because they carry
8 very few items over a broad range of categories
9 of merchandise, they need what they refer to as
10 a big ring at the cash register. They don't
11 want to carry anything that sells for less than
12 ten dollars.

13 Most toys sell for less than 10
14 dollars, 62% of all toys retail for less than 10
15 dollars. The majority of toys for every age
16 range from zero, infants, up to 11 years old,
17 retail for less than 10 dollars, basic Barbies,
18 basic GI Joes, basic Star Wars action figures,
19 all retail for less than ten dollars. The
20 warehouse clubs don't want them, because it's
21 not a big enough ring. So, traditionally
22 they --

23 MR. THOMPSON: Where is the evidence
24 that says that?

25 MR. FELDBERG: The evidence is not

1 really in dispute. Every warehouse club buyer
2 who testified at this hearing said that,
3 Commissioner.

4 MR. THOMPSON: So, where is it?

5 MR. FELDBERG: It's in the testimony.
6 If you read -- if -- we cite to it in our brief,
7 Commissioner. If you read the testimony of the
8 warehouse club representatives from Costco, from
9 Sam's, from BJ's Wholesale Club --

10 MR. THOMPSON: I don't think they
11 said it quite the way you said, but go ahead.

12 MR. FELDBERG: I don't want to take
13 issue with you Commissioner, but I believe the
14 evidence is as a rule, they do not want to carry
15 items which retail for less than 10 dollars.
16 Are there exceptions? There may well be an
17 exception here and there, Commissioner. But as
18 a rule, they don't want to carry items which
19 retail for less than 10 dollars.

20 As a consequence of that,
21 manufacturers have always created combination
22 packs for the warehouse clubs.

23 For example, one of the most popular
24 toys year-in/year-out is something called a Hot
25 Wheels car, a dye cast car that retails for

1 about 99 cents. Warehouse clubs don't want it.
2 So, Mattel, which makes this product, has
3 traditionally made a 20 pack which the warehouse
4 clubs would retail for 14 or \$15. And that's
5 the way they've traditionally done business as
6 the warehouse clubs have done business in many,
7 many other product categories.

8 If you go into any warehouse club,
9 you won't find a 16 ounce box of cereal. You'll
10 find a huge box of cereal, or three or four
11 packaged together. That's the way the clubs
12 have traditionally done business.

13 MR. PITOFSKY: Are you suggesting
14 that this combination pack approach to
15 merchandising was something the warehouse clubs
16 were happy with, and are content with?

17 MR. FELDBERG: 100%? No, sir. I am
18 suggesting that traditionally, before Toys "R"
19 Us ever came around with a warehouse club
20 policy, many manufacturers had created at the
21 warehouse clubs' request combination packs. At
22 a point in time, the warehouse clubs wanted, in
23 addition to combination packs in certain
24 merchandise, they wanted the option to buy
25 really the best selling products.

1 And that's what their testimony was.
2 We want from each manufacturer your number one
3 seller, your number two seller, your number
4 three seller. And there is no question that the
5 clubs certainly wanted to be able to cherry pick
6 the best selling individual items, and they
7 could get most of them; because one of the
8 things that is extraordinary about this case,
9 the theory of the case is, up until Toys "R" Us
10 had a warehouse club policy, every manufacturer
11 offered all of its regular line merchandise to
12 the clubs. Toys "R" Us came along, announced
13 its policy, and all of a sudden everybody hit a
14 wall, and all the manufacturers stopped selling
15 regular line merchandise to the clubs.

16 The evidence doesn't support that.
17 The evidence shows that way before Toys "R" Us
18 announced a warehouse club policy, a number of
19 significant toy manufacturers chose not to offer
20 their regular line merchandise to the warehouse
21 clubs. Important manufacturers like
22 Fisher-Price, like Lego, like Little Tikes, like
23 Step Two, major manufacturers. And the reason,
24 the reason they chose not to offer their regular
25 line merchandise to the warehouse clubs is that

1 the warehouse clubs, in the view of some
2 manufacturers, only wanted to cherry pick their
3 top selling items, which the manufacturers knew
4 they could sell out of.

5 There is a unique feature about the
6 toy business, which is critical to understanding
7 this case, if I may introduce.

8 The toy industry appears to be a
9 fashion industry. Every year, out of the
10 thousands and thousands of products that are
11 manufactured, a handful are going to become very
12 popular. You don't necessarily know in advance
13 which ones. But if you're in the business, you
14 hope something becomes popular, whether it's
15 Tickle Me Elmo, or Beanie Babies, or Teenage
16 Mutant Ninja Turtles, or whatever. And quite
17 often, the product that becomes hot comes out of
18 nowhere, comes from a manufacturer that has not
19 previously been one of the major suppliers.

20 Now, if you're a toy manufacturer,
21 and you have a broad line, you know you're going
22 to sell out of whatever product becomes hot. If
23 you're Mattel, you know you're going to sell out
24 of Holiday Barbie. There is going to be more
25 demand than supply. You know you're going to

1 sell every piece you make, and you're going to
2 have to go on what they call allocation. Which
3 means if a retailer wants a hundred thousand,
4 it's only going to get 50 thousand or 60
5 thousand.

6 Now, if you're Mattel, which makes a
7 thousand products a year, and you've got a
8 Holiday Barbie, and you know you're going to
9 sell out of Holiday Barbie, who do you want to
10 sell it to? Do you want to sell it to Toys "R"
11 Us and Wal-Mart? Toys "R" Us carries virtually
12 all of the thousand Mattel products, Wal-Mart
13 carries most of them. Or do you want to sell it
14 to Costco, which may only have two or three
15 other Mattel products.

16 From Mattel's point of view, and this
17 is what the witnesses all will testify to, in
18 their contemporaneous document that support it
19 from Mattel and Hasbro, the companies with the
20 broadest lines, when they thought about it, they
21 said this doesn't make any sense for us to sell
22 our hot product to the warehouse clubs. We're
23 going to sell Holiday Barbie anyway. We'll sell
24 every piece we can make. But what I want, if
25 I'm a manufacturer, what I want is when that

1 consumer goes into the store to buy Holiday
2 Barbie, I want her to buy some other Mattel
3 products as well.

4 Well, if that Holiday Barbie is in a
5 Toys "R" Us, Toys "R" Us has a thousand other
6 Mattel products around it, hopefully the
7 consumer will buy some of them.

8 MR. PITOFSKY: I'm a little lost
9 here.

10 You're suggesting that the
11 manufacturers were going to deny the clubs
12 individual popular products anyway. If that's
13 the case, why did Toys "R" Us have to engage in
14 a program saying, look, manufacturers, if you
15 sell to them, you can't sell to us.

16 MR. FELDBERG: I think that's a fair
17 question, Mr. Chairman. I would like to respond
18 to it, if I may.

19 I think the evidence shows that the
20 manufacturers would have, many of them would
21 have ultimately reached the position that they
22 reached. And there are really only a handful of
23 manufacturers which restricted what they offer
24 to the warehouse clubs that really comes down to
25 Mattel and Hasbro. Out of the hundreds of

1 manufacturers, there are probably only less than
2 a dozen which restricted what they offered to
3 the warehouse clubs at the end of the day, and
4 many manufacturers went back and forth on what
5 they did.

6 But I think the evidence from Mattel
7 and Hasbro and Tyco, was we probably would have
8 gotten there, to that point of view, once we
9 thought about it. But we didn't think about it,
10 because the warehouse clubs weren't big enough.
11 They weren't meaningful enough.

12 The Chairman and the Chief Executive
13 Officer of Tyco, for example, testified, and
14 this is unrebutted, well, I hadn't thought about
15 the warehouse clubs. They were a one percent
16 factor of my business. They didn't hit my radar
17 screen. He had different salesmen, and the
18 salespeople who were responsible for the clubs
19 wanted to sell more to the clubs, and the
20 salespeople who were responsible for Toys "R" Us
21 wanted to sell more to Toys "R" Us. That's
22 natural. He said they weren't big or important
23 enough to hit my radar screen. When Toys "R" Us
24 explained its point of view to me and said,
25 look, it doesn't make any sense for you to sell

1 your hot items to a retailer that's not carrying
2 the breadth of your line, doesn't make any sense
3 for you, it's like a wake up call to me. I
4 thought about it --

5 MR. THOMPSON: I don't get it.

6 MR. PITOFSKY: You, in your brief,
7 made a very big point about how much Mattel
8 tried to make something that looked exactly like
9 the Holiday Barbie, which you cited before, and
10 package it so that they could sell it to the
11 clubs. So if they didn't care, or didn't think
12 it was in their best interest, explain this to
13 me.

14 MR. FELDBERG: I will be happy to,
15 Commissioner, I think it's an excellent point.

16 One of the, if you will, fallacies of
17 this case is that the warehouse clubs were
18 excluded from toys. And the Barbie example is
19 the perfect example. One of the things that an
20 antitrust plaintiff has to show is harm to
21 intrabrand competition, harm to interbrand
22 competition, and that those harms outweigh any
23 pro-competitive benefits.

24 Take the Barbie example. Now, Mattel
25 makes X number of Holiday Barbies every year.

1 They advertise, they promote. Toys "R" Us
2 advertises, Toys "R" Us promotes. So do the
3 other full lines, Wal-Mart, Target, K-Mart,
4 Kay-Bee, the other significant toy retailers.
5 It's not like Toys "R" Us is the only big toy
6 retailer in the United States. Wal-Mart, K-Mart
7 and Target are powerful companies, each much
8 larger than Toys "R" Us, each with a significant
9 share of the toy market, growing rapidly.

10 But coming back to Holiday Barbie,
11 Mattel decides as a distribution strategy, we're
12 going to make X number, and most years they sell
13 out, and the product goes on allocation.

14 Now, Mattel says, well, Costco, you
15 want a special Barbie for the holiday season?
16 We'll make you one. We'll make you an
17 exclusive. Sam's, you want one? We'll make you
18 an exclusive. And BJ's, you want one? We'll
19 make you an exclusive.

20 The club representatives testified,
21 and one example is at tab one on the second page
22 of the testimony, it's page 1030 down at the
23 bottom right hand corner, this is Mr. Jettie
24 (Phonetic) from -- who is the Sam's toy buyer,
25 down at line 13 on page 1030, has Mattel made

1 exclusive Barbies for Sam's Club, sir? Every
2 year. Do you buy them? Yes, sir. And have you
3 enjoyed success with those exclusive Barbies?
4 Great success.

5 From Mattel's point of view, the
6 Holiday Barbie, the one that is advertised, that
7 they invest in and they promote, goes to the
8 retailers which carry their broad line, so that
9 the consumer who's seen the advertisement, when
10 she goes shopping for the Holiday Barbie that
11 she's seen on television, she's seen in her
12 newspaper, hopefully has the opportunity to buy
13 some other Mattel products.

14 The warehouse clubs want a comparable
15 product? They get a comparable product. One
16 that is as good as, there is no evidence of any
17 qualitative difference, there is no evidence of
18 any price difference. There is no evidence, in
19 fact, the complaint counsel's marketing expert
20 couldn't tell the products apart, and there is
21 no basis for telling them apart.

22 MR. THOMPSON: But obviously seven
23 year old girls can tell them apart?

24 MR. FELDBERG: No evidence of that
25 either, Commissioner. The only difference is

1 that the Holiday Barbie has been on TV. Now,
2 the warehouse clubs want it, because it's been
3 on TV. That's called free riding. They don't
4 want to promote it. They don't want to carry
5 the full line like Toys "R" Us and other
6 retailers do. They don't want to advertise it,
7 they don't want to carry it out of season. They
8 just want to cherry pick the hottest item for
9 the few critical selling weeks of the year to
10 use it to get consumers in to buy other things.
11 That's called free riding. And the antitrust
12 laws do not protect that, as case after case,
13 and we cited them in our brief, demonstrate.

14 Now, is there harm to intrabrand
15 competition? Whether you call the brand Mattel,
16 or even if you call the brand Barbie, there is
17 no reduction in intrabrand competition; because
18 Toys "R" Us has Mattel products, quality
19 products, so does Costco, so does Sam's Club, so
20 does BJ's. Is there harm to interbrand
21 competition? No, Commissioner.

22 And the reason is, that not only can
23 the clubs buy the comparable Barbie. But if
24 they don't want to do that, they can buy a
25 comparable product made by somebody else. And

1 one of the critical facts here, and we went
2 through this in great detail in the
3 cross-examination of Jim Ghoulson (Phonetic),
4 who was the BJ's wholesale club toy buyer. BJ's
5 has a document that essentially lists all their
6 toys by subcategory. It's quite detailed, it's
7 about 25 different subcategories, and he said,
8 well, if you can't buy a Tyco radio powered car,
9 what could you buy?

10 Well, I can buy a Neico (Phonetic),
11 or a New Bright radio powered car. Were they
12 good products? Absolutely.

13 And if you couldn't buy a Mattel
14 girl's basic toy in the form you wanted, what
15 could you buy? Well, I'd buy a baton girl's
16 basic toy product. Was that a good product?
17 Absolutely. And for everything he couldn't buy
18 like Lego construction products, he could buy a
19 Rite-Fit construction product. Lego, by the
20 way, which is included in this so-called
21 horizontal conspiracy. The evidence is
22 undisputed that from as early as 1987 and maybe
23 earlier, long before Toys "R" Us even thought
24 about warehouse clubs, Lego hadn't offered its
25 regular line merchandise to the warehouse clubs

1 for its own reasons, having nothing to do with
2 Toys "R" Us or any other manufacturer, and
3 they're included in the horizontal conspiracy.

4 MR. PITOFSKY: One last question
5 along this line.

6 MR. FELDBERG: Please.

7 MR. PITOFSKY: The argument seems to
8 be that the manufacturers didn't really care
9 about the clubs; they only had a small percent,
10 they weren't on the radar screen. So all that
11 happened was that Toys "R" Us called to their
12 attention how unwise it was to sell to the
13 clubs.

14 How do you reconcile that with the
15 uncontradicted testimony, as I understand it,
16 that when Toys "R" Us representatives went to
17 the manufacturers, virtually every one of them
18 said, look, I'll go along with you, I want to
19 sell to you, not to them; but I don't want to be
20 discriminated against, and, therefore, I won't
21 go along with you, unless you can give me some
22 assurance that others will do the same thing?

23 If the clubs are so unimportant to
24 the manufacturers, why would that be their
25 reaction?

1 MR. FELDBERG: I'm glad you asked
2 that, Mr. Chairman.

3 MR. PITOFSKY: Good.

4 MR. FELDBERG: Let me try to explain.

5 First of all, what actually happened
6 is slightly different from what you just
7 expressed, Commissioner, Mr. Chairman, in this
8 sense: This happened principally with Mattel
9 and Hasbro, the two largest toy manufacturers.
10 It wasn't every manufacturer. It wasn't even
11 substantially every manufacturer.

12 MR. PITOFSKY: Mr. Goddu said it
13 happened virtually every time. That's his
14 testimony.

15 MR. FELDBERG: But if you really look
16 at the evidence, it's principally Mattel and
17 Hasbro.

18 Now, what actually they said from
19 time to time was Mattel would say, are you
20 applying this policy to everybody else? How
21 come I see the other guy's stuff in the other
22 store? This applies to the vertical
23 relationship between Mattel and Hasbro.

24 Mattel, I'm Mattel, I'm trying to
25 make up my mind what I'm going to do. I don't

1 want to be discriminated against. I don't want
2 to have to make a choice if the other guy
3 doesn't have to make the same choice.

4 It's not I won't sell them if you
5 won't sell them. There is no evidence that that
6 was communicated back and forth by anybody.
7 This is not Parke Davis. There is no evidence,
8 Mr. Chairman, that -- I know you know the Parke
9 Davis case extremely well. It's the principal
10 case relied on by my friends at this table.
11 That was a resell price maintenance case where
12 the manufacturer said to the first drug store,
13 you've got to maintain a minimum resell price,
14 and the first drug store said, well, I'll do it,
15 but you've got to assure me the other is guy
16 going to do it, or the whole thing is greater,
17 and then he went back to the second retailer and
18 said, well, he'll do it if you do, communicated
19 back.

20 There is zero evidence of that.

21 MR. PITOFSKY: And Mr. Inano's
22 testimony, you think is not evidence?

23 MR. FELDBERG: No, I think it is not
24 evidence of that. Even if you credit Mr. Inano.

25 MR. PITOFSKY: He says that Hasbro

1 agreed on the understanding that Mattel, Fisher
2 Price and others would do the same thing. Why
3 is that not evidence?

4 MR. FELDBERG: Because it isn't. And
5 I'll tell you exactly why it isn't. At closing
6 argument complaint counsel conceded, they made
7 the following statement: Of course, a
8 manufacturer is going to consider what its
9 competitors are doing. Of course, they're
10 going -- when they decide -- when Mattel decides
11 or Hasbro decides what it's going to do, is it
12 going to think about what its competitors are
13 doing? Of course. As complaint counsel
14 conceded, it's page 9519 of the transcript,
15 that's the heart of competition. Of course,
16 they're going to consider it.

17 But when the Administrative Law Judge
18 then asked, well, where is the quid pro quo?
19 Where is there somebody saying I'll do it if you
20 do it? Where is the communication of that?
21 There is no answer to that. Because there is no
22 evidence of it. No evidence whatsoever of that,
23 Mr. Chairman.

24 MR. THOMPSON: But I guess what I
25 don't understand is this: That in order for

1 this to be effective for Toys "R" Us, there has
2 to be an understanding between Toys "R" Us and
3 Mattel, Hasbro, et cetera, or they would act
4 with an understanding of others, or that there
5 has to be at least some understanding between
6 the people who manufacture. Otherwise, it won't
7 work for them.

8 MR. FELDBERG: Well, may I respond,
9 Commissioner?

10 MR. THOMPSON: Sure.

11 MR. FELDBERG: I respectfully must
12 take issue with the premise. This isn't Parke
13 Davis or Interstate Circuit where substantial
14 unanimity was required. Substantial unanimity
15 wasn't required, it wasn't achieved.

16 If you turn to tab three, for
17 example, in your notebook, this is a chart that
18 was prepared by Jim Inano, the witness in the
19 case who hates us the most, this was the most
20 hostile witness in the whole case, from our
21 point of view. He's the Playskool division of
22 Hasbro's representative to -- sales rep to the
23 warehouse clubs.

24 And if you look at the chart on the
25 right hand side, he testified he got this

1 information from the clubs, as of November, '93,
2 18 months or so after Toys "R" Us announced its
3 policy, more manufacturers than not were making
4 their inline product available to the warehouse
5 clubs. And over time, manufacturers kept
6 changing their minds, they went back and forth,
7 this one went one way, this one went -- Little
8 Tikes changed three or four times, so did Tiger.
9 Tiger changed two or three times. It's the
10 opposite of any no show agreement.
11 Manufacturers, each of them, individually, would
12 try to figure out what made sense for them.

13 Did this require substantial
14 unanimity? Of course not. Toys "R" Us
15 presented its position to each manufacturer, and
16 each manufacturer was free to make a choice.

17 Now, that choice, Commissioners, has
18 been protected by authority from the Supreme
19 Court going back to the Colgate decision in
20 1919, going back to the Raymond Brothers Clark
21 decision in 1924.

22 A manufacturer can sell what it wants
23 to whomever it wants. A retailer can buy what
24 it wants from whomever it wants, for whatever
25 reason or no reason at all. Those are protected

1 choices.

2 Everyone in the case concedes that,
3 that Toys "R" Us had the right to pose a choice.
4 Even if, as is true in many of the cases, Toys
5 "R" Us was the bigger buyer than the warehouse
6 clubs, Toys "R" Us was free to say to a
7 manufacturer, look, it's us or them. Do what
8 you want. Sell it to us, sell it to them.

9 Now, the critical point here is the
10 theory of their horizontal claim is, that when
11 the manufacturers chose Toys "R" Us over the
12 warehouse clubs, and some manufacturers did,
13 those manufacturers were acting in a way that
14 was contrary to their self-interest. And the
15 evidence just doesn't support that.

16 Of course it was logical for a
17 manufacturer, if it chose to, to choose to sell
18 to Toys "R" Us.

19 The witnesses who were most hostile
20 to us, Jim Inano, I asked him that question, he
21 said, well, of course, if we have to make a
22 choice we're going to sell to Toys "R" Us.
23 What, are we nuts?

24 The economist who served as complaint
25 counsel's expert who came back two or three or

1 four times for rebuttal, surrebuttal,
2 sur-surrebuttal, whatever, we asked him that
3 question, and he conceded of course it's
4 plausible for a manufacturer to choose Toys "R"
5 Us. Not everyone did. Not every manufacturer
6 thinks that's sensible, and that's fine. The
7 most popular toy line in the United States last
8 year was something called Beanie Babies, these
9 little stuffed animals, made by a company called
10 Ty. They refused to sell to Toys "R" Us.
11 That's their merchandising philosophy. Fine,
12 they had enormous sales. We wish that wasn't
13 their merchandising philosophy, but it was. But
14 was it plausible for a manufacturer to choose
15 Toys "R" Us when confronted with a choice? Of
16 course it was. As every manufacturer testified.

17 And if it was plausible, then this
18 notion that they're acting contrary to their
19 self-interest, and, therefore, there must be a
20 conspiracy, is contradicted by the evidence.

21 MR. PITOFSKY: We're talking now
22 about the vertical, possible vertical agreement,
23 and you cite Colgate. But Toys "R" Us
24 had the right, I believe, to say to the
25 manufacturers, you've got to choose, you can

1 sell to us, you can sell to them. But if you're
2 going to sell to them, you can't sell to us.

3 But what case allows an arrangement
4 whereby the manufacturers then come back to Toys
5 "R" Us and says, well, we've got this combo pack
6 idea in mind, is that okay with you? It seems
7 to me the evidence shows that Toys "R" Us then
8 says, yes, it's okay, we approve, or, no, it's
9 not okay, we don't approve. Is that Colgate, or
10 is that an agreement?

11 MR. FELDBERG: Is that a vertical
12 agreement? I don't think -- there is obviously
13 not a case on those precise facts, Mr. Chairman.
14 But I would think that the concept of Toys "R"
15 Us saying this is our policy, what are you going
16 to do, and a manufacturer telling them what
17 they're going to do, is endorsed by Monsanto, is
18 endorsed by the Ninth Circuit's decision in
19 Jeanery, is endorsed by Garment District, is
20 endorsed by the Seimen's decision in the Second
21 Circuit, and is endorsed by a number of -- there
22 are probably other decisions that are in our
23 brief, but certainly those cases.

24 MR. PITOFSKY: I agree. But would
25 you agree that if the evidence shows that what

1 they did is came back and said is this okay, and
2 Toys "R" Us said, yeah, that's okay, now we're
3 in agreement land?

4 MR. FELDBERG: I think -- whether
5 we're in a vertical agreement land? I disagree
6 with that. If you would, Mr. Chairman.

7 MR. PITOFSKY: You don't think that's
8 an agreement?

9 MR. FELDBERG: I don't think that's
10 an agreement.

11 MR. PITOFSKY: What is an agreement
12 then?

13 MR. FELDBERG: That is somewhat an
14 illusive concept in the law of vertical
15 restraints. I will admit, I don't think that
16 that's an agreement, I mean, I think what the
17 evidence shows, by the way, is they came back
18 with combo packs in some instances and said do
19 you want to buy it to Toys "R" Us, and Toys "R"
20 Us either said yes, we do, or in most instances,
21 said no, we don't. Which is what I think the
22 evidence is.

23 But -- I've got a red light.

24 MR. PITOFSKY: Go ahead. I think we
25 have more questions, as this is sufficiently

1 complicated. Why don't you continue briefly.
2 We interrupted you a lot.

3 MR. FELDBERG: I welcome your
4 questions, Mr. Chairman, all of the
5 Commissioners.

6 But we're focusing on vertical
7 agreement, and you rightly, Mr. Chairman,
8 directed me away from horizontals, where we
9 spent a half an hour on verticals.

10 Let's say your view --

11 MR. THOMPSON: We can go back there,
12 if you want.

13 MR. FELDBERG: I would be delighted
14 to, Commissioner. I'll talk about anything you
15 folks want me to talk about.

16 But --

17 MR. THOMPSON: The training in our
18 law schools, yes.

19 MR. FELDBERG: But on the subject of
20 the vertical so-called restraint, let's say
21 their view of the evidence prevails. Going back
22 and saying is this okay makes it a vertical
23 agreement, and you find a vertical agreement
24 with a couple of manufacturers. That doesn't
25 mean -- that only starts the inquiry. What

1 about market power? Substantial market power is
2 a threshold requirement of every rule of reason
3 case. We've got a 19% share of the market. The
4 Supreme Court in Jefferson Parish says 30% is
5 insufficient as a matter of law.

6 There are cases with 100% market
7 share: The Syufy case in the Ninth Circuit.
8 Insufficient, because low barriers to entry,
9 just as there are low barriers to entry here.

10 You've got to show market power.
11 What is market power? Market power is the
12 ability to affect price, in this case, the
13 wholesale level. And there is zero evidence of
14 that. And it's the ability to restrict output.
15 And there is zero evidence of that. To the
16 contrary, the ALJ's findings, the couple that we
17 agree with, demonstrate that Toys "R" Us'
18 conduct increased industry output. It's the
19 opposite of what an antitrust plaintiff has to
20 show to show market power.

21 There is no evidence that Toys "R"
22 Us' conduct had the ability or could affect the
23 wholesale price or restrict output.

24 There are good reasons for that. And
25 the reasons are that this market is fiercely

1 competitive. Toys "R" Us has about a 19% share,
2 Wal-Mart has more than 14%. Wal-Mart is ten
3 times Toys "R" Us' size. It's the fastest
4 growing retailer, biggest retailer in the world.
5 Fastest growing retailer in the United States in
6 terms of toy retailing. K-Mart and Target
7 aren't far behind. Kay-Bee isn't far behind.
8 Regional Discounters sell toys. There are 74
9 thousand companies that sell toys in the United
10 States.

11 There is fierce, fierce price
12 competition. Prices have been trending
13 downward, retail prices and margins are trending
14 downward throughout the '90's, largely because
15 of Wal-Mart. Complaint counsel concedes
16 Wal-Mart is the downward price leader.

17 You have no evidence but for Toys "R"
18 Us' Warehouse Club policy, prices would have
19 been any lower. No evidence at all.

20 And that's an important point, and
21 there are several reasons. The principal one is
22 that the toys that the clubs mostly wanted,
23 which were the best sellers, the top 100 toys,
24 Toys "R" Us and Wal-Mart and K-Mart and Target
25 and the other big players in the toy market sell

1 them at extremely low margins, and effectively
2 the margins that Toys "R" Us and Wal-Mart and
3 K-Mart and Target sell the best selling toys,
4 are the same margins the clubs have. The
5 evidence is undisputed.

6 MR. PITOFISKY: Maybe we can discuss
7 competitive effects during your rebuttal.

8 Are there any questions?

9 All right. Thank you.

10 MR. FELDBERG: Thank you,
11 Commissioners.

12 MR. PITOFISKY: Mr. Dagen, welcome
13 back to the Commission. We took about an extra
14 five minutes, so if you want to take an extra
15 five minutes, that would be fine.

16 MR. DAGEN: Thank you.

17 Mr. Feldberg had a present, so we
18 decided to bring one of our own. We have some
19 binders and some documents.

20 Good morning. My name is Rick Dagen.
21 I would like to introduce our trial team. Barry
22 Costilo is co-lead counsel in this case.
23 Patrick Roach, James Frost and Sarah Okenham
24 Allen are also members of the trial team. We
25 also have the assistance of investigators

1 Patrice Parker and Mary Forester, as well as
2 support from the Bureau of Economics from Rick
3 Ludwick and David Glasner.

4 The facts and the law in this case
5 are straightforward. Toys "R" Us saw the
6 warehouse clubs as a threat and didn't like it.
7 So Toys "R" Us secured a series of agreements
8 from major toy manufacturers. The manufacturers
9 agreed to stop selling competitive product to
10 the clubs. The agreements between Toys "R" Us
11 and the manufacturers are vertical agreements.
12 And Toys "R" Us made sure that these agreements
13 stuck by orchestrating a horizontal agreement
14 among the manufacturers. That is, Toys "R" Us
15 used the agreement of one manufacturer to get
16 the agreement of other manufacturers. And Toys
17 "R" Us used buyer power to secure the
18 agreements.

19 Because of what Toys "R" Us did,
20 competition has been impaired. Club sales have
21 been growing dramatically. This stopped. The
22 clubs were bringing toy prices down. This
23 stopped. Because of what Toys "R" Us did, new
24 low cost entry into toy retailing has been
25 restricted. Prices to consumers are higher than

1 they would have otherwise been, consumers have
2 been harmed.

3 The Toys "R" Us conduct is unlawful
4 under the per se rule. That is, once we've
5 proven the horizontal agreement, the conduct is
6 unlawful. This is according to long established
7 Supreme Court precedent.

8 But we didn't just rely on a per
9 se rule in this case. The conduct is also
10 unlawful under the more elaborate rule of reason
11 analysis. Because Toys "R" Us conduct
12 caused substantial anti-competitive effects.
13 For these reasons we urge the Commission to
14 affirm the Administrative Law Judge's decision.

15 Now, Mr. Feldberg has made several
16 arguments, which I hope to address during the
17 course of this argument. But there are four
18 main points that I plan to emphasize today.

19 First, I want to stress that there is
20 direct evidence of agreement in this case. Now,
21 circumstantial or inferential evidence is
22 sufficient to prove agreement. The Supreme
23 Court has repeated many times, it's rare to find
24 direct evidence in antitrust cases. But we have
25 direct evidence. In this case we have direct

1 evidence of agreement. We have business
2 documents from manufacturers and Toys "R" Us
3 that explicitly talk about the agreements
4 between Toys "R" Us and the manufacturers.

5 There are even documents stating
6 unequivocally that Toys "R" Us was given the
7 right to preview what was sold to the clubs by
8 the manufacturers. Now, the second point is
9 horizontal agreement. The fact that Toys "R" Us
10 orchestrated a horizontal agreement among
11 manufacturers has two very important
12 implications.

13 First, as I mentioned, this makes the
14 conduct, per se, illegal, according to Supreme
15 Court precedent.

16 And second, even leaving the per se
17 rule aside, the existence of the horizontal
18 agreements means the manufacturers did not have
19 any efficiency reasons for restricting the
20 clubs.

21 In other words, when conduct is
22 efficient, manufacturers do it on their own
23 without any assurance or any insistence that
24 their competitors do the same thing.

25 The fact that Toys "R" Us had to

1 organize the manufacturers to restrict the
2 clubs, means that there is no valid free riding
3 defense.

4 In other words, the manufacturers
5 were not concerned that the clubs were somehow
6 taking advantage of services provided by Toys
7 "R" Us. There is no free riding.

8 Now, part of the reason for this lack
9 of concern relates to the third point. And
10 that's compensation. Manufacturers compensate
11 Toys "R" Us for the functions it performs. Even
12 Toys "R" Us' own economist, Professor Dennis
13 Carlton, conceded there is no free rider
14 problem if Toys "R" Us receives an adequate
15 compensation for advertising and warehousing
16 product, and other functions it performs.

17 Documents from Toys "R" Us say that
18 Toys "R" Us is compensated. Documents from
19 manufacturers say that Toys "R" Us is
20 compensated. Because Toys "R" Us is adequately
21 compensated for whatever it does, or receives
22 other competitive benefits, there is no free
23 rider problem here.

24 Now, fourth, Toys "R" Us has
25 significant buyer power. They buy 30% of the

1 products sold by major manufacturers. And in
2 the markets where Toys "R" Us is present, where
3 they have stores, Toys "R" Us accounts for over
4 30%, sometimes over 40% of the sales in those
5 markets. These high shares are part of the
6 reason why manufacturers testified that Toys "R"
7 Us is irreplaceable.

8 Now, when a seller can't easily
9 replace a buyer, the buyer has power. That's
10 what the foremost antitrust scholar, the late
11 Professor Areeda, wrote in his treatise.

12 So, those are the four main points.
13 There is direct evidence of agreement, the
14 horizontal agreement makes the conduct, per se,
15 unlawful, and eliminates the free rider defense.
16 The Toys "R" Us free rider defense is also
17 undercut by the compensation that Toys "R" Us
18 receives, and Toys "R" Us used buyer power to
19 get the antitrust agreements.

20 MR. PITOFSKY: Let me just ask a
21 clarifying question here. When you talk about
22 market power, are you asking the Commission to
23 address the ability of Toys "R" Us to induce the
24 manufacturers to do what it wants, the leverage
25 concept, are you talking about the power to

1 raise price in the marketplace?

2 MR. DAGEN: Primarily the issue of
3 whether they have the power to induce the
4 manufacturers to do something against the
5 manufacturers' self-interest.

6 MR. PITOFSKY: And you think that's
7 enough, under the rule of reason -- suppose the
8 evidence is that no matter what they did, they
9 couldn't raise prices in the marketplace?
10 Suppose that's the evidence. But they could
11 coerce Hasbro, not induce Hasbro, to follow
12 their marketing views, do you think that would
13 be enough to make out a violation of the rule of
14 reason?

15 MR. DAGEN: Yes, Chairman. Even if
16 Toys "R" Us had no power to raise prices, and
17 we're not conceding that, even if they had no
18 power to raise prices, the fact that they were
19 able to eliminate a new low cost competitor,
20 allowed Toys "R" Us to keep prices from falling.

21 In the Staples case, which was
22 recently argued before Judge Hogan, he addressed
23 that same issue and said that if you can keep
24 prices from falling, then you can state a
25 violation. It's like if you could suppress a

1 new patent that was going to somehow lower
2 prices, if you could suppress that, that would
3 be anti-competitive.

4 What we're looking, the ultimate
5 inquiry is whether consumers have been harmed.
6 And the ability to keep a new low cost entrant
7 from competing and lowering prices, is the
8 ultimate question.

9 MR. PITOFSKY: What's the evidence
10 that is eliminating the clubs or curtailing
11 their ability to compete prevented prices from
12 falling?

13 MR. DAGEN: Well, to begin with, even
14 as early as 1989 the clubs appeared on the Toys
15 "R" Us radar, because manufacturers were
16 starting to sell to the clubs increasingly.

17 Their growth, the growth of the club
18 sales was astronomical, according to Mattel,
19 according to Hasbro, according to Lego,
20 according to all the manufacturers. The clubs
21 were rapidly increasing in sales. It was well
22 acknowledged that the -- that their prices were
23 significantly lower than Toys "R" Us. The Toys
24 "R" Us was scared about this, because they sell
25 at a markup on average of 35%. The clubs sell

1 at a markup on average in the 10% range.

2 Mr. Goddu, the number three man at
3 Toys "R" Us, testified that the clubs were
4 redefining the low price. They're becoming the
5 price leader. This was hurting the Toys "R" Us
6 price image.

7 There had been numerous instances
8 where Toys "R" Us was forced to respond to the
9 club prices by lowering prices, sometimes 20% or
10 more.

11 MR. SWINDLE: How much of the toy
12 retail market is being captured by price clubs?
13 You said that the price clubs' rate of
14 sales was growing. How much was that in reality?
15 Let's not talk in relative terms, but in terms
16 specifically, how big a share of the market had
17 the club stores managed to attain vis-a-vis Toys
18 "R" Us?

19 MR. DAGEN: The club share around
20 1991 was approximately in the two percent range.

21 MR. SWINDLE: Two percent against I
22 think you said thirty percent?

23 MR. DAGEN: The 30% was the amount
24 that they were selling in particular markets.
25 The Toys "R" Us national share was in the 20 to

1 21% range at that point.

2 MR. SWINDLE: And the club stores are
3 dealing with a very small universe of products,
4 versus Toys "R" Us, a very large universe of
5 products.

6 Tell me how consumers are necessarily
7 harmed on some broad grandiose scale when we're
8 only talking about two percent, and only a
9 select few products. I'm sure that you can say
10 that if you stop someone from selling something at
11 a certain price, the consumer is harmed. Yes,
12 they were.

13 But in the broad universe of
14 consumers, how relevant is that?

15 MR. DAGEN: Well, Professor Scherer,
16 the economist that testified for complaint
17 counsel, he is a professor of economics at
18 Harvard University, and the former director of
19 the Bureau of Economics. He estimated that if
20 Toys "R" Us was forced to deal with the prices
21 that the clubs had, to match their prices or
22 lower their prices on say their top five hundred
23 products, then, this would result in the cost to
24 Toys "R" Us, which the flip side of that is the
25 benefit to consumers, of in the neighborhood of

1 50 million dollars a year.

2 MR. SWINDLE: I recognize if you could
3 take 500 products and draw the price down, but
4 are we really talking about 500 products here?

5 MR. DAGEN: We're talking about a
6 concern by Toys "R" Us that their price image
7 was going to be impaired.

8 MR. SWINDLE: I accept that. I
9 think that may be the biggest issue at hand
10 here, is TRU's concern with its price image
11 in the marketplace. But to the relevant
12 facts of whether or not Toys "R" Us's conduct
13 was so devastating to competition, and getting
14 back to two percent versus the 30%, and K-Mart
15 or Wal-Mart's 28%, whatever it was.

16 MR. DAGEN: Toys "R" Us projected in
17 1992 in a draft business planning document, that
18 the club share was going to grow to six percent.
19 This isn't a static situation. We're not faced
20 with a situation of the clubs being small and
21 forever condemned to two percent share. This is
22 a situation where the clubs were an increasing
23 threat. Toys "R" Us believed that the clubs
24 might grow to eight percent. Manufacturers
25 believed that this was a new outlet, a low

1 priced outlet that they could make increasing
2 sales to.

3 So the two percent, I think might be
4 somewhat misleading. The other issue, I believe
5 that you're getting to, Commissioner, is the
6 number of SKU's, stock keeping units that the
7 clubs actually carried.

8 The SKU's actually -- the club would
9 carry different SKU's, and they carried them
10 over a substantial range of products. There was
11 testimony that products were not just limited to
12 the top hundred, the hottest products that were
13 in allocation. But the clubs carried products
14 that ranged into the less popular products also,
15 for which Toys "R" Us had even greater margins
16 on those toys.

17 So this was going to cut into Toys
18 "R" Us's profits, and force them to lower prices
19 across a broad spectrum of products.

20 MR. THOMPSON: I think Mr. Swindle is
21 raising a point that I was also curious about,
22 is that I've heard about three different
23 definitions in the past few minutes about what
24 the market is. Okay? I've heard allusions to
25 geography, hot selling toys, all toys. Which is

1 it?

2 MR. DAGEN: This is a market -- there
3 are two versions that are important in a product
4 market definition. One is the geographic
5 market, and one is the product market
6 definition. Product market definition that has
7 been established in this case is all toys.

8 However, within the all toy market,
9 this is clearly a differentiated product market.
10 Not all toys substitute readily for other toys.

11 What Toys "R" Us was concerned with
12 were what they considered to be the life blood
13 of the industry. That, again, is the testimony
14 of Mr. Goddu, the number three man at Toys "R"
15 Us in charge of the club policy. And what he
16 defined as the life blood were the TV promoted
17 products, the products that were readily
18 identifiable by consumers, not the -- I can't
19 remember some of the names that Mr. Feldberg
20 used.

21 MR. SWINDLE: Excuse me. On
22 that point, a rapidly growing price club
23 surely is not rapidly growing just based on
24 the hot items. I don't think anybody has
25 denied, as I recall the testimony that I

1 read and the conversation earlier by
2 counsel, that Mattel could sell to Price
3 Club. They could even sell the Barbie
4 Doll. They might package it differently,
5 which does create somewhat of an obstacle
6 I guess for its consumers, because they
7 might have to buy more than the consumer
8 really wanted, Barbie Doll and luggage,
9 whatever they put in these things; but the
10 products cover a wide range -- a wide range
11 of products were covered that they could
12 buy.

13 Surely, a few products are not
14 driving it. It has to be a universe of a lot of
15 products, and they still have access to those
16 products.

17 MR. DAGEN: Let me make one
18 thing clear. We are not concerned with
19 the club growth, per se. We are
20 concerned about whether consumers are
21 harmed. This case is not brought on
22 behalf of the warehouse clubs. It was
23 brought on behalf of consumers. And the
24 issue is whether Toys "R" Us and other
25 retailers would be forced to lower

1 prices in response to competition from
2 the clubs.

3 MR. SWINDLE: But we have to be
4 concerned with the growth of Price Club, because
5 that's where the low prices are. Consumers are
6 benefiting by the Price Club. I'm a big shopper
7 of Price Club.

8 Consumers are benefiting by
9 those low prices. So we have to be
10 concerned by the rate of growth there.
11 So if a couple of items, the hot items,
12 are denied, those items are not going to
13 prevent the consumers from benefiting from
14 lower prices, because this industry is
15 booming.

16 MR. DAGEN: What the clubs focused on
17 to some degree were branded items. What Toys
18 "R" Us is contending is that they could easily
19 switch them to secondary toy manufacturers,
20 which were not branded, and the clubs could sell
21 those toys.

22 What that did was take away, again,
23 the price competition with Toys "R" Us. Toys
24 "R" Us, the objective of Toys "R" Us was to
25 eliminate the ability of the consumer to engage

1 in price comparisons on the products that Toys
2 "R" Us had.

3 And if there is no efficiency
4 justification for that, if there is no reason
5 for that, then all we're left with is the fact
6 that we have higher prices at Toys "R" Us than
7 other retailers, and no offsetting efficiency
8 justification. And that's the ultimate inquiry
9 under the rule of reason analysis; whether or
10 not the higher prices at Toys "R" Us are
11 justified by some efficiency benefits that
12 they're putting forward.

13 MR. THOMPSON: I have a question
14 about horizontal agreements. And I want to, if
15 you could explain to me, some of the
16 distinctions between what I call horizontal
17 agreements that may exist between the biggies,
18 like Hasbro and Mattel, versus some of the
19 smaller firms. And what evidence do you have to
20 show that the smaller firms actually
21 participated in the horizontal agreement.

22 MR. DAGEN: Most of the evidence in
23 this case deals with the majors, I think, as
24 you're acknowledging, Mattel, Hasbro, Tyco,
25 Little Tikes, Fisher-Price, the major toy

1 manufacturers.

2 The evidence with respect to the
3 lesser manufacturers is primarily twofold:
4 Mr. Goddu again testified that when they brought
5 up the subject with -- the subject of the clubs
6 with the toy manufacturers, they always told the
7 manufacturers, look, we are discussing this with
8 all the rest of your competitors, there is going
9 to be a level playing field here.

10 So, these other manufacturers, they
11 were selling to the clubs; and then Mr. Goddu
12 came forward and said here's what's going on.
13 There is going to be a level playing field.

14 That is somewhat similar to what
15 occurred in Interstate Circuit, where a series
16 of letters went out to manufacturers. That was
17 the evidence to film distributors. And that was
18 all the evidence that there existed. The film
19 distributors all got the same letter saying
20 here's what we want you to do. And that was
21 sufficient for the Supreme Court to find a
22 horizontal agreement.

23 So here we have the manufacturers
24 selling to the clubs, Toys "R" Us intervening,
25 saying we don't want you to sell to the clubs,

1 and stating the competitors were saying I'm only
2 there because you're there. But that conversation
3 occurred all the time, and then the manufacturers
4 stopped.

5 MR. THOMPSON: Isn't there a problem,
6 at least with some manufacturers who were
7 inconsistent about their adherence to that
8 agreement, even if you concede there was an
9 agreement?

10 MR. DAGEN: What that shows is that
11 as with any agreement, any cartel agreement, any
12 horizontal agreement, there can be cheating.

13 In this situation, there was some
14 evidence, for example, that Toys "R" Us
15 discovered in 1995 that they saw some Little
16 Tikes product reappearing in the clubs. They
17 went, they had another meeting with Little Tikes
18 and said what's going on? We're starting to see
19 this product in the clubs again. You had
20 previously committed not to do that. And Little
21 Tikes said, okay, sorry, you know, we won't do
22 it again. That occurred with other
23 manufacturers.

24 Whenever you have a horizontal
25 agreement, there is an incentive to use the

1 vernacular to chisel, to cheat on that
2 agreement.

3 So some of the manufacturers did, in
4 fact, occasionally sell regular line product to
5 the clubs. But that more shows the agreement,
6 it shows, in fact, manufacturers, when they saw
7 that, they reported that to Toys "R" Us, and
8 Toys "R" Us got those reports, they transmitted
9 that to other manufacturers. That's cartel type
10 behavior. That's policing, that's monitoring,
11 that's enforcement. That's what one expects to
12 see in a cartel situation.

13 Even with OPEC, one of the long
14 lasting cartels that we've seen, occasionally
15 people break out and we see some price
16 differential.

17 MR. PITOFSKY: Mr. Dagen, let's
18 assume the evidence is, as virtually conceded.
19 Toys "R" Us went to the big 20 or so, 19, 20,
20 and said if you want to sell to me, you can't
21 sell to the others, to the clubs. The response
22 was, well, I might go along with that, but I
23 want to make sure that that's true of everybody.
24 And then Toys "R" Us said, well, I'll take care
25 of that, I'll talk to the others.

1 Is it your position that that in
2 itself is the essence of an agreement? Or there
3 has to be more demonstrating some communication
4 between the manufacturers; or that Toys "R" Us
5 went to the second manufacturer, got a
6 commitment, and then came back to the first and
7 said I've got the commitment?

8 MR. DAGEN: Our position, the
9 position that the Supreme Court has announced,
10 let's not make it my decision, in Parke Davis
11 was that there doesn't have to be direct
12 communication. Parke Davis went to each of the
13 individual retailers that it wanted to stop
14 advertising and got adherence from one retailer
15 who said, well, we'll stop advertising, and went
16 to another retailer and said, look, they said
17 they'll stop advertising, so what about you
18 guys? And that's what happened here. So that
19 clearly is sufficient to show horizontal
20 agreement. Those are the facts --

21 MR. PITOFSKY: Are you saying that
22 the Macy's case, which I think perhaps had
23 something to do with Toys "R" Us adopting this
24 policy, was wrongly decided, or distinguishable?

25 MR. DAGEN: It's clearly

1 distinguishable, Mr. Chairman.

2 In the Macy's case, which I agree,
3 did have some impetus for this behavior, the
4 Macy's went to two swim wear manufacturers, and
5 the court explicitly, two or three times in its
6 opinion, said that those decisions were made
7 independently. That there was no condition, in
8 effect, that there was no condition at all. The
9 swim wear manufacturers didn't say I'll do it if
10 they do it. So, there was none of the
11 horizontal type of conduct that we have here,
12 where manufacturers said I'll stop if my
13 competitors stop.

14 Now, to put this in another context,
15 if the manufacturers had all sat down at a table
16 and had this conversation, Mattel says I'll stop
17 if you stop, Hasbro says, hmm, that sounds
18 interesting, I'll stop if you stop, and the
19 other guy says, well, I'm only there because
20 you're there, and someone else says, well, I'm
21 only there because you're there. So we've got
22 everybody sitting around the table saying that,
23 and then everybody stops selling to the clubs.
24 That would be clearly -- there would be no
25 question about that.

1 What Toys "R" Us is arguing is that
2 by virtue of them playing the intermediary,
3 playing the middleman in these conversations,
4 that that somehow makes this not a horizontal
5 agreement, that that immunizes those
6 communications, which were essentially hub and
7 spoke type communications. Toys "R" Us
8 supplied, to use the Toys "R" Us analogy,
9 supplied the rim by telling everybody that
10 everybody else was going to be on board in this.

11 MR. THOMPSON: Are there any cases
12 that you can cite that talk about the fact that
13 because a company like Toys "R" Us may be a
14 dominant customer, that that may lead more to a
15 finding agreement because of the hub and spoke
16 analysis?

17 MR. DAGEN: I'm not sure I follow
18 you.

19 MR. THOMPSON: I'm trying to think,
20 you're saying that Toys "R" Us, because they're
21 so powerful, everybody wants their business,
22 they can go and sit with each person and demand
23 this, demand certain concessions that when
24 looked on together links them together in some
25 sort of agreement. And what's the basis for

1 that? I mean, the sense is what is the legal
2 basis for saying that's enough?

3 MR. DAGEN: If I understand your
4 question, I think what you're asking is is there
5 any precedent that addresses similar type
6 conduct in the past.

7 MR. THOMPSON: Uh-huh.

8 MR. DAGEN: And clearly the Klor's
9 case decided by the Supreme Court in
10 which Klor's went to -- which was a retailer,
11 complained about its competitor, Broadway-Hale,
12 going to a number of manufacturers and getting
13 an agreement with the manufacturers, and among
14 the manufacturers to stop selling appliances to
15 Klor's. That was held to be, per se, unlawful.

16 Similarly in the Interstate Circuit
17 case, you have the film distributor, which is a
18 theater, which is similar to a retailer in that
19 sense, going to film distributors and saying --
20 sending out a letter saying here is the pricing
21 structure we want for our competitors. And that
22 would be a similar -- that would be analogous
23 to, here again, that was found to be unlawful
24 without any extended analysis of market power.

25 Finally, the Parke Davis case, again,

1 as we've talked about before, is a situation
2 where all you had was these vertical
3 discussions, the discussion between Parke Davis,
4 the manufacturer, and the retailers, and no
5 discussion among the retailers.

6 It was strictly, according to the
7 Supreme Court, discussions, Parke Davis went to
8 one retailer, then it went to another retailer,
9 and then another retailer. And there is no
10 connection between the retailers.

11 MR. THOMPSON: So are you saying that
12 for your purposes you believe that the fact that
13 Toys "R" Us is such a dominant purchaser, is
14 not determinative is my question.

15 MR. DAGEN: I think I understand you.

16 In terms of the per se analysis here,
17 whether or not Toys "R" Us has market power
18 would be irrelevant under a Supreme Court
19 precedent.

20 It is relevant, and that's, as I
21 indicated before, we didn't stop at the per se
22 analysis. We went on to show that Toys "R" Us,
23 the conduct of Toys "R" Us was anti-competitive
24 in effect. And by showing that prices would
25 have been lower, by showing that there were no

1 efficiency justifications for the conduct, and
2 showing that Toys "R" Us had market power, under
3 a rule of reason analysis, market power is
4 relevant. But under the per se analysis, which
5 is involved in the horizontal agreement, there
6 is no necessity of analyzing their market power.

7 Now, Mr. Feldberg indicated that the
8 clubs weren't on the radar screen of any of
9 these manufacturers.

10 I think it's fairly undisputed that
11 these manufacturers viewed the clubs as a
12 significant growth opportunity. In fact, Mattel
13 vice-president wrote in 1991, the clubs are one
14 of the fastest growing channels of distribution
15 in the country. We owe it to our shareholders
16 to maintain our business by selling to this class
17 of trade.

18 In addition, manufacturers saw their
19 competitors starting to sell regular line
20 products to the clubs and were afraid of losing
21 sales and market share.

22 In short, the toy manufacturers
23 recognized the club potential for selling the
24 same regular line products they offered
25 everybody else, including Toys "R" Us.

1 As we talked about earlier, this
2 scared Toys "R" Us. So Toys "R" Us went to the
3 manufacturers, talked to them individually at
4 first, and tried to get them to stop selling to
5 the clubs. This wasn't as successful as Toys
6 "R" Us would have liked. The clubs were still
7 buying regular line product.

8 According to Toys "R" Us, the clubs
9 were growing like a weed. That's from one of
10 their high officials at Toys "R" Us. And Toys
11 "R" Us said the clubs were starting to dictate
12 the low pricing in the industry. Mr. Feldberg
13 mentioned that the complaint talks about
14 Wal-Mart dictating prices. Well, Toys "R" Us's
15 internal documents talked about Wal-Mart and the
16 clubs in the same breadth, in terms of dictating
17 pricing in the industry. And this was a major
18 concern for Toys "R" Us.

19 Mr. Feldberg has indicated that there
20 was no agreement in this case. Not one single
21 solitary agreement, no horizontal agreement, no
22 vertical agreement. That's their story. But
23 the story that Toys "R" Us tells does not stand
24 up to the facts. Toys "R" Us did not just
25 announce a unilateral policy. Toys "R" Us sat

1 the manufacturers down, looked each of them in
2 the eye, told them that Toys "R" Us would only
3 support those who agreed not to support the
4 clubs. And then Toys "R" Us sought their
5 agreement.

6 And the response by the manufacturers
7 at these meetings is critical. The
8 manufacturers essentially tell Toys "R" Us, wait
9 a minute, I can't stop selling to clubs while my
10 competitors are selling to clubs. I've got to
11 be there if my competitors are there.

12 Then the manufacturers think about it
13 some more, and they tell Toys "R" Us, look, I'd
14 stop selling if my competitors stop. That's
15 from Mr. Goddu, the number three man. I'd stop
16 selling if my competitors stopped.

17 Mr. Lazarus, the founder of Toys "R"
18 Us, sat in on some of the meetings with the
19 manufacturers. He told the court the
20 manufacturers were not happy about the Toys "R"
21 Us policy. The manufacturers were afraid of
22 losing market share. It was simple economics,
23 according to Mr. Lazarus.

24 But Toys "R" Us did not just listen
25 to the manufacturers' concerns about competition

1 in the clubs. And this deals with one of the
2 issues that Chairman Pitofsky raised. Toys "R"
3 Us relayed the positions of one manufacturer to
4 another along the lines of we've talked with
5 your competitor, he says he's only selling to
6 clubs because you are. None of you will take
7 the first step on your own. He's promised to
8 stop, everyone is going to be on a level playing
9 field. What's it going to be?

10 Mr. Feldberg indicated that some
11 major concession was made at closing when I
12 stated that it's natural for competitors to view
13 what other competitors are doing. And the
14 Supreme Court has acknowledged that. Conscious
15 parallelism is just keeping track of what your
16 competitors is doing. That's not unlawful.

17 But these communications, this
18 conditioning the behavior on the conduct of
19 another, this exchange of the quid pro quo, that
20 is what becomes unlawful. That's what
21 constitutes the horizontal conduct. Not just
22 being aware of what your competitors are doing.
23 Toys "R" Us was saying we're going to eliminate
24 that concern that you have about what your
25 competition is doing. Here, here's what Mattel

1 is going to do, they told Hasbro, Fisher-Price,
2 and Mattel is going to stop selling. That is a
3 totally different situation from Hasbro going
4 out in the marketplace and seeing whether or not
5 Fisher-Price and Mattel is selling to the clubs.

6 MR. PITOFSKY: But on the quid pro
7 quo point, you're not contending that Hasbro and
8 Mattel have talked to each other?

9 MR. DAGEN: No, we're not.

10 MR. PITOFSKY: Directly.

11 MR. DAGEN: No, and I think that goes
12 back to the point before. If the
13 communications, however, essentially constitute
14 the same thing in substance. The fact that Toys
15 "R" Us communicated these quid pro quos, I'll
16 stop if you stop, does not take this out of the
17 horizontal agreement context.

18 MR. PITOFSKY: Mr. Feldberg
19 said that the combo packs were the idea
20 of the manufacturers. Toys "R" Us said
21 don't sell to them at all, and they came back
22 with the combo pack idea.

23 Do you accept that?

24 MR. DAGEN: I think the evidence is
25 mixed on that point. Toys "R" Us did say at

1 some point we don't want you to sell anything.
2 But there is also evidence that Toys "R" Us
3 explicitly said that it was okay for the
4 manufacturers to go forward with combo packs.

5 In fact, in the original statement of
6 Toys "R" Us as to what their policy would be,
7 which is found at in the binder at tab five, I
8 believe, the third bullet in tab five says old
9 and basic product should be in special packs.
10 That's January 29th, 1992. That's just before
11 Toys "R" Us goes to the manufacturers at the Toy
12 Fair and says use special packs.

13 This policy that's enunciated at tab
14 five is actually quite interesting, because it
15 talks about old and basic products should be in
16 special packs. Part of the Toys "R" Us argument
17 about what's going on here that you heard
18 Mr. Feldberg enunciate, was that this is a hot
19 product policy. The manufacturers, on their
20 own, are just going to sell to Toys "R" Us,
21 because this is hot product. But this policy
22 applied to old and basic product also. It
23 didn't just stop with hot product.

24 In addition, what makes the policy
25 particularly inappropriate is that if it

1 applied -- its application to hot product only
2 stopped direct price comparisons. The
3 manufacturers were allowed to put hot product
4 and promoted product in combination packages.

5 So, again, the clubs were able to get
6 hot products. They just were not allowed to
7 carry product that would have made it easy for
8 the consumers to engage in price comparison.
9 So, the policy has nothing to do with any of the
10 rationales that Mr. Feldberg has put forward.

11 MR. SWINDLE: Could I ask a question
12 here? I think you just answered it with this
13 exhibit. You have quite often stated that Toys
14 "R" Us went to the manufacturer and said don't
15 sell to the clubs. Don't sell to the clubs.
16 You said that several times. That means to me,
17 don't sell anything to the clubs. And it's
18 quite obvious that that was not the case. They
19 even said, made some suggestions, sell them the
20 old products, don't sell them the hot products.
21 But they didn't say don't sell to the clubs.

22 So you see Mattel in the club stores,
23 theoretically you see all these others in club
24 stores. But we're back again to the concern
25 about the hot products, because they're the

1 visible ones, and they don't want to see
2 themselves undercut in price. Yet I believe
3 Wal-Mart undercuts them, true?

4 MR. DAGEN: Wal-Mart has a
5 substantially higher margin than the clubs do.
6 As indicated earlier, Toys "R" Us might sell at
7 35%, they might be at 25%. The clubs would be
8 substantially below that.

9 So the price comparisons on say a 20
10 dollar toy, you might see a two dollar
11 difference in Wal-Mart. But you might see a
12 five or six dollar difference in the clubs. And
13 that's something the consumers were likely to
14 take notice of. And that's what Toys "R" Us was
15 afraid of.

16 MR. SWINDLE: I accept that, that
17 there are different levels in prices. But
18 theoretically, and I think in actuality, a
19 consumer could go to Price Club and buy a Barbie
20 Doll, for the sake of using an example, they
21 just bought the Barbie Doll with accessories;
22 isn't that right?

23 MR. DAGEN: That's true.

24 MR. SWINDLE: Now, in the packaging,
25 the pack, whatever the term is that we use here,

1 they bought a Barbie Doll and a piece a luggage,
2 in a Thunderbird, or whatever is in these
3 things, those each individual items have prices.
4 So how closely can we say that the price they paid
5 at the club store was significantly higher than
6 it would have been had they bought three products
7 separately. To do so is the decision of the
8 consumer. They have to buy three products to get
9 the primary one, but is the price really higher?

10 MR. DAGEN: Mattel stated that --
11 Mattel salesperson responsible for selling to
12 clubs, that they were putting in accessories
13 maybe worth 75 cents, and forcing the prices up
14 several dollars.

15 So I think that's one example.

16 There was an example of a Thunder
17 Strike toy that Tyco manufactured which, it's
18 this gun that shoots basically Ping-Pong balls I
19 think at people.

20 MR. SWINDLE: I can talk about
21 that better.

22 MR. DAGEN: Hopefully you weren't
23 armed with Ping-Pong balls.

24 MR. SWINDLE: I got hit by one.

25 MR. DAGEN: Toys "R" Us, Tyco, a

1 subsidiary, was selling this product to the
2 clubs. Toys "R" Us got wind of this, and called
3 the Tyco subsidiary executives into their office
4 and said, you know, what's going on? You're
5 selling this product to the clubs, and Tyco
6 reconfigured the product, adding many more
7 Ping-Pong balls, and raising the price, you
8 know, like another five or six dollars to the
9 clubs. So this is Toys "R" Us essentially
10 designing product that Tyco and other
11 manufacturers could sell to the clubs.

12 In order to do two things; both raise
13 the price, and make the products non-comparable.
14 That, again, was the strategy that Mr. Goddu
15 said. He wanted to require the clubs to carry
16 this accessory. And he stated explicitly in his
17 testimony that that would make it very difficult
18 for the consumers to compare prices. And allow
19 again Toys "R" Us to maintain their prices. And
20 moving back, if there is no offsetting
21 efficiency reasons for Toys "R" Us to have these
22 high prices, then the conduct is unlawful under
23 a rule of reason analysis.

24 MR. SWINDLE: But the bottom line is
25 consumers could still go to the Price Club, buy

1 that product at a cheaper price than they could
2 at TRU, they would just have to buy other things
3 with it. So prices in effect were lower.

4 But, again, I want to bring this back
5 to the fact that we're talking about a small
6 universe of hot product, right?

7 MR. DAGEN: Again, as we just noticed
8 in tab five, this policy applied to all
9 products. And the clubs did not just carry hot
10 product. They carried product that was not on
11 allocation. They carried products like
12 Monopoly, which generally is not on allocation.
13 And Toys "R" Us was not satisfied to see the
14 clubs carrying this sort of product, which Toys
15 "R" Us clearly wasn't creating any demand for.

16 This was old established product, and
17 Toys "R" Us said you have to package that with
18 other products. And they put Monopoly together
19 with another product. It's selling for
20 substantially more than Monopoly, and makes
21 it very difficult for consumers to go in and
22 say, well, I think -- it does two things: It
23 raises the price level, so it makes it more
24 likely that people would shop at Toys "R" Us.
25 And it also means that consumers who shop at the

1 clubs are unlikely to see that the prices at
2 Toys "R" Us are substantially higher.

3 MR. PITOFSKY: Mr. Dagen, as you
4 know, in the last 20 years, since Sylvania,
5 there are many, many vertical distribution cases
6 in which the court found that market power in
7 the range of 20, 25, 30%, even more than that,
8 is not adequate under a rule of reason. They
9 cited half a dozen cases like that themselves.
10 There was a case involving Miller Beer, which I
11 think went up to maybe 40% vertical
12 distribution, no violation.

13 Are you saying that properly
14 considered here, Toys "R" Us has in the range,
15 in the 40% range? Or are you saying those other
16 cases can be distinguished or are wrongly decided?

17 MR. DAGEN: I think it's a
18 combination of the two. I think most
19 importantly the question of buyer power in this
20 case is a factual question. Going back to the
21 Brown Shoe criteria. We're talking about
22 reasonable interchangeability. How easy is it
23 for a manufacturer to switch away from Toys "R"
24 Us? And Professor Areeda lists three criteria
25 in this regard. He talks about the share

1 that -- talks about hard to replace distribution
2 skills, whether the multi brand dealer could
3 threaten to drop one brand in favor of another,
4 and whether the dealer accounts for a large
5 volume of business, for such a large volume of
6 business that its replacement would involve
7 substantial disruption. So these are factual
8 questions.

9 In the case of Jefferson Parish,
10 which Mr. Feldberg alluded to, that was a case
11 where you had a hospital signing an exclusive
12 agreement with four anesthesiologists. This was
13 one hospital in Louisiana that was signing this
14 exclusive agreement.

15 The court basically undertook a
16 factual analysis there and said what's the
17 likelihood that this is being done to, as an
18 exercise in market power, or to gain market
19 power; or to gain control over prices. We're
20 talking about an agreement to get four
21 anesthesiologists to cover in the hospital.
22 It's relatively easy -- it was relatively hard
23 to see any possible anticompetitive effects in
24 that case. It's relatively easy for patients to
25 switch hospitals. And it made a lot of sense

1 for a hospital to have agreements for
2 anesthesiologists to cover in the hospital.

3 In contrast, here we're talking about
4 Toys "R" Us meddling with price, the central
5 nervous system -- which is the central nervous
6 system of the market economy.

7 Toys "R" Us essentially has to
8 concede that what they were doing was raising
9 prices in this case. They wanted to maintain
10 their margins. They say it was to prevent free
11 riding. But that essentially means we want
12 higher prices. And as we --

13 MR. PITOFSKY: Let me interrupt you,
14 because I want to come back to my question.

15 I take it your argument to the
16 Commission is that Toys "R" Us's power in the
17 marketplace is even greater than its market
18 share, when you consider where they stand and so
19 forth.

20 But when Toys "R" Us went to Mattel,
21 or any of the others and said I want you to stop
22 dealing with the clubs on certain terms, why
23 didn't Mattel just say I'm going to keep on
24 dealing with the clubs, it's none of your
25 business who I sell to. And if you don't like

1 it, I'll sell through Wal-Mart and K-Mart.

2 Eighty percent of the market is still
3 out there, as a distribution resource for the
4 manufacturers.

5 MR. DAGEN: We can listen to what
6 Mattel actually said on that. As I indicated,
7 this is a factual question. I see I'm
8 stopped --

9 MR. PITOFSKY: Please continue. You
10 can answer the question, sure.

11 MR. DAGEN: The head of Mattel
12 testified that Mattel would obviously have
13 difficulty replacing the 30% that Toys "R" Us
14 takes at the present time. This is the head of
15 Mattel. He also stated that other retailers
16 were unlikely to pick up the sales from Mattel
17 if Toys "R" Us stopped buying the product,
18 because they were buying the amount that they
19 thought was the right amount for them.

20 So, it was very unlikely that Mattel
21 could transfer any sales to another retailer.
22 It's not as easy as just adding another shift
23 for a manufacturer. You have 600 stores, and
24 Toys "R" Us accounting for 30 or 40% in any
25 particular metropolitan area. That makes it

1 very, very difficult for a manufacturer to
2 replace Toys "R" Us.

3 Hasbro said the same thing. There
4 just weren't places for Hasbro to replace the
5 sales. Other manufacturers testified to the
6 same effect.

7 MR. THOMPSON: So isn't this
8 enlightened self-interest, as your opposing
9 counsel said?

10 MR. DAGEN: No. The short answer
11 there is no. It shows that Toys "R" Us had
12 market power. Toys "R" Us did not just go to
13 the manufacturers and say here's our policy.
14 This comes back to the fact that they elicited
15 agreements in this case. They went to each of
16 the manufacturers and got commitments. The
17 manufacturers themselves said it's not in our
18 enlightened self-interest to do what you want.
19 They said we're only going to do this if you can
20 get our competitors to go along. If the policy
21 is applied across everybody. And, again, Toys
22 "R" Us said, told them, well, your competitors
23 are going to go along.

24 So, clearly the mere fact that Toys
25 "R" Us went to them was not necessarily

1 sufficient. That does not take away from the
2 finding; however, that Toys "R" Us had buying
3 power. Toys "R" Us used their leverage, tried
4 to coerce them. And then, just to make sure
5 everything stuck, given some resistance from the
6 manufacturers, turned around and said, okay, I
7 will facilitate the communication between all of
8 the manufacturers, and cement this horizontal
9 agreement to get a vertical.

10 MR. SWINDLE: Two points you just
11 covered. The first one you said the
12 manufacturers said we're not going -- this is I
13 thought paraphrasing what you said, words to the
14 effect, that we're not going to go along with
15 this, unless you, Toys "R" Us, can go and get
16 the other manufacturers to go along. And then
17 you close by saying that Toys "R" Us said we'll
18 go do that.

19 Did that exchange of words actually
20 take place?

21 MR. DAGEN: That precise exchange of
22 words probably did not occur. What did occur,
23 and I'm sorry if I led you down a different
24 path. What did occur was the manufacturers came
25 in when Toys "R" Us presented their policy and

1 said, I will stop if my competitors stop. I'll
2 go along if my competitors go along.

3 Toys "R" Us then said, for instance
4 to Hasbro, well, I've talked -- said to Hasbro,
5 Fisher-Price and Mattel are going to stop. This
6 was after they had had discussions immediately
7 prior with Fisher-Price and Mattel. Little
8 Tikes, for instance, came in and said, after
9 hearing the policy, said, after hearing the
10 statements from Toys "R" Us, said, well,
11 what's our prime competitor, what's Today's
12 Kids going to do? And Toys "R" Us said,
13 Today's Kids is going to be getting out of
14 the clubs.

15 MR. SWINDLE: Is that a statement of
16 fact?

17 MR. DAGEN: Yes, that is a statement
18 of fact.

19 MR. SWINDLE: Is Toys "R" Us
20 saying that "the manufacturer is going to
21 do this," or "I took care of this, they're
22 going to do it?" Two different things
23 there.

24 MR. DAGEN: Right.

25 Under the rule of reason analysis,

1 the distinction does not matter, because if the
2 manufacturers are doing this because the other
3 manufacturers are doing it, that shows that it's
4 not in their unilateral self-interest.

5 The best case for Toys "R" Us, the
6 best light that they can put on this is that
7 even if you didn't find a horizontal agreement
8 here, even if you just found a series of
9 vertical agreements, the manufacturers were
10 still saying we're not going to adopt this
11 policy unless the policy is enforced against
12 others.

13 A policy in the unilateral interest
14 of each of the manufacturers would be adopted,
15 regardless, totally regardless of what the other
16 manufacturers were going to do.

17 MR. SWINDLE: Didn't we just go
18 through a discussion that the power of Toys "R" Us
19 in the marketplace was so strong that if they
20 let it out on the table that if you don't quit
21 selling to price stores, Price Club, I'm not
22 going to buy from you? So, therefore, because
23 of this power, the manufacturers decided in
24 their own best interest, that "I will not sell to
25 the Price Clubs. I will sell to Toys "R" us because

1 I can't easily replace that 30%, 40%, or
2 whatever it happens to be?" You just argued in
3 both directions.

4 MR. DAGEN: I think that's counter
5 factual, because that's not what occurred here.
6 The manufacturers did not just listen to Toys
7 "R" Us, announce the policy and say, well, we've
8 got this big buyer. One of the cases that Toys
9 "R" Us cites, Garment District, a big buyer
10 comes to the manufacturer and says we're not
11 going to go to buy if you sell to other people.
12 The manufacturer, to use your terminology, in
13 his own enlightened self-interest decided, well,
14 I'm going to go with the big buyer. Well,
15 that's not what happened here.

16 Toys "R" Us then went forward and got
17 the horizontal agreements, got the agreement.
18 This wasn't just a situation where they
19 announced the policy and were willing to rely on
20 self-interest of the manufacturers. It's just
21 like in Parke Davis where the Court said you
22 can't provide a competition-free environment.
23 You can't wrap it all up in a nice little
24 package so that the manufacturers don't have to
25 worry about what their competition is doing.

1 That is not permissible under the antitrust
2 laws.

3 MR. PITOFSKY: Other questions?

4 Thank you, Mr. Dagen.

5 Mr. Feldberg?

6 MR. FELDBERG: Thank you,
7 Commissioners.

8 Mr. Chairman, the answer to the
9 question that you just posed to Mr. Dagen, why
10 didn't Mattel, when Toys "R" Us leaned on it,
11 simply say, go away, leave me alone? The answer
12 is Toy "R" Us is 20, or perhaps even 25% of
13 Mattel's business, the warehouse clubs are two
14 percent, actually they're only one percent,
15 because Sam's which is in the warehouse
16 business, won't carry the same things as
17 Wal-Mart, which carries most toys. So the
18 meaningful clubs, Costco and BJ's are one
19 percent, and Mattel thought about it for a while
20 and said, what, are we nuts, are we going to
21 give up a 20 percent customer for a one percent
22 customer?

23 The answer to the question that you
24 asked Mr. Dagen, Commissioner Thompson, is
25 wasn't it in Mattel's enlightened self-interest,

1 once they thought about it and they thought
2 about it for a while and got some consultants,
3 and they really studied the subject, is of
4 course it was in their enlightened self-interest
5 to not sell the same products, offer the same
6 products to the clubs as did Toys "R" Us.

7 The answer to the question that you
8 asked Mr. Dagen, Commissioner Swindle, why
9 wouldn't -- why isn't it just logical for a
10 manufacturer to choose Toys "R" Us, given Toys
11 "R" Us's size in the marketplace? Is, of
12 course, it was logical. And every manufacturer,
13 every representative of a manufacturer that
14 testified -- that restricted in any way what it
15 offered the clubs, that testified in this case,
16 said we did it because it made sense for us.

17 Interstate Circuit, the critical fact
18 in the Supreme Court's 1939 decision in the
19 Interstate Circuit case was that no one offered
20 an explanation at all. Every one of the
21 so-called competitors refused to give any
22 explanation for their conduct.

23 In this case, every manufacturer, now
24 not every manufacturer was restricted to clubs,
25 most didn't, but of the manufacturers that did,

1 every single one of them came into this room and
2 gave a logical, plausible, sensible reason why
3 they did so, just as the questions that you
4 asked Mr. Dagen suggest, and you know what?
5 Even the witnesses that hated us the most,
6 Professor Scherer, the principal theorist and
7 economist, said well, of course it was logical
8 for a manufacturer to choose Toys "R" Us, given
9 Toys "R" Us's volume of purchases.

10 Mr. Inano who hated us, the Hasbro
11 sales guy who met secretly with the clubs and
12 their lawyers to plot litigation against Toys
13 "R" Us, against his own company, of course it
14 was logical for the clubs to choose us once they
15 had to make a choice, for the manufacturers to
16 choose us.

17 MR. PITOFSKY: I can understand that
18 that would be the case. If each manufacturer
19 having heard the choice said, I can see that, I'd
20 rather have you than them. But that's not what
21 they said.

22 What they said was, I'm not going to
23 cut off our clubs until I'm sure that my
24 competitor does the same thing.

25 MR. FELDBERG: Well, actually that

1 isn't what they said, Mr. Chairman. We have got
2 to focus on the evidence. What the evidence
3 is -- some manufacturers said are you making the
4 other guy make the same choice? In other words,
5 are you applying the policy -- now, there is
6 some sinister implication here that we made it
7 clear the manufacturers wanted a level playing
8 field, and Toys "R" Us did something wrong by
9 saying to them, well, you know, we're applying
10 this policy to everybody.

11 The Second Circuit's decision in the
12 Burlington Coat Factory case involved the fact
13 pattern where the retailer called all the
14 manufacturers into a room together and announced
15 its policy to all of them all at once. And that
16 was considered lawful.

17 MR. PITOFSKY: Any follow-up
18 discussion in Burlington afterwards? Did they
19 negotiate with each of them after they made
20 their announcement? Since that's different than
21 this?

22 MR. FELDBERG: It's not different in
23 a substantive sense, Mr. Chairman, because all
24 that happened here, is because the meetings were
25 separate, which logic to me suggests is less

1 suggestive of a conspiracy than an open
2 announcement to all the manufacturers together,
3 giving them the opportunity to talk to each
4 other. All that happened here is the
5 manufacturers said, well, you know, are you
6 applying this policy to the other guy?

7 MR. PITOFSKY: Just a question. They
8 didn't say I won't go along with your policy
9 unless you assure me that the other --

10 MR. FELDBERG: There's is no evidence
11 of that.

12 MR. PITOFSKY: Mr. Goddu's testimony.

13 MR. FELDBERG: No evidence of that.
14 No evidence of that. There is evidence that
15 manufacturers said, well, I don't want to be
16 singled out. I don't want to be discriminated
17 against. I want -- if I'm going to do this, I
18 want to be sure that the other guy has -- has to
19 make the same choice in its relationship with
20 Toys "R" Us. That's okay. Nothing wrong with
21 that.

22 But the key point, Mr. Dagen cites
23 Parke Davis. What happened in Parke Davis, I
24 think I said this before, but at the risk of
25 being repetitious, Parke Davis, the manufacturer

1 goes to retailer A and says keep the price up.
2 Retailer A says, well, I'll do it if the other
3 guy does it. Tell me the other guy is going to
4 do it. The manufacturer goes to B and comes
5 back to A and reports. That didn't happen here.

6 We have to stick to the evidence.
7 There is nothing like that, Commissioner.

8 MR. THOMPSON: Maybe you can help me
9 a little. Because I guess the part that I have
10 a problem with is, if this was so great for
11 Mattel and Hasbro, et cetera, then why did Toys
12 "R" Us work so hard to make sure that each one
13 of them lined up?

14 MR. FELDBERG: Well, each one of them
15 didn't line up.

16 MR. THOMPSON: Well, to the extent
17 that they could get them to.

18 MR. FELDBERG: Why did Toys "R" Us do
19 this? First of all, manufacturers, they're not
20 monolithic. A company like Mattel has a lot of
21 people. And people have different interests.
22 The guy who is the salesman to the clubs, the
23 guy or woman who is the salesperson to the
24 clubs, and who's got a commission that could be
25 40% of his or her salary and is based on sales,

1 that person wants to sell to the clubs. Same as
2 the person who sells to Toys "R" Us, obviously
3 wants to sell to Toys "R" Us. There are
4 competing interests within the company.

5 MR. THOMPSON: This goes far beyond
6 that. You're talking about senior, senior
7 officials at a company --

8 MR. FELDBERG: Are there some
9 companies where executives, if they could sell
10 to both, would like that option? Sure. Would
11 they like the option not to have to choose? In
12 some cases, yes. In other cases, no. But Toys
13 "R" Us posed the choice. Said on specific
14 items, it's not all products, it's specific
15 items, said you've got to choose. The law says
16 we have the right to pose that choice. That's
17 Colgate, that's Raymond Brothers Clark.

18 Now, once we've made that choice, we
19 posed that choice, and a manufacturer has to
20 choose, many, not all, but some manufacturers,
21 said, well, it makes sense to get to Toys "R"
22 Us.

23 Now, why did Toys "R" Us work so hard
24 to do this? What was in this for Toys "R" Us?
25 One thing that's important, there is nothing in

1 it for the manufacturers with one exception,
2 there is no reason for the manufacturers to have
3 a horizontal conspiracy. This isn't their
4 policy, it doesn't emanate from them, they don't
5 get anything out of a conspiracy.

6 There is a reason that many of the
7 manufacturers articulated not to have a
8 conspiracy. Hey, if I'm selling to Toys "R" Us
9 and not to clubs, and my competitor is selling
10 to the clubs, I want to go to Toys "R" Us and
11 say, hey, my competitor is in the clubs, I want
12 something from you, shelf space. Give me the
13 other guy's shelf space. And you had
14 principally Dave Wilson from Hasbro, is one of
15 their very senior executives came in here and
16 said, I was delighted when I found out my
17 competitors were selling to the clubs, because
18 that gave me an argument for something I wanted
19 most, the other guy's shelf space. Give it to
20 me instead of him. That's competition.

21 Now, why did Toys "R" Us care about
22 this? There is some evidence about price image
23 kinds of issues, although, quite frankly, that
24 evidence is somewhat overstated, because the
25 evidence is very clear that on the top 100 toys,

1 which weren't the only things the clubs were
2 carrying, but were the principal things they
3 wanted, what Mr. Dagen refers to as the life
4 blood of the toy industry. There weren't any
5 price differences between Toys "R" Us and
6 Wal-Mart and K-Mart and Target and Costco and
7 the other clubs, because everybody had the same
8 margins.

9 Competition for TV-advertised-top-100
10 toys was so fierce that everybody's margins,
11 comparing them on an apples to apples basis, and
12 we go through the math somewhere in the briefs,
13 were about the same. There is no evidence of
14 price differences on top 100 toys, which were
15 the toys the clubs most want.

16 So, there is some evidence about
17 price. But the other principal concern,
18 Commissioner, is short supply. These hot toys,
19 we can't get enough of them. We carry, we, Toys
20 "R" Us, carries a full line of toys all year.
21 Invests enormously in carrying a selection. You
22 can walk into a Toys "R" Us store today,
23 February 19th, and find a full selection of
24 toys, just as hopefully you can in October. The
25 clubs don't do that. But when something becomes

1 hot, when something takes off, whether it's
2 Power Rangers or Tickle Me Elmo, we want to make
3 sure we've got it in stock. We've had it all
4 year, the customer expects us to be in stock,
5 we've advertised it, the manufacturers have
6 advertised it. Our image is if it's a toy you
7 want, we've got it.

8 MR. PITOFSKY: Mr. Feldberg, you're
9 at a very important point here. Let me see if I
10 can frame this carefully.

11 There are two possible reasons that
12 are being discussed here. One is Toys "R" Us
13 didn't like its image being impaired by the fact
14 that somebody else was selling at a lower price
15 than them. The other possibility is Toys "R" Us
16 didn't like the idea on hot products to have
17 those products going through the clubs when Toys
18 "R" Us worked solely on behalf of the
19 manufacturer.

20 If the latter was the reason, why
21 should the policy not have been by Toys "R" Us,
22 don't sell hot products to the club? Wasn't
23 there a less restrictive alternative, to get to
24 your business purpose?

25 MR. FELDBERG: Well, as a matter of

1 fact, as Mr. Goddu testified, and this is the
2 point complaint counsel always makes, the first
3 iteration, and let me just find that document,
4 the first iteration, their tab five, their
5 notebook, no new or promoted product.

6 MR. PITOFSKY: That was just one
7 paragraph among five.

8 MR. FELDBERG: There is another
9 iteration, it started out as hot product. But
10 it didn't work, because you couldn't really
11 define -- it was too hard to define. And you
12 don't know in March what's going to be hot
13 necessarily in October. And it was simply too
14 hard and too subjective. So the policy --

15 MR. PITOFSKY: Old and basic products
16 should be sold in special packs. If your only
17 concern was hot products, why were your
18 representatives proposing to the manufacturers
19 that old and basic products be sold in special
20 packs?

21 MR. FELDBERG: Because the policy
22 evolved to we won't buy it if you sell it to
23 them, whatever it is, because the hot product
24 choice became too difficult to deal with. It
25 was because we don't know at the beginning of

1 the selling season what the hot products are
2 going to be. And, therefore, when, at Toy Fair,
3 in February, last week, you don't necessarily
4 know what's going to be hot come fall. And so
5 it became an impossible concept to administer.
6 Impossible to organize. And -- or to think
7 about. And, therefore, the policy was if you --
8 a simple, if you sell it to them, we probably
9 won't buy it.

10 Now, what was the principal concern?
11 Was there a price concern? I'm not going to
12 deny that Toys "R" Us didn't want somebody out
13 there with an unreasonably low price, because
14 they could free ride if they didn't carry a full
15 line, they didn't advertise, they didn't
16 warehouse, they didn't provide the services
17 that Toys "R" Us provides with its showroom
18 and everything else. I'm not going to deny
19 that that's a concern. Of course it is.

20 But the principal concern is, if we
21 spend millions of dollars all year to carry a
22 full selection, and we advertise it, and we
23 warehouse it, and we have it all year, and the
24 only way we get compensated is, A, when the
25 consumer comes in in October we make the sale,

1 not just of that hot product, which hopefully we
2 have, but maybe the consumer buys a few other
3 things while she's in my store, hopefully.
4 That's the way Toys "R" Us is compensated. It
5 makes the sale. That's what all the free riding
6 cases talk about. Compensation is making the
7 sale.

8 If we don't have the product, because
9 some guy that only wants to carry Mattel's top
10 two sellers, and only during October and
11 November comes along, and we can't get it,
12 whether it's Tickle Me Elmo or Holiday Barbie,
13 or whatever else, and that other guy who's just
14 cherry picking the best sellers for the critical
15 couple months of the year, he's got it, then, A,
16 we're embarrassed, B, we're losing a sale, C,
17 we're not getting compensated for the services
18 we provide, and, whatever letter I'm up to,
19 chances are in the long-run we're going to stop
20 providing these services and that will restrict
21 output, and that's the opposite of what
22 antitrust law are supposed to encourage.

23 MR. PITOFSKY: Can you point me to
24 any document prior to this lawsuit beginning in
25 which the company discussed the fact that they

1 were upset about free riding by the clubs; or is
2 that a pretext that the lawyers came up with
3 afterwards?

4 MR. FELDBERG: It's a fair question,
5 Mr. Chairman. The lawsuit was started in May of
6 1996. There is enormous --

7 MR. PITOFSKY: I'm sorry, before the
8 policy was implemented, and the clubs threatened
9 to sue you. Before the policy was implemented,
10 is there any indication in any document that
11 Toys "R" Us's concern was free riding?

12 MR. FELDBERG: I know that there is
13 testimony about meetings between Toys "R" Us and
14 manufacturers that predate the formulation of
15 the policy in which Toys "R" Us said this is
16 nuts. We can't get your hot products. And it's
17 crazy. It's making us crazy that these other
18 guys are just cherry picking and free riders. I
19 know that comes up in testimony, Mr. Chairman.
20 I can not, as I stand here, point to a document.
21 But there were very few letters back and forth.

22 MR. PITOFSKY: Pre Toy Fair, pre '92
23 Toy Fair, there were meetings in which free
24 riding was discussed?

25 MR. FELDBERG: Oh, sure. And the

1 concern about short supply.

2 MR. THOMPSON: Wait a minute. There
3 is a distinction between what I call short
4 supply, which manufacturers and purchasers talk
5 about all the time, and free riding, which is
6 cherry picking. And that I make a distinction
7 about.

8 MR. FELDBERG: Yes, sir. Two
9 different things, Toys "R" Us is concerned about
10 them both, and it raises that concern in
11 meetings.

12 If I could just have a couple more
13 minutes.

14 This notion about price that there
15 was some big price issue that somehow consumers
16 would have benefited, we've got to look at the
17 evidence. A, on top 100 toys, there is no
18 differences in price. B, we gave an econometric
19 analysis, that as it happens is the same
20 econometric methodology that the Commission
21 staff used in the Staples case. There is one
22 difference, in the Staples case they showed
23 price differences ranging from five to thirteen
24 percent, depending on the presence or absence of
25 one of the relevant competitors. In this case,

1 the price difference was one percent or less.

2 MR. THOMPSON: How do you deal with
3 the facts though that it doesn't necessarily
4 have to show an actual difference in price, but
5 there could be a fear of a reduction in price?

6 MR. FELDBERG: All right. But there
7 has got to be evidence to be concerned about.
8 And there is no evidence, no econometric
9 evidence, no empirical evidence that but for
10 Toys "R" Us's policy, prices would have been
11 driven down. Toys "R" Us's prices are
12 constrained to the competitive level everywhere,
13 principally because of Wal-Mart, partially
14 because almost everywhere there is a Toys "R" Us
15 and there is a Wal-Mart or a Target or a club,
16 and there is zero evidence, I deal with it by
17 saying there's got to be evidence, they're the
18 plaintiff. There's got to be some evidence in
19 the case. And there isn't any.

20 I've got to come back to the market
21 power point, and then one more point, if I can.

22 Mr. Dagen essentially answered
23 Chairman Pitofsky's questions by saying, well,
24 this is buyer power. And that's the argument
25 that the FTC staff used below. It's a little

1 different than market power. It's buyer power.
2 And they made two principal arguments which were
3 accepted below: One is that the campaign
4 worked. We had the power, because some
5 manufacturers changed their distribution
6 philosophy. That argument was rejected last
7 year by the Commission in the interpreter's
8 case. This Commission, one year ago, rejected
9 that very argument, which had been accepted by
10 the very same ALJ in the Commission case.

11 The other argument they make is that
12 Toys "R" Us has buyer power, because it provides
13 unique services. That argument was rejected by
14 the United States Supreme Court in Fortner
15 (Phonetic) too.

16 Now, does Toys "R" Us provide a lot
17 of services? You bet. But that's a good thing.
18 Not a bad thing. This case is turning antitrust
19 law on its head. Toys "R" Us increases output.
20 It buys products other companies in general
21 don't buy. It adds to production and output in
22 the provision of services, and that, up until
23 today, has always been thought to be a good
24 thing under the law.

25 One more word, if I may, about the

1 order which has been -- which is part of the
2 initial decision below. That order would work a
3 revolution in the law. It would prohibit the
4 kinds of communications between a retailer and a
5 manufacturer that the Monsanto decision from the
6 Supreme Court says are important, critical
7 sources of information. It would curtail Toys
8 "R" Us's Colgate rights.

9 Now, are there consent decrees in
10 which companies have voluntarily given up their
11 Colgate rights? Yes. Has any court ever
12 endorsed that? No. Colgate rights are right
13 granted by the Supreme Court in the United
14 States. There has never been a litigated case
15 in which a court has ordered a curtailment of
16 Colgate rights.

17 Think about what that means. The
18 order says we must buy, we can not refuse to buy
19 a product if in whole or in part, one of the
20 reasons is it's offered, not sold, offered to a
21 warehouse club. What that means is that if a
22 manufacturer offers a product to a warehouse
23 club, we've got to buy it, even if we can't sell
24 it profitably, even if we think it isn't safe.
25 We've still got to buy it. It's unthinkable.

1 We cite an article from some years
2 ago by Professor Turner in one of our briefs in
3 which he said, you know, one of the things to
4 think about in an antitrust case is how to fashion
5 a remedy. And if you can't fashion a remedy that
6 makes sense, maybe there isn't an antitrust
7 violation. That's true here.

8 I have many more things to say. I'm
9 out of time. Thank you, Commissioners.

10 MR. PITOFSKY: I want to thank both
11 sides for exceptional briefs in this matter, and
12 for very illuminating arguments. We appreciate
13 it very much. Thank you all.

14 (Hearing adjourned at 11:50 A.M.)

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C E R T I F I C A T I O N O F R E P O R T E R

DOCKET/FILE NUMBER: D09278 CASE TITLE: TOYS R US, INC. HEARING DATE: FEBRUARY 19, 1998

I HEREBY CERTIFY that the transcript contained herein is a full and accurate transcript of the notes taken by me at the hearing on the above cause before the FEDERAL TRADE COMMISSION to the best of my knowledge and belief.

DATED:

JOSEPH A. GRABOWSKI

C E R T I F I C A T I O N O F P R O O F R E A D E R

I HEREBY CERTIFY that I proofread the transcript for accuracy in spelling, hyphenation, punctuation and format.

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