

IN THE MATTER OF

TOYS "R" US, INC.

FINAL ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF  
SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

*Docket 9278. Complaint, May 22, 1996—Final Order, Oct 13, 1998*

This final order prohibits, among other things, the nation's largest toy retailer from continuing, entering into, or attempting to enter into, vertical agreements with its suppliers to limit the supply of, or refuse to sell, toys to a toy discounter. The order also prohibits Toys "R" Us from facilitating, or attempting to facilitate, an agreement between or among its suppliers relating to the sale of toys to any retailer, and from urging or coercing suppliers to restrict sales to any toy discounter.

*Participants*

For the Commission: *L. Barry Costilo, Richard Dagen, Patrick Roach, Sarah Allen, James Frost, Michael Antalics, William Baer, Richard Ludwick, David Glasner, and Jonathan Baker.*

For the respondent: *Michael Tumolo, in-house counsel, Paramus, N.J., Michael Feldberg, Schulte, Roth & Zabel, New York, N.Y. and Irving Scher, Weil, Gotshal & Manges, New York, N.Y.*

## INITIAL DECISION \*

BY JAMES P. TIMONY, ADMINISTRATIVE LAW JUDGE  
SEPTEMBER 25, 1997

## INTRODUCTION

The Commission's complaint of May 22, 1996, charges respondent Toys "R" Us, Inc. with unfair methods of competition in violation of the Federal Trade Commission Act, alleging as follows:

- The low toy prices of the warehouse clubs put competitive pressure on TRU, compromising TRU's image for everyday low prices.
- Being the largest toy retailer in the United States, TRU used its power to gain agreements with various suppliers to limit toy sales to the club.
- Suppliers agreed not to sell to the clubs the same toys that TRU carried. TRU and the suppliers agreed upon specially packaged toy products that could be sold to the clubs. These "club specials" consisted of packs of two or more items.

\* Note: [ ] indicates information has been redacted.

- The suppliers agreed to get TRU's approval in advance of items they wanted to sell to the clubs. The sellers could sell the product. TRU facilitated understandings among competing manufacturers to achieve substantial unity of action among them relating to their dealings with the clubs.
- TRU policed the manufacturers' sales and infractions and enforced its policy. By 1994, most of the major U.S. toy manufacturers stopped selling to the clubs the toys carried by TRU.
- TRU unreasonably restrained competition among toy manufacturers and retailers. Toy prices to consumers are higher. The clubs' costs increased, impeding the growth of a new method of toy distribution in its incipiency. Information to enable consumers to make price comparisons was suppressed.

Respondent denied the principal allegations of the complaint. Respondent's motion for summary decision was denied on February 27, 1997. The hearing in this matter began on March 5, 1997. Complaint counsel called 25 witnesses including two expert witnesses and the respondent called 18 witnesses including three expert witnesses.

Respondent subpoenaed Gary L. Roberts, Associate Director for Antitrust in the Commission's Bureau of Economics, asserting that his uncle was the chief executive officer of Wal-Mart, and that Mr. Roberts' parents had received a substantial gift from his uncle. I granted a *motion in limine* for failure to allege facts indicating conflict of interest and to avoid interference with the deliberative process of the Commission. (RX-885.)

Complaint counsel's economic expert, F. M. Scherer, submitted rebuttal evidence on June 25, 1997. Closing arguments were on July 1, 1997 and September 5, 1997, closing a trial of 43 trial days and over 9500 pages of trial transcript; about 2600 exhibits were admitted (CX-1 through CX-1830; RX-1 through RX-915).

#### FINDINGS

##### RETAIL SALE OF TOYS IN THE UNITED STATES

###### A. Respondent

1. Toys "R" Us, Inc. ("TRU") is a corporation organized, and doing business under the laws of Delaware, with its principal office at 461 From Road, Paramus, New Jersey.

2. TRU is the world's largest toy retailer, operating over 650 toy stores in the U.S. and 300 in twenty other countries. (TRU Answer to Complaint ¶ 2.) TRU had revenues of \$9.4 billion in 1995 and \$10 billion in 1996. (TRU Answer to Complaint ¶ 2.)<sup>1</sup>

3. TRU is a "category killer" chain -- a specialized retailer offering an array of merchandise in a particular category, sold at discount. (Scherer (CX-1822-C) ¶ 6.) TRU stores offer children's toys, games, bicycles, and electronic video games -- 16,000 "SKUs" in the early 1990's.<sup>2</sup> (Goddu 30:6574/10 - 6575/17.). TRU's stores are typically 45,000 square feet in major markets. (Goddu 30:6973/11-12.) TRU operates self-service where customers find products. (Goldstein 36:8242/18 - 8243/1.)

### *B. Toy Industry*

#### 1. Retail sale of toys

4. Traditional "mom and pop" stores "were challenged by department stores, which were challenged by mail-order houses, chain stores, supermarkets, hypermarkets, and more recently, "category killers" like TRU. Price-cutting by chain stores was the target during the 1930's of the Fair Trade laws and the Robinson-Patman Act. (Scherer CX-1822-B-C.) Between the end of World War II and the late 1980's, there were major innovations in retail toy distribution. Television ads "pull" toys making self service retailing feasible. The repeal in 1974 of the Miller-Tydings Act supporting state resale price maintenance laws facilitated discounting of toys at retail. With consumers' increased mobility, discount chains proliferated. They began stocking nationally advertised toys at discount prices. Toys "R" Us was one of the first specialized "category killer" retailers. (Scherer CX-1822-C.)

5. During the early 1990's, some other major toy supermarket chains (Lionel Leisure and Child World) went out of business. (CX-503-A.) By the 1990's, TRU's principal competition came from

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<sup>1</sup> References to the record use the following abbreviations:

F. (Findings of Fact), CX (Commission Exhibit), RX (Respondent's Exhibit); References to trial transcript are made using witness name, volume, page and lines. References to exhibits include prefix, number and page. References to investigational hearing or deposition transcripts included as exhibits include witness name and the designation "IH" or "Dep.", exhibit number, and transcript page and lines. In camera portions of the record are in italics/brackets.

<sup>2</sup> A "SKU" (stock-keeping unit) is a product in an inventory control system.

national, mass-market general merchandise discount chains like Wal-Mart, Target and K-Mart. (Goddu 30:6517/7-10.) [ ]

6. [ ]

7. [ ] TRU carries toys year-round, but the fourth quarter exceeds their sales for all three prior quarters combined. (CX-1616.) [ ]

8. [ ] TRU recently reduced its SKUs to 11,000, three times as many SKUs as its next closest competitor. (RX-621 at 27; Goddu 30:6574/22-25; Walters, 28:6068/21 - 6069/7.)

## 2. Toy manufacturing

9. The top four manufacturers of toys in the U.S. market are Mattel, Hasbro, Tyco and Little Tikes. In 1994, for the total U.S. toy market, Mattel had 18%, Hasbro had 17 %, Tyco had 3.2% and Little Tikes had 2.8%. (CX-1669-C; CX-1230-J.)

10. [ ] Hasbro sells Mr. Potato Head, G.I. Joe, Monopoly, Tinker Toys, Lincoln Logs, Play-Doh, and toys based on motion pictures such as Star Wars and Jurassic Park. (Verrecchia 7:1412/14-16, 1548/1-13, 1336/13.) Tyco sells the Magnadoodle, radio control cars, and matchbox cars. (Grey 14:2986/5-9.) Little Tikes sells large blown plastic toys. (Schmitt 11:2275/12-23; DePersia 10:2133/11-18; CX-1230-J.)

11. In recent years, there are fewer toy manufacturers. The three largest toy manufacturers acquired a dozen smaller competitors. In 1993, Mattel acquired Fisher-Price, Inc., a \$1.2 billion transaction. (Cohen, 35:7926/7-8.) In 1994, Hasbro acquired the game division of Western Publishing, adding "Pictionary" to its collection of other board games such as Monopoly. (Wilson, 26:5784/24-5785/2.) Recently, Mattel has merged with Tyco. (Grey 14:2985/16-22.)

12. The market for toys is highly differentiated -- a plastic sandbox is an imperfect substitute for a Hot Wheels car. (Carlton (RX-877) at 9.) Competition among toy manufacturers is most direct between those firms whose products are substitutes such as firms which produce large molded plastic toys. (Murdough 27:5884/16 - 5886/15.) Television ads "drive" demand for toys. (CX-773-J.)

13. Because of the seasonal demand for toys and the desire of toy manufacturers to operate their plants year-round, manufacturers induce retailers to ease the burden of warehousing. These incentives include "dating" terms (deferring the date by which the retailer must

make payment), allowances for placing orders and taking shipment of goods early, and warehousing. (Okun 13:2829/24 - 2838/1.)

### *C. Warehouse Clubs*

#### 1. Growth

14. Warehouse clubs are low-frills, low-cost, low-price retailers, undercutting other firms in both price and service. (Ingene 41: 9039/25 - 9040/8.) The first modern warehouse club was the original "Price Club" opened by Sol Price in a converted airport hangar in San Diego in 1976. (Buzzell (RX-894) at 8 n.2; CX-178-C). [ ]

15. Warehouse clubs do not sell to the general public but to members who pay an annual fee to shop at the warehouse club. (Sinegal 2:147/24-148/17; Zarkin 21:4784/1-2.) Warehouse clubs offer prices below those available in other retail channels. (Sinegal 2:149/11 - 150/1; Zarkin 21:4801/17 - 4802/19.)

16. Warehouse clubs operate at profit margins lower than other channels. Their gross margin -- the difference between the selling price and cost of merchandise -- averages about 9-12%. (Sinegal 2:150/2-12; Zarkin 21:4803/15-4804/1; Buzzell (RX-894) at 18; RX-741.) This is lower than for other channels like discount drugstores, 20 % (Buzzell (RX-894) at 18; RX-741); grocery stores, 20-25% (Sinegal 2:150/19-20; Buzzell (RX-894) at 18; RX-741); mass merchandisers, 25% (Zarkin 21:4804/4-8; Buzzell (RX-894) at 18; RX-741); and department stores, 45-50% (Sinegal 2:150/18-19; Zarkin 21:4804/8-9).

17. The main warehouse clubs in 1992 were Sam's Club (a division of Wal-Mart, 256 stores, Pace (a division of Kmart, 115 stores), Price Club (based in San Diego, 94 stores), Costco (based in Redmond, Washington, 100 stores), and BJ's Wholesale (based in Natick, Massachusetts, 39 stores). [ ] After consolidations, by early 1997 the main warehouse clubs were Price/Costco (renamed Costco) (with 1996 sales of about \$20 billion). Sam's (also \$20 billion in 1996 sales), and BJ's (with \$3 billion in 1996 sales). (Sinegal 2:145/5-147/10; Zarkin 21:4785/15 - 4786/22.)

18. Warehouse clubs sell to small business customers and to individual consumer members. (Buzzell (RX-894) at 8-9.) [ ]

19. Warehouse clubs' sales consists of food and grocery products, (Sinegal 2:207/25-208/11; Zarkin 21:4789/22-24), (grocery about 60% of sales at Costco and BJ's), and electronics, appliances, jewelry,

cameras, video and audio recordings, books, hardware, housewares, sporting goods, automotive, tires, office supplies, health and beauty aides, apparel, seasonal goods and others. (Sinegal 2:147/13-21; Zarkin 21:4789/11-15.) With non-food products, warehouse clubs compete with other warehouse club chains, discounters such as Wal-Mart and Kmart and specialized "category killer" retailers such as Toys "R" Us, Sports Authority, and Circuit City. (Zarkin 21:3787/8-20.)

20. Warehouse clubs keep down prices by reducing operating costs and increasing the rate of inventory turnover. Warehouse clubs reduce capital costs for storing goods in inventory; a warehouse club selling merchandise to club members before payment is due to the vendor does not bear the capital costs of carrying that merchandise. (Sinegal 2:159/7-160/7; Zarkin 21:4807/17-4808/13; Buzzell (RX-894) at 18.) [ ]

21. Warehouse club buildings are large buildings (100,000 square feet or more) using industrial lighting and plain steel shelving, located in areas where land acquisition or lease costs are low. (Buzzell (RX-894) at 13; Ingene 41:9045/15 - 9046/2; Sinegal 2:156/23 - 157/6.) Warehouse clubs are staffed with few employees. Checkout lanes have a single employee operating the cash register and scanner, and customers pack their own purchases. (Zarkin 21:4806/24 - 4807/16; Buzzell (RX-894) at 14-15.)

22. The clubs purchase merchandise from suppliers packed on pallets and marked with computerized codes that can be read by the scanners at checkout lanes. (Sinegal 2:157/13-21; Zarkin 21:4806/11-4807/3, 4809/9-15.) Goods are shipped by vendors to centralized distribution centers to reduce freight costs and typically are dispatched the same day to individual warehouse clubs. (Zarkin 21:4809/16 - 4810/8.) Merchandise is delivered directly to the sales floor, displayed on the pallets on which it was shipped, or stored in tall steel shelving. (Sinegal 2:157/12-21; Zarkin 21:4809/24-4810/6.) This lessens costs of labor, inventorying, unpacking, marking and displaying goods. (Sinegal 2:157/22 - 159/6.)

23. Maximizing inventory turnover affects products offered by the warehouse clubs. Warehouse clubs carry the most popular branded items that are most likely to generate the high inventory turnover. (Zarkin 21:4797/4-7; Sinegal 2:153/1-17,161/8 -162/21; Buzzell (RX-894) at 10-12.) Warehouse clubs carry 4000 "SKUs" (Zarkin

21:4808/14-19; Sinegal 2:151/19-23), compared to about 22,000 SKUs at a supermarket or 80,000 SKUs at a Wal-Mart. (Zarkin 21:4808/22-25; Buzzell (RX-894) at 11.) The smaller assortment of products simplifies inventory and ordering. (Sinegal 2:161/23 - 162/17.)

24. Name-brand merchandise is important to the clubs. (Zarkin 21:4797/15-16.) Members are more likely to be aware of the prevailing price for the item in other outlets and recognize the low price in the club as a value. (Zarkin 21:4797/17-22.) About 70-80% of club items are branded products. (Buzzell 38:8381/12-13; RX-433; Zarkin 21:4829/23 - 4830/11; Sinegal 2:153/1-17.)

25. Some manufacturers have restricted the availability to warehouse clubs of name-brand products (Sinegal 2:230/17 - 237/18), typically brands that manufacturers choose not to distribute in any discount or mass merchant channel, not merely warehouse clubs. (Buzzell 38:8377/20 - 8406/25; Zarkin 21:4829/23 - 4830/11; Ojendyk 18:4035/8 - 4038/13, 4290/11 - 4298/14; Hilson, 20:4542/6-4543/4.)

26. Warehouse clubs frequently change the mix of non-food products offered. Warehouse clubs create a "treasure hunt" atmosphere that will persuade members to take advantage of bargains that may not be available the next time the member comes to shop at the club. (Zarkin 21:4788/18 - 4791/14; Sinegal 2:151/4 - 152/13.) This assists the clubs by developing its reputation and membership by word-of-mouth spread by their members. (Zarkin 21:4798/2-17.)

27. Warehouse clubs often stock packages containing multiple items or larger quantities of the product, to encourage members to make larger purchases and increase inventory turnover. (Zarkin 21:4799/9-24; Sinegal 2:166/25 - 167/23; Buzzell (RX-894) at 17.) This technique is best suited for products that are highly consumable. (Zarkin 21:4800/10 - 4801/8; Sinegal 2:167/24 - 168/14.)

28. The clubs advertise by direct mailings to members, newsletters listings products currently for sale in the clubs. (Sinegal 2:160/19 - 161/7; Zarkin 21:4825/11 - 4826/4.) The clubs make few expenditures for advertising in mass media. (Zarkin 21:4824/24 - 4825/9; Sinegal 2:160/8-21.)

29. Members pay annual fees of about \$30-35 to shop at a warehouse club. (Sinegal 2:165/12-16; Zarkin 21:4820/18-24.) Clubs require association with a business or employment group (Sinegal



2:148/5-15), or permit any member of the public to join at a higher fee. (Zarkin 21:4821/3-6.) The gross income provided by membership fees for Costco and BJ's has exceeded the net income of those clubs. (Sinegal 2:163/17-24; Zarkin 21:4824/1-22.)

30. The requirement of the membership fee provides a financial incentive to shop at the club consistently and in larger quantities in order to realize the greatest value from their investment in the fee, achieving greater inventory turnover. (Zarkin 21: 4821/5 - 4822/19.) The fee also ensures that club members have resources to spend. Club members are more likely to be homeowners and long-time residents, with higher income and larger households than the general population. (Sinegal 2:171/19 - 172/21; Zarkin 21:4822/20 - 4823/13.) Warehouse clubs costs for bad checks and loss of inventory are lower than other forms of retailing. (Sinegal 2:156/13-22, 172/7-174/9.)

## 2. Toy sales

31. Toys are well-suited to the "treasure hunt" approach of the warehouse clubs. (Zarkin 21:4828/1-16.) Warehouse clubs sell toys at their average merchandise margins. [ ] Halverson 3:355/22-25 (Pace, 10-14% including freight); Hilson 20:4436/1-3 (BJ's, 10%).)

32. Warehouse clubs carry fewer toys and periodically change the mix of toys that they carry; they carry more toys during the holiday season. Pace had about 50 toys during January to September and about 125 items in the Christmas season from October to December. (Halverson 3:484/24 - 485/4.) Costco had about 100 toy items in the Christmas season and 15 at other times with the total number of toy items carried during a year about 400. (Moen 4:615/5 - 616/20.) BJ's (including juvenile furniture items) had about 150 toy items during the holiday season and 50 items in January, with the total in the year of 300. (Hilson 20:4417/23-4419/11.) Sam's Club had about 60 toy items during the fall and about 45 items at other times. (Jette, 5:996/2 - 997/22.)

33. Warehouse club toy buyers attend the annual New York Toy Fair in February and other industry shows. (Hilson 20:4424/10 - 4426/16; Jette, 5:1007/5-13.) Warehouse club toy orders for the holiday season are typically placed during March, April, and May presentations by manufacturers at Toy Fair. (Hilson 20:4424/10 - 4426/16; Moen, 4:611/2 - 613/14; Halverson 3:349/7-11; Jette, 5:1006/12 - 1007/4.) Shipments of products for sale during the

holiday season begin to arrive at the warehouse clubs in August or September. (Hilson 20:4419/2-11; Moen 4:622/3-5.)

34. Up to the early 1990's, warehouse clubs purchased regular line products of toy manufacturers. (Halverson 3:357/3-20; Moen 4:606/8-22.) Warehouse clubs also worked with toy manufacturers to develop specially-packaged products increasing the price and value of an item offered for sale to warehouse club members. Warehouse clubs purchased "combo" packs of ten or twenty Matchbox or Hot Wheels toy cars that could be priced for sale to club members in the \$10 - 15 dollar range (Moen 4:606/23 - 608/8; Halverson 3:358/2-22). [ ]

35. Costco's toy buyer preferred open line products to combo packs because combo packs could make it difficult to compare prices in other retailers. (Moen 4:608/9-22; Hilson 20: 4573/15 - 4575/7.) Up to 1991 about 15-20% of Pace's toy selection was combo packs. (Halverson 3:358/19 - 359/21.) About half of the toy items offered by Sam's were regular line products rather than combo packs. (Jette 5:1001/18 - 1002/13.)

36. In deciding whether products are likely to be good sellers, the warehouse club toy buyers rely on their own assessments of products characteristics, the strength of the product brand and on information concerning such things as planned manufacturer advertising in support of the products. (Halverson 3:352/4 - 353/18; Hilson 20:4581/4 - 4582/13; Jette 5:1003/12 - 1004/16.) Warehouse club toy buyers typically do not make product selections based on other retailers' advertising plans or sales experience. (Hilson 20:4582/14-21; Halverson 3:354/5-19; Jette 5:1004/17-23.)

37. Many toys carried by warehouse clubs are not best-sellers. Complaint counsel's marketing expert showed that in 1991 of 310 toy items carried by warehouse clubs that year, 11% were among the 100 top-selling toys industry-wide, and 27 % were among the top 500. (CX-1827; Ingene 41:9078/20 - 9079/20.) In 1991 the warehouse clubs were not successful in "cherry-picking" only the best-selling toy items for their product lines.

#### AGREEMENTS

##### *A. Warehouse Clubs as an Innovation*

38. [ ] During the 1980's, warehouse clubs were selling mainly to business customers. But then they began to encourage private consumers to become members. (Zarkin 21:4791/24 - 4792/10.) [ ]

Using selective procurement of merchandise, sales from pallets rather than shelves, wide aisles to facilitate easy pallet movement, and avoiding low-priced items, the clubs operated at retail margins lower than those of TRU and the discounters. The margin between retail sales revenues (excluding fees) and merchandise procurement costs for Price Costco ranged from 9.1 - 9.4% in fiscal years 1992 to 1995. (RX-342 at 8; Sinegal 2:150/2-12.) At Pace, the average mark-up was 10 - 14 %. (Halverson 3:355/22-25.) [ ] Sinegal, the president of Price Costco, testified, "Almost invariably our presence in the community is going to have a tendency to drive prices down." (Sinegal 2:200/10-12.)

39. [ ] According to a May 1989 analysis by Goldman Sachs in the TRU files (CX-1632):

We continue to regard the warehouse club industry's prospects as quite bright \*\*\* Price Company's skills as a merchant and an operator are unsurpassed \*\*\* we also believe that the combination of value and merchandise excitement offered by warehouse clubs is simply being discovered by more and more shoppers \*\*\* We continue to believe that this retailing revolution has much further to go, and the tilt to retail simply means that warehouse clubs are becoming an increasingly important competitive factor for traditional retailers in nearly every merchandise category.

40. The clubs' lower prices threatened TRU's reputation as a toy discounter. (Goldstein 36:8110/2-10.) [ ]

41. Toys "R" Us initiated a price image program in February 1991. This program lowered prices on some high profile, volume products. (CX-1038-E.)

42. TRU knew that consumers form opinions of a store's relative prices based on highly visible items. (Scherer 22:5006/21 - 5008/7; Carlton 32:7075/1-11.) TRU designates these toys as "Price Image" or "Price Sensitive" items. (Goddu 30:6543/23 - 6544/13.) TRU priced these items at lower margins than other products to enhance TRU's price image. (CX-1024; Goddu 30:6544/18-19.) These items bring customers into the TRU stores where they will also buy other, high profit margin toys. (Goldstein 36:8135/4.) TRU had sales of \$500 million of these items in 1995. (CX-1826.)

43. [ ]

44. [ ]

45. TRU price charts track competition in geographic areas. (Goddu 30:6555/19 - 6558/5.) These areas match newspaper circulation areas (known as an ADI or Area of Dominant Influence).

(Goddu 30:6556/12-23.) Price-sensitive items are priced based on the competition in an ADI. (Goddu 30:6554/6 - 6559/7; 31:6790/22 - 6796/23.) In setting prices, TRU considers national discounters (Target, Kmart and Wal-Mart) and some regional retailers. (Goddu 30:6527/11-19.)

46. Senior TRU executives discussed the warehouse clubs since 1989. (Goddu 30:6613/8-10.) The architects of the response to club competition at TRU were Goddu, Lazarus, Nakasone and Goldstein. (Goddu 31:6826/3-6.)

47. [ ]

48. TRU shopped warehouse clubs in 1989. (Goddu 30:6746/3-9; CX-1545-B.) TRU learned that Price Club, Costco, BJ's and Pace carried 120-240 toy SKUs competing with TRU. (CX-1545-B.) [ ]

49. TRU knew that the clubs had lower costs and thinner margins. (CX-1042-43; CX-1036-I.) TRU felt its costs were the lowest in retailing, other than the warehouse clubs. TRU's U.S. expense rate to sales is 17%. The expense ratio at the clubs is 9%. (Sinegal 2:162/22-163/9.)

50. [ ]

51. TRU executives believed that the clubs were in the same class as Wal-Mart as a competitive threat. [ ] Spencer, 9:1844/19 - 1845/1.)

52. TRU feared that the clubs' prices could damage its price image and cause it to lower prices. (Goddu 31:6798/24 - 6807/8; [ ] TRU worried that the clubs were forcing down prices at other retailers the same way that Wal-Mart had. (Goddu 30:6615/20-6618/2; 31:6818/11-6819/7; CX-1576-B.) [ ]

53. TRU feared that the clubs would erode TRU's profits and price image. "We were concerned that, in the eyes of the customer, they would be recognized as being a price leader." (Goddu 30:6616/11-12; [ ]

54. [ ]

55. TRU watched warehouse clubs competing near TRU stores. In 1992, TRU created a list of TRU stores that competed within a five-mile radius of warehouse clubs. (CX-912-A.) This document was circulated to Lazarus, Goddu, Goldstein, Nakasone, and Reinebach. (CX-912-A.)

56. [ ]

57. [ ]

*B. TRU and the Warehouse Clubs*

1. Toy manufacturers

58. TRU began to discuss the clubs with its suppliers, Mattel, Fisher-Price, and Playskool in 1989-1991. (CX-529; Cohen 35:7937/7-24, 7938/6-13; Spencer 9:1847/18 - 1851/11.) TRU said it might stop buying from manufacturers that sold to the clubs. (Spencer 9:1850/3-18.) TRU's top officials contacted Mattel and "threatened to 'review' their support of those manufacturers that overly supported the warehouse clubs." (CX-529.)

59. TRU's first written policy relating to sales by manufacturers to warehouse clubs was in late 1990 or early 1991. (CX-957, Goddu 30:6628/10-23.) This early approach was complicated and was abandoned by TRU. (Goddu 30:6629/16-25.)

60. Prior to and at Toy Fair 1992, TRU informed the manufacturers of its warehouse club policy (CX-1681):

Warehouse Clubs - TRU Position

- No new or promoted product unless entire line is carried.
- All specials and exclusives to be sold to the clubs should be shown first to TRU to see if TRU wants the item.
- Old and basic product should be in special packs.
- Clearance/Closeouts are OK providing TRU is given first opportunity to buy this product.
- No discussion about prices.

This document, drafted by Goddu, is dated January 29, 1992. (CX-955; Goddu 30:6631/11 - 6638/8, 31:6826/11 - 6829/22; CX-1793.)

61. The TRU theme at Toy Fair 1992 was the clubs. (Spencer 9:1863 - 1864; Verrecchia 7:1503 [ ]

62. [ ]

63. [ ] To avoid the future meetings, TRU sought the commitments up front.

64. [ ] A May 1991 LEGO market report gave the toy manufacturer's view of the clubs:

Warehouse clubs are the ultimate extensions of low margin, low cost, high turn philosophy. In fact, clubs may be the most important new format development in retailing in the past century. Retail sales should approach 28 billion in 1991, which is a four fold increase over the past four years. . . . There will be over 500 warehouse clubs in the U.S. by the end of the year generating about 55 million each in sales. No single market is saturated yet. . . .

(CX-487-B; CX-523 (Mattel) ("retail business is rapidly swinging to the clubs"); CX-506-B ("they sell large volumes of product to a certain type of consumer who chooses to shop there rather than elsewhere"); CX-698-B (Fisher-Price) (the opportunity for growth is phenomenal); CX-573-H (from 1988 to 1992, clubs fastest growing retail segment); CX-78 (Hasbro) ("Clubs are one of the fastest growing segments of the entire retail business"); CX-526.)

65. TRU also had to alleviate the manufacturers' fears of losing business to rivals who did sell to the clubs. (Scherer (CX-1822) at ¶¶ 32-53.)

## 2. Ceasing sales to the clubs

66. Manufacturers were reluctant to restrict sales to the warehouse clubs. [ ]

67. [ ]

68. The manufacturers did not want to give up sales and they were also concerned that their competitors would gain share at their expense. "[I]t was obvious it was an economic thing as far as they were concerned. If the competitor's products was there, they wanted to be there too." [ ] The manufacturers did not want their competitors to sell to the clubs if they could not. (Lazarus 24:5443/9-10; [ ])

69. The competition between the manufacturers with respect to the clubs -- the interbrand competition -- was intense. The manufacturers told TRU that they were in the clubs because their competitors were there. This information was transmitted between the manufacturers by TRU.

70. Mattel, Hasbro, Tyco, Little Tikes, Fisher-Price and others all wanted to know how competitors were reacting to TRU. The manufacturers wanted assurances from TRU that their competitors were subject to the same rule. (DePersia 10:2149/15 - 2151/4; Goddu 30/6679/20 - 6680/13.) They informed TRU that they wanted a level playing field to avoid being placed at a competitive disadvantage. (Goldstein 36:8157/23 - 8158/4.)

71. The president of Hasbro's Playskool division testified that he wanted a level playing field, which included not wanting competitors to have access to volume that Hasbro could not have. He did not want to be at a competitive disadvantage. (Owen 6:1131/3-18.) [ ]

72. Verrecchia believed that the agreements would not hold, and that Hasbro would be able to sell to the clubs again. (Inano

16:3335/15-20.) Verrecchia established club shops to determine whether Mattel or other competitors were selling regular line product to the clubs. These shops began after the restrictions. (Verrecchia 7:1365/18-1366/1, 1368/3-9; 1373/16-20; CX-46 - CX-63; CX-71.)

73. Prior to the TRU conduct, Hasbro knew that its competitors were selling regular product to the clubs. [ ] He asked Hasbro personnel to be "very aggressive" in determining what Mattel and other competitors were selling to the clubs. (Verrecchia 7:1489/13-23.) [ ]

74. Hasbro complained the most frequently about competitor product in the clubs. [ ] 30:6701/13-18; CX-336.) [ ] Fisher-Price and others also complained when regular line product from their competitors was found in the clubs. [ ] Weinberg 34:7628/15-34:7629/1; CX-811; Shiffman 10:2017-7-18; 2018/3-16, 2021/24 - 2022/7, 2026/3-6.) And when Mattel heard rumors that Hasbro and Tyco might be selling regular line to the clubs, the president of Mattel's Boy Division instructed that the clubs be shopped and the information sent to TRU. (CX-626-B.)

75. The manufacturers told TRU that they did not want to be prevented from selling regular line product to the clubs without assurances that their competitors were similarly excluded. Goddu found it "frustrating" that vendors were always talking about what their competition was doing. (Goddu 31:6877/11-13.)

76. The manufacturers did not want to be selling to the clubs when none of their competitors were. (Inano 16:3451/13 - 16; Moen 4:648/24 - 649/4, 651/17 - 23.) [ ]

### 3. Coordinated response

77. TRU tried to obtain a coordinated response from manufacturers by assuring them that TRU was applying its policy to each of its competitors and by telling each of the major manufacturers that its competitors were only selling to the clubs because the other was. TRU explained that the policy applied to everybody. (Goldstein 36:8157/23 - 8158/4.) Lazarus told manufacturers that TRU was talking to each manufacturer about its club policy, so that they would know there was going to be a level playing field. (Lazarus 24:5440/5 - 10, 5442/14 - 16.)

78. TRU told vendors that it would administer the TRU policy "in a fair and equitable manner across all vendors." TRU did this

"because it was of concern to the vendors that whatever we did with them, the same kind of merchandising approach was applied to their competition." (Goddu 30:6679/20 - 6680/4, 31:6871/11 - 6878/1, 6880/7 - 6883/3.)

79. [ ]

80. The manufacturers required assurance that their competitors would go along; they were aware that TRU was communicating its policy to the other manufacturers and that without unanimity, regular line product sales to the clubs would recommence.

#### 4. Manufacturers

81. In an October 1991 meeting between high officials of Mattel and TRU, Mattel CEO, John Amerman, told TRU CEO, Charles Lazarus, that Mattel "[W]ould not sell the clubs the same items we were selling them. This was based on the fact that competition would do the same." (CX-532-A.)

82. [ ]

83. Goddu understood each of the major manufacturers when they said that they were only selling to the clubs because their competition was selling to the clubs. and that they would get out of the clubs if their competition got out.

#### 5. *Quid Pro Quo*

84. During conversations with manufacturers, TRU did not merely announce that it would refuse to deal with manufacturers selling to the clubs, or inform manufacturers that all manufacturers would be treated equally. Instead, TRU communicated the *quid pro quo* (i.e., I'll stop if they stop) from manufacturer to manufacturer. (Goddu, IH (CX-1658) at 276-80.)

#### 6. TRU's orchestration of combination

85. TRU used the acquiescence of certain manufacturers in order to obtain the acquiescence of others. After Mattel agreed not to sell to the clubs the same products "based on the fact that competition does the same" (CX-532), TRU told Hasbro that Mattel had agreed. (Verrecchia 7:1393/5-14, 23-25, 1394/1-4; Owen 6:1128/5 - 1129/25, 1132/6 - 1135/9; Inano 16:3333/12 - 3335/7.)



86. TRU informed Hasbro that the club special pack only approach would probably also fly with other manufacturers. (Owen, 6:1136/20-1141/14.) [ ]

87. Before committing not to sell certain products to the clubs, Little Tikes asked TRU what its main competitor in the clubs (Today's Kids) was going to do. Goddu informed Little Tikes that Today's Kids "was going to start doing less business with the warehouse clubs," whereupon Little Tikes committed to restrict its sales. (DePersia 10:2147/7-14, 2147/18-24, 2150/3-12, 2150/25-2151/4.) [ ]

88. TRU attempted to gain agreement from Sega and Nintendo to not sell any products to the clubs.<sup>3</sup> [ ]

89. TRU's Goddu explained how he dealt with Sega and Nintendo [ ]

90. Lazarus and Goddu told Sega that TRU had convinced Nintendo to stop selling product to the clubs as part of TRU's effort to convince Sega to do the same. (CX-1776; Kalinske 12:2490/7-25, 2491/24 - 2492/2.) TRU argued that Sega should stop selling because TRU had convinced Nintendo to stop. (Kalinske 12:2515/12 - 2516/2.) Hasbro's Milton Bradley division president wrote on August 13, 1992, that TRU's Goddu told him what Hasbro's competitor, Mattel, was doing regarding the clubs (CX-1612):<sup>4</sup>

In a conversation I had with Roger Goddu yesterday, I thought it was interesting to note that he claims to have had a conversation with Mattel executives, including Amerman, on Tuesday concerning the warehouse clubs and Mattel's fear that this whole issue will end up in the courts.

He further went on to explain that their fear wasn't based on the issue of a manufacturer's right to pick and choose the customers they want to sell, but rather, they were concerned that the case could lead to questions concerning the discounts and favorable treatment that one customer may receive relative to another. In essence, Mattel's major concern is that a court case could lead to exposure of the terms and discounts that they give to Toys "R" Us.

91. [ ]

92. [ ]

93. On August 10, 1992, TRU circulated internal Hasbro memoranda detailing the extent to which Hasbro's competitors,

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<sup>3</sup> [ ]

<sup>4</sup> This discussion refers to the memorandum summarizing the results of TRU's contacts with various manufacturers. (CX-913-A-F.)

including Mattel, were restricting (or not restricting) sales to the clubs. (CX-1633; Goddu 30:6689/13 - 6690/10.) [ ]

94. TRU promised to "take care of it" after Fisher-Price representatives complained about a TV-promoted Playskool product they found in Price Club. (Chase 8:1666/4 - 1667/1.) After Tiger complained about finding a competitor's product in the clubs, a Tiger representative testified that Goddu told him: "because this was a new company and they hadn't, you know, explained their policy with regard to club sales to the people at Yes Entertainment, basically, it was you know, kind of like what we told them, don't do it again or God knows what." (Shiffman 10:2027/10-14.)

95. The transmission of the complaints between the manufacturers allowed TRU to monitor compliance with the agreements and assured the manufacturers that their competitors were complying.

96. By these communications, TRU facilitated horizontal agreement among the manufacturers.<sup>5</sup>

97. The manufacturers did not want to be placed at a competitive disadvantage against their rivals. (Scherer (CX-1822) ¶ ¶ 41-50; Owen, 6:1130/15 - 1134/18; DePersia. 10:2146/10-25; Lazarus, 24:5441/17 - 5442/16.)

98. TRU policed the agreements with the manufacturers. It regularly conducted "shops" of the warehouse clubs to determine which manufacturers were selling product to the clubs. (Goddu 30:6746/3-9; CX-1545 through CX-1565.) [ ] TRU's policing was aided by manufacturers who reported to TRU when they found their competitors' products in the clubs, including Mattel, Hasbro, Fisher-Price, Nintendo, Sega, Western Publishing, and Little Tikes. (Goldstein 36:8157/2-22, 36:8230/12 - 8242/10.)

99. [ ] These contacts were made at the request of Charles Lazarus. (24:5437/18-22.) Zablow of Mattel wrote on September 12, 1991, that Bob Weinberg of TRU "visited Costco on the West Coast. He called to comment that he felt that there was an 'inordinate' amount of Mattel infant product being sold in this store vs. product of other vendors." (CX-529.) Weinberg of TRU called Today's Kids about two products he saw in a warehouse club. Weinberg told Today's Kids that it needed "to do something to the item or the packaging." (CX-857.)

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<sup>5</sup> When a manufacturer complained about sales to the clubs, these communications related to the most immediate competitors. [ ]

100. In the spring of 1992, Goddu and his staff investigated products found in the clubs during a club shop (CX-926 - CX-927); the results were reported in a memo from Goddu to TRU's Lazarus in June 1992. (CX-913; Goddu, 30:6748/2-6754/13.) TRU discussed this with manufacturers during 1992 and 1993. (Goddu. 31:6863/19 - 6864/4.)

101. TRU's threats resulted in manufacturers' communicating back to TRU their commitment not to sell certain toys to the clubs. [ ] This memo was sent to TRU's then-CEO, Charles Lazarus:

MFG.	DESCRIPTION	COMMENTS
Hasbro	Puppy Surprise	Shipped early. No more will be shipped to warehouses.
Binney & Smith	{various}	Per Brent Blaine, understood our concern. Going forward they will offer special packs only for '93. Commitments already made for '92.
Mattel	Barbie Dream House	Sold LY mdse. Will not sell again.
Huffy Sports	Graphite Ultra Pak	Per Dave Allen, VP Sales, they admit their mistake. Effective immediately only special Backboards will be sold to clubs...
Playtime, (Div. of Tyco)	Super Saturator	Per Howard Abrams, SVP Sales, pleaded ignorance. He's now aware and other than some prior commitments, they will only sell club "special" item or items we don't carry.
Today's Kids	Activity Rocker Little Golfer All Star Baseball	Per Jim Stephens, they needed the business, but fully understand our position. They will sell special items going forward.
Tyco	123 Firehouse Blocks Deluxe Set Magnadoodle DB Nursery/Playground	Per Ken Shumaker, these are goods shipped last year - prior to their new "no ship" policy on current goods we carry.
Century Fisher-Price	Elite Car Seat Nursery Monitor	Vendor will stop shipping BJ's. They have agreed to stop selling this item to the clubs.
Safety 1 <sup>st</sup>	Swivel Bath Seat	They have agreed to stop selling the clubs this item.

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Playskool Baby (a Hasbro Div.)	Nighttime Feeder	We have reached a corporate agreement on the sale of this item to the club stores.
Kransco	Swim Sweater	Will not be selling like items to them next year. Will change graphics/packaging to differentiate item in future.
Morey Boogie	Sting Ray Board	Admitted they screwed up - will not happen again. Will continue to sell them but in a "completely" different packaging and graphics on the boards.
Nintendo	Asst.	"Not getting it from Nintendo" per Randy. They will "look into."
Sega	Asst.	Will continue to sell as long as Nintendo is in Warehouse Clubs.

102. TRU became dissatisfied with the manufacturers' efforts not to sell hot or promoted products to the clubs. TRU concluded that commitments relating to hot product were too difficult to interpret. (Goddu 30:6639/6 - 6645/2.)

103. TRU changed and simplified its policy during late '92 or early '93. TRU told manufacturers it would not buy any product sold to warehouse clubs. (Goddu 30:6645/5-9; 31:6846/22 - 6848/9; 31:6861/22 - 6862/22.)

104. There was some testimony that TRU stated they were simply "reserving the right not to buy" products they found in the clubs, but the weight of the evidence is that TRU told manufacturers that TRU would not buy products that did not comply with the TRU policy. [ ] (CX-809 (Tiger) (TRU won't buy, period end of story); CX-1521 (Little Tikes) ("make it clear that TRU will not carry identical products as the warehouse clubs"); CX-532 (Mattel) (TRU will "allocate open-to-buy based on who agreed not to support the clubs"). [ ] In a document drafted around Toy Fair 1993, Greg Staley from TRU's international division summarized TRU's policy as follows:

Our buying is simple - we will not carry any identical item which is sold to a Warehouse Club. If we find an item in both our assortments and those of a Club, we will discontinue carrying that item immediately; and we reserve the right to take clearance markdowns to dramatically accelerate the rate of sale on that item. In

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summary, the vendor has to make a choice as to whom he sell an item - either us or them. Discussions with our vendors should not go beyond what I have stated above.

(CX-1591; Goddu 6864-65 (confirms this was TRU policy at the time).)

105. By early 1993, Mattel, Hasbro and others ceased selling any identical product to the clubs. TRU policed these agreements by "shopping" the warehouse clubs. (Scherer 24:5403/1-2.) Manufacturers also continued to report to TRU when they saw their competitors products in the clubs. (CX-811: Shiffman 10:2017/7- 18, 2018/3-16, 2021/24-2022/7, 2026/3-6.)

#### 7. TRU's intent

106. TRU club policy aimed at eliminating the competitive threat of the clubs. TRU tried to keep merchandise out of the clubs, or to make sure that the price of toys in the clubs was not directly comparable to TRU's price. (Goddu, 3 1:6840/20 - 6841/7.)

107. TRU tried to gain commitments from the manufacturers to sell the clubs only combo packs or differentiated product: [ ]

108 TRU did not object to the clubs selling combination packs because (1) they prevented the customer from making a direct pricing comparison between items on TRU shelves and the clubs shelves, (2) TRU did not want the packs, and (3) consumers were less likely to want combination packs than individual items. (Lazarus 24:5430/16-23, 5430/24-5431/4, 5431/18-29, 5432/12-14, 5433/3-10; Goddu 30:6635/13-24; 31:6827/20-22; RX-813-A.)

109. TRU argues that the primary reason for the club policy was TRU's inability to obtain hot product. (Lazarus 24:5350/21 - 5351/3; Butler 5490/17-22.) The exhibits relating to perceived shortages occurred after the club policy was implemented, and those shortages were not attributed to the clubs. (Carlton 32:7227/6 - 7228/11.) [ ]

110. Goddu testified that shortages were not the primary focus of the policy. [ ]

111. [ ]

#### C. Agreements

##### 1. Mattel

112. Since 1993, Mattel Inc. ("Mattel") has been the nation's largest toy manufacturer. (CX-1814; Verrecchia 7:1317/25 - 1318/11.)

In 1994 its share of the U.S. toy market was 18%. (CX-1669-C.) Mattel's products include the Barbie doll line, Hot Wheels, Disney toys, pre-school toys and Nickelodeon. (Okun 13:2604/24 - 2605/4.)

113. In November 1993, Mattel acquired Fisher-Price, [ ] (Chase 8:1641/9-13; Cohen 35:7926/9-17; [ ]) In 1997, Mattel acquired Tyco, then the nation's third largest toy maker whose popular toys include Magna-Doodle, Tickle Me Elmo and Sesame Street products. (Grey 14:2985/16-22, 2986/5-9, 16-18; Hilson 20:4484/23 - 4486/1; CX-1814.)

114. TRU is Mattel's largest customer. (CX-1669-D; CX-1276-D-E.) TRU bought 25% of Mattel products in 1992 and 29% in 1993. (CX-1276-E; CX-1669-D; [ ]) In 1985, TRU accounted for 12% of Mattel sales. (CX-1669-D.)

115. In December of 1990, Mattel's CEO, John Amerman, stated to his staff: "The constriction in the number of traditional retail outlets that carry toys" was going to be a "bigger and bigger problem as time passes." (CX-523.) He mentioned the financial problems of Child World and other major customers of Mattel. (CX-523; [ ])

116. Amerman noted the clubs' rapid growth rate. He told his staff that he wanted to be much more aggressive in pursuing the club channel of distribution, so Mattel would not be as dependent on TRU. (CX-523; [ ])

117. Mattel's retail customers became increasingly concentrated. Mattel's sales to the top five toy retailers (TRU, Wal-Mart, Kmart, Target and Kay Bee) increased from 28% in 1985 to 53% by 1990 and a projected 72% in 1994 (CX-1669), with TRU and Wal-Mart accounting for almost half of Mattel's sales volume. (CX-1669-B; [ ])

118. [ ] From 1989 to 1991, Mattel's sales volume to the clubs increased by 87%. (CX-574; [ ] 2653/19.) Mattel's overall sales growth rate increased by 10% during this period. (CX-530-E; [ ]) In 1989, 94% of the clubs' purchases from Mattel were from its regular product line (as compared to customized product). (CX-691; [ ])

119. On September 26, 1991, for a meeting called by TRU to discuss the club and other issues (CX-530-A; [ ]), Mattel's vice president, Frederick Okun, sent a briefing memo to his boss Jill Barad (then-president of Mattel's girls division):

WAREHOUSE CLUBS

This is one of the fastest growing channels of distribution in the country. As a public company we owe it to our shareholders to maintain our business by selling this class of trade. . . . Two years ago we committed to Toys R Us that we would do our best not to sell them regular line goods. We have reached a point where we are selling them approximately 50% of our volume on a customized basis. We will continue to move in this direction and promise to increase the percentage sold on a customized basis.

(CX-530-B.) The memo recommended in connection with the upcoming meeting with TRU that Mattel "should commit" not to sell critical items to the clubs. (CX-530-B.)

120. The memo's reference to Mattel's commitment to TRU two years earlier to do its best not to sell the clubs regular line product relates to Toy Fair 1990. ([ ]) TRU's officials met in February 1990 with Mattel's officials and "threatened to review their support of those manufacturers that overly supported the warehouse clubs" (CX-529; [ ]). Following Mattel's commitment to TRU in February 1990, by September 1991 Mattel's sales of regular line product to the clubs dropped from 94% in 1989 to 50% in 1990. (CX-530-B; CX-691.)

121. An April 1990 Mattel memo states that Mattel's then-president, Bob Sansone, discussed with TRU Mattel's "policy to grow the Wholesale Club business with non-competing SKUs." (CX-600-B; [ ]) Mattel vice president Okun's response in December 1990 to John Amerman's memo (CX-523) urged Mattel to aggressively pursue the club channel of distribution. In his memo, Okun states "[w]e must acknowledge the TRU issue, but if we give [the clubs] specials we should be ok." (CX-595-B; [ ].)

122. In 1990, TRU and Mattel reached an agreement under which Mattel committed to TRU that it would do its best to move the clubs away from regular line product to customized product and Mattel adhered to its commitment.

123. The meeting referred to in Okun's September 6, 1991 memo was at TRU's headquarters on October 3, 1991. (CX-1763.) High level TRU and Mattel executives attended. (CX-532; [ ]) Okun wrote a summary of that meeting the same day. ([ ]; CX-532.)

124. At the meeting, [ ] He said "regular line specials" were not the answer and that Mattel would have to choose between selling the same items to TRU and to the clubs. (CX-532-A; [ ]) At the meeting TRU vice chairman, Michael Goldstein, said that TRU "was

going to allocate open-to-buy based on who agreed not to support the clubs." (CX-532-A).

125. In response to TRU's threats ([ ] Barad 35:7843/18 - 7844/1), Mattel's CEO, John Amerman, assured TRU that Mattel would not sell the same items to the clubs that it was selling to TRU. (CX-532-A; [ ]) TRU vice president, Roger Goddu, testified that Amerman committed to TRU that Mattel would not sell any merchandise to the clubs. (Goddu 30:6663/6-22.)

126. Okun's meeting summary said that Amerman's statement not to sell the same items to the clubs that it was selling to TRU "was based on the fact that competition would do the same." (CX-532-A.) [ ]

127. Mattel conditioned its agreement on its competitors also going along with TRU's club policy. (Goddu IH (CX-1658) at 276/8 - 279/21.) I find that it was not in the unilateral business interest of Mattel to enter alone into an agreement with TRU because if it was in Mattel's unilateral interest, it would have done so without regard to the positions taken by its competitors.

128. Mattel also "agreed" at the meeting to supply TRU with customer quantities and volume, even though Okun was nervous about supplying data to TRU about TRU's competition. [ ] I find it was against Mattel's unilateral business interests to transmit this confidential competitive information to TRU.

129. After the October 3, 1991 meeting, Barad told TRU's Roger Goddu that he should realize that Mattel could not live up to what its CEO has agreed to and added, "we need to talk." (Goddu 31:6885/17 - 6887/2; Barad 35:7891/19 - 7892/10.) Barad then called Goddu a few days later and told him [ ] "we'll get back, we'll work this thing out." (Goddu 31:6887/17 6888/15; Goddu IH (CX-1658) at 282/13 - 284/12.)

130. Barad testified that she also called TRU's Michael Goldstein within a few days of the October 3, 1991 meeting, in order to tell him that she knew what Amerman had said, but that Mattel could not stop selling everything to the clubs because Mattel already had outstanding commitments to them, and what Mattel really wanted to do was to sell special packs to the clubs. (Barad 35:7894/7-20; Goldstein IH (CX-1659) at 100/17-101/13; Goldstein 36:8266/25 - 8268/22.) Barad further testified that Mattel wanted to continue selling to the clubs because she thought the clubs were an important channel of



distribution in order to grow Mattel's business. (Barad 35:7896/21 - 7897/7.) [ ]

131. Following the October 3, 1991 meeting and Barad's follow-up phone calls to Goddu and Goldstein, Mattel committed to sell only exclusive items to the clubs. (Goddu 31:6891/13 - 6892/14.)

132. Two weeks after the October 3, 1991 meeting, a memo from Rita Rao of Mattel to Mattel's Arco division president, Bill Quinlan, stated that Arco would not be permitted to sell the clubs Mattel's current promoted products. (CX-624.) Rao also suggested showing specialized products to TRU's Peter Spencer before showing them to the clubs. If Spencer passed on buying these products, she wrote, it would then be "ok to sell to the Clubs." (CX-624.)

133. A January 22, 1992 memo from Cathy Larson, Arco's then-vice president of marketing who had just come to Arco from its parent company Mattel [ ] summarized a conversation she had with Okun and stated that Mattel had initially "committed" not to do "any business with the clubs" but that Mattel had been able to "negotiate to do exclusive items only so that there would be no direct competitive threat to TRU." (CX-540.)

134. The Larson memo stated that "our agreement with TRU is that all of these [club] items will be offered to them as well so we must plan for a presentation to TRU." (CX-540.) It also stated that the clubs "do not know that we will not be selling them the regular line dolls. U.S. Sales will position it to them as risky availability items." (CX-540.)

135. Mattel's Arco division operates as a letter of credit business under which its customers purchase products by paying prior to shipment from manufacturing plants located in the orient. (Leighton 15:3145/14 - 3146/3.) The reference to "U.S. Sales" in Larson's memo refers to the Mattel Toys U.S. operation. (Okun 13:2604/5-21.) Okun, Mattel's vice president for U.S. sales, and Tom Northup, the Mattel employee who sold to the clubs (Ojendyk 18:3983/2-12), received copies of this memo. (CX-540.)

136. Okun discussed with Larson TRU's meeting with Mattel where according to him, "TRU came away thinking there was an agreement." [ ]

137. [ ] that the contemporaneous business documents and Mattel's actions that are consistent with these documents are entitled to more weight than Okun's explanation.

138. [ ] Butler told Spencer that they would review Arco merchandise to "select what merchandise could be shown to the warehouse clubs or what merchandise was not to be shown to them." (Spencer, 9:1860/3 - 1861/25.)

139. A July 21, 1992 memo to Mattel CEO Amerman from Arco's president Bill Quinlan, who also was present at Toy Fair 1992 when Arco showed its club specials to TRU's Spencer and Butler [ ], corroborates this account of the event: "At Toy Fair we showed Van and Peter all of our club specials. We paid particular attention to the Barbie doll/Arco accessory combinations. We offered each and every one to TRU on a 'right of first refusal' basis. They passed on every item leaving us free to sell to the Wholesale Clubs." (CX-550-A; CX-624.)

140. At Toy Fair 1992, Mattel told Costco's toy buyer Michelle Moen that some items that she wanted would not be available because they would be in short supply. (Moen 4:609/9-610/19-20.) Items are not typically in short supply at that time: some items have not even been produced yet. (Moen 4:612/9-15.)

141. During Toy Fair 1992, Pace's Halverson asked Mattel salesman Nick Snider why they were not stopping to look at certain regular line Mattel products, and Snider told Halverson that Pace could not buy those products. (Halverson 3:378/24 - 379/16.) Snider admitted to Halverson that TRU executives had pressured higher-level Mattel people not to sell key items to the clubs, in part because the clubs sold these products at a lower retail price than TRU, which hurt TRU's value image. (Halverson 3:379/15 - 381/12.)

142. At Toy Fair 1992 and on other occasions, TRU told Hasbro that Mattel and other manufacturers had agreed not to sell promoted product to the clubs. (Inano 16:3333/12 - 3335/5, 3343/17 - 22; Owen 6:1132/6 - 1135/9; Verrecchia 7:1391/22 - 1393/14, 1393/23 - 1394/4.)

143. At a meeting on February 27, 1992, TRU executives Goddu, Butler and Spencer and Mattel's Okun (CX-541) agreed to TRU's right of first refusal and Mattel's not selling certain products to the clubs. [ ] Mattel's written summary of the meeting describes the agreements reached (CX-541):

WAREHOUSE CLUB

- Agreed to show TRU all specials/exclusives . . . they will have first right of refusal.

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- Regular line product - won't sell them hot product that we know about, i.e., Teen Talk, Totally Hair, etc. We did not agree that we would not sell them any 1992 regular line items.
- We agreed not to ship Warehouse Club items we can't supply TRU.
- Roger will talk to Charles . . . can't predict his reaction.

144. During the spring of 1992, Mattel was still taking orders from the clubs for regular line product. In March and April 1992, Costco placed with Mattel orders for the Christmas season, with deliveries to begin in early August. (Moen 4:611/2-7, 619/10-25.) In April of 1992, in response to a letter from Costco about certain products Costco wanted that Mattel was not offering to them (CX-1369), Mattel's Jill Barad informed Costco that "when we feel production capacity or availability are potential issues, we have tried to guide you away from the item." (CX-1371.)

145. Pace also placed orders with Mattel in the spring for the Christmas 1992 season (CX-1710-A-Z-33) and received written confirmation from Mattel. (Halverson 3:371/18 - 372/15, 561/6 - 563/14.) One of the items Pace ordered from Mattel was Air Pro Hockey, but Mattel tried to steer Pace to a "special" version with extra hockey sticks added, which would have made the product a poor value and the retail price non-competitive for Pace. (Halverson 3:372/12 - 374/13; CX-1633-B.) Pace buyer, Scott Halverson, complained to Mattel and Mattel shipped some of the regular line product in the spring without the added sticks. (Halverson 3:374/14-25; CX-1633-B.)

146. Pace's additional orders for Air Pro Hockey were scheduled to be delivered in July 1992. (Halverson 3:375/1-9.) However, the product did not arrive on schedule, and when Pace asked Mattel when it could expect shipment, it received no answer. (Halverson 3:375/3-9; CX-1692.)

147. In late June 1992, one of TRU's vice presidents, Robert Weinberg, complained to Mattel about finding Air Pro Hockey and two other TRU-promoted products in the clubs. (Weinberg 34:7690/20 - 7691/23, 7701/10 - 7702/3; [ ].) To protect its image for low prices and avoid being embarrassed with its customers, TRU marked down the prices on these products [ ] to meet the club prices in areas where the club stores competed with TRU stores. (Weinberg 34:7696/13 - 7698/10, 7701/10-19, 7703/20 - 7705/6; [ ].) TRU put a hold on payment to Mattel for these products in order "to send a message" to Mattel. (Weinberg 34:7692/11 - 16, 7699/13 - 22.) [ ]

148. At a meeting on July 17, 1992, of TRU CEO Charles Lazarus and Mattel CEO John Amerman (CX-1772), [ ]

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

150. On July 24, 1992, the president of Mattel's boys' division, David Mauer [ ] wrote a memo to Mattel's CEO. (CX-626.) The memo states: "Our company policy is to ship only specials to the clubs. As a general rule, the specials will not include what is likely to be hot/allocated first year merchandise. I recommend, however, that if we are in doubt about whether a special falls within the guidelines that we expose it to TRU, rather than assume it shouldn't be shipped." (CX-626-A.)

151. Mauer's memo states that the "'specials only policy' will be implemented immediately .... Our new policy will result in some volume loss to Mattel for the balance of the year,"<sup>6</sup> and that an upcoming meeting was scheduled on August 10, 1992 between Mattel and TRU for TRU "to review the specific product that will be shipped to the clubs for the balance of the year." Mauer suggested that Mattel should ascertain what its competition was shipping to the clubs so that the matter could be raised with TRU and that the 'specials only policy' should be conveyed to the clubs at Mattel's pre-Toy Fair meeting in La Jolla, California. (CX-626.)

152. [ ]

153. Also on August 10, 1992, TRU's Goddu sent to his CEO confidential internal Hasbro reports listing various Mattel regular line products that Hasbro found in the clubs and relating assurances by Mattel's Amerman to one of the clubs' toy buyers that Mattel would ship the club the regular line items it had ordered. (CX-1633.) On August 12th, Goddu talked to a Hasbro division president about a conversation he had with Mattel executives, including Amerman, concerning the warehouse clubs. (CX-1612.)

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<sup>6</sup> Mattel reported that "in 1992, Price Costco was booked in excess of \$13,000.0 million [sic] prior to Mattel's decision to sell only customized products" to the clubs, but only sold \$5.7 million. (CX-590.) This confirms both the implementation of a specials only policy in 1992, and the effect on sales to the clubs.

154. Goddu testified about ongoing conversations he had with both Mattel and Hasbro (as well as other vendors), in which he assured each that the other was selling to warehouse clubs "only because my competitor is there." (Goddu IH (CX-1658) at 276/17 - 277/25): [ ]

155. Pace's buyer testified that around August 10th "all of our orders for Mattel dried up." (Halverson 3:414/14-20.) Mattel toys due at Pace in the beginning of August did not arrive and Mattel representatives said the goods were not available and could not be shipped. (Halverson 3:414/21 - 415/9.)

156. On July 7, 1992, Mattel informed Costco that deliveries scheduled later in July would be on time. (CX-1372-A; Moen 4:619/10-25.) When the orders were not received by August 10th or 11th, Costco's toy buyer, Michelle Moen, called Mattel's sales representative who told Moen there were some product availability issues. (CX-1372-A; Moen 4:620/1-16.)

157. At Mattel's pre-Toy Fair in La Jolla, California held on August 24, 1992, Mattel told Moen and Costco's merchandise manager, Gary Ojendyk, that except for a few items, the unshipped orders from Mattel would not be delivered because the product was unavailable. (CX-1375-A; Ojendyk 18:3989/1 - 3990/11.) These orders were for the bulk of the toys Costco ordered for the 1992 Christmas season. (CX-1375-A; Moen 4:623/19 - 624/2; Ojendyk 18:3990/1-11.)

158. Mattel tried to sell Costco products from its international line, but Costco declined these items as higher priced than the domestic products Costco already had ordered. (CX-1375-A; Moen 4:622/18 - 623/7; Fuentesvilla 18:4117/2-24; CX-626-A.) When Costco asked if it could purchase other items from Mattel's domestic line, Mattel's Okun said everything in their domestic line was in short supply and nothing was available. [ ] CX-1375-A; Moen 4:623/8-18; Ojendyk 18:3991/5-13, 3992/17-24.) Mattel had over 1000 regular line products in 1992, and they were not all in short supply (Barad 35:7907/25 - 7908/5; [ ]

159. Mattel salesman Nick Snider, who attended the 1992 pre-Toy Fair meeting, called Ojendyk to apologize and told him that what Okun told Costco about product unavailability was untruthful. (Ojendyk 18:3996/5 - 3997/12; CX-1677.)

160. Mattel also told BJ's at the 1992 pre-Toy Fair that there was a shortage or every item that BJ's had ordered but had not yet received. (Hilson 20:4440/25 - 4442/4, 4443/1-8.) BJ's had placed its orders for the fall season in the spring and Mattel confirmed the orders. (CX-1330-A; Hilson 20:4443/21 - 4444/3.) But Mattel now said that BJ's would only be sold products that were reconfigured, bundle-packed or made special for the club channel of distribution. (Hilson 20:4441/21 - 4442/4.) When BJ's toy buyer, James Hilson, asked why there was a change in Mattel's policy, Mattel vice president Ramon Fuentesvilla said that Mattel's senior management was being either coerced or influenced by TRU. (Hilson 20:4453/3 - 4454/1.)

161. Following the August 1992 pre-Toy Fair, Costco, BJ's and Pace sent letters to Mattel complaining about the claimed shortages and threatening litigation if the products were not supplied. (CX-1688 (Pace); CX-1330 (BJ's); CX-748 (Costco).) Mattel then notified the companies that it would supply most of the products that Mattel previously said were unavailable to the clubs. (Hilson 20:4440/25 - 4441/20; Moen 4:628/2-18; Halverson 3:419/8-22.)

162. Following the 1992 pre-Toy Fair, Mattel created a task force to study how it should deal with the clubs. (CX-553-B; Amerman 17:3693/6-13.) In its memo setting up the task force, Mattel stated that its "marketing independence was compromised in 1992 by uninvited communications from Toys "R" Us." (CX-553-A.)

163. In late December 1992, Mattel's general counsel promulgated the formal club policy recommended by the task force that Mattel will not sell the same SKUs to the clubs as it sells to traditional retail channels and will only offer differentiated product to the clubs. ([ ] CX-688; [ ]) Mattel has followed this policy ever since. ([ ]; Barad 35:7917/22 - 7918/16.) [ ]

164. I find that Mattel's policy was not arrived at unilaterally, but through TRU's orchestration, with other manufacturers, including Hasbro. I also find that Mattel and TRU agreed that Mattel would submit to TRU for approval a product Mattel intended to sell to the clubs.

165. Mattel's change of policy in selling to the clubs retarded the growth of the clubs' sales of Mattel product. Mattel's sales of regular line product to the clubs dropped from \$17 million in 1991 to zero in

1993, and its sales of customized product to the clubs only increased from \$6.7 million to \$7.5 million in the same time. (CX-574.) Costco's sales of all Mattel products (both by Mattel Toys and by divisions owned by Mattel) dropped by more than half during this period (CX-1745-Z-11), even though the number of Costco stores increased (including Price Clubs) by over 40% (CX-1745-Z-10) and Costco's overall sales growth was over 25%. (CX-1745-Z-9.)

166. Based on the evidence discussed above and elsewhere in these findings, I find that Mattel, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to clubs.

## 2. Hasbro

167. Hasbro, Inc. ("Hasbro") is the second largest U.S. toy manufacturer with worldwide sales of \$3 billion. (Verrecchia 7:1316/16-17.) It has a 12-14% share of the traditional toy market in the United States. (Verrecchia 7:1317/5-13.) Forty percent of Hasbro's business is done outside the United States. (Verrecchia 7:1316/20-22.)

168. Hasbro's products include Mr. Potato Head, G.I. Joe, Monopoly, Tinker Toys, Lincoln Logs, Play-Doh, and toys based on motion pictures such as Star Wars and Jurassic Park. (Verrecchia 7:1412/14-16, [ ], 1336/13; Halverson 3:527/17-19.)<sup>7</sup> Hasbro's domestic operations include its Hasbro Toy Group (Playskool Toy, Hasbro Toy, Playskool Baby, Kid Dimension, and Kenner divisions), and its game group, (Milton Bradley and Parker Brothers). (Verrecchia 7:1315/19 - 1316/13.)

169. TRU is Hasbro's largest customer. (Owen 6:1102/13-14.) Currently, TRU buys 30% of Hasbro's toy and game sales in the United States. (Owen 6:1102/5-17.) [ ]

170. In 1991, Hasbro's Playskool division viewed the clubs as having growth potential that it wanted to exploit. (Owen 6:1105/4-7.) [ ]

171. In the fall of 1990, TRU's CEO, Charles Lazarus, met with Hasbro's executives and told them that the clubs were a threat to TRU because of their low prices. (Spencer 9:1848/4 - 1849/22.) He said that if Hasbro continued to aggressively supply the clubs, especially Pace, that this could affect their business at TRU, although he was

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<sup>7</sup> [ ]

open to the sale of multi-packs to the clubs. (Spencer 9:1850/3 - 1851/11.)

172. Playskool's president responded that his company could not stop doing business with the clubs, and that in view of the consolidation in the retail trade it was important for Playskool to have other customers than TRU. (Spencer 9:1850/23 - 1851/4.) [ ]

173. When national toy chains Lionel Leisure and Child World went out of business in the early 1990s, TRU was the only national free standing toy chain left. (Owen 6:1158/9-23.) The demise of these toy chains made TRU more important to Hasbro. (Owen 6:1158/24 - 1159/2.)

174. If TRU stopped purchasing toys found in the clubs, there would not be enough other outlets to make up the volume. (Owen 6:1151/3-10.) TRU's support in promoting a new product is necessary for success. (Owen 6:1154/6-9.)

175. Between late 1991 and 1992, TRU's vice president, Roger Goddu, complained to Playskool's CEO, Dan Owen, that a Playskool product was in the clubs. (Owen 6:1106/5 - 1107/25.) Goddu told Owen that TRU would not carry products Hasbro sold to the clubs. (Owen 6:1108/1-5.)

176. Owen wrote a memo on January 24, 1992 to Hasbro's CEO Verrecchia stating the clubs are one of the fastest growing segments of the entire retail business, and that Playskool's cost of doing business with the clubs is lower than average and much lower than for TRU. (CX-78.) He stated that "it is very important that we achieve some major concessions if we are to dramatically change the way we approach the Warehouse Clubs [sic]." (CX-78.)

177. Just before or at Toy Fair 1992, Hasbro's then western regional sales manager, James Inano, met with Verrecchia. (Inano 16:3333/12-3334/2.) Verrecchia said that he had just come from a meeting with TRU, that TRU had met with Hasbro's competitors, including Mattel and Fisher-Price, and that they had agreed not to sell promoted products to the clubs. (Inano 16:3334/21 - 3335/5, 3343/17-22.) Verrecchia said that because Hasbro's competitors had agreed not to sell promoted product, Hasbro would go along with the agreement, that Verrecchia did not expect them to stick to this course for long, and that when someone else sold promoted product to the clubs, "the door would be open for us." (Inano 16:3335/15-20.)

178. Verrecchia had complained to TRU that it was selling knock-offs of Hasbro merchandise and "that was one of the things he hoped



to gain in return." (Inano 16:3335/21 - 3337/6.) Verrecchia told his staff that Hasbro would not sell promoted products to the clubs and that Hasbro would watch other manufacturers' sales to the clubs. (Inano 16:3338/15-21.) Hasbro would refrain from selling to the clubs until another manufacturer broke the agreement. (Inano 16:3335/15-20.)

179. Inano's testimony about the agreement of major toy manufacturers not to sell promoted products to the clubs is corroborated. Verrecchia testified that TRU told him that the other major manufacturers would go along with its policy, which Verrecchia took to mean Mattel, Fisher-Price, Little Tikes, Tyco, and maybe Lego. (Verrecchia 7:1393/5-14, 1393/23-25, 1394/2-4.) Owen understood from his discussions with Goddu that Mattel, Fisher-Price, Tyco and Little Tikes would not be selling promoted individual in-line merchandise to the clubs. (Owen 6:1132/6 - 1134/17.)

180. The effort by Hasbro to seek concessions from TRU, including knock offs, is corroborated in a Hasbro document (CX-78) [ ] The reference to Verrecchia wanting to monitor what was happening with respect to the other manufacturers' sales to the clubs is also corroborated. (CX-180.)

181. Inano's testimony is further corroborated by notes showing that Inano told Pace's Scott Halverson in December of 1992 (which is closer to the time of the event) that he obtained information from his company that Mattel's Amerman agreed that Mattel could no longer sell products to the clubs and that Mattel would end up selling specially configured products to the clubs. (CX-1630-A-B; Halverson 3:428/17 - 430/4.)

182. Inano's bonuses were based on his sales to the clubs. (Inano, 16:3544/22-3545/6.) Acting without Hasbro's knowledge or authority, and perhaps showing more affiliation with stockholders than his superiors, Inano tried to help the clubs by talking to the clubs and their lawyers about possible litigation. (Inano 16:3454/10 - 3462/21, 3468/14-25.) Nevertheless, Inano's testimony is corroborated by other evidence, and I rely on it.

183. TRU asked Hasbro for a response to TRU's "policy." (Goddu IH (CX-1657) at 130/20-25). TRU informed Hasbro that its competitors had agreed not to sell promoted product to the clubs. Hasbro went along.

184. During 1992 and 1993, Hasbro's Owen spoke to TRU and described his company's evolving policies relating to not selling to the clubs some of the hottest toys. (Owen 6:1114/21 - 1115/5, 6:1117/6-9.)

185. When contacted by TRU about Hasbro products found in the clubs, Hasbro explained to TRU that its Puppy Surprise product was shipped early and that Hasbro did not plan to ship any more to the clubs. (Butler 25:5535/24 - 5535/18; CX-913-B.) TRU Vice President Butler confirmed that "[T]his was during the [1992] period...when they [Hasbro] had told us that they weren't going to ship key product to the warehouse clubs." (Butler 25:5535/5-9.)

186. In regard to a TRU inquiry to Hasbro's Playskool baby division about Hasbro product found in the clubs, TRU noted "[w]e have reached a corporate agreement on the sale of this item to the club stores." (CX-913-F.) Playskool was under the impression that less important items could be sold to the clubs." (CX-913-C.)

187. Hasbro wanted to ensure that TRU's policy on sales to the clubs was being applied to its competitors so that Hasbro would not be discriminated against. (Verrecchia 7:1385/7-25, 1376/16 - 1377/12.) TRU assured Hasbro that it was talking to the major manufacturers about the clubs [ ], Owen 6:1128/5 - 1131/2.)

188. Hasbro did not want to be placed at a competitive disadvantage by losing club sales volume to its competitors if it complied with TRU's policy and its competitors did not. It wanted a level playing field. (Owen 6:1130/24 - 1131/18.) [ ]

189. In May of 1992, at a toy manufacturers conference, Hasbro's CEO Allan Hassenfeld discussed with Tyco's CEO Richard Grey what each company was doing or not doing with respect to the clubs. (Grey 14:3011/12 - 3012/24.) Tyco's CEO discussed its 25-item policy with Hassenfeld. (Grey 14:3012/25 - 3013/4.)

190. Following Toy Fair 1992, Hasbro monitored its competitors' products in the clubs. (Verrecchia 7:1366/6 - 1367/7; CX-309; CX-47 - CX-50.) Verrecchia directed his staff to be "very aggressive" in determining whether Mattel and other competitors were selling to the clubs. (CX-180; [ ]; CX-363.)

191. Hasbro complained to TRU when it discovered product from competitors like Mattel, Fisher-Price, Nintendo, Little Tikes, and Tyco that should not have been in the clubs. (Verrecchia 7:1374/13 - 1376/20; CX-336.) [ ] Fisher-Price complained TRU that the clubs were selling Playskool's products. (Weinberg 34:7628/15 - 7629/1.)

And Mattel, through John Amerman or Jill Barad, complained to TRU that Hasbro's products were in the clubs. [ ]

192. [ ]

193. TRU's CEO admitted that he sent competitors' complaints about each other to the respective competitors. (Lazarus 24:5452/12-18.) He admitted that he could have sent to Mattel Hasbro's complaints about Mattel's product being shipped to the clubs. (Lazarus 24:5451/14 - 5452/7.) [ ]

194. At a meeting on July 17, 1992 (CX-1772) between TRU's Charles Lazarus and Mattel's John Amerman [ ] Later on the same day, Lazarus met with Hasbro's CEO, Allan Hassenfeld. (CX-1772; CX-1773-B; Lazarus 24:5448/13-16; CX-1174.)

195. Following the July 17th meeting with Hasbro, TRU received confidential internal Hasbro memos dated from June 30 to July 31, 1992, which reported information about Mattel's sales to the clubs as well as those of other Hasbro competitors. (CX-1633.) On August 10<sup>th</sup>, Goddu sent this information to TRU's CEO, [ ]

196. In an August 13, 1992 memo, the president of Hasbro's Milton Bradley division referred to a conversation he had with Goddu the day before concerning a discussion Goddu had with Mattel's CEO about the clubs. (CX-1612.) Around this time, Pace's and Costco's scheduled shipments from Mattel stopped because of alleged availability problems. (Halverson 3:414/4 - 415/9 (shipments "dried up"); Moen 4:619/10 - 621/22.)

197. TRU complained to Hasbro during 1992 about Hasbro products found in the clubs, most often through high level officials, Mike Goldstein or Roger Goddu. (Verrecchia 7:1353/6-17, 1363/13-24.) If the products sold violated Hasbro's policy, Hasbro would ensure that the sales to the clubs would not be repeated. (Verrecchia 7:1364/10-15.)

198. Playskool's former president, Dan Owen, was pressured by TRU and Goddu in 1992, concerning Hasbro's dealing with the clubs. (Owen 6:1145/17 - 1146/14, 1148/12-16.) Hasbro worried that TRU could retaliate against it in subtle ways, involving end caps, shelf space and advertising. (Owen 6:1109/1-14; Verrecchia 7:1407/10 - 1408/15.) But for TRU's pressure in 1992, Playskool would have sold more or different toys to the clubs. (Owen 6:1147/8-11.) Verrecchia acknowledged that Hasbro might have sold more toys to the clubs were it not for TRU's position. (Verrecchia 7:1414/5-12.)

199. Owen's statements about unwanted pressure from TRU were confirmed by other statements from Hasbro representatives. Jeff Berman of Hasbro told Pace's Halverson that "Geoffrey" [the TRU giraffe symbol] was "putting the screws to them." (Halverson 3:391/18-22.) Jim Inano also told Pace about TRU pressure and said the source of his information was Hasbro's CEO, Al Verrecchia. (Halverson 3:388/25 - 389/12.) Inano also made statements to Costco about TRU pressure. (Moen 4:769/12-19.)

200. In August of 1992, Goddu told then Playskool sales vice president, George Miller, that if Playskool continued to ship to the clubs, TRU would continue to purchase Playskool's TV-promoted product, but "wouldn't still buy [Playskool's] basic product." (Inano 16:3376/13-20, 3377/7-9, 3378/2-10.)

201. In 1992, when TRU found Hasbro selling its toys to Price Club, TRU called Playskool's then Vice President George Miller to its offices, and "took him to the shed." (Chase 8:1673/17-23.) Miller said "I never in my life want to go through that again." (Chase 8:1673/23-24.)

202. This occurred when Fisher-Price complained to TRU that Hasbro toys were in the clubs. (Chase 8:1666/4 - 1667/1.) TRU told Fisher-Price that "TRU was going to take care of it." (Chase 8:1666/18 - 1667/1; Verrecchia 7:1353/6-17, 1363/13-24.)

203. In 1992, Playskool promulgated a list of products captioned as "Verboten" to its sales staff that could not be sold to the clubs without receiving specific authorization. (CX-127; CX-130; [ ]

204. Some of Hasbro's claims that production shortages accounted for the clubs not getting product are specious. Inano told Costco that toys were available but that he was forbidden to sell them to Costco. (Ojendyk 18:4016/8-21.) A Hasbro memo states: "As discussed, we have no other planned business for the other warehouse clubs listed. We steered away from our regular items...due to 'capacity issues.'" (CX-132 quotes in original.)

205. Hasbro was willing to sell 15,000 One-Two-Three bikes to Costco in 1991, but only 2,000 of the bikes in 1992 when the line was no longer a new item. (Moen 4:665/18 - 668/11.)

206. In July 1992, Joseph Antonini (CEO of Pace's parent corporation, Kmart) complained to Hasbro's CEO: "Playskool has cut Pace's allocation over 75% from what was ordered and what PACE was told it would receive; and future orders are 'in doubt.'" (CX-364; CX-182.)

207. In 1992, Hasbro told Costco an item would be shipped, but it was not delivered. (Moen 4:668/24 - 669/7.) From August to September of 1992, there were erratic shipping patterns. (Moen 4:669/8-13.) Hasbro kept changing its mind whether it was going to cancel orders. (Moen 4:668/24 - 669/13, 670/22 - 671/5.) Inano informed Costco that his company was thinking about canceling orders as Mattel had done. (Moen 4:670/22 - 671/16.)

208. In 1992, Pace canceled \$1.8 million orders with Hasbro because Hasbro was "very ambiguous" and could not give Pace confirmation of delivery information on when products were going to be shipped or if they ever were going to be shipped. (Halverson 3:372/1-11, 443/22 - 444/13; CX-1633.)

209. TRU's complaints to Hasbro about product found in the clubs increased in the 1992 Christmas selling season. ([ ] Owen 6:1143/2 - 1144/23.)

210. Hasbro's policy of selling to the clubs evolved by Toy Fair 1993 into its present policy of only selling differentiated products to the clubs. (Owen 6:1112/13-15, 1144/20 - 1145/14; Inano 16:3428/1-4.)

211. Before Hasbro's 1993 policy became final, Hasbro told its plans to Goddu. Goddu gave his assent. (Owen 6:1136/20 - 1141/14.)

212. [ ] In Costco's FY 1992, Hasbro and its subsidiaries products accounted for 14.1% of Costco's sales. By Costco's FY 1996, they accounted for 2.6% of Costco's sales. (CX-1745/11.)

213. In June of 1994, Hasbro issued a written statement of only selling differentiated product to the clubs. (CX-243.) This document is dated after Hasbro received the Commission's February 7, 1994 letter requesting documents.

214. Hasbro also sent a letter to Costco in March 1994 indicating Hasbro's willingness to sell the clubs individual toys if Costco was willing to change the way it does business and promote and support Hasbro's product line to the extent of other retailers. (RX-373.)

215. Hasbro, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to the clubs.

### 3. Fisher-Price

216. During the early 1990's, Fisher-Price was the third largest toy manufacturer in the U.S. (Cohen 35:7926/9-17.) In 1993, Fisher-Price merged with Mattel. (Cohen 35:7926/7-8.) Fisher-Price makes

products for infants and juveniles, including pre-school toys, outdoor environmental play products and Power Wheels (battery-operated ride-ons). (Cohen 35:7928/5-12.) TRU has been Fisher-Price's largest customer since 1992, currently with 35% of its business. (Cohen 35:7926/18 - 7927/4.)

217. Fisher-Price considered the clubs to be a growth business and told its sales force to aggressively pursue club sales. (Chase 8:1646/23 - 1747/3.) [ ] Fisher-Price's regular line was sold to the clubs without restriction in the late 1980's. (Chase 8:1645/5-18.)

218. At a 1989 Toy Fair meeting with Fisher-Price, TRU's CEO stated that it would have to consider whether it would carry the same products being sold in clubs located near TRU's stores. (Cohen 35:7937/7-24, 7938/6-13.) In 1990 or 1991, TRU stated its policy to Fisher-Price and asked how it was going to deal with the clubs. (Cohen 35:7792/10-19; Weinberg 34:7732/8 - 7733/19; Weinberg IH (CX-1662) at 97/1-5.) [ ] TRU's approval of manufacturers selling special packs to the clubs was because they "avoid the customer being able to make a direct pricing comparison" between items sold by the clubs and TRU. (Goddu 30:6635/13-24.)

219. In 1990, Fisher-Price's sales staff received a list of items -- mostly new, hot or allocated product -- that they could not sell to clubs. (Chase 8:1652/14-19.) [ ]

220. In 1990, Fisher-Price still allowed some restricted items to be sold to the clubs. (Chase 8:1652/23 - 1653/7.) Fisher-Price was still selling a broad line of opening stock items to BJ's in 1991. (Cohen 35:7942/3-9, 8005/4-18.) [ ]

221. In 1991, Price Club's toy buyer asked Fisher-Price what he had to do to get product other than combo packs. (Chase 8:1655/10-18.) He was willing to consider buying more SKUs, taking delivery earlier, and warehousing products. (Chase 8:1655/10-25.) When Fisher-Price salesman John Chase asked Fisher-Price's regional sales manager Ken Walters how he should respond, he was told "don't tell them you can't sell because Toys "R" Us is pressuring, just make up a reason, tell them anything, but don't tell them you can't sell them because we're not allowed to because Toys "R" Us. [sic]." (Chase 8:1657/1-7.)

222. In September 1991, Fisher-Price's regional manager sent Chase a copy of a TRU shopping report showing products of Hasbro, Fisher-Price and Playskool found in Price Club. (Chase 8:1660/16 - 1661/5.) He told Chase that a TRU executive had sent the report to

Byron Davis, Fisher-Price's vice president for sales. (Chase 8:1660/16 - 1661/5.) The words "Byron, you promised this wouldn't happen" were written on the report. (Chase 8:1661/4-5.) After this event, Fisher-Price limited its club sales to special and combination packs. (Chase 8:1661/6-8.)

223. At Toy Fair 1992, TRU informed Hasbro that Fisher-Price and Mattel had agreed not to sell promoted product to the clubs. (Inano 16:3334/21 - 3335/5.) TRU's Goddu told Hasbro officials that Fisher-Price and other manufacturers would not be selling in-line promoted products to the clubs. (Owens 6:1132/6 - 1134/17; Verrecchia 7:1393/5 - 1394/4.)

224. Fisher-Price's meeting notes of Toy Fair 1992 state that Pace's Scott Halverson asked Fisher-Price what it would take to do business with Fisher-Price in 1992. (CX-684-A; Cohen 35:8011/9 - 8012/1.) The notes state that "[w]e were deliberately vague on our answer" and that "[w]e denied they [TRU] were the cause, but we weren't to [sic] convincing." (CX-684-A.) The notes point out that after Toy Fair 1992, Hasbro's Kenner and Playskool representatives told Fisher-Price that their company was "adamant that they would not be shipping key SKUs [sic] to the Clubs, at least not yet." (CX-684-B; Cohen 35:8015/3-23.)

225. In June of 1992, TRU contacted Fisher-Price about its nursery monitor that was found in Price Club. Fisher-Price "agreed to stop selling this item to the clubs." (CX 913-E.)

226. In November 1992, Fisher-Price's Byron Davis and John Chase were at a Price Club and saw a TV-promoted Playskool product in the club. (Chase 8:1666/4-13.) Davis told Chase he would call TRU to see if "they'll take care of it." (Chase 8:1666/14-16.) Davis then made a telephone call to TRU and later told Chase that Playskool was not "going to get away with it, that Toys 'R' Us is going to take care of it." (Chase 8:1666/18 - 1667/1.)

227. [ ] TRU's vice president Weinberg said that Fisher-Price complained to him about Playskool products that Fisher-Price found in the clubs. (Weinberg 34:7628/15 - 34:7629/1.) [ ]

228. At Toy Fair 1993, Fisher-Price offered the clubs combo packs and special packs. (Chase 8:1678/3-5.) Fisher-Price added extra dishes to a toy kitchen to create a combo pack. (Chase 8:1678/9-12.) When Fisher-Price executives walked through the display, they noticed the kitchen. (Chase 8:1678/16-17.) They took the person who

was in charge of developing the item, Jamie Leder, into a back room. (Chase 8:1678/17-18.) When he came out ten minutes later, "he was white." (Chase 8:1678/19.) Chase's regional manager told Chase about a half hour later that Leder was almost fired over the incident, because the kitchen was a "sensitive item" for TRU. (Chase 8:1678/20-23.) The item was pulled from display to the clubs. (Chase 8:1678/24-25, 1680/5-6.)

229. [ ]

230. A Fisher-Price study prepared for its 1993 annual meeting, stated the opportunity for toy growth at the clubs was "phenomenal." (CX-698-D; Cohen 35:7958/22 - 7959/4.) It refers to TRU "demanding" that the club products be differentiated from the products it carries. (CX-698-C; CX-699-A.)

231. Fisher-Price never imposed the restrictions it imposed on the clubs on any other channel of distribution. (Chase 8:1691/16-20.)

[ ]

232. Fisher-Price, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to the clubs.

#### 4. Tyco Toys

233. During the 1990's, Tyco Toys was the third-largest traditional toy manufacturer in the United States, with worldwide sales of about \$750 million in 1995. (Grey 14:2986/16-18.) Tyco makes radio-controlled toys, die-cast Matchbox cars, a drawing toy called Magna-Doodle, electric racing sets, boys toys, dolls and girls toys, games, science sets, and preschool toys. (Grey 14:2986/5-9.) During the trial in this case, Tyco was acquired by Mattel, Inc. (Grey 14:2985/16-22; RX-819; Barad 35:7912/10-15.)

234. During the 1990's, TRU was the largest customer of Tyco, buying between 30 and 41.4% of Tyco's domestic United States sales from 1990 to 1994; this was two to three times the next largest customer. (CX-1272-B; Grey 14:2986/22-2989/13.)

235. Tyco began to sell toys to the warehouse clubs in the 1980's. (Gray 14:2993/13-19; CX-1420, CX-1424, CX-1263, CX-1264.) Richard Grey (Tyco's CEO between 1981 and 1995), testified that Tyco sold the warehouse clubs primarily regular-line products, although Tyco sometimes would make up a special package. (Grey 14:2993/20-2994/9.)



236. [ ] "At some point we asked Tyco, as we did other vendors, you know, what is your merchandising philosophy. And I believe Dick Grey said, We'll get back to you." (Goddu 30:6677/6-8.)

237. At a 1992 Toy Fair luncheon, TRU again discussed the clubs with Tyco, with Lazarus telling Tyco that it and other toy manufacturers were making a mistake selling regular line merchandise to the clubs. (Grey 14:2996/9-17, 2996/22 - 2997/9.)

238. [ ]

239. [ ]

240. The policy adopted by Tyco in 1992, required customers wishing to purchase products from Tyco's regular line to submit a \$20,000 minimum purchase order and order a minimum of 25 Tyco items. The policy required that the smallest quantity of any item ordered must be at least 20% of the unit count of the highest quantity ordered. The policy made exceptions for categories of customers (other than warehouse clubs) that did not typically purchase as many as 25 separate Tyco products. (CX-1418; Grey 14:3006/18 - 3009/1.)

241. The Tyco 25-item policy plainly was directed to the warehouse clubs. (CX-1418.) Prior to 1992 the warehouse clubs had not commonly purchased as many as 25 Tyco items (Grey 14:3002/12-14) and in discussing the proposed policy prior to its adoption Tyco executives "recognized that we might lose some or all of our warehouse club business." (Grey 14:3001/1-2.) The policy excepted other categories of Tyco customers who did not purchase 25 regular line items: specialty retailers, electronics customers, Disney stores and other sellers of licensed products, and customers who bought Tyco products for use as promotional premiums. (CX-1418 at ¶ 3; Grey 14:3008/9 - 3009/1, 3002/15 - 3006/3.) In effect, the policy applied only to the warehouse clubs. (Grey 14:3009/2 - 3010/15.)

242. TRU executives considered the policy adopted by Tyco a "unique" response. (Lazarus 24:5388/11-14; Goddu 30:6678/8-24, 6681/15-18.) [ ]

243. TRU contacted Tyco after a competition shop in the spring of 1992 found several Tyco products for sale in the clubs; TRU's Goddu reported to Lazarus by memo that the products were "goods shipped last year prior to their new 'no ship' policy on current goods we [TRU] carry." (CX-913-D.) TRU's Robert Weinberg spoke with the Tyco salesman and testified that the reference to a "no ship" policy was language used by the Tyco salesman Ken Shumaker

referring to the 25-item policy. (Weinberg 34:7716/2-5.) Tyco's Grey confirmed that Tyco had a "no-ship policy" -- the 25-item policy adopted in February 1992. (Grey 14:3047/2-11.)

244. In the summer of 1992 Goddu sent to senior TRU executives internal Hasbro correspondence which characterized the Tyco policy as a "tough program . . . impossible to qualify for the SKU-conscious club." (CX-1633-D.) After learning that BJ's had placed an order for 25 Tyco products, TRU obtained from Tyco details of the items and quantities ordered and shipped, which Goddu reported by memo to senior TRU executives in September 1992. (CX-808.) Tyco provided this information to TRU without BJ's knowledge. (Hilson 20:4505/5-4507/13).

245. In May of 1992 at an industry conference Tyco's CEO Grey and Hasbro's CEO Al Hassenfeld discussed their respective companies approaches to warehouse club sales. (Grey 14:3011/12-22). Grey told Hassenfeld about Tyco's 25-item policy, and Hassenfeld told Grey there were three different approaches at the time by the three Hasbro divisions. (Grey 14:3011/22 - 3013/4.)

246. Hasbro's Jim Inano, then western regional manager of sales, testified that at a trade show in California in April or May 1992, Tyco's regional sales vice-president Joel Tasman told him that the manufacturers problems in selling to the clubs began when the head of Mattel returned from a visit to TRU saying that Mattel would no longer be selling promoted products to the clubs. (Inano 16:3345/2 - 3347/4.)

247. After Toy Fair in 1992, Price Club placed an order meeting the 25-item minimum (Grey 14:3013/12 - 3015/17); Price Club met the minimum quantity requirement by buying the products for its clubs in various areas. (CX-1633-D.)

248. BJ's placed an order for 25 Tyco items, with large quantities of some items but small quantities of others; because the order failed to comply with the minimum quantities required under the Tyco policy, BJ's was shipped some combination pack products but not the regular line Tyco products it ordered. (Hilson 40:4478/1 - 4479/9, 4506/5 - 4507/6.) Pace considered a strategy similar to the one attempted by BJ's but decided not to place an order after being told that Tyco would not ship an order that did not comply with the policy. (Halverson 3:368/1 - 369/12.)

249. Costco also decided not to place an order under the 25-item policy in 1992 because Costco believed that the minimum quantity

requirements of the policy made it impractical to place an order for as many as 25 items. (Ojendyk 18:4009/22 - 4011/5; Moen 4:646/4-648/23.) Costco's toy buyer Michelle Moen asked Tyco how the mass discounters were able to satisfy the minimum quantity requirements of the Tyco policy. Tyco salesperson Julie Edwards told her that exceptions were made to those requirements for companies like Kmart, Target and TRU. (Moen 4:648/3-20.)

250. In 1992 after its adoption of the 25-item policy Tyco did "considerably less business" with the warehouse clubs than the \$5 to 8 million it had been doing in prior years. (Grey 14:3016/11 - 3017/2; CX-1432 Z-7-Z-19.)<sup>8</sup> Tyco developed for 1993 a line of specially configured products which were offered to the warehouse clubs without regard to the 25-item minimum. (Grey 14:3017/3-3018/3, 3067/16-21.) The warehouse club line was printed on a blue price list and consisted of combination packs and other products packaged specially for the warehouse clubs that were different from Tyco's regular line merchandise. (Grey 14:3017/3 - 3018/3; CX-1269.)

251. Costco's toy buyer Moen testified that in late 1992 or early 1993 Tyco's salesperson Edwards told her that TRU put pressure on Tyco to sell combination packs to the warehouse clubs because other major toy companies were doing so; when Tyco went along, this fact was used by TRU to persuade other companies to go along. The three companies mentioned by Edwards were Tyco, Mattel and Hasbro. (Moen 4:651/17 - 652/9.)

252. Tyco continues to have the 25-item policy for regular line products, and a line of differentiated warehouse club products. (Grey 14:3020/22 - 3021/1, 3057/21 - 3058/24; CX-1405.) In effect this policy is similar to that of other major manufacturers who permit warehouse clubs to purchase only differentiated products. (CX-1412-B; Grey 14:3027/22 - 3029/12.) After 1992, no club bought regular line merchandise under the 25-item policy. (Grey 14:3021/13-23.)

253. TRU contacted Tyco's Playtime division to enforce the TRU warehouse club policy. Playtime, a division of Tyco operated separately from the principal domestic toy division of Tyco, had a separate sales staff and sold toys on a letter-of-credit basis to domestic United States customers. (Grey 14:2989/14 - 2991/1.)

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<sup>8</sup> In September 1992 Tyco told TRU that its sales to the clubs the prior year were \$11 million and estimated that its sales in 1992 would be \$2 million or less. (CX-808-B; [ ]

254. In its warehouse club competition shop in April 1992, TRU discovered a Playtime product, Super Saturator, for sale in warehouse clubs. (CX-193-D.) TRU's Robert Weinberg, a divisional merchandise manager reporting to Roger Goddu, contacted Playtime's senior vice-president for sales Howard Abrams about the product, which was heavily promoted. (Weinberg IH (CX-1662) at 149/19 - 150/7; Weinberg 34:7677/14 - 7678/5; CX-1414-B.) Playtime's Abrams told Weinberg that, other than for some prior commitments, Playtime would sell the warehouse clubs only "special" items or items that TRU didn't carry. (CX-913-D; Weinberg 34:7719/7-22.)

255. [ ]

256. [ ] A confirming letter received by Weinberg from Playtime shortly after the meeting stated that "Playtime will not offer any merchandise to Warehouse Clubs that is bought by Toys R Us. This will make our policy exactly the same as Tyco's." (CX-914-A.)

257. [ ]

258. Playtime informed its warehouse club customers that they could only purchase the reconfigured Thunderstrike product. (Moen 4:655/7 - 659/4; Hilson 20:4481/18; CX-1408-A; CX-1409.) Playtime representatives told Costco buying personnel that the reason was pressure from TRU. (Moen 4:657/5-6, 658/1-3.) After Costco sent an angry letter to Tyco CEO Grey (CX-1270), Grey replied confirming that the product would be sold to Costco only in the "exclusive value-added version" (CX-1412-B); Costco canceled pending orders for \$3.8 million from several Tyco divisions. (CX-1411.) Another separate Tyco subsidiary, Tyco Preschool, reconfigured several of the products to sell to warehouse clubs to comply with a policy "to offer the Clubs customized items only." (CX-1413-A.)

259. In 1993 and later years, Tyco sold to warehouse clubs only differentiated products from the special warehouse club line. (Grey 14:3021/13-23.) By 1995, Tyco's sales to the warehouse clubs were \$8-10 million, all differentiated products. (Grey: 14/3021/24 - 3023/7.)

260. Tyco Toys, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to the clubs.

##### 5. Little Tikes

261. The Little Tikes division of Rubbermaid Corporation makes large plastic outdoor children's toys and other juvenile products.

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Initial Decision

(Schmitt 11:2275/12-23; DePersia 10:2133/11-18.) [ ] TRU has been the largest customer of Little Tikes since the mid-1980's (Murdough 27:5862/20-24); in the early 1990's Little Tikes' sales to TRU were two or three times larger than to its next largest customer. (Schmitt 11:2282/7-14.)

262. Little Tikes was founded in 1970 by Thomas Murdough, who sold the company to Rubbermaid in 1984 and continued to manage the business as president and general manager of Little Tikes until leaving the company in 1989. (Murdough 27:5855/16 - 5857/2.) Under Murdough's leadership, Little Tikes focused on full-line dealers to preserve the profit margins of the retailers that distributed its products. (Murdough 27:5862/20 - 5864/7; DePersia 10:2134/21-2135/15.) Murdough preferred not to sell to warehouse clubs or other retailers he believed would "football" the products by selling at prices he thought were too low. (Murdough 27:5858/17 - 5859/6, 5861/4-12, 5882/13 - 5884/11; Ojendyk 18:4020/8 - 4021/8 (for a period in the late 1980's Costco carried Little Tikes items).) Murdough's strategy was motivated by the "rotational molding" process used to produce the products, which is more costly and time-consuming than the induction molding process used for other kinds of plastic products, and the bulkiness of the products which make them difficult to ship and display. (Murdough 27:5865/9 - 5867/8, 5859/12-19; DePersia 10:2134/21 - 2135/15.) Little Tikes' limited distribution strategy under Murdough differed from the strategy of the Rubbermaid organization which sought "to have products available wherever consumers wanted to purchase them." (Schmitt 11:2276/12 - 2277/3; CX-483.)

263. Murdough left Little Tikes in 1989, (Murdough 27:5856/25-5857/2, 5867/9 - 5868/21.) In 1991 Murdough founded the Step 2 Corporation, a manufacturer of rotationally-molded plastic products, including toys that compete with those made by Little Tikes. (Murdough 27:5857/12 - 5858/10, 5884/16 - 5885/4.) Step 2 has followed a distribution strategy similar to that which Murdough used at Little Tikes; Step 2 offered no products to the warehouse clubs until 1996 when it began to sell discontinued or low-demand products to the warehouse clubs. (Murdough 27:5868/22 - 5870/6, 5871/17 - 5872/12; DePersia 10:2226/6-16.)

264. Little Tikes made no sales to warehouse clubs early in 1990. (DePersia 10:2136/6-2 137/6; Ojendyk 18:4020/8-4021/8.)

265. By late 1990 or early 1991 Little Tikes began sales to the warehouse clubs, and sold to the clubs from 1991 to 1993. (DePersia 10:2137/2-11, 2138/17 - 2139/6; CX-1533-C-D.) [ ]

266. In late 1992, Wolf Schmitt, Rubbermaid CEO, wrote "For 1993 every one of our business units has tremendous upside potential with [the club]. Are your plans firmly in place to take advantage of those opportunities?" (CX-483 (11/21/92).)

267. After Little Tikes in the fall of 1992 agreed to broaden the range of products it would sell, Costco resumed purchasing from Rubbermaid and by January 1993 placed orders for a number of Little Tikes spring 1993 products. (Ojendyk 18:4025/6-20; CX-1385.) Costco believed that Little Tikes had agreed to make eight of its ten top-selling regular line items available for purchase each season, giving Little Tikes a year-round presence in Costco clubs. (CX-1387-B; Ojendyk 18:4023/12 - 4025/2.) [ ]

268. At Toy Fair in February 1993, TRU's Lazarus, Goddu and Sullivan met to discuss the warehouse clubs with Gary Baughman and Neal DePersia, Little Tikes president and sales vice-president, in the Little Tikes showroom in New York. (DePersia 10:2143/2 - 2144/11, 2145/4-14; Goddu 30:7613/16-25.) TRU had learned through its competition shops that Little Tikes had begun to sell its products to the clubs. (Goddu 30:6713/16 - 6714/20.) Goddu raised the warehouse clubs issue "strongly" because TRU perceived a change in Little Tikes sales activity with the warehouse clubs -- Little Tikes under Murdough had not been selling to the warehouse clubs but had begun to do so after Murdough left. (CX-509; Goddu 30:6713/23 - 6714/15.)

269. At the 1993 Toy Fair meeting TRU's Goddu told the Little Tikes executives TRU's policy that if a manufacturer was going to sell products to warehouse clubs, TRU would possibly not carry them. (DePersia 10:2144/12-22.) In response, the Little Tikes executives asked whether the TRU policy also would be applied to Today's Kids, at the time the only manufacturer of large plastic toys competitive with Little Tikes' whose products were being sold in the warehouse clubs. (DePersia 10:2146/17 - 2146/6; 2148/7-22.) The primary concern of Little Tikes was that this competitor might take away business and market share from Little Tikes. (DePersia 10:2214/23 - 2215/3.) Goddu responded that Today's Kids was not doing a lot of business with the clubs and would be getting out of the

business of selling to the warehouse clubs. (DePersia 10:2147/7-14, 2150/3-12.)

270. Goddu met with Today's Kids concerning the TRU warehouse club policy and he was told about that company's plans to discontinue sales to the warehouse club channel. (Goddu 30:6726/2-11; 6727/8-12; 6730/20 - 6732/2; 30:6738/5 - 6739/25.) [ ]

271. At the Toy Fair meeting and on the telephone with Goddu later in February 1993, Little Tikes' president Baughman told TRU that Little Tikes was only selling discontinued products to the warehouse clubs (which was not accurate), and in the future would only sell discontinued, near-discontinued or "value pack" merchandise to the clubs. (DePersia 10:2145/15 - 2146/9, 2151/13-23; CX-1510.) Baughman assured Goddu that Little Tikes' sales to Costco were a "one shot deal" and that Little Tikes did not plan to sell regular products to Costco in the future. (CX-1510.) Baughman told Goddu that the sales to Costco were made because Costco "threatened to throw Rubbermaid out" and told Goddu that he "may need his help" in dealing with Rubbermaid management. (CX-1510; Goddu 30:6714/21 - 6715/14.)

272. In a meeting at Toy Fair and in February and March 1993, Little Tikes personnel told Costco that Costco would not have access to Little Tikes' regular product line for the fall 1993 season, but would be offered only combination packs. (Ojendyk 18:4028/22 - 4029/25; CX-1387-A; CX-1511; CX-1513.) Costco threatened again to discontinue purchasing products from all Rubbermaid divisions. (Ojendyk 18:4029/20-25; CX-1387-B.)

273. In early April 1993 senior management of TRU and Little Tikes met with Wolf Schmitt, the recently-appointed CEO of Rubbermaid. (DePersia 10:2159/9 - 2160/7; Schmitt 11:2283/24 - 2284/23, 2288/2-7; Goddu 30:6715/15-6716/9.) Before the meeting TRU provided Little Tikes with a competitor shop report showing Little Tikes products for sales in warehouse clubs at prices less than at TRU. (CX-1516-B; DePersia 10:2162/15 - 2164/10.) [ ]

274. At the April 1993 meeting, TRU repeated that it would not carry any products carried by the clubs, asked to be informed what products were being sold by Little Tikes to the clubs, and expressed interest in purchasing value packs prepared by Little Tikes. (CX-1521 (Baughman file memo); CX-1519 (Schmitt handwritten notes);

Schmitt 11:2291/25 - 2292/13; 2297/1 - 18; DePersia 10:2172/7 - 2173/12.) [ ]

275. Little Tikes represented that its future sales strategy for warehouse clubs would be to sell value packs and discontinued and near-discontinued items. (CX-1521; DePersia 10:2170/22 - 2171/12; Schmitt 11:2294/2-14; Goddu 31:6900/8-20; 6916/18 - 6916/6.) There was further discussion focusing on the issue of products for which Little Tikes had unabsorbed production capacity. Schmitt felt that the parties did not find common ground on that "clarification" of the Little Tikes future strategy to sell the warehouse clubs value packs and discontinued and near-discontinued items. (Schmitt 11:2305/22-23, 2296/7-10.)

276. Little Tikes' vice-president of sales DePersia believed that the April 1993 meeting resolved the issue of warehouse clubs in the eyes of Little Tikes and TRU, and that Little Tikes would only be selling discontinued, near-discontinued and value pack merchandise to the warehouse clubs. (DePersia 10:2177/13-22.) Schmitt's contemporaneous notes of the meeting use the words "Agreement" and "Understandings" in referring to the discussion of the warehouse club distribution issues. (CX-1519.) TRU's President Michael Goldstein came away from the meeting understanding that the Rubbermaid/Little Tikes executives did not intend to sell to the clubs. (Goldstein 36:8298/9-20.)

277. In mid-April 1993, about a week after the meeting at TRU headquarters, Little Tikes issued a memo to its sales force listing the only Little Tikes items that were available for sale to warehouse clubs for the fall of 1993; the list was made up of value packs, discontinued and near-discontinued items. (CX-1520; DePersia 10:2176/16 - 2177/4; 2177/23 - 2179/10.) During the balance of 1993, the sales staff of Little Tikes limited the products available to the warehouse clubs to "value packs, discontinued and near-discontinued." (Hilson 20:4494/3-9; CX-1523; DePersia 10:2179/11-2180/13, 10:2180/15-2181/3.)

278. In August 1993, because of the limitations on availability of Little Tikes products, Costco again discontinued its purchases of products from Rubbermaid Corporation. (CX-1524; CX-1522.) This action cost Rubbermaid \$15 to \$20 million in annual sales to Costco. (Schmitt 11:2342/18 - 2343/6.)

279. During 1993 and 1994 Little Tikes tried to resolve the differences with Costco by offering to sell Costco its popular items



which were late in their product life-cycles. (DePersia 10:2183/2-2184/11 (Party Kitchen); Schmitt 11:2340/16 - 2341/9 (Cozy Coupe).) Little Tikes' DePersia believed this approach was consistent with the "value packs, discontinued and near-discontinued" commitment to TRU. (DePersia 10:2184/12 - 2185/11.) These offers were not accepted by Costco and the differences between Little Tikes and Costco continued to be unresolved through early 1994. (RX-225; DePersia 10:2187/24 - 2190/2; CX-1531; Schmitt 11:2346/21 - 2350/17.)

280. In January 1995 TRU's Lazarus contacted Rubbermaid's Schmitt to meet to discuss the warehouse clubs in light of changes in senior management at Little Tikes (Baughman, the president, and DePersia, the vice-president of sales, left Little Tikes in late 1994 and early 1995). (Schmitt 11:2325/10 - 2326/1, 2327/11 - 2328/5.) TRU competition shops showed that Little Tikes had begun to sell products to the clubs that did not conform to the strategy communicated to TRU in 1993. (Goddu 31:6896/9 - 6897/9, 6898/25 - 6901/1; Goddu IH (CX-1657) at 314/5-8, 317/11-18.)

281. At a January 1995 meeting Little Tikes told TRU that none of the products sold to TRU were sold to the clubs. (CX-1535; Schmitt 2338/2 - 2339/13.) TRU's president Goldstein felt that after the 1995 meeting TRU's concerns had been resolved (Goldstein 36:8286/25 - 8287/4.) [ ]

282. [ ]

283. Little Tikes and its parent Rubbermaid, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to the clubs.

## 6. Today's Kids

284. Today's Kids manufactures plastic toys for children up to nine years old. (Stephens 27:5893/9-10.) Today's Kids is smaller than its principal competitors, Little Tikes, Fisher-Price, and Step 2. (Stephens 27:5893/20 - 5894/1.) [ ]

285. From 1990 to 1993, Today's Kids directed its sales force to try to get as much of the warehouse club business as it could. (Stephens 27:5964/16-19.) [ ]

286. During the early 1990's, Today's Kids sold its regular line products to the clubs without restriction. (Stephens 27:5965/25 - 5966/3, 5896/24 - 5897/1; CX-902.) In 1993, Sam's wholesale club

was Today's Kids' largest customer among the clubs with purchases of [ ] in regular line product. (Stephens 27:5965/19-21; [ ]

287. In June 1992, TRU's Robert Weinberg complained to Today's Kids about an item that was found in the clubs and told Today's Kids that it needed to "do something to the item or the packaging." (CX-857.) TRU contacted Today's Kids about other products that were found in the clubs. (CX-913-D.) Today's Kid's sales vice president, James Stephens, stated that Today's Kids understood TRU's position, but needed the clubs' business. (CX-913-D.) Stephens told TRU that Today's Kids would sell "special items going forward." (CX-913-D.)

288. [ ]

289. Thereafter, there were several meetings between TRU and Today's Kids. (Goddu 30:6733/23 - 6734/3.) TRU told Today's Kids that it did not want to carry any identical product that was sold to the clubs. (Goddu 30:6728/10-15, 6730/20 - 6732/24.) If Today's Kids was going to sell product to the clubs, TRU wanted Today's Kids to notify it about the product so that TRU would not buy it. (Butler 25:5524/6 - 5525.) Today's Kids' response was to inquire "how much would we [TRU] work with them, how much time would they have, how much more business could we do with them" if they changed their distribution "away from the warehouse club channel." (Goddu 30:6729/9-22.)

290. In 1993, Today's Kids told TRU that they changed the amount of business they were doing with the clubs for their own benefit. (Goddu 30:6738/5-22, 6739/12-14.) Today's Kids told TRU that it was going to stop selling to the clubs or to minimize what they were going to sell to them. (Butler 25:5526/7-10, 25:5551/2-7.) Today's Kids asked TRU "if we could have more time." (Goddu 30:6739/4-7; Goddu IH (CX-1657) at 167/11-14.) [ ]

291. Today's Kids got back to TRU later in 1993 and discussed its intention of not selling to the clubs at all. [ ]

292. Also in 1993, Little Tikes complained to Roger Goddu of TRU about Today's Kids sales to the clubs. (DePersia 10:2146/10-25.) Goddu told Little Tikes' vice president, Neil Crosby DePersia, that Today's Kids would be getting out of the business of selling to the clubs. (DePersia 10:2147/7 - 2148/6, 2150/3-12.)

293. In November of 1993, a TRU representative warned Today's Kids that it might not order a product which Today's Kids sold to the clubs even though it was selling well at TRU. (CX-891.) The

following day, she advised Today's Kids that TRU's "top echelon said don't order any more now." (CX-892.) [ ]

294. In early February 1994, a Costco representative who met with Today's Kids stated that a change in Today's Kids' policy relating to the clubs might be made because of pressure from TRU. (Moen 4:682/11 - 684/6; CX-1678.)

295. In March 1994, following Toy Fair, Today's Kids informed the clubs that it would no longer sell any product to them. (Stephens 27:5985/5-11.) This was the first time that Today's Kids had ever decided not to sell a class of distribution. (Stephens 27:5989/22 - 5990/3.) [ ]

296. Today's Kids witness Stephens attributed Today's Kids' decision not to do business with the clubs to the unpredictability of the clubs' purchases, the lower price points at which the clubs sold, the clubs' cherry picking, and clubs tendency to cancel orders. (Stephens 27:5927/6-24.) I did not consider this to be credible testimony. (Stephens 27:5991/23 - 5992/5; CX-893.)

297. Today's Kids, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to the clubs.

#### 7. Tiger Electronics

298. Tiger Electronics ("Tiger") makes electronic toys, hand held games and family games. (Shiffman 10:1993/4-12.)

299. TRU was Tiger's largest customer through 1994. In 1993 TRU bought twice as much as Tiger's second largest customer. (CX-822; Shiffman 10:1998/2-4) TRU's share of Tiger's sales was between 23% and 35.4% in the years 1991-1996. (CX-822; [ ]

300. Between 1992-1994, Tiger felt it needed to sell to TRU for Tiger to launch successfully a nationally advertised product. (Shiffman 10:2002/2-23.) The number and geographic coverage of TRU stores made it essential. [ ]

301. Between 1991 and 1993, Tiger's club business was growing well, and it was selling its regular line product, including some of its top ten items, to the clubs. (Shiffman 10:2004/22-24, 2012/24 - 2013/8; CX-1756.) In 1991, Tiger sold \$273,000 worth of merchandise to the clubs. [ ]

302. In June of 1993, Tiger's Shiffman spoke over the telephone with TRU's Roger Goddu, during which he first heard directly from TRU about its warehouse club policy. (Shiffman 10:2007/17 -

2008/2, 2015/23 - 2016/8.) After the phone call, Shiffman dictated a memo of his talk with Goddu. (Shiffman 10:2008/3-14: CX-809.) In this memo, Shiffman wrote: "TRU will NOT handle any item that is made available for sale through clubs. Period. End of story. It makes no difference who the club is or what the price is. If it is a new television advertised product, they will drop it immediately and will not handle it whatsoever." (CX-809.) [ ]

303. Shiffman had asked Goddu whether TRU's policy applied to BJ's, a small club compared to the other warehouse clubs. (Shiffman 10:2013/22 - 2014/17.) Goddu's answer was that "the policy stands. If it is in a club including BJ's, it is out at TRU. Period. End of story one more time." (CX-809; Shiffman 10:2014/2-10.) Shiffman got the impression from Goddu that TRU's club policy would apply to all manufacturers in the industry. (Shiffman 10:2016/18 - 2017/1.)

304. Several months later, Shiffman wrote to TRU's Goddu in early December 1993 informing Goddu that Tiger had found one of its competitor's products in a BJ's club. (CX-811; Shiffman 10:2017/2 - 2019/12.) The club version of the competitive product merely had one additional videotape inside the box and a sticker attached to the outside of the box to differentiate it from the regular line product being sold at other retailers, including TRU. (Shiffman 10:2021/20 - 2022/7.) Shiffman felt that the package of the club version of the competitor's product was not differentiated enough from the regular line product's package and that the consumer could too easily compare the two versions of the product to comply with TRU's club policy. (Shiffman 10:2022/24 - 2023/14, 2023/25 - 2024/22.)

305. In his letter Shiffman wrote, "I understand that with regard to hot new product, television items, high profile items, etc., the only way these can be sold to the clubs is through very 'creative' packaging." (CX-811.) Shiffman indicated that, as Goddu knew, Tiger had not sold its similar product "to any club in the country," although Tiger "could have easily responded with a similar answer as this [competitive] product if we had known that it was acceptable to you." (CX-811.) Shiffman asked Goddu to let him know if that type of packaging was "satisfactorily meeting the needs and concerns of Toys R Us." (CX-811.) After sending this letter, Shiffman spoke with Goddu, who told him that although the competitive product's package did not meet TRU's club policy criteria, TRU had not yet explained its club policy to the company, but that Goddu would tell the competitor "don't do it again or God knows what." (Shiffman

10:2026/7 - 2028/13.) I find that Tiger's concern about its competitor's product being in the clubs and its statement to TRU that Tiger could "easily have responded with a similar answer" for selling its like product to the clubs if it had known that was acceptable to TRU shows that it was not in Tiger's unilateral business interests not to sell its regular line version of this product to the clubs.

306. In late January 1994, Shiffman had dinner with TRU's Goddu and after dinner, wrote an e-mail relating their conversation. (CX-814; Shiffman 10:2033/12-25.) At this dinner, Shiffman wanted more information on TRU's club policy so that he would know what products Tiger could sell to the clubs without jeopardizing its sales to TRU. (Shiffman 10:2037/4-10.) At dinner, Goddu told Shiffman that if Tiger sold the clubs a five-year-old product called Skip-It, as well as handheld games "in multipack with high price point," that would comply with TRU's club policy and would not adversely affect Tiger's sales to TRU. (CX-814; Shiffman 10:2037/1 - 2038/18, 2039/15-2040/2.) Goddu told Shiffman that he could get back to Goddu to review Tiger's club strategies with him and get approval in advance, even for individual products and packaging. (Shiffman 10:2044/21 - 2045/9; CX-814.)

307. On March 5, 1994, Tiger vice president of sales, Bernbaum, sent an e-mail to Tiger president Rissman urging Tiger to "address the club situation" since Costco wanted to purchase up to 300,000 handheld games alone, and "between their own stores and the Price Club acquisition they are going to be a huge factor." (CX-812.) Bernbaum explained that he needed an answer to give Costco since "I have to address the problem, TRU or no TRU." (CX-812.)

308. On April 6, 1994, executive vice president Shiffman, with the help of Tiger's in-house counsel, wrote and distributed a document that set out in a formal fashion Tiger's policy regarding sales to the clubs. (CX-818; Shiffman 10:2058/10 - 2059/3.)

309. After Tiger's policy went into effect, its sales to the clubs dropped from \$3.5 million in sales to the clubs in 1993 to \$31,740 in sales in 1994. (CX-822; Shiffman 10:2004/22-2005/6, 2055/22-24.) [ ] Tiger attempted to sell multi-packs to the clubs, but these were not successful. (Shiffman 10:2055/11-13.) I find that this also illustrates that it was not in Tiger's unilateral best interests to restrict its sales to the clubs.

310. Tiger's decision to restrict the clubs to multi-packs was not attributable to the fact that the clubs bought too few of its SKUs. (Shiffman 10:2053/3-9.) Tiger continued to sell its regular line products to drugstores, which carry an average of 4-10 Tiger products each year. (Shiffman 10:2052/14 - 2053/4.) Drugstores do not carry Tiger products year-round and like to be out of stock on Tiger items by December 25th each year. (Shiffman 10:2106/6-24.)

311. Tiger did not sell regular line products to the clubs again until 1996. (Shiffman 2057/7-12.)

312. Tiger, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to the clubs.

#### 8. VTech Industries

313. VTech Industries makes electronic educational toys. (Walter 29:6061/22 - 6062/7.) In 1992, Toys "R" Us purchased 33% of VTech's U.S. sales. No other customer bought more than 9.6%. (CX-1305.) In 1993, VTech wanted to sell to retailers other than TRU to "reduce their dependence" on TRU. (CX-1301, CX-1318; O'Brien 12:2423/5-17.)

314. VTech sold regular line merchandise to the warehouse clubs for the 1992 Christmas season. (Walter 28:6087/21-24.) In 1993, VTech stopped selling regular line product to the clubs. (Walter 28:6087/21-24, Hilson 20:4508/6-9.) VTech "promised" TRU during the 1993 Toy Fair that they would not sell to the warehouse clubs. (CX-1318, O'Brien 12:2426/16 - 2427/18.)

315. Bill Walter, VTech's vice president of sales, testified that VTech stopped selling regular line products to the warehouse clubs for reasons unrelated to TRU. (Walter 28:6108/17 - 6109/17). He testified that clubs had excessive returns, returned product in poor condition, bought on a domestic rather than a letter of credit basis, and insisted on guaranteed sales. (Walter 28:6088/2 - 6090/2.)

316. Walter's testimony includes much post-hoc rationalization. (CX-1318; O'Brien 12:2432/1-19, 2424/10-14, 2412/1-3.) The TRU campaign motivated VTech's decision to stop selling to the clubs. (Walter 29:6190/19 - 6191/3.)

317. According to Walter, these issues were discussed orally with the clubs. (Walter 28:6189/10-19, 6190/19 - 6191/3.) This conflicts with the testimony of Jim Hilson, a toy buyer for BJ's, and a credible witness, who never heard any complaints about excessive returns

from VTech before VTech stopped selling to BJ's. (Hilson 20:4512/12-19.)

318. VTech, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to the clubs.

#### 9. Binney & Smith

319. Binney & Smith (B&S) makes "Crayola" crayons, markers, colored pencils and similar products. (Blaine 29:6326/19 - 6327/20.) B&S competitors include Rose Art, Dixon Ticonderoga, Sanford Corporation, Amov and Battat. (Blaine 29:6340/23 - 6342/16.)

320. B&S began selling to the warehouse clubs in the 1980's. (Blaine 29:6342/17 - 6343/1.) B&S had trouble selling to the warehouse clubs because B&S regular line products had low price points. (A box of 64 Crayola crayons retails from \$1.99 to \$4.99.) (Blaine 29:6343/11 - 6344/24, 6328/6-10.)

321. B&S bundled packs of regular line merchandise for the warehouse clubs. (Blaine 29:6345/11-16.)

322. In May or June 1992, B&S' vice president of sales Brent Blaine was contacted by [ ] This meeting was called by TRU, after TRU found B&S products in the warehouse clubs. (Weinberg 34:7614/8 - 7617/5.)

323. At the meeting, Brent Blaine agreed to offer special packs only for 1993. (CX-913-C; Weinberg 34:7666/14 - 7667/18.)

324. After this meeting, B&S stopped selling regular-line merchandise to the warehouse clubs. (CX-913; Blaine 29:6934/2-19.) B&S makes differentiated products for drug stores and supermarkets. (Blaine 29:6461/7-25.) These other customers may also buy B&S regular line. (Blaine 29:6462/5 - 6463/17.)

325. In December 1992, Weinberg contacted Blaine and asked him to meet with him about B&S' warehouse club strategy. (Blaine 29:6418/11-19.) Blaine showed Weinberg samples of warehouse club products that B&S planned to sell to the warehouse clubs. (Blaine 29:6422/10-17.) After viewing these products, [ ]

326. After this December meeting, Blaine wrote a letter to Weinberg summarizing their discussions on the clubs: "Our intent is to differentiate our product offering to Membership Clubs from that sold through our traditional retail trade channel. We will do this with larger sets and multi-packs that move the clubs to higher price points.

In addition, we will alter contents to present the club customer with a non-comparable value." (CX-2.)

327. BJ's purchased regular line B&S products before B&S established their warehouse club policy. (Hilson 20:4531/23 - 4543/2.) BJ's had been successfully selling a B&S product called the "Crayola Drawing Desk." (Hilson 20:4532/13-14.) However, B&S stopped offering the regular line Crayola Drawing Desk to BJ's. (Hilson 20:4532/13-25.) B&S provided BJ's with no explanation for their change in policy. (Hilson 20:4533/10-15.)

328. Binney & Smith, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to clubs.

#### 10. Lego

329. Lego is a leading manufacturer of plastic construction toys.

[ ]

330. Until 1991, Lego sold to the clubs discontinued product. (CX-487-A; Hilson 20:4528/24 - 4529/8.) However, the growth of the clubs made the clubs an attractive market. (CX-487; CX-491.)

331. In the early 1990s, BJ's purchased older regular line product but sought new regular line products from Lego. The Lego salesman told BJ's that his management was influenced by TRU not to sell to the clubs. (Hilson 20:4529/18-4530/1.)

332. In December 1992, TRU informed Lego that it will "delist or not list any" Lego item that has wholesale club distribution. This policy affected several items that Lego was considering for the clubs. (CX-492.)

333. In February 1993, Lego decided to sell two items to the clubs and accept the consequences from TRU, but to change the color of two other items for the clubs and to use two combination packs for the clubs. Lego also decided to sell some discontinued product to the clubs and "to resurrect the strategy" of providing customized product for the clubs in 1994. (CX-493-A-B.) BJ's made no purchase of Lego product for several years until 1996 when it purchased some older product, some of which was about to be discontinued. (Hilson 20:4530/2-4531/1.)

334. Lego, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to the clubs.



## 11. Sega

335. Sega of America, Inc. ("Sega") makes home video game hardware and software. Its products include Sega Genesis, Saturn video game system and Game Gear hardware and software titles, including Sonic the Hedgehog and Joe Montana Football. (Kalinske 12:2470/20 - 2471/9.)

336. In 1990 Sega had 8-10% of United States sales of home video games, with Nintendo having almost all of the rest. (Kalinske 12:2473/13-15.) By 1994 Sega had 50% of the video game market. (Kalinske 12:2518/24 - 2519/2.) Sega's percentage of TRU's sales of video games ranged from the "high teens or low 20s." (Kalinske 12:2495/5-8.)

337. In 1990-1991 Sega sold to the clubs, which it considered to have sales growth potential. (Kalinske 12:2473/16-23, 12:2474/17-19.) In 1991, Sega sold old bundled software to Sam's. (CX-754.) Sega wanted to sell Sam's everything that it had in inventory. (Kalinske 12:2513/16 - 2514/5.)

338. [ ] In a fall 1991 meeting between Sega's CEO Thomas Kalinske, Charles Lazarus and top TRU executives at TRU's headquarters (Kalinske 12:2475/3-9), Lazarus expressed concern about Sega's sales to the clubs (Kalinske 12:2476/11-23), and said do not sell to them. (Kalinske 12:2540/17-20.) At the meeting, TRU asked what Sega's policy was in selling its Genesis product to the clubs. (Goddu IH (CX-1658) at 387/1 - 388/6.)

339. Kalinske said he was not selling any Genesis product to Sam's. Later, upon learning that his statement was not correct, he wrote a letter to Lazarus stating that he "could not look you in the eye" if he did not explain the following: "Frankly, we were also looking for a way to get Wal-Mart's attention. . . . The quantities of hardware are low with the software greater, but it's a one shot deal that when sold out, will not be restocked." (CX-754.) Kalinske further assured Lazarus that "Sam's Wholesale Club will have old Genesis software bundled with Hardware this Fall. . . ." (CX-754.)

340. [ ]

341. [ ]

342. In 1991, Sega sold Costco in-line product which it tested for Sega. (Moen 4:692/15-18.) By Christmas of 1992, Sega would only offer combo packs to Costco. (Moen 4:692/13 - 693/7). In 1992, Sega was selling BJ's its open line of merchandise, including a wide variety

of software. (Kalinske 12:2486/5-12, 12:2500/8-23; CX-769-A.) Sega's sales to BJ's were \$25 million. (Kalinske 12:2498/5-9.)

343. In late spring or early summer of 1992, TRU contacted Sega about Sega product found in the clubs. Sega said that it would sell to the clubs "as long as Nintendo is in the warehouse clubs." (CX-913-F; Goldstein IH (CX-1659) at 59/10-17) [ ]

344. By February 1993 Sega limited its sales to BJ's to hardware packs only, as it was to the other clubs. (CX-769-A; Moen 4:692/15-693/18.) A Sega memo states "we have made a decision to package our product consistently with other manufacturers who sell to the warehouse club class of trade." (CX-769-A.) BJ's wanted to buy Sega's regular line video game software. (CX-769-A; Hilson 20:4520/19 - 4521/17.) Costco, Sam's and Pace also wanted to buy regular line product. (CX-701-B; CX-710-A; CX-716-B; CX-727 (Nintendo product); Moen 4:692/10 - 693/5 (Sega product).)

345. In April of 1993, BJ's still was selling regular line Sega merchandise. (Hilson 20:4521/6 - 4523/6; CX-678.) Charles Lazarus angrily confronted Kalinske at a Charity Ball about Sega's sales to the clubs and some other outlets TRU disfavored. Lazarus asked Kalinske "what he thought he was doing" (Lazarus 24:5393/14 - 5394/11) and implied that he had convinced Nintendo not to sell to the clubs and that Sega should follow suit. (CX-1776; Kalinske 12:2490/7-25, 2491/24 - 2492/2.)

346. Kalinske was concerned that TRU might retaliate against Sega. (CX-767-.A; Kalinske 12:2494/21 - 2495/4; CX-766.) Sega decided to restrict the clubs to bundled hardware/software packs rather than cutting them off completely. (Kalinske 12:2507/7-21.) Sega concluded that TRU has more to lose than Sega since Sega supported TRU with more product and promotional monies than all its other accounts combined, and Sega felt it could replace any shortfall with other customers. (CX-767-B.)

347. Sega's position from 1993 to near the time Kalinske left Sega in 1996 was that the clubs had to buy bundled packs. (Kalinske 12:2507/7-20; CX-760-A.) In 1995, after the popularity of Sega's products had declined somewhat, Sega offered Costco in-line products if it would purchase 16 SKUs of software. However by this time Costco was not interested. (Moen 4:692/15 - 693/18.) In 1996, Sega permitted BJ's to purchase from open stock. (Hilson 20:4526/19 - 4527/8.)

348. Sega agreed with TRU to restrict its sales to the clubs to combination packs of video game hardware and software. In the face of TRU pressure not to sell to the clubs at all, Sega told TRU that it would restrict the products it sold to the clubs to bundled software and hardware packs. Sega stopped selling regular line product to BJ's even though its business with BJ's was satisfactory to Sega.

349. Sega, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to the clubs.

## 12. Huffy

350. [ ]

351. [ ]

352. [ ]

353. [ ]

354. [ ]

355. [ ] At one point, Huffy asked TRU whether using a different name or color on a product that it sold to the clubs would differentiate it. (Butler 25:5560/5-12, 5561/6-10.) Van Butler of TRU advised that a name change would not be sufficient. (Butler 25:5561/6-10.)

356. [ ]

357. [ ]

358. Huffy, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to the clubs.

## 13. Just Toys

359. Just Toys, a maker of foam plastic toys and licensed toys, was selling toys to warehouse clubs by 1996; it sold regular line products as well as combo packs and specially configured products. (Hilson 20:4498/25 - 4500/5.) In 1993, Just Toys informed the buyer for BJ's that it would no longer sell BJ's regular-line products but only specially-configured products. A sales VP for Just Toys said that his management was being strong-armed by TRU and that Just Toys risked having its products thrown out of TRU if it continued to sell them to the warehouse clubs. (Hilson 20:4500/6-22.) Just Toys continued to follow this policy after 1993 until a management change in 1996; at the time of trial it offered its products to BJ's without restriction. (Hilson 20:4501/9-11, 4503/4-15.)

360. During 1993, Just Toys asked whether BJ's would participate in a product test, and BJ's agreed to place the item (a stretchable

plastic figure) in two of its stores in the New York area. Just Toys later informed BJ's that TRU had seen the product in BJ's stores, had decided not to carry it and had returned all of its inventory of the product to Just Toys. Without the support from TRU, Just Toys determined that it could not give the toy the promotional support it had intended. BJ's did not go forward with the item. (Hilson 20:4501/12 - 4503/3.)

361. Just Toys, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to the clubs.

#### 14. New Bright

362. New Bright, a Hong Kong-based maker of radio controlled toys and other toys, sold both regular line and combination pack or differentiated products to warehouse clubs since the late 1980's. (Hilson 20:4515/6-22.) Just before Toy Fair in 1994, a New Bright sales representative told the toy buyer for BJ's that New Bright was "taking a vacation" from selling to the warehouse clubs. The New Bright representative said that his management had been reminded by TRU that products on the shelf at BJ's would not be purchased by TRU, and that if New Bright wanted to have its assortment expanded at TRU it would have to stop selling to BJ's. (Hilson 20:4515/23 - 4516/17.) After discontinuing sales to BJ's in 1994, New Bright resumed sales the following year and has sold to BJ's since. (Hilson 20:4517/17-23.)

363. New Bright, other toy manufacturers and TRU had a common design or understanding to restrict toy sales to the clubs.

#### *D. Success of the TRU Campaign*

364. The TRU campaign against the warehouse clubs achieved participation by toy manufacturers, including the largest toy makers.

365. [ ]<sup>9</sup>

366. In February 1994 the FTC's investigation was known by "virtually everybody in the industry." (Muris 33:7469/17-24.) After this date, some of the manufacturers who restricted their sales to warehouse clubs in cooperation with TRU began to sell to the clubs. This may have been caused by the FTC's investigation and proceeding. (Hilson 21:4776/22 - 4777/1.)

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<sup>9</sup> [ ]

## ANTICOMPETITIVE EFFECTS

*A. Effects*

367. The purpose of the agreements in this case was to restrain competition among toy retailers and among toy manufacturers. TRU intended to prevent the clubs from competing with TRU (Kalinske 12:2488/20 - 2489/3 [ ]), to prevent toy manufacturers from competing with each other to sell products to the clubs ([ ] Kalinske 12:2488/20 - 2489/3, 2491/19 - 2492/6), and to prevent consumers from making direct price comparisons between products sold by TRU and products sold by the clubs. (Butler 25:5560/13-24; Goddu 30:6635/7-21.)

368. The TRU campaign had its intended effect -- the evidence shows that the campaign impeded the growth of the clubs as a emerging and innovative method of toy distribution, restrained retail price competition and caused toy prices to be higher than they would have been.

1. TRU impeded growth of the clubs

- a. *Growth of the warehouse clubs*

369. The rise of the warehouse clubs and TRU's response is part of a recurring historical pattern in retailing -- [ ] (Scherer(CX-1822-B-C), Ingene 41:9039/25 - 9040/22; Okun 13:2791/15-2792/11.)

370. Ironically, when TRU was just becoming successful, established retailers thought the toy manufacturers should not sell to TRU because its prices were too low. (Kalinske 12:2516/13 -2517/5; [ ])

371. As a new, low cost toy retailer in Japan, TRU fought efforts by toy distributors in Japan to "pressure suppliers to not sell us or charge us higher prices. . . ." (CX-1031-G; Goldstein 36:8257/19-8258/10.)

372. [ ]

373. Toy manufacturers recognized the clubs potential. In 1990, Mattel's chief executive officer, John Amerman, instructed his staff to be aggressive in new channels of distribution, especially the clubs. (CX-523.) In September 1991 Fred Okun of Mattel wrote, "This is one of the fastest growing channels of distribution in the country. As a public company we owe it to our shareholders to maintain our business by selling this class of trade." (CX-530-B.) A 1992 Hasbro

memo states "[w]e have only begun to see the potential for this channel of distribution." (CX-11; CX-78.) [ ]

374. The clubs were seeking aggressively to grow their toy business. (CX-1664; CX-373). Pace's toy department was one of the highest growth departments in the company. (Halverson 3:348/25 - 349/6.) Costco's toy sales from its FY 1991 to FY 1992 increased by 28%, compared to Costco's overall sales growth of 15%. (CX-1745-Z-9.) BJ's' purchases of toys in the early 1990's were also growing at a rapid rate. (CX-373.) Mattel's sales to the clubs increased 50% a year in both 1989 and 1990. (CX-530-E.)

375. The TRU campaign halted this growth trend and the clubs' threat to TRU's price image. [ ]<sup>10</sup>

376. An internal TRU memo in July 1993 removed the clubs from the list of "knock-off" competitors whose presence in the vicinity of a TRU store warranted an adjustment in sales and profit expectations of the store for manager compensation -- because the clubs were thought to have "no significant knock off impact on TRU stores." (CX 1058.)

*b. The clubs' ability to obtain regular line toy products*

377. Before the TRU conduct at issue in this case, warehouse clubs were able to buy regular line toys from toy manufacturers. (Moen 4:606/8 - 608/11; Halverson 3:357/3; Hilson 20:4573/15 - 4575/14; 4430/4-6.) In 1989, over 90% of Costco's purchases of Mattel's toys were regular line items. (CX-691) Eighty to eighty-five percent of Pace's toys were regular line items. (Halverson 3:359/13-21.)

378. The clubs purchased combinations packs or other differentiated products from leading toy manufacturers following TRU's actions. (Hilson 20:4536/18 - 4538/22.) While the clubs wanted some combination packs (Moen 4:634/12-15; [ ]),<sup>11</sup> they prefer to sell the same regular line product as the manufacturers sell to their retail competitors. ([ ] Moen 4:634/9-15; Jette 5:1001/13-17.)

<sup>10</sup> [ ] In 1993 and 1994 the clubs sales volume growth slowed sharply when consolidations were occurring, but their growth rate is beginning to increase again. (Sinegal 2:154/5 - 155/15 (Costco); Zarkin 21:4785/15-23 (BJ's); Ingene 41:9042/23 - 9045/5; CX-1824; CX-1825.)

<sup>11</sup> Combination packs of hot wheel cars that each retail for less than a dollar make sense because the value is clear to the consumer who can see that the total price of the pack is less than the total of the retail price of each car. (Halverson 3:358/2 - 359/7.)

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379. Parents see an individual toy promoted on TV or in a magazine and want to buy that individual toy. ([ ])

380. Combination packs make it difficult for consumers to compare prices of like items between the clubs and other retailers. (Butler 25:5560/13-24; Goddu 30:6635/7-21; [ ]) Manufacturers want to prevent such price comparisons by putting together combination packs for the clubs. (Okun 14:2897/23 - 2898/8; RX-813; CX-2.)

381. [ ]

382. The inability of the clubs to obtain regular line merchandise (CX-691; CX-447-A-E; Hilson 20:4437/5-19), caused by TRU's conduct, impeded the clubs' ability to become a more competitive force in the retail distribution of toys. TRU's conduct, which led the manufacturers to move the clubs into combination packs, made it difficult for consumers to make informed price comparisons between toys for sale in the clubs and those in other outlets such as TRU.

*c. The clubs ability to obtain products from major manufacturers*

383. The clubs relied on the brands of well-known toy manufacturers to attract customers to their stores. The TV-promoted products of these companies are the "lifeblood of the industry." (Goddu 23:6572/9-20; Hilson 20:4538/6-18; Halverson 3:356/19 - 357/2.)

384. In 1990 and 1991, a large part of Costco's toy purchases consisted of the products of major toy manufacturers. (Moen 4:603/24-605/9, CX-1745-Z-15.) In 1995, 64% of TRU's price image/sensitive toys were from major manufacturers and 70% of those toys were advertised on TV. (Ingene 41:9084/2 - 41:9085/1; CX-1826.)

385. The clubs' purchases of the brands of leading manufacturers dropped in 1993 after they were precluded from purchasing regular line toys from major manufacturers. ([ ]; CX-691 (Mattel); CX-1745-Z-15.) From FY 1993 to FY 1996, Costco's toy sales decreased by 1.6% whereas its overall sales increased by 19.5%; from Costco's FY 1991 to FY 1993 toy sales increased by 51% and Costco's sales of all products increased by 25%. (CX-1745-Z-9.) These decreases were caused at least in part by TRU's conduct and they had a negative impact on the ability of the clubs to become a competitive force in the retail distribution of toys.

386. After the clubs encountered difficulties obtaining regular in-line product from major toy manufacturers, they shifted their toy purchases to second or third-level toy manufacturers. (Hilson 20:4538/19-22; Halverson 3:434/7-23; Moen 5:893/17 - 5:894/8.)

387. These toys were generally not desirable for the clubs. (Sinegal 2:205/3-14; Hilson 20:4536/18 - 20:4537/3; Halverson 3:356/15 - 357/2.) The major manufacturers did the bulk of promotion and the lesser known brands "didn't have [the] dollars to do this type of promotion." (Halverson 3:356/19-24.) If these second and third-tier manufacturers were as desirable to the clubs' customers as the brands of major toy makers, the clubs would have carried more of these lines in the first place. (Hilson 20:4537/21 - 4538/18.)

## 2. Retail price competition

### a. TRU's prices to consumers

388. [ ] TRU was concerned about the clubs impairing its image for fair and low prices. (Weinberg 34:7697/4-11; 34:7699/7-12; [ ].)

389. The price differentials between toys sold by the clubs and TRU were illustrated by the competition shop reports prepared for TRU and toy manufacturers, which show the products and prices for toys available in TRU stores and warehouse clubs at particular times. (CX-46 through CX-64; CX-1545, CX-1550 through CX-1563.) These reports show warehouse clubs prices well below TRU. [ ] (CX-54-B).

390. When Costco enters a market, its presence pushes competitors' prices down. (Sinegal 2:200/7 - 201/9.) [ ] To keep its image for low prices from being eroded, in 1992 TRU lowered its prices to meet the clubs' prices on Mattel toys in local areas where the clubs competed (TRU reduced its price by 19% on 47,000 units of Mattel's Air Pro Hockey). (Weinberg 34:7696/13 - 7699/12, 7704/5 - 7705/3.)

391. In 1992, there were warehouse clubs within the areas of dominant influence of 486 out of 497 TRU stores -- that is, in the same local geographic areas reached by the newspapers in which TRU advertises. (CX-1823; Ingene 41:9050/2-21.) That same year, there were 238 TRU stores within five miles of a warehouse club; and 20% of TRU's stores were within one mile of a club. (CX-912; Ingene 41:9051/12 - 9052/11.) [ ]

392. I find that TRU would have lowered its prices had it not taken action to stifle the competitive threat posed by the clubs. If TRU, as the nation's largest toy retailer lowered its prices to meet the clubs competition, this would likely have driven prices down among all retailers. (Goddu 30:6616/19-23; Blaine 29:6372/12-20.) (Binney & Smith believed that the prices charged by the warehouse clubs would become the prevailing market price.)



*b. The clubs' prices*

393. By inducing the toy manufacturers to shift the clubs from regular line products to combination packs, TRU's conduct raised the clubs' retail prices. (CX-2; [ ] Hilson 20:4464/24 - 4465/20, 4473/11 - 4475/13; Ingene 41:9083/1-19.) After the TRU policy the club packs sold by manufacturers to the clubs were designed to avoid price comparisons that would have been unfavorable for TRU.

394. Mattel's club policy required that the retail price of the combination packs sold in the clubs be higher than the retail price of any single component item in the package carried by TRU or other retailers. (CX-688; Okun 13:2809/11 - 2810/23; Halverson 3:374/4-18; Hilson 20:4473/11 - 4475/13.)

395. Hasbro's Playskool division designed its combination packs for the clubs to ensure that the retail price of the combination pack in the clubs would not be lower than the retail price of one of the regular-line items sold alone in other outlets. (Inano 16:3384/13 - 3385/5.) Hasbro told Hilson that it would not allow a combination pack to be put together for BJ's that would retail for less than one of the items elsewhere. (Hilson 20:4464/17 - 4466/6.)

396. Hilson testified that this raised the retail prices of the Hasbro products that BJ's could sell. (Hilson 20:4466/7-16.) BJ's placed an order for a combo pack made up of an inflatable toy with a pump, where the cost of the pack to BJ's would have permitted BJ's to sell the two items to consumers at a price less than the retail price for the inflatable toy alone (without the pump) in other retailers. A Hasbro vice-president later returned the purchase order papers to Hilson, saying that "a decision came down from above" at Hasbro not to sell the combo pack to the warehouse clubs. (Hilson 20:4466/7 - 4473/2; CX-1433.)

397. Consumers who only desired to purchase a promoted individual product would tend to purchase the product in regular toy channels because of the clubs higher price points for combination packs. (CX-688; Okun 13:2811/17-22.) Consumers therefore paid more to get the individual toy they wanted -- [ ]

398. Costco charged higher prices for regular line products that were unavailable directly from the manufacturers because Costco had to purchase through distributors whose prices were higher than those charged by manufacturers and Costco passed on part of the added cost to its members. (Ojendyk 18:3999/8 - 18:4002/1; CX-1379; Sinegal 2:309/17 - 311/7.)

### 3. The warehouse clubs' price competition

399. TRU's marketing expert witness, Professor Buzzell, testified that even if TRU limited the availability of some toys to the clubs, the effect on toy prices would be trivial. (RX-894 at 32.)

400. Professor Buzzell relies on a list of 70-100 toys, which TRU deems to be price image ("PI") toys. (Goddu 30:6543/23 - 6544/1, 6551/19-22.) TRU prices these high profile toys at nationwide "sharp" prices. (Goddu 30:6544/18 - 6545/23, 6653/25-6554/11.)[ ]

401. Professor Buzzell fails to consider competition by warehouse clubs on toys outside this group of toys. Another 130 - 150 toys are deemed by TRU to be price sensitive ("PS") toys (Goddu 30:6551/23 - 6552/1), priced on competition in local markets. (Goddu 30:6554/12 - 6555/13.) TRU prices these "PS" toys at margins of 20%. (CX-1826.) TRU's margins are 30-35 % for toys ranked lower than the top 500 - 1000 toys. (Ingene 41:9078/20 - 9080/24.)

402. Most toys carried by the clubs rank lower than the top 500 - 1000 toys, and the difference between a club 10% margin and a TRU 30-35% margin is important to consumers. (CX-1827; Ingene 41:9080/2 - 9081/16.) "The real price impact and the real image impact comes not in the top 100 toys but outside of the top 100." (Ingene 41:9086/12 - 9087/3.)

403. The clubs wanted to expand their toy business. (CX-1664 (Costco); CX-373 (BJ's); Chase 8:1655/9 - 1656/3 (Price).) The expansion of the clubs' toy departments would have placed more downward price pressure on TRU.

404. [ ] However, his testimony is contradicted by evidence that TRU lowered its prices to respond to the clubs' prices.

405. Concerned about the clubs' low prices, and the effect on TRU's price image and profits, TRU took steps to prevent competition from the clubs. I conclude that the clubs' pressure on TRU to lower its prices would have caused TRU to lower its prices on toys beyond the top 100 - 250 toys.

406. TRU points to RX-430, a one page Costco document entitled "Items Price Costco Would Have Bought Individually But Did Not Want In Combination Packs." The document lists 13 items in fiscal years 1996 and 1995. TRU argues this shows the minor impact of its policy.

407. Little weight will be given to this ambiguous document. TRU did not clarify its meaning by questioning Costco witnesses at the hearing. (5:884/6-21.) [sic]

408. At Toy Fair 1997 there were 60 toys displayed that Costco wanted to purchase but the manufacturers would not sell to Costco. (Moen 4:638/5-649, 641/10 - 644/9.) There were more than 13 toys that Costco wanted in FY 1995 and 1996 that manufacturers refused to sell to Costco.

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409. TRU argues that Sam's warehouse club is not affected by the TRU policy because Wal-Mart, its parent, prevents Sam's from carrying the same toys as Wal-Mart. (Reinebach 39:8724/17 - 8725/3.)

410. Christopher Jette, Sam's toy buyer from 1991 to 1995 (Jette 5:992/10- 993/3) testified that Wal-Mart had no policy against Sam's carrying the same toys as Wal-Mart, despite the industry rumor of such a policy. (Jette 5:1011/20 - 1012/1, 1012/21 - 1013/6.) Sam's has carried toys that were also carried at Wal-Mart. (Jette 5:1012/2-6.)

411. TRU policy did affect Sam's toy business. Sam's relied more heavily on combination packs than the other clubs (Jette 5:998/22 - 1001/12), but half of the toys carried by Sam's were regular line toy items, many "hotter sellers." (Jette 5:1001/13-25.)

412. [ ] Sam's placed orders for regular line toys from Hasbro's Playskool division in 1994, but Playskool would sell to Sam's only specially configured "value packs." (CX-462; CX-461.)

#### *B. Market Power*

413. [ ] Other TRU executives reported TRU's share at 22-25%. (CX-1052-E (June 1989); CX-1039-E (March 18, 1992); CX-1040-A (April 2, 1992).)

414. National statistics are poor indices of market structure in retail markets. [ ]

415. Local competition is recognized by Toys "R" Us. [ ]

416. [ ]<sup>12</sup>

417. TRU calculated its share among all toy retailers in newspaper areas of dominant influence ("ADI"). [ ]

418. TRU's own documents state that TRU is the dominant toy retailer. (CX-1040-A ("TRU is the dominant market share leader"); CX-1039-E; CX-1042; CX-1048-A; Goldstein 36:8249/16 - 8250/11.)

419. TRU studies show that toy retailing is growing increasingly concentrated, CX-1043-L-M:

Other remaining retailers are the mass merchants such as Sears, Penneys and Wards and the catalogue showrooms. The mass merchants are losing share because they can't compete with the toy supermarkets on price and selection and can't compete with the disc on price. The catalogue stores are losing share because of their lack of selection. Other retailers include mom and pop toy stores, department stores, high priced toy shops like FAO Schwartz and convenience stores such as variety stores, drug stores and supermarkets. These retailers are losing share to the toy supermarkets and discounts because of price and to Kay-Bee because of convenience. So, just as there is consolidation in the toy industry with Hasbro, Mattel, Tyco gaining huge market shares, there is also consolidation in toy retailing

<sup>12</sup> RX-895 was developed specifically for this litigation.

with Toys R Us, Wal-Mart, Kmart and Kay-Bee gaining large market shares. I see this consolidation continuing with intensity in the 1990's.

420. On October 29, 1991, Mr. Goldstein, TRU's CEO, stated:

[W]e have seen the domination of category killers like Toys "R" Us, Home Depot, Circuit City, Staples and Office Club. So, what we have seen are new concepts, consolidation and huge, powerful retailers dominating the retail landscape. \*\*\* In my opinion, the companies such as Wal-Mart, Home Depot and Toys "R" Us that can continue to lower prices, gain market share and lower costs again will dominate retailing in this decade. \*\*\* Regarding category killers, consolidation is happening here also. Toys "R" Us is dominating the toy industry and is gaining market share.

(CX-1042-G-I (October 29, 1991); CX-235-A.)

421. TRU exerts its dominance as a buyer of toys. TRU also exercises market power as a seller of toys. TRU's power as a buyer and seller are related.

#### 1. TRU's buyer power

422. TRU, the leading retailer of toys in the United States, has power as a purchaser of toys from manufacturers. (Scherer (CX-1822) ¶ 13; CX-1624-C (for 1986, largest drug chain had 3.8 % of U.S. drug industry's sales; the largest food store had 4% of food sales).)

423. Toy manufacturers would have difficulty finding alternative buyers to replace TRU. (Scherer (CX-1822) ¶16.)

424. TRU is the largest customer for the major traditional (non-video) toy manufacturers. (Okun (Mattel) 13:26-8/22-2609/1; Owen (Hasbro) 6:1102/13-17, 1159/1-2; CX-1272 (Tyco); DePersia (Little Tikes) 10:2256/8-10, 2257/15-16; Cohen (Fisher-Price) 35:7926/18 - 7927/4.)

425. In 1994, TRU had 29% of the sales of the top ten traditional toy manufacturers. TRU purchased 28% of Mattel's toys, 28% of Hasbro's toys, 31% of Little Tikes' toys, and 48% of Tyco's toys. TRU has 35% of Fisher-Price's sales. (Cohen 35:7927/2-4.) TRU's average market share for four years from top ten firms is [ ] For the seven traditional manufacturers, the average share is [ ] These shares were growing, indicating that manufacturers were becoming more dependent on TRU. (Scherer (CX-1822) ¶13 & Exh. 1; Cohen (Fisher-Price) 35:7926/18 - 7927/4.)

426. [ ]

427. [ ]

428. Top manufacturers account for a low percentage of TRU's sales. [ ] This gives TRU leverage over the manufacturers.

429. Toy retailing is local (Scherer 23:5161/3-15), and because TRU has high local market shares in metropolitan areas, this adds to TRU's buyer power. To sell in many metropolitan areas, the manufacturer must have TRU distribution. (Shiffman 10:2249/12 - 2250/6, 2001/21 - 2002/1.)

430. TRU's buyer power is magnified when compared to other toy retailers. [ ] Kay-Bee sells discontinued and close-out merchandise. (Verrecchia 7:1549/18-20; CX-1036-C.)

431. TRU's main competitors (Wal-Mart, Kmart, and Target) carry less than a third of the toys carried by TRU; their floor space for toys is far less than TRU's. TRU's main competitors also carry a lower percentage of the manufacturers' lines after the Christmas season. (Goddu (CX-1658) at 356-57; Goldstein 36:8242/18 - 8249/5.)

432. [ ]

433. Manufacturers would have difficulty replacing sales if TRU did not purchase an item. (Okun 13:2813/22 - 2814/1; Owen 6:1151/3-10; Verrecchia 7:1412/19-22.) As Amerman of Mattel testified, "Toys 'R' Us is 30% of our business, so that is a very big number to put to other accounts that are already committed to what they feel is correct and would be unwilling to take more." (Amerman 17:3617/23 - 3618/16.)

434. A new toy can cost \$12 million in television and tooling costs (sunk costs). (Verrecchia 7:1409/14 - 1410/2.)

435. TRU's support is essential in the sale of a new promoted toy because its size and geographic coverage generate the sales necessary to support an effective advertising campaign. (Fuentevilla 18:3886/12-15, 3888/9-22; Owen 6:1154/20 - 1155/2; CX-773 -F-G; Shiffman 10:2001/21 - 2002/1, 2002/20-23, 2249/12 - 2250/6.)

436. Manufacturers depend on TRU for promotion. Other national chains do not advertise toys year-round or to the extent that TRU does. (Goldstein 36:8244/21 - 8245/13.)

437. TRU's refusal to purchase a new toy could cause serious financial harm to manufacturers. In 1994 a small video game company put itself up for sale after TRU dropped its line. (CX-773-G.) Major manufacturers took seriously TRU's statements that it would not carry the same toys that the manufacturers sold to the clubs. (Fuentevilla 18:3892/17-20, 3893/17-20; Amerman 17:3656/19-25; Verrecchia 7:1486/14 - 1487/12.)

438. Mattel and Hasbro need TRU's purchases, the "critical mass" is essential for continued production. If TRU did not purchase older, basic toys, manufacturers could not profitably make them. Since initial promotion and tooling cost have already been amortized, these toys profit the manufacturers. (Amerman 17:3622/18 - 3624/24, Inano 16:3378/11-23; Owen 6:1151/11 - 1152/12.)

439. TRU used this power to enforce its club policy. In 1993, Just Toys asked BJ's to test a new item (a stretchable plastic figure) in two of its stores in the New York area. After TRU saw the product in BJ's stores, it returned all of its inventory of the product to Just Toys. Without the support from TRU, Just Toys could not promote the toy and did not go forward with the item. (Hilson 20:4501/12 - 4503/3.)

440. When considering whether to reduce the number of SKUs it carries, [ ] (CX-1013-Z-1.)

441. Hasbro officials were concerned that if they alienated TRU by selling first-year, TV-promoted products to clubs, TRU could retaliate by reducing purchases of their basic toys on which they depend. (Inano 16:3378/11-23.)

442. Manufacturers fear TRU retaliation by not including their products in TRU's catalogues and flyers or not giving them endcaps or desirable shelf space. (Owen 6:1109/1-14.)

443. Amerman of Mattel worried about increasing toy retail concentration. Mattel's top five customers doubled their share of Mattel's sales between 1985 and 1990 to half of Mattel's sales. (CX-1699.) On December 13, 1990, Amerman wrote "The constriction in the number of traditional retail outlets that carry toys is going to become a bigger and bigger problem as time passes." (CX-523.) By 1994, Mattel's top five customers accounted for 72% of Mattel's sales. (CX-1669.) Mattel's CEO wanted to increase sales to clubs to reduce dependence on TRU. (Okun 13:2631; CX-523.)

444. [ ]

445. A Tiger Electronics vice president of sales wrote: "I am very worried about our future business as a whole for the following reasons: \*\*\*(2) TRU dictating to Tiger and becoming even a bigger percentage of our business...." (CX-813; Shiffman 10:2003/13-16, 2029/13-21.)

446. [ ] and Video Tech ("VTEch") wanted to reduce dependence on TRU. ([ ]; CX-1301 (Video Tech).)

447. The manufacturers also depend on TRU for international sales. Half of Mattel's and Hasbro's sales are now outside the United States. TRU is the largest worldwide retailer of toys. [ ] (Scherer (CX-1822) at ¶16; Goldstein IH (CX-1659) at 179; Staley IH (CX-1729) at 56; CX-773-A-O; CX-235-C-D.)

448. [ ]

449. [ ] In addition, the monopsony regression could not determine whether TRU exercised its buyer power by extracting agreements from the manufacturers to restrict sales to the clubs. (Carlton 32:7036/25 - 7038/9.) Finally, Professor Carlton disregarded the manufacturer testimony as to their dependence on TRU. (Carlton 32:7059/19 - 7061/20.)

450. TRU pressured Playskool in 1992 and this pressure limited Hasbro's flexibility in the marketplace. (Owen 6:1145/17-20, 1146/5-14, 1148/12.) Playskool would have sold more and different products to the clubs were it not for the TRU pressure. (Owen 6:1147/8-11.) Limits on dealing with the clubs were in Hasbro's best business interest. (Owen 6:1146/24 - 1147/7.)

451. Mattel's CEO testified that TRU's club policy caused Mattel to "lose flexibility to enhance shareholder value and do things that were in the economic best interests of Mattel." (Amerman 17:3658/10 - 3659/4.)

452. TRU recognized that manufacturer profitability depended on TRU: "The key to increased profitability in the 90's will be doing more business with Toys R Us since most of the expansion in the toy industry, at retail, will be taking place in Toys R Us stores in the U.S. and throughout the world." (CX- 1650-E.)

453. Manufacturers were faced with TRU not carrying its toys, giving them inferior shelf space, or not buying nonpromoted toys. (Scherer 23:5172/24 - 5173/9, 5177/22 -5179/2.) Because of TRU's dominant position, I find that the threat faced by the manufacturers to be credible. (Scherer 22:5022/15-25.)

454. TRU has substantial buyer power or leverage and the ability to cause severe economic harm to its suppliers.

## 2. TRU's power at retail

455. [ ]

456. It is unnecessary for TRU to have the power to raise prices in order for its conduct to result in anticompetitive effects. (Carlton 32:7034/15 - 7035/25; Dennis W. Carlton and Alan S. Frankel, *The Antitrust Economics of Credit Card Networks*, 63 Antitrust L.J. 643, 654 (1995); Dennis W. Carlton and Alan S. Frankel, *The Antitrust Economics of Credit Card Networks: Reply to Evans and Schmalesee Comment*, 63 Antitrust L.J. 903, 904-05 (1995).)

457. Thus, even where a firm does not have the power to raise prices, the prevention of entry by a new, low cost efficient competitor can cause consumer harm. The question is whether TRU has the ability to prevent entry that could result in lower prices. (Carlton 32:7034/9-14; Scherer 22:5024/1-14.)

458. Even if market power as a seller were necessary, TRU has such power. (Scherer (CX-1822) ¶ 28, 22:5025/16-20.)

459. A key in determining whether TRU has the power to raise price is whether TRU's prices vary according to the degree of competition it faces. TRU concedes that its prices are highest where it has the least competition. (Goddu 31:6951/19-22, Dep. (CX-1651) at 174.)

460. [ ]

461. Professor Carlton's reliance on industry concentration data at the national level is misplaced. [ ]

462. [ ]

463. [ ]

464. TRU argues that entry into toy retailing is easy. [ ] This evidence shows, however, that it is difficult to enter as a significant competitor on a

national basis. [ ] Business documents from the manufacturers and TRU describe a consolidated industry. (CX-1043-K-M; CX-1031.) In a 1995 speech, the CEO of TRU explained the difficulties of succeeding in the toy business (CX-1031-C):

[T]o be successful in the toy business, because of the extreme seasonality, you need unique expertise in systems, logistics, warehousing, buying, human resources that takes a long time to develop and if rushed leads to disaster as we have seen in the U.S. as evidenced by Child World and Lionel which at one time did over \$1BB combined and both went bankrupt and have been liquidated and Toy City in Canada, formerly part of the #1 toy retailer in Canada, and which is now out of business.

465. I find that TRU has market power. TRU has raised barriers to entry into toy retailing by the warehouse clubs. (Scherer 22:4974/4-23.)

#### DEFENSES

##### *A. Economic Defenses*

466. TRU argues that its conduct was justified as an effort to protect against free-riding. Free-riding does not justify TRU's conduct in this matter. (Scherer 3:5068/1 - 5070/11.)

467. [ ] (Scherer (CX-1822) ¶ 57 (citing Griliches, "The Search for R&D Spillovers," 94 *Scandinavian J. Econ.* 29-47 (1992 Supp.)) Without them, economic progress would grind to a halt. Paul M. Romer, "Endogenous Technological Change," 98 *J. Pol. Econ.* no.2, part 2, p. S89.

468. [ ]

469. TRU may provide spillover benefits for third parties, but it also takes advantage of uncompensated spillover benefits that are provided by others in the economy. TRU locates near shopping centers so as to benefit from the traffic without having to pay the higher shopping center rents. (Scherer 23:5073/9 - 5074/17.)

##### 1. Advertising

470. TRU argues that the clubs free-ride on its advertising. In the toy industry, the manufacturer is primarily responsible for generating the demand for toys through television advertising. (Spencer 9:1866/7-10; Amerman 17:3738/8-17; Weinberg IH (CX-1662) at 48/21-25.) Consumer demand is driven primarily by the manufacturer's advertising efforts, not TRU's. (CX-773-J; CX-1053.)

471. TRU advertises price of toys for sale in TRU stores. (Spencer 9:1866/23-25.) The TRU's price image toys, with the lowest margins, are selected by manufacturer promotion, not TRU promotion. (Goddu 30:6594/6 - 6596/2.)



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472. TRU receives compensation from the manufacturer for advertising. [ ]

473. [ ]

474. [ ] TRU's senior vice-president of advertising felt that TRU received more in advertising allowances than it spent on advertising. (Spencer 9:1867/7-14.)

475. Toy manufacturers spend 8% of their total sales dollars on advertising. (CX-1624-Z-11.) This 8% for all manufacturers understates the spending for manufacturers who advertise their products, since it includes manufacturers who do not engage in any advertising. Hasbro's advertising expenditures are much higher, some divisions with advertising expenditures of 19.3% of total sales. (CX-88.)

476. [ ]

477. Professor Scherer corrected errors in the Carlton regression and concluded [ ] (Scherer (CX-1831) ¶ 6-8.)

478. [ ]

479. Professor Scherer reasonably relied on testimony from deposition testimony from buyers. (Scherer (CX-1831) ¶ 8.) [ ]

480. Demand for toys is mostly created by manufacturer advertising, not advertising by TRU. TRU benefits from its own advertising and promotional efforts. TRU is compensated for promotional expenses that benefit the manufacturer. There is no evidence connecting the clubs to any free-riding on TRU advertising. There is no evidence that TRU advertising generates sales at warehouse club stores.

## 2. In-store promotion

481. TRU is like a warehouse selling toys. Like Wal-Mart, Kmart, and the clubs, TRU does not provide service in demonstrations or informed sales personnel. TRU stores are like the chain discounters and clubs in lack of personal service. [ ]

482. TRU's Goldstein acknowledged that TRU provides "limited service" today, and even less in 1992. (Goldstein 36:8242/18--8243/1.)

483. TRU's low service is [ ] In a New York Times article ("Lost in Toyland," March 31, 1996, at 3, 12) (CX-807), TRU's service was described as follows:

"I don't know a single retailer about which I hear as many complaints as TRU," said Barry Bryant, an analyst at Rodman & Renshaw and the father of a 3-year old son. "You never know where anything is, and there is no one to help. . . . All of these things combine to create a uniquely unpleasant shopping experience for the parent."

The supermarket style of selling playthings has always been the TRU trademark. Shoppers squeeze through charmless, colorless aisles, and pick through rows of [toys] displayed often without care or accessibility.

Merchandise is often piled so high it is impossible to reach. . . . And if a sales clerk can be unearthed, chances are his or her job is to stock, not to serve. . . . By offering a giant selection with very low prices and plenty of inventory, TRU has been able to get away with this no-frills, service short shopping experience.

484. [ ]

485. Because TRU sells products that require little service, TRU competes on price, as well as selection. (CX-1052.)

### 3. Showroom

486. TRU argues that its around-the-year stocking policy helps manufacturers identify items that are selling well, facilitating production planning, and that the warehouse clubs free-ride by observing what toys TRU is buying, thereby identifying the "hot items" (Scherer (CX-1822) ¶ 63.)

487. The warehouse clubs attend toy fairs, decide what will sell, and order merchandise near the same time as the rest of the trade. The clubs place most of their orders in the springtime (March and April) when it is still uncertain which toys would be the "hot" toys for the upcoming Christmas season. (Hilson 20:4424/10-4426/16; Moen 4:611/2 - 613/14; Halverson 3:349/7-11; Jette 5:1006/12-1007/4; CX-113; CX-748-A-B; CX-816; CX-930; CX-1265-D; CX-1385; CX-1387-A-B; CX-1664; Okun 13:2809/3-10, 14:2939/8-12.)

488. The clubs selecting toys to purchase cannot consider other retailers' sales or advertising of products because their purchasing decisions are made early in the season before the toys are for sale in other retailers; with older toys, sales history from prior years is not reliable because what sells from one year to the next can be totally different. The clubs rely on their own perception of the toy, and on the manufacturers' promotional plans: television advertising was key in creating demand. However, there is no way to know in advance whether a toy will sell well. (Halverson 3:351/1-2, 3:352/20 - 353/12; Hilson 20:4581/4 - 4582/10, 20:4582/14-21, 20:4585/21 - 4586/23.)

489. TRU is compensated in part for the risks it takes stocking new items by manufacturers' discounts for those that turn out to be "duds." (Scherer (CX-1822) at ¶ 63c.) TRU is compensated by the manufacturers with extended "dating" terms that allow it to delay payment until December for merchandise it received earlier in the year. (Spencer 9:1873/19-21, 1874/22-25.)

490. TRU is not a toy showroom upon which the clubs can free-ride. TRU is not a showroom such as high ticket automobile or furniture showrooms; TRU is more like a supermarket. (CX-1034-B, D; CX-1051-C; CX-1031-C.)

## 4. Year-round full line.

491. TRU benefits from its full-year, full-line coverage. Taking product early, TRU reduces the risk of being out-of-stock when a product becomes hot and in short supply. [ ] (CX-1586-B; CX-1597-A; CX-1044.)

492. By buying early and monitoring sales TRU has an advantage over other retailers in identifying what products will be "hot." (Lazarus 24:5351/18 - 5352/16, Lazarus Dep. (CX-1654) at 55-56; Verrecchia 7:1457/18-1458/3.)

493. TRU buys and takes delivery of merchandise early in the year to get the merchandise onto its shelves at the time that the consumers want the merchandise. (Scherer 22:4906/2-7.) [ ]

494. For the toys that make TRU a "full-line" toy supermarket -- the non-promoted toys. [ ] (Scherer (CX-1822) ¶18; Butler 25:5569/7-14.)

495. The toy industry is seasonal. Manufacturers traditionally ship, and retailers sell, most toys during the fourth quarter. [ ]

496. That the clubs sell a high percentage of toys in the fourth quarter is of little importance. (RX-621 at 28 (Table 7) (62-64% for clubs; 56-57% for TRU); CX-723-C.)

497. Prior to 1996, TRU carried between 15,000 and 18,000 SKUs. TRU reduced the number of SKUs by one third, to around 10,000 to 11,000 SKUs. (Goddu Dep. (CX-1651) at 218/3 - 222/5; Goddu 30:6576/1-4; 6578/6-13; Goldstein 36:8265/12 - 8266/9; CX-994.)

498. Fewer SKUs carried by TRU is not related to free riding nor does it imply a reduction in output. (Scherer 23:5063/1-12.) [ ]

## 5. Compensation

499. Dating terms enable TRU to carry a full line of toys for most of the year. (CX-1012; CX-1611.)

500. TRU convinced the manufacturers to produce toys for delivery earlier in the year in return for TRU paying later. (Lazarus 24:5353; 5362 - 5363.)

501. [ ]

502. [ ]

503. Manufacturers also give TRU warehouse, early buy, early ship discounts or other allowances to compensate TRU for purchasing product early. (CX-1730.) When a manufacturer wants TRU to take more product earlier than planned, TRU charges the manufacturer an additional warehousing fee. (Spencer 9:1876/15-21; CX-1730; CX-548.)

504. [ ]

505. A Mattel briefing paper preparing for a meeting with TRU stated that the extended dating and other allowances compensate TRU for taking product early (CX-686-B):

- In some respects, you are our warehouse, but be aware that we pay you for the privilege through:
  - A dating program that pays a great amount.
  - Policy allowances.
- You might not want to hear it, but it's the truth.... You are our most expensive customer.
- Other accounts accept significant quantities early and are paid less benefits, less discounts, and with no extended dating.

506. [ ]

507. [ ]

508. [ ]

509. If a toy continues not to sell manufacturers provide additional allowances to TRU. [ ]

510. [ ]

511. TRU's standard contract contains a "Most Favored Nation Clause" whereby if a TRU competitor receives a lower price after TRU purchases the product during the same calendar year, TRU gets the benefit of the lower price. (CX-1030-F.)

512. [ ]

513. [ ] If TRU advertises the product and it does not sell as expected, TRU charges the manufacturer. (Spencer 1874/2 - 1875/10.)

514. TRU is the most expensive customer for Mattel and Hasbro. (CX-686-B; CX-7-A.) [ ]

515. [ ]

516. [ ]

517. TRU is or can be compensated for costs and risks it assumes by ordering a broader product line earlier in the year. TRU gains price concessions from manufacturers through direct wholesale price reductions, or better dating terms. TRU is compensated for carrying toys not carried by the clubs.

#### 6. Benefits to TRU

518. TRU receives other benefits for taking in product early. TRU takes in product early as a trade-off for hot product later in the year. (Lazarus 24:5364.)

519. TRU receives a disproportionate share of hot products. [ ]

#### 7. "Hot" Toys

520. TRU places most of its orders for the Christmas season in the spring, and receives some product early in the year, and some as the year progresses. TRU, like all retailers of toys, adjusts its order as the year progresses, increasing orders for toys that are selling well, and decreasing or canceling orders for toys that are not. The clubs place their orders soon

after TRU places its orders. At the time that the clubs place their orders, neither the clubs nor the manufacturers know which toys will become hot.

#### 8. "Free-Ride"

521. TRU accounted for 48% of the toy industry's retail advertising support from January through May of 1994, while Wal-Mart accounted for 2%. [ ]

522. [ ] I find no significant difference between Wal-Mart and the clubs in terms of advertising.

523. The chain discounters have done little warehousing. They operate on a just-in-time system, like the clubs. (Okun 13:2815 - 2817/12.)

524. TRU provides a greater level of services for manufacturers than any other of the national chains, including Wal-Mart, Target and Kmart, by taking product earlier, carrying a fuller line, carrying less-popular or non-promoted toys, advertising year-round, test-marketing products, avoiding knock-off products, and promoting manufacturer brands. (Goldstein 36:8252/18 - 8259/5.)

525. If free-riding were the true rationale, one would expect to see similar restrictions on the clubs in other countries. However, no such restrictions exist in Canada. From 1990 to the present, Costco Canada has purchased regular line toys from Mattel, Hasbro, Lego, Irwin Toys (both a manufacturer and distributor, 5:942/11-12), V-Tech, Tyco, Today's Kids, Little Tikes, Binney & Smith and Playmates. (Nickel 5:922/9-16.) The Canadian arms of Mattel, Hasbro, Binney & Smith, Lego, Video Tech, Tyco and Playmates all marketed and sold independently of their parent companies. (Nickel 5:922/25 - 924/2, 967/21 - 969/24, 972/21 - 975/25, 977/7-14.)

526. TRU may have less market power in Canada than in the United States. (CX-1648-T, V (Zeller's in Canada is "about as tough a competitor in the toy business as we have in the world").) The absence of restraints in Canada supports the view that the restraints are market power driven rather than efficiency driven.

#### 9. Overall costs and benefits

527. TRU's economic expert, Professor Carlton, did not attempt to quantify whether TRU was adequately compensated for its "showroom" functions. (Carlton 32:7021/15 - 7022/11.)

528. TRU's Thomas Reinebach created a chart for purposes of this litigation that shows his estimates of the net costs to TRU of providing services to manufacturers. I find his calculations fail to substantiate the existence of any significant free-rider problem.

529. Mr. Reinebach calculated [ ] This includes actual costs for advertising and markdowns, derived from TRU business documents, as

well as estimates for the costs [ ] Mr. Reinebach testified that the manufacturers provide allowances to TRU related to these services. [ ] Reinebach 40:8881/3-12.)

530. [ ] This equals about 1.6% of TRU's 1995 sales revenues. (Reinebach 8881/23 - 8882/9.) [ ]

531. [ ]

532. TRU also benefits from taking product early. Mr. Reinebach did not account for such benefits.

533. I find that whatever free-rider issues may exist are insubstantial, and outweighed by the competitive harm caused by the TRU campaign against the warehouse clubs.

#### *B. Other Defenses*

534. The respondent alleges that prior to the Commission's vote to issue the complaint in this case an unidentified Commission employee provided non-public information to the Wall Street Journal; that this leak of information influenced the vote of the Commission to issue the complaint; that the leak was a federal crime; and that the complaint should be dismissed because it was issued as a result of criminal conduct by Commission employees.

535. The evidence introduced by the respondent was a copy of a Wall Street Journal article dated May 21, 1996, concerning the investigation in this case (RX-776) and a copy of a June 4, 1996, letter from the Director of the Commission's Bureau of Competition to counsel for the respondent indicating that the respondent's allegations were being brought to the attention of the Commission's Inspector General. (RX-915.)

536. The Wall Street Journal article does not indicate that anyone at the Commission was the source of information for the story; it describes its sources as "people familiar with the situation" and specifically states that "an FTC spokeswoman declined to comment." (RX-776.) The Bureau Director's letter notes that the news article "does not demonstrate that the source or sources [for the article] included any Commission employees" and notes that the existence of the investigation had earlier been reported in the press based on information attributed to "industry executives." (RX-915 at 2.) During the course of the trial the respondent stipulated that "virtually everybody in the industry" was aware of the FTC's investigation as of February 1994. (33:7469/17-24.)

537. I find that the record evidence does not show that any Commission employee provided any person with any non-public information concerning the Commission's investigation in this case. The respondent has failed to substantiate the factual allegations in its affirmative defense.

## REMEDY

538. There is no evidence that the respondent TRU has discontinued its warehouse clubs policy. The respondent asserts that its warehouse club policy is legal and justified by the needs of its business. (43:9390/2-15.)

539. Some toy manufacturers who joined in the TRU campaign against the warehouse clubs have recently relaxed their earlier restrictions on sales of products to the clubs; other toy manufacturers continue to apply the restrictive sales practices that they adopted pursuant to their concert of action with TRU. These include both Mattel and Hasbro, the two largest toy manufacturers.

540. The relief contained in the order is reasonably necessary to remedy the effects of the respondent's conduct. Each of the provisions addresses conduct that might be used by the respondent to perpetuate the restraint.

541. Among the remedial provisions is one which, for five years, would prohibit the respondent from communicating to any supplier that it may discontinue purchasing toys because the supplier sells to toy discounters. (III.E.) This provision is reasonable to "fence in" a respondent that has orchestrated an extensive concert of action with toy manufacturers to restrict toys to a competing channel of trade.

542. Executives of toy manufacturers that participated in the TRU campaign commented negatively on the foregoing provisions of the order. (Owen 6:1166/4 - 1170/6; Verrecchia 7:1446/12 - 1447/21; Wilson 26:5705 - 5707/16; Barad 35:7870/12 - 7871/13.) I find that this testimony should be given little weight. The premise of the respondent's questions to these witnesses presumed that during the 5-year "fencing in" period the respondent would be permitted to continue to refuse to deal with suppliers who sold to the clubs, but could not inform the suppliers of the reason for such a decision. (6:1166/25 - 1167/12.) The order prohibits respondent from making a purchase decision. The order does not prohibit the respondent from communicating with suppliers about issues other than the matter of the suppliers' sales to toy discounters like the clubs.

543. I find that entry of the order is necessary to cause the respondent to discontinue the challenged conduct and to dissipate the anticompetitive effects of the existing restraint. Entry of the order is in the public interest.

## LEGAL ANALYSIS

In the early 1990's, TRU was the largest toy retailer in the United States. Toy manufacturers depended on TRU with its 20% of national retail toy sales. TRU's principal competition came from chain discounters Wal-Mart, Kmart and Target. An aggressive, low-margin retailer, Wal-Mart, forced lower retail toy prices.

Another new factor stirred price competition in the retail sale of toys. The warehouse clubs ("clubs"), operating at lower margins than the chain discounters, were expanding their toy operations. TRU acted to meet this competition. TRU announced to toy manufacturers that it would refuse to carry toys that the clubs carried. The question is whether TRU agreed with the manufacturers, and orchestrated agreement among them, to limit their sales of toys to the clubs.

During the late 1980's and early 1990's, toy manufacturers were losing retail outlets at the same time that the clubs were expanding their toy departments. In 1990, Mattel's chief executive officer, John Amerman, instructed his staff to be aggressive in new channels of distribution, especially the clubs. In a September 1991 Mattel document, Fred Okun, Mattel's senior vice president, wrote, "This is one of the fastest growing channels of distribution in the country. As a public company we owe it to our shareholders to maintain our business by selling this class of trade." Other major toy manufacturers felt the same.<sup>13</sup>

Toy retailer concentration increased.<sup>14</sup> The other national chain toy stores, Lionel Leisure and Child World, were in financial distress, leaving TRU difficult to replace.<sup>15</sup> TRU accounted for 30% of the sales of major manufacturers including Mattel, Hasbro, Tyco, Little Tikes, and Fisher-Price.<sup>16</sup>

TRU viewed the clubs as a competitive threat. TRU feared that the clubs' prices could hurt the TRU price image.<sup>17</sup> The clubs' mark-up was only 10% -- which is lower than the Wal-Mart mark-up and lower than the TRU mark-up of 30%. The difference between club prices and TRU prices was "embarrassing."<sup>18</sup> An internal TRU analysis projected that by 1997, the warehouse clubs would have between 6 - 8 % of the U.S. Toy market.<sup>19</sup>

In 1990, TRU threatened to stop buying from Mattel if Mattel supported the clubs.<sup>20</sup> At Toy Fair 1990, Mattel gave TRU its commitment to move the clubs away from regular line product.<sup>21</sup> This first agreement is a vertical agreement between TRU, the largest toy retailer, and Mattel, the largest toy manufacturer. The clubs had been buying regular line product

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<sup>13</sup> CX-78 (Hasbro); CX-1670 (Fisher-Price); CX-483 (Little Tikes).

<sup>14</sup> CX-136-G; CX-523.

<sup>15</sup> Verrecchia 7:1549/13 - 1550/1; Okun 13:2664-65; Owen 6:1159/1-2.

<sup>16</sup> Scherer (CX-1822) at ¶ 13. Exh. 1.

<sup>17</sup> CX-1576-B.

<sup>18</sup> Weinberg IH (CX-1662) at 206/10-19.

<sup>19</sup> CX-1070-C.

<sup>20</sup> CX-529; F. 120.

<sup>21</sup> CX-530; F. 119.



from Mattel. After Mattel agreed to move the clubs away from regular line product, only half of Mattel's club sales were from the regular line. However, this reduction was not sufficient for TRU.

In late 1991 and early 1992, TRU told its main suppliers it did not want them to sell products to the clubs, and that it would not purchase products sold to the clubs. In response, Mattel and Hasbro both agreed not to sell hot toys to the clubs after being assured by TRU that their prime competitors would not do so.<sup>22</sup> TRU conveyed to each major manufacturer the *quid pro quo* (this for that) offered by that manufacturer's competitors, and *vice versa*. Each would stop selling to the clubs if its competitors would.

After Mattel stated that it would go along based on competition doing the same, TRU approached Hasbro. In late 1991, TRU told Hasbro that TRU would not carry products Hasbro sold to the clubs.<sup>23</sup> Hasbro, like Mattel, worried about being at a competitive disadvantage. Hasbro indicated that it wanted a level playing field if it were to restrict its sales to the clubs. At a conference between Hasbro and TRU, a meeting of the minds was reached. Hasbro agreed not to sell promoted products to the clubs after it learned from TRU that Hasbro's competitors, including Fisher-Price and Mattel, had agreed not to sell.<sup>24</sup>

TRU assured Hasbro that there would be a level playing field, and that Hasbro's competitors were going along.<sup>25</sup> Hasbro's CEO Alfred Verrecchia said in substance that because Hasbro's competitors had agreed not to sell promoted product, Hasbro therefore agreed to a similar restraint.<sup>26</sup>

TRU found that the clubs were still carrying competing toys, and that these toys were lower priced. TRU established a more restrictive policy. TRU gained agreements from the manufacturers to sell no regular product at all to the clubs, regardless of whether it was hot. At Toy Fair in 1992, companies communicated their commitments to restrict the clubs, and TRU monitored compliance.<sup>27</sup> Manufacturers also monitored compliance.

<sup>22</sup> CX-532-A; Goddu IH (CX-1658) at 276/1 - 277/11; 278/22-24; F. 125.

<sup>23</sup> Owen 6:1107/14-16, 1108/1-5.

<sup>24</sup> Inano 16:3334/21 - 3335/5, 3343/17-22. Other Hasbro officials confirmed that TRU's Goddu told them that Fisher-Price and other manufacturers would not be selling in-line promoted products to the clubs. Owen 6:1132/6 - 1134/17; Verrecchia 7:1393/5-13, 23-25, 8:1394/1-4; F. 177.

<sup>25</sup> Verrecchia 7:1393/5-14, 1393/23-25, 1394/1-4; Owen 6:1132/6 - 1134/17; F. 179.

<sup>26</sup> Inano 16:3335/15-20; F. 177.

<sup>27</sup> TRU shopped the clubs. Just after Toy Fair 1992, TRU contacted manufacturers whose products were found in the clubs. (CX-913). The TRU shopping report shows agreements between TRU and manufacturers. The document shows how TRU went far beyond Colgate, F. 101, CX-913-B, the third party entry down, refers to Hasbro's Puppy Surprise: "Shipped early. No more will be shipped to warehouses." Further down Mattel's Barbie Dream House: "Will not sell again." Under that there is an assurance from Mattel with respect to Totally Hair Ken that Mattel did not sell it to the clubs. A reference to Birney & Smith notes: "Per Brent Blaine, understood our concern. Going forward they will offer special packs only for '93." At the bottom of (CX-913-C) is a Playskool reference: "They were

Thus, the record shows that after Toy Fair conversations in February 1992, TRU contacted manufacturers to discuss the status of the agreements. These conversations show that TRU sought and received commitments. TRU sought assurances from Tyco and Fisher-Price that they would not sell to the clubs. Both Tyco and Fisher-Price worried about competitors. Both companies agreed with TRU that the clubs would be restricted.

Other manufacturers also joined. TRU agreed with Little Tikes, Tiger, Sega, Video Tech, and Today's Kids in 1993 and 1994. These agreements prevented competition between TRU and the clubs over toys that are the "lifeblood" of the industry.<sup>28</sup> The agreements involved much of the toy industry. Mattel and Hasbro accounted for 35% of national toy sales in 1994.<sup>29</sup>

#### AGREEMENTS

##### *A. Vertical Agreement*

To meet the competition of the clubs, TRU could have announced a unilateral policy by TRU and a refusal to deal with suppliers that did not comply.<sup>30</sup> The issue is whether TRU went further, entering agreements with each manufacturer.<sup>31</sup>

To rely on the Colgate doctrine,<sup>32</sup> a firm must "content itself with announcing its policy ... and [follow] this with a simple refusal to have business relations with any [persons] who disregarded that policy."<sup>33</sup> Having announced its policy, the firm must "rely on individual self-interest to bring about general voluntary acquiescence" with its policy.<sup>34</sup> It can not go beyond that and take the affirmative action of asking for or inducing acquiescence to its policy.

TRU first communicated to its suppliers that it would not purchase hot product carried by the clubs, and then that it would not purchase any products carried by the clubs. TRU and the manufacturers reached an

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under the impression that less important items could be sold to clubs. We informed them if so, perhaps at the expense of selling us these goods."

<sup>28</sup> Goddu 23:6572/9-20.

<sup>29</sup> CX-1669-C.

<sup>30</sup> *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919); *FTC v. Raymond Bros. - Clark Co.*, 263 U.S. 565 (1924).

<sup>31</sup> That the distribution policy was on advice of counsel is not relevant. *United States v. Champion Int'l Corp.*, 1979-2 Trade Cas. (CCH) ¶¶ 62,862, 78,989-991 (D. Or. 1979) ("Before their convictions under the Sherman Act, none of the defendants even knew their actions were unlawful .... Even their lawyers, all honorable and ethical people, believed defendants' bidding practices were lawful.")

<sup>32</sup> *United States v. Colgate & Co.*, 250 U.S. 300 (1919).

<sup>33</sup> *United States v. Parke, Davis & Co.*, 362 U.S. 29, 45 (1960).

<sup>34</sup> *Id.*, at 46-47.

agreement when TRU sought acquiescence from the manufacturers. *Monsanto*, 465 U.S. 752, 766 n.9 (1983). TRU asked the manufacturers how they planned to respond, and the manufacturers gave their acquiescence.

### 1. Manufacturers' acquiescence

TRU monitored and communicated with its suppliers regarding compliance. TRU's Roger Goddu, the executive vice president who was responsible for TRU's club policy, informed toy manufacturers "that we had no intention of buying product that was carried by the clubs." Goddu testified that he would then ask the manufacturers what their intentions were with respect to selling to the clubs.<sup>35</sup> To avoid future meetings, TRU sought immediate commitments.<sup>36</sup> TRU contacted manufacturers whose product appeared in TRU shops of the clubs.<sup>37</sup> The pressure from TRU to gain agreements continued through 1992 and 1993.<sup>38</sup>

TRU policed its program by "shopping" the clubs or by learning from manufacturers what their competitors were selling in the clubs.<sup>39</sup> When TRU learned that Mattel, Hasbro or any other manufacturer was selling new or promoted individual toys to the clubs, TRU officials would call the offending company to complain and would threaten to stop buying those products.<sup>40</sup> TRU's threats resulted in manufacturers agreeing not to sell certain toys to the clubs. The conversations were described in a memo prepared by Roger Goddu,<sup>41</sup> summarizing contacts made by Goddu and his four divisional vice presidents, and sent to TRU's then CEO, Charles Lazarus. Excerpts from this memo use the language of vertical agreement. This document, and the Goddu testimony, show that TRU asked for and received acquiescence from its suppliers regarding restrictions on sales to the warehouse clubs. TRU describes how Hasbro, Mattel, Today's Kids, Huffy, Tyco and others communicated acquiescence to TRU. TRU reached vertical agreements with its suppliers.

**Mattel** -- Mattel "committed to Toys "R" Us that we would do our best not to sell [clubs] regular line merchandise."<sup>42</sup> This agreement was reaffirmed in an October 1991 meeting in which Michael Goldstein, chief operating officer of TRU, stated that TRU was "going to allocate open-to-

<sup>35</sup> Goddu IH (CX-1657) at 130/20-25; Goddu IH (CX-1657) at 125/19-21.

<sup>36</sup> Goddu IH (CX-1657) at 209/21-23; F. 63.

<sup>37</sup> Lazarus IH (CX-1660) at 55/12-21.

<sup>38</sup> Owen 6: 1148/6-16.

<sup>39</sup> Goddu IH (CX-1657) at 128/11 - 129/5.

<sup>40</sup> Goddu IH (CX-1657) at 124/12 - 125/21.

<sup>41</sup> Goddu 30:6572/20 - 6574/13; CX-913-A-F; F. 101.

<sup>42</sup> CX-530-B.

buy based on who agreed not to support the clubs."<sup>43</sup> John Amerman, the CEO of Mattel said that Mattel "would not sell the clubs the same items we were selling to them," and that "this was based on the fact that competition would do the same."<sup>44</sup> Mattel executives later informed TRU that Mattel could not completely stop selling to the clubs, but in January 1992, a Mattel memo noted that "We've been able to negotiate to do exclusive items only [customized product for the clubs] so that there would be no direct competitive threat to TRU."<sup>45</sup>

At a February 27, 1992 meeting with TRU, Mattel agreed not to sell the clubs "hot" product, not to ship to clubs items that Mattel could not supply to TRU,<sup>46</sup> and to give TRU a right of first refusal on special club packs.<sup>47</sup> These were the points on which TRU sought acquiescence.<sup>48</sup>

At Toy Fair 1992 Mattel "showed [TRU's] Van [Butler] and Peter [Spencer] all of our club specials.... We offered each and every one to TRU on a 'right of first refusal' basis."<sup>49</sup> After Toy Fair 1992, Mattel representatives met with Roger Goddu who was "adamant that Mattel should not offer first year promoted stand alone items to the clubs. He was also comfortable with combinations of product that we were going to offer."<sup>50</sup> A Mattel memo dated July 1992 states that if Mattel shipped a particular product to the clubs, "arguably we are violating the spirit of our agreement."<sup>51</sup> Mattel's sales of open stock toys to the clubs dropped from over \$10 million in 1991 to zero in 1993.<sup>52</sup>

**Little Tikes** -- During the early 1990's, under the influence of its parent corporation Rubbermaid, Inc., Little Tikes modified its earlier strategy that had limited distribution of its large molded plastic toy products. By early 1993, Little Tikes had begun to sell its open stock products to warehouse clubs.<sup>53</sup>

At a meeting with Little Tikes executives at the 1993 Toy Fair, TRU's Goddu said that if Little Tikes was going to start selling products to the

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<sup>43</sup> CX-532-A; F. 124.

<sup>44</sup> CX-532; F. 125; F. 126.

<sup>45</sup> CX-540; F. 133.

<sup>46</sup> CX-541; F. 143.

<sup>47</sup> CX-541; F. 143.

<sup>48</sup> CX-1681.

<sup>49</sup> CX-550-A; F. 139.

<sup>50</sup> CX-550-A.

<sup>51</sup> CX-550-B.

<sup>52</sup> CX-574.

<sup>53</sup> DePersia 10:2260/10 - 2261/3; CX-1533-D; F. 268.

clubs, TRU would contemplate dropping the products.<sup>54</sup> Little Tikes' president told TRU that Little Tikes intended to sell warehouse clubs only low-priority, discontinued and near-discontinued products, and value-packs. He assured TRU that "we do not plan to sell regular products to Costco in the future."<sup>55</sup>

The Little Tikes president told Goddu that not selling to Costco "will create a major problem with Rubbermaid" because Costco had threatened to discontinue buying Rubbermaid products if Little Tikes did not sell regular line products to Costco. He told Goddu "I may need [your] help."<sup>56</sup> At the invitation of TRU, in early April 1993, the chairman of Rubbermaid and executives from Little Tikes attended a meeting at the TRU corporate offices where the warehouse clubs were discussed. At that time, TRU was one of the largest customers of the entire Rubbermaid corporation.<sup>57</sup> Little Tikes sold [ ] as much in dollar volume to TRU than all of Rubbermaid combined sold to Price Costco.<sup>58</sup>

During the meeting Little Tikes again acquiesced to the TRU policy: "Little Tikes sales strategy to warehouse clubs in the future will be to sell value packs, as well as discontinued and near-discontinued products."<sup>59</sup> The handwritten notes of Rubbermaid's chairman reflect that there was "agreement" and "understandings" on the distribution issues discussed.<sup>60</sup>

After the April meeting, a Little Tikes' memo to the sales force listed products that could be offered for sale to warehouse clubs for the fall of 1993. The memo indicated that combination packs of Little Tikes items were the "only products that are available to the clubs at present."<sup>61</sup> A TRU executive concluded that Little Tikes "for the most part did not have product in the clubs or anything that was first line product"<sup>62</sup> until late 1994, when TRU shopping reports showed Little Tikes' first-line product being sold to the clubs.<sup>63</sup> TRU wanted a clarification of Little Tikes' club

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<sup>54</sup> Goddu 30:6713/23 - 6714/15; CX-509; F. 269.

<sup>55</sup> CX-509-A; F. 271.

<sup>56</sup> CX-509-A; F. 271.

<sup>57</sup> CX-1533-C; CX-1514-C; Schmitt 11:2282/1 - 2283/5; DePersia 10:2161/20 - 2162/14.

<sup>58</sup> CX-1533-C; CX-514-C.

<sup>59</sup> CX-509-B; DePersia 10:2177/13-22; F. 275.

<sup>60</sup> CX-1519; F. 275.

<sup>61</sup> CX-1520-A-C; F. 277.

<sup>62</sup> Goldstein IH (CX-1659) at 110/11-14, 114/21-24.

<sup>63</sup> Goddu IH (CX-1658) at 313/6 - 314/16.

policy because Little Tikes management had changed.<sup>64</sup> In January 1995, at the invitation of TRU, the chairman of Rubbermaid and the new management at Little Tikes again met with senior executives of TRU.<sup>65</sup> The meeting reaffirmed the understandings from the April 1993 meeting concerning Little Tikes' dealings with warehouse clubs.<sup>66</sup>

**Hasbro** --In early 1992, after being informed by TRU that Mattel and Fisher Price had agreed not to sell promoted product to the clubs, Hasbro committed to TRU that it would not sell new and promoted individual product to the clubs.<sup>67</sup> Later in 1992, the president of its Playskool division explained its policy of selling only special packs to the clubs to Roger Goddu as a "trial balloon." Mr. Goddu indicated to him that this policy was satisfactory.<sup>68</sup> As a result of the agreements, Hasbro sales of toys to the clubs from its Hasbro, Playskool, Playskool Baby and Kenner Divisions decreased from [ ] in 1991 to [ ] in 1993.<sup>69</sup>

**Tyco** -- Tyco began selling toys to the warehouse clubs in the late 1980's. The clubs purchased individual toy products from open stock.<sup>70</sup> In 1991, TRU approached Tyco on the issue of Tyco's sales to the clubs. Tyco wanted to sell to the clubs because their competition did.<sup>71</sup> TRU asked Tyco what their plans for the clubs would be.<sup>72</sup> At a luncheon meeting with TRU executives during Toy Fair in 1992, Tyco unveiled their new "25 item" policy to TRU.<sup>73</sup> Under Tyco's 25 item policy, if the clubs purchased 25 SKUs, the clubs could buy regular line product.<sup>74</sup> However, the policy contained exceptions for Tyco customers (other than warehouse clubs) that did not typically purchase a minimum of 25 items.<sup>75</sup> Since the clubs could not purchase so many different products from one manufacturer because of their limited selection of toys, Tyco's plan was acceptable to TRU.<sup>76</sup>

<sup>64</sup> Schmitt 11:2325/10 - 2326/1, 2327/11 - 2328/5; F. 280.

<sup>65</sup> Schmitt 11:2328/15-20, 2333/13-21; F. 281.

<sup>66</sup> Schmitt 11:2328/15-20, 2333/13-21; Goddu IH (CX-1658) at 316/11-16; F. 281.

<sup>67</sup> Inano 16:3335/15-20; F. 177.

<sup>68</sup> Owen 6:1136/20 - 1141/14.

<sup>69</sup> CX-448; CX-447-E; F. 212.

<sup>70</sup> Grey 14:2993/13-19; CX-1420; CX-1424; CX-1263-64; F. 235.

<sup>71</sup> Goddu IH (CX-1658) at 271/23 - 272/22, 273/24 - 274/3; Goddu 30:6876/20 - 6877/13; F. 239.

<sup>72</sup> Goddu 30:6677/6-8; F. 236.

<sup>73</sup> Goddu IH (CX-1675), at 177/6-8; F. 238.

<sup>74</sup> CX-1418; F. 240.

<sup>75</sup> CX-1418; CX-1667; Grey 14:3006/18 - 3009/1; F. 241.

<sup>76</sup> Lazarus IH (CX-1660) at 169/3 - 170/12; F. 242.

The 25 item policy was a commitment not to sell to the clubs.<sup>77</sup> Ken Shumaker, the Tyco sales representative to TRU, referred to it as the "no ship" policy.<sup>78</sup> Playtime told TRU it "will not offer any merchandise to warehouse clubs that is bought by TRU. This will make our policy exactly the same as Tycos."<sup>79</sup> By Toy Fair in February 1993, Tyco had a special line of products for the warehouse clubs, ignoring the 25-item minimum. Tyco's warehouse club line was similar to that of other major toy companies.<sup>80</sup>

Tyco's subsidiary Playtime acquiesced in TRU's efforts to restrict sales of products to the warehouse clubs. In 1992, TRU contacted Playtime concerning the Super Saturator (water gun) sold to TRU and discovered by TRU for sale in warehouse club stores. The Playtime executive assured TRU that Playtime would only sell the clubs special items, or items that TRU did not carry.<sup>81</sup>

In the spring of 1993 respondent discovered another Playtime product carried by TRU (a toy gun called the "Thunderstrike" that shot foam rubber balls) was sold in the warehouse clubs.<sup>82</sup> TRU met with Playtime<sup>83</sup> and received a confirming letter from Playtime which stated: "I want to apologize for misunderstanding the Toys R Us desire to merchandise their stores in a different manner than the Price Clubs. To confirm the meeting we had, Playtime will not offer any merchandise to Warehouse Clubs that is bought by Toys R Us. This will make our policy exactly the same as Tyco's."<sup>84</sup>

A Playtime executive later presented a warehouse club version of the Thunderstrike to TRU, in a larger package and a different color with more foam balls, which would cost more to the clubs than the standard version. TRU told Playtime that the reconfigured product was acceptable.<sup>85</sup> By 1993, the Tyco policy was essentially identical to that of other major manufacturers: a commitment to TRU not to sell identical product to the clubs.

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<sup>77</sup> CX-1633-D; F. 242.

<sup>78</sup> Weinberg 34:7715/18 - 7716/5; F. 242.

<sup>79</sup> CX-914; F. 256.

<sup>80</sup> CX-1412-B; Grey 14:3027/22 - 3029/12.

<sup>81</sup> Weinberg 34:7719/7-22; CX-913-C; F. 254.

<sup>82</sup> Weinberg IH (CX-1662) at 119/9-13; Moen 4:655/18-24; CX-1414-B; F. 255.

<sup>83</sup> Weinberg IH (CX-1662) at 169/10 - 170/4, 172/12-16; F. 256.

<sup>84</sup> CX-914-A.

<sup>85</sup> Weinberg 178, 184; F. 257.

**Fisher-Price** -- Before merging with Mattel in 1993, Fisher Price was the third largest toy manufacturer in the U.S.<sup>86</sup> Fisher-Price's regular line was sold to the clubs without restriction in the late 1980s.<sup>87</sup> At the 1989 Toy Fair, TRU told Fisher-Price that TRU might not carry the same products being sold in competing clubs.<sup>88</sup> TRU stated its policy and asked how Fisher-Price was going to deal with the clubs.<sup>89</sup> The answer can be inferred.

In 1991, Price Club's toy buyer asked Fisher-Price what it had to do to get product other than combo packs. Price Club would buy more SKUs, take delivery earlier, and warehouse products.<sup>90</sup> When Fisher-Price salesman John Chase asked his supervisor how he should respond, he was told "don't tell them you can't sell because Toys 'R' Us is pressuring, just make up a reason, tell them anything, but don't tell them you can't sell them because we're not allowed to because [of] Toys 'R' Us."<sup>91</sup>

A TRU shopping report showed products of Fisher Price found in Price Club.<sup>92</sup> On the report were written the words "Byron, you promised this wouldn't happen."<sup>93</sup> This is direct evidence of agreement between Fisher-Price and TRU: a promise from Fisher Price to TRU that they would not sell certain products to the clubs.<sup>94</sup> After this event, Fisher-Price sold only special and combination packs to the clubs.<sup>95</sup>

Fisher-Price was concerned with what its competitors were doing.<sup>96</sup> In 1992, Fisher-Price representatives saw a TV-promoted Playskool product in the Price Club.<sup>97</sup> The CEO of Fisher-Price telephoned TRU to see if "they'll take care of it."<sup>98</sup> Fisher-Price was informed by TRU that Playskool

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<sup>86</sup> Cohen 35:7926/9-17; 35:7926/7-8; F. 216.

<sup>87</sup> Chase 8:1645/5-18; F. 217.

<sup>88</sup> Cohen 35:7937/12-21, 35:7938/6-13; F.218.

<sup>89</sup> Cohen 35:7792/10-19; Weinberg 34:7732/8 - 7733/19, 34:7629/1; Weinberg, CX-1662-Z-73; F. 218.

<sup>90</sup> Chase 8:1655/10-15; F. 221.

<sup>91</sup> Chase 8:1657/1-7; Cohen 35:8094/25 - 8095/5; F. 221.

<sup>92</sup> Chase 8:1660/16 - 1661/5; F. 222.

<sup>93</sup> Chase 8:1661/4-5; F. 222.

<sup>94</sup> At Toy Fair 1992, TRU informed Hasbro that Fisher-Price had agreed not to sell promoted product to the clubs. (Inano 16:3334/21 - 3335/5; Owens 6:1132/6 - 1134/17; Verrecchia 7:1393/5-14, 23-25, 8:1394/1-4.

<sup>95</sup> Chase 8:1661/6-8; F. 222.

<sup>96</sup> Goddu (CX-1658) at 328/25 - 329/2; F. 226.

<sup>97</sup> Chase 8:1661/6-8; F. 226.

<sup>98</sup> Chase 8:1666/14-16; F. 226.



wasn't "going to get away with it, that Toys "R" Us is going to take care of it." (Chase 8:1666/18 - 1667/1.)

**Other manufacturers** -- TRU sought and received acquiescence from Tiger, Today's Kids, Huffy, Video Tech, and Binney & Smith.<sup>99</sup>

**Tiger** -- After Tiger Electronics was informed by TRU of its club policy, Tiger's president, Randy Rissman committed that Tiger would not sell any product to the clubs.<sup>100</sup> Tiger vice president Roger Shiffman asked Mr. Goddu whether it would be permissible for Tiger to sell older product and combo packs. Mr. Goddu specifically "OK'D sales of Skip It (5 yrs. old) and HHG's [hand-held games] in multi-pack with high price point."<sup>101</sup> Tiger complained to TRU when it saw one of its competitor's products in the warehouse clubs.<sup>102</sup> Mr. Goddu responded that the company (Yes, Inc.) would be punished in the future if it continued.<sup>103</sup>

**Video Tech** -- Video Tech ("VTech") sold regular product to the clubs through the 1992 Christmas season.<sup>104</sup> After VTech "promised" TRU that they would not sell to the clubs.<sup>105</sup> VTech's sales of regular line product to the clubs became virtually non-existent.<sup>106</sup>

**Today's Kids** -- At a meeting between Today's Kids and TRU, Mr. Goddu asked Today's Kids about their sales to the clubs. TRU told Today's Kids president that TRU would delay taking action against Today's Kids upon the "understanding" that Today's Kids would get back to TRU and tell TRU its plans regarding sales to the clubs.<sup>107</sup> Today's Kids got back to TRU and "said they didn't want to sell the clubs any product."<sup>108</sup>

**Huffy** -- When TRU discovered Huffy product in the clubs identical to that carried by TRU, it complained to Huffy. Huffy responded by committing not to sell identical product to the clubs.<sup>109</sup>

**Binney & Smith** -- After TRU called Binney & Smith to complain about finding product in the clubs, TRU reported, "Per Brent Blaine

<sup>99</sup> Lazarus IH (CX-1660) at 71; Goddu IH (CX-1657) at 79-80, (CX-1658) at 379-80; Weinberg IH (CX-1662) at 146-56; CX-2.

<sup>100</sup> CX-814; F. 302.

<sup>101</sup> CX-814.

<sup>102</sup> CX-811; F. 304.

<sup>103</sup> Shiffman 10:2026/7 - 2028/13; F. 305.

<sup>104</sup> Walter 28:6087/21-24; F. 314.

<sup>105</sup> CX-1318; F. 314.

<sup>106</sup> CX-1310; CX-1738.

<sup>107</sup> Goddu IH (CX-1657) at 167/11-14; F. 290.

<sup>108</sup> Goddu IH (CX-1657) at 168/19 - 170/12; Goddu 30:6729/9-22; F. 291.

<sup>109</sup> Goddu (CX-1658) at 380/18 - 381/6; CX-913-C; F. 354.

[director of national account sales for Binney & Smith], understood our concern. Going forward they will offer special packs only for '93."<sup>110</sup>

## 2. Advance approval

Manufacturers agreed to notify TRU in advance of toys they planned to ship to the clubs. The manufacturers would sell to the clubs only those toys about which TRU had no objection. Mattel, Tyco, Little Tikes, and Tiger gave TRU advance approval.

Mattel, at the Toy Fair 1992, provided TRU with a right of first refusal over toys being sold to the clubs.<sup>111</sup> Mattel agreed to ship only specials to the clubs and not hot/allocated first year product.<sup>112</sup> If Mattel shows TRU a product and TRU does not order it, Mattel would be "free" to sell it to the clubs.<sup>113</sup>

Little Tikes informed TRU of products "that we think we can sell the clubs that should not be a conflict."<sup>114</sup> TRU's CEO, Michael Goldstein, testified: "That if they were going to sell anything to the clubs they would tell us about it before hand so we had the opportunity to pass on the item and not buy the particular item."<sup>115</sup>

## 3. Colgate

TRU agreed with suppliers that they would not supply toys to the clubs that were carried by TRU. Manufacturers agreed to submit products for TRU's review to ensure that these products would not cause a competitive conflict. This exceeded the limitations of the Colgate doctrine.<sup>116</sup> When TRU discovered companies selling to the clubs, TRU sought and received assurance that use the language of "agreement" and "commitment." Several manufacturers agreed to allow TRU to preview their club selections. Where TRU learned that product had found its way to a club, TRU contacted the manufacturer and sought renewed acquiescence, which the manufacturers provided. This is evidence of vertical agreement, and not a Colgate announcement of a unilateral policy by TRU.

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<sup>110</sup> CX-913-C; CX-2; F. 101; F. 236.

<sup>111</sup> Leighton 15:3267/21 - 3268/6, 3269/3 - 3271/2, 3272/8-18; F. 138; F. 139.

<sup>112</sup> CX-626-A. Mattel personnel collected information on product of Mattel's competitors that was appearing in the clubs so that it could be brought to TRU's attention. CX-626-B.

<sup>113</sup> CX-550-A.

<sup>114</sup> Goddu 311-12.

<sup>115</sup> *Id.*; F. 274.

<sup>116</sup> *Parke Davis*, 362 U.S. at 45.

*B. Horizontal Agreement*

TRU orchestrated a horizontal conspiracy among its suppliers. The major manufacturers knew that TRU was contacting the other manufacturers with the same proposal and that concerted action was invited. Each also knew that unanimous action was necessary;<sup>117</sup> manufacturers did not want to be singled out and put at a competitive disadvantage. The evidence shows that "compliance with the proposals involved a radical departure from the previous business practices of the industry,"<sup>118</sup> which for the major toy manufacturers had been to actively pursue sales to the warehouse clubs as an innovative and rapidly growing new channel of toy distribution. Here, the manufacturers told TRU they went along with the plan because their competitors were going along with the plan. TRU informed the major manufacturers that their competitors said they were only selling to the clubs because their competitors were. TRU communicated acquiescence to their competitors, and the manufacturers participated in policing other manufacturers who violated the agreement.

## 1. Manufacturers' interest

Major manufacturers were reluctant to restrict sales to the warehouse clubs, being concerned with their competitor's sales to the clubs.<sup>119</sup> The manufacturers felt pressure to be in the clubs because their competitors were selling to the clubs.<sup>120</sup> The manufacturers did not want to give up sales and were also concerned that their competitors would gain share at their expense.<sup>121</sup> The manufacturers did not want their competitors to sell to the clubs if they could not.<sup>122</sup> The competition between the manufacturers with respect to the clubs was intense. The manufacturers told TRU that they were in the clubs because their competitors were there. This information was transmitted among the manufacturers by TRU.

Mattel, Hasbro, Tyco, Little Tikes, Fisher-Price and others expressed to TRU concern with how their competitors were reacting. Manufacturers wanted assurance from TRU that their competitors were subject to the same

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<sup>117</sup> *Interstate Circuit v. United States*, 306 U.S. 208, 222 (1939).

<sup>118</sup> *Ibid.*

<sup>119</sup> Goddu IH (CX-1658) at 276; Goldstein IH (CX-1659) at 59/13-17; Lazarus (CX-1654) at 72, 181-82; F. 82.

<sup>120</sup> Lazarus (CX-1654) at 62; F. 83.

<sup>121</sup> Lazarus IH (CX-1660) at 127/12-14; Goddu IH (CX-1657) at 272-73; Okun 13:2651/14-25.

<sup>122</sup> Lazarus 24:5443/9-10; F. 97.

rule.<sup>123</sup> They informed TRU that they wanted a level playing field to avoid being placed at a competitive disadvantage.<sup>124</sup>

Because of the incentives to sell to the clubs, Mr. Verrecchia, the CEO of Hasbro, believed that the agreements would not hold, and that Hasbro would be able to sell to the clubs again. (Inano 16:3335/15-20.) Mr. Verrecchia put into place a regular club shop to determine whether Mattel or other competitors were selling regular line product to the clubs. These shops began after the restrictions. (Verrecchia 7:1365/18 - 1366/1, 7:1373/16-20.) Hasbro complained the most frequently about competitive product in the clubs.<sup>125</sup> Mattel, Fisher Price and others also complained when regular line product from their competitors was found in the clubs.<sup>126</sup> And when Mattel heard rumors that Hasbro and Tyco might be selling regular line to the clubs, the president of Mattel's boy division instructed that the clubs be shopped so that the information could be brought to TRU's attention.<sup>127</sup> The manufacturers explained to TRU that they did not want to be prevented from selling regular line product to the clubs without assurance that their competitors were similarly excluded.<sup>128</sup>

Manufacturers also were concerned that if they were the only one selling to the clubs, they could be easily disciplined by TRU. (Moen 4:648/24 - 649/4, 651/17-23.) TRU had a greater ability to replace a manufacturer than the manufacturer did to replace TRU.<sup>129</sup>

## 2. Coordinated response

Respondent tried to obtain a coordinated response from manufactures by assuring them that they would not be placed at a competitive disadvantage because TRU was applying its policy to their competitors. Respondent told each major manufacturer that its competitors were only selling to the clubs because it was.<sup>130</sup> Mr. Lazarus told manufacturers that TRU was talking to each manufacturer about its club policy, so that they would know there was going to be a level playing field.<sup>131</sup>

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<sup>123</sup> DePersia 10:2149/15 - 2151/4; Goddu 30:6679/20 - 6680/13; F. 87, *et seq.*

<sup>124</sup> Goldstein 36:8157/23 - 8158/4.

<sup>125</sup> Goddu IH (CX-1658) at 329/23-24; Goddu 30:6701/13-18.

<sup>126</sup> Goldstein IH (CX-1659) at 59/10-17, 61/17-22. Goddu IH (CX-1658) at 328/18 - 329/29; Weinberg 34:7628/15 - 34:7629/1; CX-811; Shiffman 10:2017-7-18; 2018/3-16, 2021/24 - 2022/7, 2026/3-6.

<sup>127</sup> CX-626-B.

<sup>128</sup> Goddu 31:6877/11-13.

<sup>129</sup> CX-486-B; CX-1141.

<sup>130</sup> Goldstein 36:8157/23 - 8158/4.

<sup>131</sup> Lazarus 24:5440/5-10, 5442/14-16; Goddu 30:6679/20 - 6680/4, 31:6871/11 - 6878/1, 6880/7 - 6883/3.

The manufacturers did not act out of independent self-interest. The manufacturers did not focus on the clubs' taking advantage of others' promotion of the toys ("free-riding"); rather, they required assurances that their competitors would go along. The absence of efficiencies is demonstrated by the fact that the manufacturers feared that the restrictions would place them at a competitive disadvantage unless adopted by rivals.

TRU coordinated its policy with the manufacturers. The manufacturers all were aware that TRU was communicating its policy to everyone and that uniformity was contemplated. And everyone knew that without unanimity, regular line product sales to the clubs would recommence.<sup>132</sup>

### 3. Manufacturers would go along

A Mattel memo on the October 1991 meeting between high officials of Mattel and TRU, shows that Mattel's CEO, John Amerman, told TRU's CEO, Charles Lazarus, that Mattel "[W]ould not sell the clubs the same items we were selling them," and that "this was based on the fact that competition would do the same."<sup>133</sup> Mr. Goddu recalled that all of the major toy companies told him that they would stop selling to the clubs if their competitors would do the same. He understood that the major manufacturers, when they said that they were only selling to the clubs because their competition was selling to the clubs, actually meant that they would get out of the clubs if their competition got out.<sup>134</sup>

### 4. *Quid Pro Quo*

During conversations with manufacturers, respondent did not simply explain a Colgate policy announcing that it would refuse to deal with manufacturers selling to the clubs. Nor did it merely inform manufacturers that they would be treated equally. Instead, TRU passed the implied *quid pro quo* (they will stop if you stop) from manufacturer to manufacturer.<sup>135</sup> These communications by TRU ensured that the "conspirators had a unity of purpose or a common design and understanding, or a meeting of the minds." *American Tobacco Co. v. United States*, 328 U.S. 781, 809-10 (1946).

### 5. TRU's assurances

Respondent used the acquiescence of one manufacturer to obtain the acquiescence of another. After Mattel agreed not to sell to the clubs the same products "based on the fact that competition does the same" (CX-

<sup>132</sup> *Interstate Circuit*, 306 U.S. at 222.

<sup>133</sup> CX-532-A.

<sup>134</sup> Goddu IH (CX-1658) at 271-72.

<sup>135</sup> Goddu IH (CX-1658) at 276/63 - 277/11.

532), TRU told Hasbro that Mattel had agreed.<sup>136</sup> Mr. Goddu indicated that he passed on assurances of compliance from one manufacturer to another: "We may have indicated to one supplier that his competitor is going to do nothing but warehouse club packs and, you know, 'you should do the same.'"<sup>137</sup>

When TRU asked it not to sell certain products to the clubs, Little Tikes asked what its main competitor in the clubs (Today's Kids) was going to do. Mr. Goddu informed Little Tikes that Today's Kids "was going to start doing less business with the warehouse clubs."<sup>138</sup> Whereupon Little Tikes committed to restrict its sales.

Like each of the major manufacturers, Tyco discussed its competitors with TRU.<sup>139</sup> Respondent pressured Sega and Nintendo to not sell any products to the clubs.<sup>140</sup> Mr. Lazarus and Mr. Goddu told Sega that TRU had convinced Nintendo to stop selling product to the clubs as part of TRU's effort to convince Sega to do the same.<sup>141</sup>

#### 6. Policing the agreement

Manufacturers complained to respondent about sales by their competitors to the clubs. During July and August 1992, TRU conveyed complaints from Mattel to Hasbro and Fisher-Price and back again.<sup>142</sup> At one meeting on July 17, 1992, TRU told Mattel that its competitors, including Hasbro, were upset about Mattel product appearing in the clubs.<sup>143</sup> Mattel assured TRU that it was not selling regular line product to the clubs.<sup>144</sup> Later that same day TRU met with senior executives from Hasbro.<sup>145</sup>

On August 10, 1992, using internal Hasbro memos detailing the extent to which Mattel and other Hasbro competitors were selling to the clubs,<sup>146</sup>

<sup>136</sup> Verrecchia 7:1393/5-14, 23-25, 1394/1-4; Owen 6:1128/5 - 1129/25, 1132/6 - 1135/9; Inano 16:3333/12 - 3335/7; F. 114.

<sup>137</sup> Goddu IH (CX-1658) at 279.

<sup>138</sup> DePersia 10:2147/7-14, 2147/18-24, 2150/3-12, 2150/25 - 2151/4. Today's Kids' sales to warehouse clubs fell from \$8 million in 1993 to zero in 1994. CX-902-A.

<sup>139</sup> Goddu IH (CX-1658) at 271/19 - 272/13, 273/24 - 274/3.

<sup>140</sup> Moen 4:692/15 - 693/18. TRU does not account for as high a percentage of Sega or Nintendo sales as it does for sales by traditional toy manufacturers. (Scherer (CX-1822) at Exh. 1.)

<sup>141</sup> CX-1776; Kalinske 12:2490/7-25, 2491/24 - 2492/2.

<sup>142</sup> Lazarus IH (CX-1654) at 141.

<sup>143</sup> CX-1772; Amerman 17:3795/5-12; 3800/7 - 3802/9, 3806/24 - 3808/4; Lazarus 24:5451/4 - 5452/18.

<sup>144</sup> Amerman 17:3802/10 - 3804/14.

<sup>145</sup> CX-1772; CX-1773-B; Lazarus 24:5448/13-16.

<sup>146</sup> CX-1633; Goddu 30:6689/13 - 6690/10.

TRU met with Mattel to discuss its sales to the clubs.<sup>147</sup> The clubs found it increasingly difficult to obtain regular line product from Mattel and Hasbro.<sup>148</sup>

TRU promised to "take care of it" after Fisher-Price representatives complained about Playskool product they found in Price Club.<sup>149</sup> After Tiger complained about finding a competitor's product in the clubs, Mr. Goddu told the offending manufacturer "don't do it again or God knows what."<sup>150</sup> TRU facilitated horizontal agreements among the manufacturers.<sup>151</sup>

#### 7. Manufacturers contacted each other

Manufacturers discussed with each other their responses to the TRU policy. A Fisher-Price representative wrote: "After discussions with other vendors at the Lounge show, I believe the industry is backing away from the clubs. Kenner and Playskool in particular were adamant that they would not be shipping key SKUs to the Clubs, at least not yet."<sup>152</sup> A Fisher-Price representative spoke to a Little Tikes' regional manager to find out if Little Tikes had experienced any repercussions from TRU about products it offered to the clubs.<sup>153</sup>

Hasbro and Tyco discussed their policies relating to the clubs. In May 1992, Richard Grey, president of Tyco, discussed with Allan Hassenfeld, chairman of the board of Hasbro, how to respond to TRU. Both later adopted identical policies.<sup>154</sup>

#### 8. Summary of agreement

As a result of respondent's conduct, by 1995, the five top manufacturers of popular toys, and many other manufacturers complied with TRU's policy restricting toy sales to the clubs; the conspiracy included much of the toy manufacturing industry. The manufacturers agreed, reluctantly, to go along with the plan as long as there was a level playing field; that is, as long as

<sup>147</sup> Leighton 15:3291/2 - 3294/24.

<sup>148</sup> Halverson 3:414/14 - 415/9; Moen 4:619/10 - 621/22.

<sup>149</sup> Chase 8:1666/4 - 1667/1.

<sup>150</sup> Shiffman 10:2027/10-14.

<sup>151</sup> Complaints about competitor's sales to the clubs generally related to the most immediate competitors. Hasbro, Tyco and Mattel were most interested in learning from TRU what each other's plans were. Little Tikes was concerned most with Today's Kids. Sega was most interested in Nintendo. Tiger complained about its closest competitor. Goddu IH (CX-1658) at 276/8-16 (Mattel and Hasbro); Goddu IH (CX-1657) at 228/24 - 229/15 (Sega); DePersia 10:2149/15 - 2151/4 (Little Tikes); CX-811 (Tiger).

<sup>152</sup> CX-684-B.

<sup>153</sup> CX-563.

<sup>154</sup> Grey 14:3011/8 - 3013/4; F. 245; F. 259; F. 213.

their competitors also acquiesced so that they were not at a competitive disadvantage. Respondent used its buying power to organize and coordinate this understanding.

The horizontal agreement was not initiated by the manufacturers to fix prices. It involved price nonetheless. It was initiated by TRU, which was concerned that its image as a price discounter would be eroded. Pressure from TRU, and the orchestration of assurances between key manufacturers, resulted in a horizontal agreement restricting sales to the clubs.

The agreement cut off the club's supply of TV-advertised toys, and eventually stopped the sale to the clubs of any individual toy carried by TRU. Respondent permitted the manufacturers to sell specially bundled "packs" of individual toys that consumers could not readily compare to the products on TRU's shelves. The packs had to be submitted to TRU for advance approval. The horizontal agreement facilitated by TRU is *per se* illegal. *United States v. Parke, Davis & Co.*, 362 U.S. 29, 45 (1960).<sup>155</sup>

The agreement here -- manufacturers changing their distribution policy to deny warehouse clubs products based on respondent's assurances that competitors would do the same -- is also a boycott.<sup>156</sup> The vertical agreements were entered into only if there was an assurance that other manufacturers would forgo that method of competition as well. Mattel and the other manufacturers entered agreements with TRU "based on the fact that competition would do the same." Under the *per se* rule the TRU conduct violates Section 5 of the FTC Act.<sup>157</sup>

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<sup>155</sup> In *Parke Davis*, a drug manufacturer led a horizontal agreement among its retail customers (drug stores) not to advertise prices below its suggested retail prices. The Court described the conduct of Parke Davis, as the instigator of the horizontal agreement. *id.* at 46:

First it discussed the subject with Dart Drug. When Dart indicated willingness to go along the other retailers were approached and Dart's apparent willingness to cooperate was used as the lever to gain their acquiescence in the program. Having secured those acquiescences Parke Davis returned to Dart Drug with the report of that accomplishment. Not until all this was done was the advertising suspended and sales to all the retailers resumed. In this manner Parke Davis sought assurances of compliance and got them, as well as the compliance itself. It was only by actively bringing about substantial unanimity among the competitors that Parke Davis was able to gain adherence to its policy.

<sup>156</sup> In *Klor's, Inc. v. Broadway-Hale Stores*, 359 U.S. 207 (1959), the Supreme Court held *per se* illegal a group boycott. Broadway-Hale, a retailer of appliances in Los Angeles, orchestrated an agreement with ten appliance manufacturers. The target was Klor's, a discounter located next door to Broadway-Hale. The appliance manufacturers agreed among themselves and with Broadway-Hale not to sell to Klor's or to sell only at discriminatory prices. *Id.* at 209. The Supreme Court held that "[g]roup boycotts, or concerted refusals by traders to deal with other traders, have long been held to be in the forbidden category" of conduct that is *per se* illegal. *Id.* at 212.

<sup>157</sup> Violations of Sherman Act §1 are within the scope of "unfair methods of competition" that violate Section 5 of the FTC Act. *FTC v. Motion Picture Advertising Service Co.*, 344 U.S. 392, 394-95 (1953); *Fashion Originators' Guild v. FTC*, 312 U.S. 457, 463-64 (1941). Conduct far short of the campaign orchestrated by TRU here would likely be held to violate Section 5. *FTC v. Brown Shoe Co.*, 384 U.S. 316, 321-22 (1966) (section 5 includes incipient violations of antitrust laws).



### C. Proof of Agreement

Witnesses from respondent and the manufacturers denied any vertical or horizontal agreements, contending that TRU and the manufacturers all acted independently and unilaterally. "Little weight can be given to testimony which is in conflict with contemporaneous documents." *United States v. United States Gypsum Co.*, 333 U.S. 364, 396 (1948); *Adolph Coors*, 83 FTC 32, 185 (1973).

Respondent argues that the restrictions varied over time and by manufacturer, so that the requisite common design or understanding is missing. This argument is unpersuasive. The fact that the agreements changed over time and that additional manufacturers were added as time passed does not negate the finding of agreement. It relates to anticompetitive effect.

Respondent argues that there can be no agreements because formal contract law requirements are missing. An antitrust agreement does not need to meet the Uniform Commercial Code.<sup>158</sup> Agreements to fix prices where parties were free to change their minds whenever they wanted are agreements nonetheless. "No formal agreement is necessary to constitute an unlawful conspiracy."<sup>159</sup> For an agreement under the antitrust laws, all that is required is a meeting of the minds.

### D. Rule of Reason

#### 1. Non-price vertical restraint

If the respondent's conduct was solely vertical and not motivated by price competition, such non-price vertical restraints of trade are governed by the rule of reason. *Continental T.V., Inc. v. GTE Sylvania*, 433 U.S. 36 (1977). Vertical restraints limiting the ability of retailers to compete in selling products of the same brand can be pro-competitive. While vertical restraints may diminish intrabrand competition, interbrand competition could offset any potential anticompetitive effects. *Sylvania*, 433 U.S. at 54-55.

Respondent argues that its discussions with manufacturers of its policy concerning the clubs was governed by *Sylvania*, *Monsanto*,<sup>160</sup> and *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988), protecting communication between manufacturers and dealers. The Supreme Court recognized that communication may be necessary to ensure efficient distribution. Complaints from one dealer to the manufacturer about another dealer may serve a legitimate function. In the absence of market power, competition with other manufacturers in the same industry

<sup>158</sup> *Isaksen v. Vermont Castings, Inc.*, 825 F.2d 1158, 1164 (7<sup>th</sup> Cir. 1987).

<sup>159</sup> *American Tobacco v. United States*, 328 U.S. 781, 809 (1946).

<sup>160</sup> *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752 (1984).

will prevent any anticompetitive effects from the dealer complaints about another dealer on the same brand.<sup>161</sup> The communications at the heart of this case, however, are not dealer complaints about one brand. Here, manufacturers complain to respondent about other manufacturers, eliminating interbrand competition. By recognizing the possible pro-competitive efficiency of communication between a manufacturer and a dealer, the Court did not take conspiracy out of the antitrust laws.

Once there is proof that a vertical restraint adversely affects competition, respondent must show that the restraint in fact has a pro-competitive effect.<sup>162</sup> Respondent argues that its policy prevents free-riding by the clubs. But, as shown later in this opinion, TRU fails to establish free-riding at retail. TRU is already compensated by toy manufacturers for the retailing "services" on which it claims the clubs are free-riding. The fact that manufacturers required assurances that their competitors would go along so they would not be placed at competitive disadvantage, shows that the restraints were not in the manufacturers' independent, unilateral self-interest. The anticompetitive purpose and effect of vertical non-price restraints and the lack of pro-competitive justifications make them illegal under the rule of reason.<sup>163</sup>

### 2. Purpose of the restraint

The objective of TRU's limitations on sales by toy manufacturers was to suppress price competition and exclude competitors. The policy was to keep merchandise out of the clubs, and to make sure that the price of merchandise that was in the clubs was not directly comparable to TRU's price.<sup>164</sup> TRU approved packs for the clubs because they prevented the consumer from making price comparisons and finding TRU's prices were higher than the clubs' prices.<sup>165</sup>

### 3. Competitive effects of the restraint

The campaign worked. The clubs had been viewed in the same class as Wal-Mart in setting the lowest prices for the toy industry,<sup>166</sup> and during

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<sup>161</sup> *Monsanto*, 465 U.S. at 762.

<sup>162</sup> *Graphic Products Distributors v. Itek Corp.*, 717 F.2d 1560, 1576(11th Cir. 1983); *United States v. Brown University*, 5 F.3d 658, 669 (3d Cir. 1993) ("burden shifts to the defendant to show that the challenged conduct promotes a sufficiently pro-competitive objective.").

<sup>163</sup> *Eiberger v. Sony Corp.*, 622 F.2d 1068 (2d Cir. 1980)(vertical restraint by manufacturer of dictation equipment with 12% share unlawful where the agreement restricted intrabrand competition but did not promote interbrand competition).

<sup>164</sup> Goddu 31:6840/20 - 6841/7.

<sup>165</sup> Goddu IH (CX-1657) at 215/19 - 216/8; Lazarus IH (CX-1660) at 271/1-25; Nakasone IH (CX-1661) at 165/5 - 166/24.

<sup>166</sup> CX-1576-B.

1992 were "a strong competitive force."<sup>167</sup> But by mid-1993, TRU no longer viewed the clubs as significant competition.

The downward pressure on pricing was eliminated. Consumers who would have bought toys at the clubs now paid 10-20% higher prices at other retailers.<sup>168</sup> The special packs available to the clubs, were less attractive to consumers, and cost more. Clubs that purchased popular individual toys from diverters, raised their costs. Added costs were generally passed on to consumers who bought toys at the clubs.<sup>169</sup>

The effects of TRU's conduct have been on TV-promoted items that had been carried by both TRU and the clubs. Roger Goddu called TV-promoted product the "lifeblood of the industry." It was these "lifeblood" products that the clubs sought and were denied so that TRU could preserve its price image. Toy prices to consumers were higher than they would have been in the absence of the agreements.<sup>170</sup>

By 1993, the major manufacturers of TV toys sold only special packs to the clubs -- or they did not sell to the clubs at all. Respondent's conduct suppressed information that consumers needed to make informed price comparisons.<sup>171</sup> The foreclosure succeeded in inhibiting the growth of the warehouse clubs, a promising entrant into toy retailing.<sup>172</sup> The clubs, like Wal-Mart, set the lowest prices for the toy industry,<sup>173</sup> but were rendered less effective competitors. Respondent made no showing that this anticompetitive effect was offset by any increase in interbrand competition.

The anticompetitive effects caused by respondent's conduct are the best evidence of its market power. *FTC v. Indiana Federation of Dentists*, 476 U.S. 447, 460-61 (1986). Those effects "can obviate the need for an inquiry into market power, which is but a surrogate for detrimental effects."<sup>174</sup> Here, TRU's ability to bring about a sharp turnaround in the major manufacturers' dealings with the clubs (a "radical departure from the previous business practices of the industry.")<sup>175</sup> not only is a strong

<sup>167</sup> CX-1618.

<sup>168</sup> Weinberg IH (CX-1662) at 205/10-16, 206/24 - 211/22; Nakasone IH (CX-1661) at 42/13 - 45/9.

<sup>169</sup> Ojendyk 18:3999/8 - 4002/1.

<sup>170</sup> Goddu 30:6616/19-23.

<sup>171</sup> *FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447, 463 (1986).

<sup>172</sup> Scherer (CX-1822) at ¶ 54.

<sup>173</sup> CX-1576-B.

<sup>174</sup> "[W]hen a court finds actual anticompetitive effects, no detailed examination of market power is necessary to judge the practice unlawful." *International Ass'n of Conference Interpreters* ("AIIIC"), Dkt. No. 9270 (Feb. 19, 1997) at 33-34.

<sup>175</sup> *Interstate Circuit*, 306 U.S. at 222.

indicator of its market power, but also proves the ultimate question of anticompetitive effects.<sup>176</sup>

#### 4. Market power

##### *a. Retail market power*

Respondent's share of all toys sold nationally in 1992, was [ ]<sup>177</sup> However, retailing is local from the consumer's perspective.<sup>178</sup> TRU focuses on densely populated urban areas. TRU calculated its share among toy retailers in 30 local markets in 1990: TRU's share was over [ ]<sup>179</sup> In 1993, TRU adjusted its national market share figures to account for the fact that "we reach geographically about 65% of the toy dollars in the U.S.A."<sup>180</sup> This consists of consumers within a 30 minute drive of a TRU store. Using this measure, TRU's market share was 32%.

Major toy manufacturers refer to TRU as dominant. TRU refers to itself as dominant.<sup>181</sup> Market shares are used as a predictor of market power and anticompetitive effects: in this case, however, the anticompetitive effects are apparent, and TRU exercises market power as a buyer and as a seller of toys.

##### *b. Leverage*

Market power exists if Toys "R" Us can exert leverage over the manufacturers. Leverage exists when the manufacturer cannot find a ready substitute.<sup>182</sup> A retailer has sufficient bargaining power to cause anticompetitive effects, when the retailer (1) has "hard-to-replace distribution skills or facilities," (2) is a multibrand retailer that could threaten to drop one brand in favor of another, or (3) "accounts for such a large volume of business that his replacement would involve substantial disruption that would not be outweighed by retaining a smaller complained-against dealer."<sup>183</sup>

<sup>176</sup> *California Dental Ass'n*, Dkt. No. 9259 at 25 (March 25, 1996).

<sup>177</sup> CX-1039-E; CX-1040-A.

<sup>178</sup> Scherer (CX-1822) at ¶¶ 24-28.

<sup>179</sup> Chicago (42%), Detroit (44%), Los Angeles (41%), New York (43%), San Francisco (46%), Seattle (35%), and Washington, D.C. (43%). CX-1577-B.

<sup>180</sup> CX-1576-A, D.

<sup>181</sup> On October 21, 1991, Mr. Goldstein, TRU's CEO, stated: "Toys R Us is dominating the toy industry and is gaining market share." CX-1040; CX-1048; CX-1042-G-1.

<sup>182</sup> *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451, 476 n.23 (1992) (citing F.M. Scherer & D. Ross, *Industrial Market Structure and Economic Performance* 16-17 (3d ed. 1990)); *California Dental Assn.*, Dkt. No. 9259 at 30.

<sup>183</sup> VII Areeda, *Antitrust Law* ¶ 1457-C 3 at 171.

TRU's share of the sales of the major toy manufacturers is high. TRU is usually the largest customer for the major traditional (non-video) toy manufacturers.<sup>184</sup> In 1994, TRU purchased [ ] of Mattel's toys, [ ] of Hasbro's toys, [ ] of Little Tikes' toys, and [ ] of Tyco's toys.<sup>185</sup> TRU accounts for [ ] of Fisher-Price's sales.<sup>186</sup> Conversely, each manufacturer accounts for a relatively low percentage of TRU sales. In 1994 TRU accounted for over [ ] of Little Tikes sales, but Little Tikes accounted for only [ ] of TRU's sales. In 1994, TRU accounted for over [ ] of Tyco's sales. Tyco accounted for under [ ] of TRU sales. Mattel and Hasbro account for more of TRU's sales [ ] but still below the share for which TRU accounts of their sales.<sup>187</sup> This gives TRU additional leverage over the manufacturers.

Respondent's national market share does not account for the geographic distribution of its stores across the country. Toy retailing is local,<sup>188</sup> and because TRU has high local market shares in major metropolitan areas, this adds to its buyer power. To be present in many metropolitan areas, the manufacturer must have TRU distribution.<sup>189</sup> In the New York metropolitan area, TRU had [ ] of retail toy sales. Its high market share in many important local retail markets shows market power.

In 1995 Wal-Mart accounted for 14% of the toy market, Kmart (8%), Target (6%), and Kay-Bee (4%), with the other retailers in the 1-2% range or less.<sup>190</sup> The manufacturers' dependence on TRU increased when Lionel Leisure and Child World went out of business, leaving TRU as the only remaining full line national toy chain.<sup>191</sup>

It would be very difficult for a manufacturer to replace respondent as a customer.<sup>192</sup> Wal-Mart and Kmart, who are already promoting and selling as many toys as they can, could not absorb a [ ] increase in toy sale volume by adding another shift.

It would be difficult for manufacturers to produce products without TRU. For promoted product, a manufacturer has to generate volume to support the TV advertising, and TRU's distribution is needed to reach that

<sup>184</sup> Okun(Mattel) 13:2608/22-2609/1; Owen(Hasbro)6:1102/13-17, 1159/1-2; CX-1272 (Tyco); DePersia (Little Tikes) 10:2256/8-10, 2257/15-16; Cohen (Fisher-Price) 35:7926/18-7927/4.

<sup>185</sup> Scherer (CX-1822) at Exh. 1; F. 504.

<sup>186</sup> Cohen 35:7927/2-4.

<sup>187</sup> CX-1141; CX-486-B.

<sup>188</sup> Scherer 23:5160-61.

<sup>189</sup> Shiffman 10:2249/12 - 2250/6, 2001/21 - 2002/1.

<sup>190</sup> F. 5.

<sup>191</sup> Verrecchia 7:1549/13 - 1550/1; Okun 13:2664-65; Owen 6:1159/1-2.

<sup>192</sup> Okun 13:2813/22 - 2814/1; Owen 6:1151/3-10; Verrecchia 7:1412/19-22.

volume. And for many basic products, TRU is almost the only purchaser.<sup>193</sup> The manufacturers also depend on TRU's international sales. Nearly half of Mattel's and Hasbro's sales are now outside the United States. The dollar volume at risk by alienating TRU is more substantial when these international sales are included.

Hasbro documents refer to their dependence on TRU.<sup>194</sup> A Tiger Electronics VP for Sales wrote "I am very worried about our future business as a whole for the following reasons:\*\*\*(2) TRU dictating to Tiger and becoming even a bigger percentage of our business due to not selling and broadening our account base."<sup>195</sup> A Fisher-Price memo discusses the Fisher-Price desire to reduce dependence on TRU.<sup>196</sup>

When TRU makes decisions regarding retail price, sales goals and incentive bonuses, it ignores "mom-and-pop" stores and focuses on its significant competitors.<sup>197</sup> TRU faced no significant competition in [ ] markets during 1994.<sup>198</sup> TRU's prices are highest where they have the least competition.<sup>199</sup> TRU has market power as a seller.

#### DEFENSES

##### A. Respondent's Legal Argument

Respondent relies on *Elder-Beerman Stores v. Federated Department Stores, Inc.*, 459 F.2d 138 (6th Cir. 1972). Plaintiff there alleged vertical conspiracies (involving the leading department store in Dayton, Ohio and numerous suppliers to boycott the second largest department store) and a horizontal conspiracy *per se* unlawful under Klor's. Each of the three opinions of the court rejected the horizontal conspiracy on a mere showing that the suppliers were aware that others were being coerced into vertical agreements. The "majority" opinion concluded that the record was "devoid" of any evidence of a group boycott,<sup>200</sup> the two concurring/dissenting opinions similarly held that there could be no horizontal conspiracy without evidence that the suppliers "consulted with or agreed with each other"<sup>201</sup> or

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<sup>193</sup> Owen 6:1153/1-17; 1154/10 - 1155/2.

<sup>194</sup> CX-444; CX-158-S-U; Owen 6:1158/9 - 1159/13.

<sup>195</sup> CX-813.

<sup>196</sup> CX-648-A-B.

<sup>197</sup> During various time periods, TRU included the following retail operations as competitors for the purpose of its knock-off calculations: [ ] CX-950-A; CX-970; CX-1003; CX-1014; CX-1017.

<sup>198</sup> CX-1014-A.

<sup>199</sup> F. 459.

<sup>200</sup> *Elder-Beerman*, 459 F. 2d at 146 n.11.

<sup>201</sup> *Id.* at 155.

"any communication or agreement between them."<sup>202</sup> None of the opinions required communication directly between the competitors; an agreement or meeting of the minds, whether reached directly or through an intermediary, was sufficient. Judge Kent explained that the conspirators did not even need to know "the number of people involved"; they simply had to know that "other persons would be performing illegal acts in furtherance of the conspiracy."<sup>203</sup> Judge Miller explained that the conspirators need not have knowledge of the actual conduct of the co-conspirators or even the "existence of their co-conspirators." The court did not find that "evidence of communication among the suppliers" was required.<sup>204</sup>

Respondent also cites *Toys "R" Us, Inc. v. R.H. Macy & Co.*, 728 F. Supp. 230 (S.D.N.Y. 1990). In *Macy*, the court found no *per se* violation where two manufacturers of children's swimwear bowed to pressure from Macy's not to deal with Kids "R" Us.<sup>205</sup> Although there was some communication between the two manufacturers, there was "no evidence that Backflips and Little Dippers made any agreement with each other about not selling to Kids. Each company acted independently of the other in response to pressure by Macy."<sup>206</sup> There was no evidence that manufacturers expressed concern about being placed at a competitive disadvantage, that Macy made it a point to assure its suppliers that it would apply its policy across the board so that none would be placed at a competitive disadvantage, or that either manufacturer made its participation contingent upon the other going along. The *Macy* decision was probably the impetus behind the TRU conduct at issue here; however, TRU crossed a line that *Macy* did not by orchestrating an agreement among the manufacturers and by using market power that *Macy* did not have.

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<sup>202</sup> *Id.* at 163.

<sup>203</sup> *Id.* at 146.

<sup>204</sup> Respondent also relies on *U.S. Healthcare, Inc. v. Healthsource, Inc.*, 986 F.2d 589 (1<sup>st</sup> Cir. 1993). There, an HMO required its participating doctors to sign agreements whereby they received greater compensation if they agreed not to participate with other HMOs. The court noted that if the doctors had agreed among themselves not to provide services to competing HMOs, and the agreement was "devoid of joint venture efficiencies," the conduct might be *per se* illegal. *Id.* at 594. There was no evidence that doctors indicated that they would not participate unless the HMO forced other doctors to go along, or that the doctors feared being at a competitive disadvantage. In short, the court found no evidence of a horizontal agreement; rather, the facts disclosed merely a series of vertical agreements.

<sup>205</sup> TRU did not prevail because TRU's complaint, filed prior to *Sharp*, relied on the theory that it was *per se* unlawful for Macy's to extract alleged vertical agreements from two children's clothing suppliers to stop selling certain merchandise to plaintiff's Kids "R" Us discount operation. Deciding the case after *Sharp* had been handed down, the district court held under *Sharp* that the *per se* rule was inapplicable. In any event, TRU did not present evidence that a restriction on only these two manufacturers could have any anticompetitive effect.

<sup>206</sup> *Macy*, 728 F. Supp. at 232-33, 236.

*B. Free-Rider and Efficiency Justifications*

Respondent argues that the procompetitive nature of its conduct offsets anticompetitive effects. TRU must show that its conduct was (a) procompetitive or (b) that it was reasonably necessary to meet the competitive problems.<sup>207</sup>

TRU's free-rider argument focuses on its investment in creating hits for the industry in its "showroom." TRU's contemporaneous documents concerning the development of its campaign against the clubs refer to neither preventing "free-riding," nor the showroom issue. TRU's campaign was directed solely at the clubs, which threatened TRU with the lowest prices, with smaller selections than TRU, focusing on the more popular toys, on a more seasonal basis, with little advertising outside of the Christmas season. TRU shifts many retailing functions to toy manufacturers. TRU's dating terms with major toy manufacturers provide that payment for shipments it receives earlier in the year is not due until December. The cost of advertising and product promotions is born mostly by TRU's suppliers, not TRU.

The vertical agreements by the manufacturers did not help them compete more effectively against other manufacturers. Manufacturers agreed after being assured that other manufacturers would forgo selling open stock to the clubs, not in order to achieve efficiencies in distribution in each manufacturer's own individual, independent self-interest.

Toys are less susceptible to free-riding than higher cost goods where services are provided by the retailer.<sup>208</sup> Consumers are unlikely to obtain services from TRU and then travel to a club to purchase the product.

1. TRU advertising

In the toy industry the manufacturer generates demand for products through television advertising.<sup>209</sup> Consumers are informed by the manufacturer's advertising efforts, not TRU's. TRU on the other hand advertises availability and price of toys for sale in its stores.

Respondent receives compensation for this advertising. The manufacturers pay TRU to appear in TRU advertisements. In 1994, TRU spent [ ] million for advertising, and received [ ] million in compensation. Its net cost of advertising was [ ] As a percentage of net sales, TRU's net advertising expenditures were [ ]<sup>210</sup> In 1993, TRU

<sup>207</sup> *Graphic Products Dist. v. Itek Corp.*, 717 F.2d 1560, 1576, 1577 n.31 (11<sup>th</sup> Cir. 1983).

<sup>208</sup> *Sylvania*, 433 U.S. at 55.

<sup>209</sup> Spencer 9:1866/7-10; Amerman 17:3738/8-17; Weinberg IH (CX-1662) at 48/21-25.

<sup>210</sup> CX-1012.



reported that "We are getting vendor funding for all the roto advertising - it's essentially free."<sup>211</sup>

Toy manufacturers spend over 8% of sales dollars on advertising.<sup>212</sup> This figure includes manufacturers that do not engage in advertising. Mattel and Hasbro, the two largest manufacturers, spend a higher percentage of sales on advertising. Demand for toys is created in advertising by the manufacturer, not by TRU. TRU benefits from its own advertising and promotional efforts. There is no evidence that TRU advertising generates sales at warehouse club stores.

## 2. TRU in-store promotion

Respondent's stores resemble warehouses. Like Wal-Mart, Kmart, and the clubs, TRU does not provide demonstrations or informed sales personnel.<sup>213</sup> TRU characterizes itself as a low to non-existent service provider.<sup>214</sup>

## 3. TRU's year-round full line

Respondent carries more toys year-round than the clubs or other toy retailers. TRU argues that this service saves manufacturers warehouses, smooths manufacturer production, and lowers costs to consumers; that it bears risk by obtaining product early in the season before hot toys are known; that TRU in fact helps create hot toys; that its compensation for providing this service is threatened by club sales, and the clubs learn which toys are hot based on the TRU efforts, and then free-ride on that information.

Respondent benefits from its full-year, full-line coverage. This is not just a cost to TRU. By taking product early, TRU reduces the risk of being out-of-stock, especially when a product becomes hot and is in short supply. TRU's full-line gives it an advantage over competitors with fewer toys.<sup>215</sup> TRU has higher profits on less popular items.<sup>216</sup>

Respondent contends that the clubs order after winners and losers are determined. The clubs place most of their orders in the spring when it is uncertain which toys will be the "hot" toys for the Christmas season. The clubs' offer to carry toys all year did not change the manufacturers' refusal

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<sup>211</sup> CX-967-C.

<sup>212</sup> CX-1624.

<sup>213</sup> TRU's low service reputation is reported in consumer surveys (CX-917-A-D) and is well known to the public. New York Times article ("Lost in Toyland," March 31, 1996, pp.3, 12) (CX-807).

<sup>214</sup> Goldstein IH (CX-1655) at 36/20-23; Lazarus 24:5356/11-22.

<sup>215</sup> CX-1586; CX-1597-A; CX-1611-F.

<sup>216</sup> Scherer (CX-1822) ¶ 18.

to sell the clubs identical toys.<sup>217</sup> The toy industry is seasonal. Manufacturers ship, and retailers sell most of the toys during the fourth quarter. Many promoted toys are not even available until then. (CX-1624.)<sup>218</sup> That the clubs sell a high percentage of toys in the fourth quarter is of little importance. There is little variation in seasonality between the warehouse clubs and TRU.<sup>219</sup>

Respondent argues that it is not compensated for carrying inventory early in the year and promoting new toys. TRU receives compensation from the manufacturers which reduces this risk. [ ]<sup>220</sup> This compensates TRU for warehousing product early.<sup>221</sup> Manufacturers give respondent warehouse, early buy, early ship discounts or other allowances for purchasing early.<sup>222</sup> In 1994, TRU received [ ] in merchandising allowances. This covered TRU's early purchases and warehousing expenses, as well as compensation for endcaps, sidecaps, and register lane placement. Dating terms enable TRU to carry a full line of toys all year.<sup>223</sup> Respondent has leverage to negotiate favorable terms.<sup>224</sup> If TRU buys products early in the year that do not sell by late in the year, TRU obtains cost markdowns, credits, extended dating terms, redating, consumer coupons, and free goods. TRU received [ ] million in markdown allowances in 1994.<sup>225</sup> If a toy still does not sell after the first markdown allowance manufacturers provide additional allowances to TRU or further extend the dating. Respondent is also compensated by manufacturers for promotions. And it receives a disproportionate share of hot, allocated product.<sup>226</sup> It is compensated for ordering more toys earlier in the year. It gains price concessions from manufacturers. It is compensated for carrying toys not carried by the clubs.

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<sup>217</sup> CX-1664.

<sup>218</sup> In 1992, Parker Brothers sold 72% of its toys in the 4th quarter, Milton Bradley 69%, and Tyco 64%. Toy sales and shipments are heavily skewed to the 4th quarter. In 1994, Mattel sold nearly 62% of its product in the 4th quarter; Hasbro sold almost 70% of its games and puzzles. (CX-139-K.)

<sup>219</sup> *RX-621*, Table 7 at 28 (62-64% for clubs; 56-57% for TRU).

<sup>220</sup> [ ]

<sup>221</sup> CX-686-B.

<sup>222</sup> CX-1730; CX-1012.

<sup>223</sup> CX-1012; CX-1611.

<sup>224</sup> CX-683-A-E.

<sup>225</sup> CX-1012.

<sup>226</sup> CX-530-A; CX-530-D; CX-527-A-B; CX-533-A ("... Toys R Us is receiving a disproportionate share of our quotas."); CX-5; CX-10-A-B; CX-444-B; CX-200.

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Initial Decision

#### 4. "Hot" toys

Respondent argues that it orders toys earlier than the clubs, and that the clubs order only toys identified as "hot" by its efforts. TRU places most of its orders for the Christmas season in the spring, and receives some toys early in the year, and some later. The clubs order soon after TRU. At the time that the clubs order, neither the clubs nor the manufacturers know which toys will be hot.

#### 5. Other retailers

Toy manufacturers offer their full line of toys to Wal-Mart, Kmart and drug stores and supermarkets which do not carry the manufacturers' full lines or advertise nearly to the extent TRU does.<sup>227</sup> TRU's free-rider argument cannot justify its conduct targeted at the warehouse clubs. Despite the similarities between warehouse clubs and other discount retailers, respondent did not pressure the manufacturers regarding Wal-Mart or other retailers. The TRU campaign was not directed at "free-riding" by the clubs on TRU's retailing functions.

#### 6. Canada

Respondent has expressed concern to manufacturers that their products were being carried by the clubs' stores in Canada and the United Kingdom.<sup>228</sup> However, TRU was unsuccessful in Canada. TRU has less leverage in Canada, due to another retailer (Zellers), "about as tough a competitor in the toy business as we have in the world."<sup>229</sup> If free-riding were the true rationale, the manufacturers would cut-off the clubs in Canada as they have at TRU's behest in the United States. This has not occurred.

### CONCLUSIONS OF LAW

1. The Federal Trade Commission has jurisdiction over the subject matter of this proceeding and over the respondent, Toys "R" Us, Inc.

2. Respondent Toys "R" Us, Inc. ("TRU") is a corporation doing business under the laws of Delaware, with its office at 461 From Road, Paramus, New Jersey.

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<sup>227</sup> Mr. Goldstein, vice-chairman and CEO of TRU, testified that respondent provides more services for manufacturers than any other of the national chains, including Wal-Mart, Target and Kmart, by taking product earlier, carrying a fuller line, carrying less-popular or non-promoted toys, advertising year-round, test-marketing products, avoiding knock-off toys (imitations), and promoting manufacturer brands. (36:8252/18 - 8259/5.) TRU accounted for [ ] of the toy industry's retail advertising from January through May of 1994, while Wal-Mart accounted for [ ]. (CX-1732; CX-155.) Wal-Mart does not advertise heavily, and instead, offers low prices. This policy is similar to that used by the warehouse clubs. (CX-137-B.)

<sup>228</sup> Nakasone IH (CX-1661) at 84, 90, 118; Goldstein IH (CX-1659) at 102-04.

<sup>229</sup> CX-1648-T.

3. TRU is a corporation, within the meaning of Section 4 of the Federal Trade Commission Act, 15 U.S.C. 44, as amended.

4. TRU's acts and practices are in or affect commerce as "commerce" is defined in the Federal Trade Commission Act.

5. Respondent engaged in agreements, contracts or combinations with toy manufacturers constituting unfair methods of competition, in violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. 45.

6. TRU's importance as a distributor of toys has given it market power over toy manufacturers.

7. Since 1989, TRU used its market power to gain agreements or understandings with suppliers relating to toy sales to the clubs. These agreements or understandings included:

(a) The suppliers agreed not to sell to the clubs the same toys that TRU carried;

(b) TRU and the suppliers agreed upon toys that could be sold to the clubs. These were "club specials" consisting of pack of items, differentiated from regular open stock items. The club specials could not be readily price-compared to products sold by TRU, cost more, and raised the clubs' prices to consumers; and

(c) The suppliers agreed to advise TRU in advance of club specials that the suppliers wanted to sell to the clubs.

8. Some major manufacturers were reluctant to give up their sales of individual toys to the clubs so long as their competitors were selling those products to the clubs. TRU then facilitated agreements or understandings among competing manufacturers to achieve substantial unity of action among them relating to their dealings with the clubs.

9. The agreements or understandings facilitated by TRU between competing manufacturers are *per se* unlawful.

10. The agreements or understandings between toy manufacturers and between TRU and toy manufacturers were not a legitimate effort to protect TRU and the manufacturers from "free-riding" by the warehouse clubs.

11. The purpose and effect of the agreements or understandings between toy manufacturers and between TRU and toy manufacturers was to restrain competition among toy retailers and among toy manufacturers.

12. The respondent has unreasonably restrained competition.

(a) Retail price competition has been restrained, and toy prices to consumers are higher than they would have been;

(b) Competition among toy manufacturers in the distribution of toys to TRU's competitors has been restrained;

(c) The clubs' costs were increased, which impeded the growth of a new method of toy distribution in its incipency; and

(d) Information that would enable consumers to make informed price comparisons has been suppressed.

13. The agreements or understandings between the manufacturers and between TRU and the manufacturers tend substantially to reduce output and restrain competition. None of these agreements or understandings is supported by a cognizable or demonstrated efficiency or other procompetitive justification. As a result, under a rule of reason analysis, these agreements or understandings constitute an unreasonable restraint of trade.

14. The acts or practices of TRU prejudice and injure the public. The acts or practices constitute unfair methods of competition in or affecting commerce in violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. 45. These acts or practices are continuing.

15. TRU has failed to demonstrate that the complaint of the Commission herein was issued without reason to believe that TRU had violated the Federal Trade Commission Act or that the complaint was issued as a result of any legal insufficiency.

16. The order is in the public interest to remedy the violation of law and is necessary to bring to an end the challenged conduct and to dissipate the anticompetitive effects of the restraint.

#### ORDER

##### I.

A. "*Respondent*" means Toys "R" Us, its directors, officers, employees, agents and representatives, predecessors, successors and assigns; its subsidiaries, divisions, and groups, and affiliates controlled by Toys "R" Us, and the respective directors, officers, employees, agents and representatives, successors, and assigns of each.

B. "*Toy discounter*" means any retailer of toys, including but not limited to membership retail outlets such as Price-Costco, Sam's Club, and BJ's Wholesale Club, that sells toys at discounted prices.

C. "*Toys and related products*" means any product that is sold by respondent.

D. "*Commission*" means the Federal Trade Commission.

##### II.

*It is ordered*, That respondent, directly or indirectly, through any corporation, subsidiary, division or other device, in connection with the actual or potential purchase or distribution of toys and related products, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, forthwith cease and desist from:

A. Continuing, maintaining, entering into, and attempting to enter into any agreement or understanding with any supplier to limit supply or to refuse to sell toys and related products to any toy discounter.

B. Urging, inducing, coercing, or pressuring, or attempting to urge, induce, coerce, or pressure, any supplier to limit supply or to refuse to sell toys and related products to any toy discounter.

C. Requiring, soliciting, requesting or encouraging any supplier to furnish information to respondent relating to any supplier's sales or actual or intended shipments to any toy discounter.

D. Facilitating or attempting to facilitate agreements or understandings between or among suppliers relating to limiting the sale of toys and related products to any retailer(s) by, among other things, transmitting or conveying complaints, intentions, plans, actions, or other similar information from one supplier to another supplier relating to sales to such retailer(s).

E. For a period of five years, (1) announcing or communicating that respondent will or may discontinue purchasing or refuse to purchase toys and related products from any supplier because that supplier intends to sell or sells toys and related products to any toy discounter, or (2) refusing to purchase toys and related products from a supplier because, in whole or in part, that supplier offered to sell or sold toys and related products to any toy discounter.

Provided, however, that nothing in this order shall prevent respondent from seeking or entering into exclusive arrangements with suppliers with respect to particular toys.

### III.

*It is further ordered,* That respondent shall:

A. Within thirty (30) days after the date on which this order becomes final, mail to each of its suppliers and employees who have purchasing responsibilities a copy of the Commission's complaint and order in this matter, along with a letter from respondent's chief executive officer stating that its suppliers can sell whatever products they wish to retailers, and that respondent will not take any adverse action for selling toys and related products to retailers in whole or in part due to the retailer's retail prices or price policies;

B. Within ten (10) days after the date on which any person becomes an employee of respondent with purchasing responsibilities for toys and related products, or a director, officer, or management employee of respondent, or a new supplier of respondent, provide a copy of this complaint and order to such person; and

C. Require each employee, director, or officer to whom a copy of this complaint and order is furnished pursuant to subparagraphs III A and B of

this order to sign and submit to Toys "R" Us, Inc., within thirty (30) days of the receipt thereof a statement that: (1) acknowledges receipt of the complaint and order; (2) represents that the undersigned has read and understands the complaint and order; and (3) acknowledges that the undersigned has been advised and understands that non-compliance with the order may subject Toys "R" Us, Inc. to penalties for violation of the order.

## IV.

*It is further ordered*, That respondent shall:

A. Within sixty (60) days after the date on which this order becomes final, and annually thereafter on the anniversary of the date this order becomes final, and at such times as the Commission may by written notice to the respondent require, file with the Commission a verified written report setting forth in detail the manner and form in which respondent has complied and is complying with this order;

B. Maintain and make available to the staff of the Federal Trade Commission for inspection and copying, upon reasonable notice, all records of communications with suppliers of respondent relating to any aspect of actual or potential purchase or distribution of toys and related products, and records pertaining to any action taken in connection with any activity covered by paragraphs II and III of this order; and

C. Notify the Commission at least thirty (30) days prior to any change in respondent such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries, or any other change in the corporation that may affect compliance obligations arising out of this order.

## V.

*It is further ordered*, That this order shall terminate twenty(20) years after the date on which this order becomes final.