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FTC Judge Upholds Charges Against Toys "R" Us

Law Judge Finds that Nation's Largest RetailerInduced Toy Makers to Cut Off Discount Warehouse Clubs

FOR RELEASE

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A judge has upheld Federal Trade Commission charges that Toys "R" Us -- concerned that warehouse clubs with two thirds lower margins would erode its reputation for low prices -- used its power to muscle toy makers to stop selling their popular toys to the clubs, or to sell the clubs only the more expensive combination packs so consumers couldn't easily compare prices. Administrative Law Judge James P. Timony ruled in an initial decision announced today that, beginning in 1989, Toys "R" Us entered into vertical agreements with manufacturers to restrict their sales to clubs, and then orchestrated horizontal agreements among the otherwise competing manufacturers to adhere to the club sales restrictions by ferrying messages back and forth and using the acquiescence of one manufacturer to obtain that of another.

Toys "R" Us enforced the agreements by shopping the clubs for products sold in its own stores and, when it found them or when manufacturers complained about their competitors' products being sold in warehouse clubs, Toys "R" Us threatened to stop buying the products and got renewed acquiescence to the sales restrictions, according to the decision. As a result, by early 1993, Mattel, Hasbro and other major toy manufacturers had stopped selling to Price Club, Sam's, B.J.'s and other clubs any identical products they sold to Toys "R" Us, and toy prices were higher than they otherwise would have been, Timony found.

Timony followed his decision by issuing an order that will prohibit Toys "R" Us from:

> attempting or continuing any agreement or understanding with a supplier to restrict the supplier's sales to any toy discounter;
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> urging or pressuring a supplier to restrict its sales to any toy discounter;
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> requiring or encouraging any supplier to furnish information about any other supplier's sales or shipments to any discounter;
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> facilitating agreements among suppliers related to limiting the suppliers' sales to any retailer (by, among other things, transmitting complaints or intentions); and

> for five years, from announcing that it will discontinue purchasing products from any supplier because the supplier sells to any toy discounter, or refusing to purchase from a supplier because that supplier dealt with any toy discounter.

The initial decision follows charges detailed in an administrative complaint that was issued by the Commission in May 1996. Trial in the case began in May 1997 and the final closing argument was on Sept. 5. Judge Timony issued his decision Sept. 25, and it was announced today.

Timony devoted a portion of his decision to a discussion of Toys "R" Us' market power. He noted findings that, in 1994, Toys "R" Us had 29 percent of the top 10 toymakers' sales. But he said that the market power of Toys "R" Us also is demonstrated by the fact that all major toy manufacturers agreed to restrict sales to the clubs -- with most instituting policies of selling only value packs or discontinued items to the clubs, and later agreeing to advise Toys "R" Us in advance of club specials they intended to sell, in order to keep the chain as an outlet, according to the decision. Yet the warehouse clubs were an outlet that these manufacturers had projected to be very important, Timony said. Even an internal Toys "R" Us document projected the clubs to have 6 percent to 8 percent of the market by this year. As the only national full-line toy chain, the support of Toys "R" Us is necessary for success in promoting a new product, he said, adding that toymakers worried about retaliation for failing to adhere to the restricted policies in the form of less shelf space, less valuable store location and less advertising. Still, they would only agree to follow the policy so long as they could be assured that their competitors would do the same, and Toys "R" Us provided that assurance, Timony said.

Toys "R" Us prices were not the lowest in the industry, Timony also said. One finding in the decision notes reports showing that warehouse clubs prices were well below Toys "R" Us and that Toys "R" Us lowered its prices in areas where it competed with the warehouse clubs.

In addition, the industry was widely recognizing the warehouse clubs as a growing outlet as the number of other toy chain outlets was shrinking, which made the clubs even more of a threat to Toys "R" Us. "Ironically when [Toys "R" Us] was just becoming successful, established retailers thought the toy manufacturers should not sell to [it] because its prices were too low," Timony said.

Nonetheless, Timony said, Toys "R" Us began trying to restrict toy makers' sales to the clubs with three goals in mind:

> to prevent the clubs from competing with Toys "R" Us;
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> to prevent toy makers from competing with each other to sell to the clubs; and
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> to prevent consumers from comparing Toys "R" Us prices to warehouse club prices.

Judge Timony rejected Toys "R" Us' argument that the agreements were necessary to prevent free riding on its advertising and "showroom" status. Demand for toys is created mostly by manufacturer advertising, Timony said, and Toys "R" Us gets compensation from manufacturers who appear in its advertisements. Toys "R" Us also gets compensated in various ways for carrying a full-line of inventory year around, Timony said.

Timony also rejected Toys "R" Us reliance on a case involving two manufacturers who bowed to pressure from Macy's not to sell to Kids "R" Us. But in this situation, Timony said, Toys "R" Us "crossed a line that Macy did not by orchestrating an agreement among the manufacturers and by using market power that Macy did not have."

Judge Timony's order is subject to review by the full Commission either on the Commission's own motion or on appeal by the respondent. If not appealed within 30 days, it will become the Commission's decision and order, effective 60 days after it is served.

Copies of the initial decision and order, as well as the May 1996 complaint, are available from the FTC's web site at *http://www.ftc.gov* and also from the FTC's Public Reference Branch, Room 130, 6th Street and Pennsylvania Avenue, N.W., Washington, D.C. 20580; 202-326-2222; TTY for the hearing impaired 1-866-653-4261. To find out the latest news as it is announced, call the FTC NewsPhone recording at 202-326-2710.

(FTC File No. 941 0040; Docket No. 9278)

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