Slotting Allowances and the Antitrust Laws

Testimony of
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presented by
Willard K. Tom, Deputy Director
Bureau of Competition

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Mr. Chairman and Members of the Committee, my name is Willard K. Tom and I am the Deputy Director of the FTC's Bureau of Competition. I appreciate the opportunity to testify before you today about competition issues in agriculture and food marketing. I understand that other witnesses will address specific questions involving packers and stockyards, an area over which our jurisdiction is extremely limited in any event. I will focus instead on the way that slotting agreements are assessed under the antitrust laws. My written testimony states the views of the Federal Trade Commission on this subject, but my oral presentation and my answers to any questions that you ask will be my own. Let me add that the Commission has at least one nonpublic law enforcement investigation pending in this area, and so I respectfully request your indulgence if I don't reveal the investigative details.

The Federal Trade Commission is an independent agency that has the mission of ensuring that consumers have the benefits of free and fair competition. We enforce a number of antitrust statutes, such as the FTC Act and the Clayton Act with its merger provisions, which ensure that the marketplace remains competitive. We also enforce a number of consumer-protection statutes, which ensure that customers can make their selections in the marketplace on the basis of accurate rather than of deceptive information. Working together, the two main missions of the FTC ensure that consumers are able to go into a competitive marketplace and make free choices there.

Today's hearing asks how slotting allowances should be assessed within this framework. The term "slotting allowance" typically refers to a lump-sum, up-front payment that a food manufacturer must pay to a supermarket for access to its shelves. The term has been used to cover an extremely broad range of conduct, some of it clearly unlawful, some clearly lawful, and a great deal of it in the gray area in between, the legality of which can be determined only in light of all the surrounding facts and circumstances.

At the clearly unlawful end of the spectrum is commercial bribery. This is an under-the-table payment to a purchasing agent of a retailer that goes straight into the agent's pocket, in violation of the fiduciary duties owed by the agent to his principal. Allegations of this sort have arisen in public discussions of the issue, such as the recent hearings held by the Senate Committee on Small Business.[(1)] If such instances come to our attention, we will promptly refer the matter to the relevant state or local authorities for criminal prosecution. Only criminal sanctions can provide adequate deterrence for this sort of covert, blatantly illegal conduct, and it would not be appropriate for us to try to apply antitrust standards and remedies to conduct that is universally condemned for reasons wholly apart from antitrust.

At the other end of the spectrum are payments from a manufacturer to a retailer that really constitute only an ordinary price discount. For example, a short-term agreement for advance payments that does nothing more than obligate the retailer either to buy a certain number of units of a manufacturer's product or to return a proportionate share of the advance payment may be little different from a simple price cut. In such a situation, the retailer gets, in effect, a certain per-unit discount off the nominal selling price. The only difference is that the retailer receives the discount at the outset of the contract. If the retail market is competitive - a very important precondition - the discount is likely to be passed through to consumers and competition will not ordinarily be harmed.

In between these two extremes is a gray area. We have heard on occasion from small manufacturers that complain about activity in this area. For example, they have reported that strong buyers, such as supermarket chains, are demanding large up-front payments not tied to volume. In some cases, we have been told, these allowances are so large that some small manufacturers cannot afford them and are dropped from the store.

When we evaluate this kind of conduct, the antitrust statutes require us to determine whether particular actions have harmed the overall level of competition in a market. If a market can be kept competitive, then consumers will receive the benefits of low prices and wide product selection, and businesses will receive the benefits of having many suppliers and many outlets.

In light of this principle, how do we determine when slotting allowances have actually put competition at risk? And what should an antitrust agency do to prevent or remedy such situations?

Evaluating Slotting Allowances

The first question is how to determine when slotting allowances have actually had a harmful effect on competition. Unfortunately, the answer, as for many economic practices, is that it depends on the circumstances. Very often debates over slotting allowances have assumed that all slotting allowances, and all of the market conditions in which they are used, are the same. Life would be a lot simpler both for law enforcers and for legislators if only that were so. But in fact there are significant differences both in the terms of the allowances, and in the contexts where they are used.

First, there are differences in the terms of the slotting allowances themselves. The actual allowances -- the payment from manufacturer to retailer -- are one side of a bargain, the other side of which can offer tremendous variety. What does the retailer offer in exchange for the payment?

- Is it a payment simply to be carried somewhere in the store?
- Is it for a fixed amount of shelf space?
- Is it for preferential display -- the end-caps or eye-level shelves?
- Is it for the right to be the exclusive, or nearly exclusive, supplier in that product category?
- Is it for the right to control what other products in that category will be allowed on the shelves?
- And is it for a long or a short time?

The answers to these questions can have a major effect on how much room is left for other suppliers in the market, and therefore on whether the allowances are harmful or innocuous, procompetitive or anticompetitive.

Thus, if a dominant manufacturer, in exchange for slotting allowances, secures promises from a large number of retailers not to carry the products of its competitors, competition might be seriously harmed. Indeed, if so many retailers were tied up by these contracts that competing manufacturers could not secure enough distribution to stay in business, outright monopoly could be the result.

Similarly, if a dominant manufacturer or a small group of manufacturers were able to secure exclusive arrangements with all the desirable retailers, thus forcing other competitors to use only less desirable retailers, they might be able to raise prices because they would face less effective competition.

Even without 100% exclusivity, a manufacturer or a group of manufacturers might be able to marginalize their competitors and lessen the competition they face through partial exclusivity requirements that, for example, guarantee the manufacturer (or the group) a large percentage of shelf space or give it a veto right over other manufacturers' products.

On the other hand, payments of reasonable amounts to compensate the retailer for the costs and risks of stocking a new, unproven product, without exclusivity requirements, are unlikely to harm competition. This was the original context for the term "slotting allowances." Taking on a new product confronts the retailer with not only the actual costs of restocking shelves, changing labels, and reprogramming scanner equipment, but also the potential costs of product failure and being left with unsold inventory. Moreover, taking on a new product often means that some other product must be dropped from a store. The average supermarket stocks 30,000 items, but fully

100,000 grocery products are available from manufacturers, and another 10-15,000 new ones are offered each year. Supermarkets cannot stock all the available products, and when a new product comes in, that typically means an old product must go. Under those circumstances, it may be reasonable to ask the manufacturer, which has usually done the test-marketing and has the best information about the potential of each individual product, to bear some of the supermarket's risk if it wants to persuade the supermarket to try the product.(2) Such an arrangement may be reasonable if the payments are roughly equal to the risk-adjusted costs involved.

So far we've been talking about the different kinds of slotting allowances and associated agreements. In addition, the market circumstances in which the agreements take place can vary widely, and with equally important consequences.

The Supreme Court has told us that even outright exclusive dealing agreements can be lawful and procompetitive where markets are relatively unconcentrated.(3) Exclusive arrangements between a manufacturer and a retailer may help them work together to compete more effectively against other manufacturer-retailer pairs. The retailer that is specializing in the product of one supplier can become more familiar with it, better able to convince customers of its merits, more motivated to sell it, and better able to service it. And as long as there are many comparable manufacturers and many equivalent outlets for their products, and as long as only relatively few outlets are needed to reach nearly all of the end user customers, competition should be vigorous, notwithstanding the exclusive contracts. Consumers will still have multiple brands to choose from and manufacturers will have multiple routes to the marketplace.

Conversely, when the market is highly concentrated in the hands of one or a few firms, or when one can compete only if one has access to most of the outlets in the market, anticompetitive effects become more likely. If one supplier has exclusive contracts with all or most of the outlets in a market, and especially if slotting fees are paid to maintain an existing product line rather than to introduce a new one, competition can be diminished in terms of both variety and price. Competition can be diminished in terms of variety, because other suppliers cannot easily find enough outlets to become an effective presence in the market, and because shoppers will have difficulty locating those products even if they are available somewhere. It can be diminished in terms of price, because all products are likely to be more expensive as a result of the lessened rivalry among manufacturers.

To see if these outcomes are likely, the Commission looks at concentration at both the manufacturer and the retail levels. Dominant manufacturers are more likely to have the ability to engage in the kinds of exclusive dealing strategies outlined above, even if retailing is fairly unconcentrated. Similarly, when a handful of companies dominate retailing of particular types of products, they are more likely to be able to impose terms such as slotting allowances, and also more likely to have only limited competition among themselves at the retail level, so that they are more likely to retain the slotting allowance as a bonus for themselves, rather than being induced by the competitive environment to pass it on as a cost saving to consumers.

Enforcement Approaches to Slotting Allowances

Given that slotting allowances can have such varied effects in various circumstances, how should an antitrust enforcement agency approach the issue, and how should it deal with those problems that do exist?

The first and most important step is surely merger enforcement. It is when either manufacturing or retailing becomes highly concentrated that we see the greatest potential for practices such as slotting allowances to have anti-consumer rather than pro-consumer effects. Merger enforcement is one way of setting some limits on increasing concentration.

As everyone in this room knows, we have been in the midst of an enormous merger wave for some time now. Merger transactions reported under the Hart-Scott-Rodino Act have increased from 1529 in fiscal 1991 to 4679 last year, with no end in sight. The antitrust agencies have handled this dramatic increase in mergers with, at best, a modest increase in budget. Although this has put an obvious strain on Commission resources, the agency has been able to continue ferreting out the relatively few mergers that may harm competition, and has blocked or restructured them so that the interests of consumers are protected.

This merger program has been active at the retail level as well as at the manufacturer level. In recent decades the conventional wisdom was that retailing was characterized by a great deal of competition and low barriers to entry, so that few mergers there were likely to be anticompetitive. The retail world has been changing, however. When the agency investigated the proposed merger of Staples and Office Depot, the two largest of only three national office supply superstore chains, we learned that non-superstore retailers did not exercise a significant competitive constraint on these chains. Instead, we found that the chains were a market unto themselves. Consumer prices were higher in markets that had only two chains rather than three, and higher still in markets that had only one, regardless of what other types of outlets were present. Even the presence of Wal-Mart or other general merchandise discounters did not alter this fact. The Commission therefore successfully challenged the proposed merger in court.(4)

In grocery retailing, the agency maintains a very active program of merger enforcement. In the last four and a half years the Commission has brought enforcement actions in 10 major supermarket mergers. These cases have resulted in the divestiture of 277 individual supermarkets or building sites. One of the agency's most recent matters of this sort involved Albertson's acquisition of American Stores. The consent agreement in that one case alone calls for the divestiture of 144 supermarkets and 5 building sites, generally to smaller chains or to independent wholesalers.

In addition to merger enforcement, we also scrutinize agreements -- including agreements on slotting allowances -- where the restraints and market structure seem likely to produce anticompetitive effects. One such case involved a powerful retailer demanding the kind of exclusivity that we sometimes see associated with slotting allowances. This is the case against Toys 'R' Us, now on appeal before the Seventh Circuit.(5) In that case, the Commission found, among other theories of violation, that Toys 'R' Us used its power as a retailer to orchestrate a conspiracy among large toy manufacturers to withhold the more desirable toys from the lower-cost warehouse clubs against which Toys 'R' Us competed. By enlisting the manufacturers into the conspiracy, it was able to weaken the warehouse clubs as competitors in the retail market. In reaching its conclusion, the Commission carefully examined, and rejected, a variety of efficiency defenses that Toys 'R' Us offered to justify its conduct. The evidentiary record gave the Commission a high degree of confidence that Toys 'R' Us's practices were what they seemed to be -- a way of cutting off supplies to rivals in order to relieve the competitive pressure that had produced benefits for consumers. Controlling practices of this kind can go a long way toward ensuring a competitive landscape.

The Commission is committed to pursuing anticompetitive practices vigorously. The Commission recognizes that competition is at least potentially harmed, not only in the commercial bribery situations alluded to earlier, but also in cases where the slotting payments are associated with predatory pricing, price and other forms of discrimination, monopolization, or raising the distribution costs of rivals in order to make them less effective constraints on a dominant manufacturer's pricing. We remain alert to the possibility of harm in all these circumstances.

Conclusion

To sum up, the term "slotting allowances" covers a wide variety of practices under a wide variety of market circumstances, and the competitive effects are not always clear-cut. But five specific points can be fairly made in closing.

First, the Commission, under its statutes, looks to determine whether particular conduct has harmed the overall level of competition; this means that harm to an individual competitor is not necessarily an antitrust violation. Second, in practical effect some slotting allowances can be discounts off of list price and beneficial to competition, particularly when they are passed on to consumers. Third, the FTC nonetheless considers complaints about particular slotting allowances very carefully, precisely because their market effects can be so different. Fourth, the FTC does not receive many complaints in this area - perhaps one every three months on average.

Fifth, however, the FTC remains committed to pursuing evidence of antitrust violations when it finds them, and welcomes hearing from anyone who may be aware of such evidence. We would like to affirmatively encourage this by assuring small manufacturers that we are aware of their concerns about the possible business repercussions of complaining to the government, and that, accordingly, we always hold the names of complainants in confidence. We also look forward to working with this Committee as it continues to study this complex subject.

Thank you again for this opportunity to present the Commission's views.

Endnotes:

1. "Slotting: Fair for Small Businesses & Consumers?," Hearings before the Committee on Small Business, United States Senate (Sept. 14, 1999).

2. Another way this has been expressed is that the manufacturer's willingness to "put its money where its mouth is" signals a greater likelihood that the product actually will succeed.

3. *See, e.g.,* Standard Oil Co. v. United States, 337 U.S. 293 (1949).

4. *FTC v. Staples, Inc*., 970 F. Supp. 1066 (D.D.C. 1997). In recent years the Commission has also devoted significant enforcement resources to mergers of consumer product manufacturers. *See, e.g.*, S. C. Johnson, FTC Dkt. No. C-3802 (acquisition of DowBrands conditioned on divestiture of "Spray 'n Wash," "Spray 'n Starch," and "Glass Plus" brands) (consent order) (1998).

5. FTC Dkt. No. 9278 (Opinion and Final Order, Oct. 13, 1998) (Comm'r Swindle concurring in part and dissenting in part), *appeal filed*, Dkt. No. 98-4107 (7th Cir., filed Dec. 7, 1998).