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Antitrust Law Update

The FTC Staff's Report on Slotting Allowances: Doctrinal Indecision With a Mandate to Dig Deeper

In late February, the FTC staff issued its long-anticipated Report on the Federal Trade Commission Workshop on Slotting Allowances and Other Marketing Practices in the Grocery Industry. www.ftc.gov/bc/slotting/index.htm The report discusses and analyzes information collected and views expressed at an FTC public workshop last spring. Slotting fees and similar practices are becoming an increasingly prominent subject for FTC scrutiny. Accordingly, we thought it would be useful briefly to summarize and comment on the report and discuss some potential implications for retailers and manufacturers that distribute their products through retailers.

Slotting allowances, as defined by the report, are "lump-sum, up-front payments from a manufacturer or producer . . . to a retailer to have a new product carried by the retailer and placed on its shelves." Similarly, manufacturers sometimes pay retailers "pay-to-stay" fees to keep existing products on the shelves. Although these and similar marketing practices have long been a retailing fixture, they are controversial. Most prominently, some have complained that such practices unfairly limit rivals' shelf space, thereby entrenching market leaders and denying smaller or incipient competitors opportunities to gain market presence.

Although slotting fees and the like have generated controversy for at least a decade, they have received increased scrutiny in the last two years as Congress has delved into the issue. During the 106th Congress, both the House Judiciary and Senate Small Business Committees held hearings on slotting fees and similar marketing practices. The genesis of the FTC's workshop and report -- as well as its continuing focus on these practices -- may well lie in this Congressional interest. Congress has appropriated $900,000 for the FTC to study slotting fees in the grocery industry in fiscal 2001.

The report reflects a balanced and pragmatic view of slotting allowances, pay-to-stay fees, and similar practices, recognizing that such practices may be procompetitive in some circumstances and anticompetitive in others. It does not, however, make any significant progress towards defining a coherent, orderly methodology for assessing the competitive effects of particular marketing practices in real-world markets. That being so, the most significant aspect of the report is the FTC staff's proposal for further investigation of slotting fees and other marketing practices. Such an investigation has strong Congressional support, is fully funded, and is likely to make use of the Commission's subpoena power.

The Report: Structure and Coverage

The report includes five parts:

Part I describes the marketing practices that workshop participants identified as the most competitively significant, including slotting allowances, pay-to-stay fees, payments to limit rivals' shelf space, and discriminatory payment of access fees. Focusing on slotting allowances, the report identifies potential procompetitive benefits, such as encouraging retailers to take on new products by shifting the risk of product failure to the manufacturer and permitting the manufacturer to signal confidence in its product's success. It also identifies potential anticompetitive effects, including exclusion of small manufacturers, reduced innovation and product variety, and increased consumer prices. This part also examines possible less restrictive alternatives for achieving the efficiencies that slotting fees provide, such as test stores, per-unit introductory allowances, and buy-back guarantees or failure fees.

Part II evaluates whether the identified marketing practices threaten to exclude competitors at the manufacturing level. It focuses, in particular, on the economic theory of "raising rivals' cost" and applying that theory to practices like slotting allowances, pay-to-stay fees, and payments to limit rival's shelf space.

Part III examines two related business practices, "category management" and "category captains," that are designed to help retailers allocate shelf space based on consumer demand patterns and provide alternatives to slotting allowances in some circumstances. It analyzes potential competitive concerns from these practices and suggests ways in which those competitive concerns might be minimized.

Part IV discusses the additional concern that slotting allowances and similar practices may be attributable to retailer market power. In particular, it explains potential concerns about monopsony power, buyer power without monopsony, and gatekeeper power, and briefly analyzes the evidence about whether grocery retailers actually enjoy market power.

Finally, Part V summarizes policy recommendations that a panel of experts formulated as part of the workshops and provides the FTC staff's recommendations. Those recommendations include: (a) additional empirical research; (b) postponement of issuing formal slotting allowance guidelines pending further study; and (c) further analysis of specific areas of potential concern relating to slotting fees and other marketing practices, such as (i) price and promotional discrimination, (ii) exclusive-dealing contracts, (iii) slotting allowances, (iv) pay-to-stay fees and other exclusive conduct, (v) category management and captains, and (vi) merger enforcement, insofar as it bears on retailers' possible acquisition of market power.

Identifying Issues but Not New Solutions

The underpinnings of the controversy surrounding slotting allowances and similar practices are familiar: Conduct may simultaneously lead to both procompetitive and anticompetitive effects, and the relative weight given to those effects depends heavily on the individual circumstances and may well have a subjective component (particularly when quantification is imperfect or non-existent). Those who see these practices as procompetitive emphasize that slotting allowances and related practices fund the introduction of new products to the marketplace and place the risks on manufactures (who are best positioned to bear them), thus encouraging entry and innovation. Those opposed to these practices, however, argue that they put the costs of entry beyond the reach of some manufacturers, and thereby deprive consumers of choice and price competition that they might otherwise enjoy. (For one FTC Commissioner's views about the potential emerging importance of evaluating effects on consumer choice in antitrust analysis, *see* Timothy B. Leary, *The Significance of Variety in Antitrust Analysis*, 68 Antitrust L.J. 1007 (2001) (forthcoming), available at http://www.ftc.gov/speeches/leary/atljva4.htm.)

Although the FTC report describes the issues at great length, it fails to shed any new light on how to resolve them in real-world applications. For instance, the report recognizes that slotting fee requirements could exclude manufacturers that are unable to pay them or could raise rivals' costs by denying them effective distribution (in terms of number of outlets or shelf space in particular stores), but then acknowledges that such concerns are of little importance if competition at the manufacturing level would remain healthy nonetheless. The report, however, simply falls back on existing, generalized approaches for analyzing potential exclusion and vertical restraints and offers no new approaches or refinements for analyzing slotting fees in particular. Accordingly, under the analysis in the report, because competition *could* be harmed, it is necessary to determine whether the particular practices could negatively affect prices, output, quality, innovation, or variety. If an anticompetitive effect is found, the next step is to determine whether the conduct has procompetitive benefits and is reasonably necessary to achieve them.

This proposed analysis breaks no new ground: It merely follows the basic outlines for all rule of reason analyses. Indeed, it is substantially similar to the analysis for slotting fees that the then-director of the Bureau of Competition proposed nearly ten years ago. (*See* Kevin J. Arquit, Antitrust Analysis of Slotting Allowances, Prepared Remarks before The National Grocer's Association (1991).) Insofar as the report considers harm to rivals falling short of total exclusion, it is patterned largely on Steven Salop's and Thomas Kratenmaker's seminal article on raising rivals' costs, published in 1986. (Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power Over Price*, 96 Yale. L.J. 209 (1986).) It also owes a great deal to the more recent effort by three senior FTC Bureau of Competition lawyers to refine further that theory of competitive harm. (Willard K.Tom, David A. Balto & Neil W. Averitt, *Anticompetitive Aspects of Market-Share Discounts and Other Incentives to Exclusive Dealing*, 67 Antitrust L.J. 615 (2000).)

More Study with Subpoenas to Come

As noted above, we believe the report's most significant legacy will be its recommendation that the Commission initiate one or more research projects to learn about the use of slotting allowances and similar marketing practices. In particular, the staff recommends that the Commission gather: (a) general information about slotting allowances and pay-to-stay fees (such as particular product categories for which they are used, frequency of use, magnitude, and efficiencies); (b) evidence about whether such allowances have excluded competing producers; and (c) evidence about whether supermarkets have acquired market power through mergers.

Most significantly, the report recommends that “[i]n order to avoid skewing the results of the study through self-selection by interview subjects and to obtain a more complete picture . . . . at least part of the inquiry be conducted using compulsory process.” The possibility of intensive investigations of specific manufacturers and retailers in the near future, including the issuance of subpoenas, is very real. Indeed, as the report notes, Congress has specifically earmarked funding to enable the FTC to investigate slotting allowances in the grocery industry.

Although the staff recommends that any subpoenas be drawn as narrowly as possible to reduce the burden on recipients, we believe that such subpoenas likely would, in fact, call for a vast array of information. For example, a subpoena to a large, multiproduct manufacturer could easily seek information for 100 or more of the manufacturer’s products. The FTC could request information about all discounts, slotting fees, pay-to-stay fees, rebates, and allowances by product and by retailer over an extended time period, in addition to data about sales by SKU by retailer. The subpoena might well also request infomation about actual, potential, and former competitors and the resources necessary to enter markets. Finally, the subpoena might seek information about the amount and quality of distribution needed to reach minimum viable and efficient scale.

Subpoenas to retailers could be even more detailed. They would likely seek information about payments the retailer receives that is similar to information sought from manufacturers about payments made. The subpoenas, however, would probably also call for information about the effects of payments on retail prices and service levels, both for the products with which payments are associated and other products the retailer sells. Responding to such a request would likely require production of extensive data on costs, retail prices, capital budgets, personnel, and so on.

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Although the report contributes little to resolving the controversy over slotting fees and similar practices, it makes clear that such practices will be a focus of FTC scrutiny going forward and likely the subject of subpoenas to selected manufacturers and retailers. Accordingly, parties that make or receive slotting fees or similar payments (or propose to do so) need to be particularly careful in evaluating their practices. If you have questions concerning the FTC's report or slotting fees and other marketing practices in general, please call us.

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