FEDERAL TRADE COMMISSION

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FEDERAL TRADE COMMISSION

In the Matter of:)
WORKSHOP ON SLOTTING ALLOWANCES.) Volume 2
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Room 432
Federal Trade Commission
6th Street and Pennsylvania
Ave., NW
Washington, D.C. 20580

The above-entitled matter came on for panel discussion pursuant to notice, at 8:30 a.m.

PANEL 2: POTENTIAL EFFECTS OF SLOTTING ALLOWANCES: CONCERNS OVER EXCLUSION AND EXCLUSIVE DEALING

PANEL 2 MODERATORS

DAVID BALTO, FTC

BILL COHEN, FTC

NEIL AVERITT, FTC

PANEL 2 GUESTS

SCOTT HANNAH (Pacific Valley Foods)

VICTOR THOMAS (Ahold)

KEVIN HADE (Ukrop's)

TOM STENZEL (UFFVA)

GREG SHAFFER (Economist)

JOHN EAGAN (Costco)

DAVID NICKILA (Portland French Bakery)

KAREN CARVER (Elan Natural Waters)

JACK MCMAHON (Gallant Greeting Cards)

PAMELA MILLS (Tortilla Industry Association)

GUS DOPPES (California Scents Air Fresheners)

MIKE WHINSTON (Economist)

GREG GUNDLACH (Marketing academic)

P R O C E E D I N G S

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MR. BALTO: We're going to start promptly at 8:30. I'm David Balto. This is day 2 of the slotting allowance workshop. Today we have a busy schedule. We start off with the panel on the question of exclusion. We follow with a panel on retailer market power.

Today's lunch, as I mentioned earlier, in the cafeteria on The Top of the Trade, 7th floor, is fried chicken with homemade potato salad.

Following that, we're going to have an interesting panel on category management and an exciting videotape to show you about how not to do category management, and that will be followed by a panel of expert lawyers and economists from all over the United States who are going to tell the FTC what they should do.

Let me start off with a couple of housekeeping notes. If you want materials from this conference or additional materials, it would be very helpful if you registered, and we have registration sheets out in the front. We are going to prepare copies of all of the handouts, including Professor Salop's paper, and they'll be ready for distribution sometime later on this morning.

I wanted to ask the panelists to try to be very careful about terminology. I heard yesterday a couple comments from people that we seem to be periodically confusing slotting allowances -- up front payments for new products -- with pay to stay.

So if you could try as much as possible, when you're using terminology that a layperson, someone who is not experienced in this field, may not be familiar with, please identify what you're talking about. Specifically when we're talking about slotting allowances, let's try to make it clear whether we're talking about something for new products or for incumbent products.

This morning we're starting off without a court reporter, so I want to emphasize as much as possible that when you speak, at least for this first panel, please identify your name before you speak, so the court reporter later can transcribe that.

In addition, we're accepting written comments. We've actually received one set of written comments, two sets of written comments, and those will be posted on our web site.

If you want to submit written comments, you have up until June 23 to do so.

With that, let's begin today's panel. Let me turn to my right. Neil Averitt is walking into the room, and Neil was the first person to introduce himself. Why don't we introduce ourselves counterclockwise beginning with Professor Whinston.

MR. WHINSTON: Michael Whinston, professor of economics, Northwestern University.

MR. STENZEL: I'm Tom Stenzel, president of United Fresh Fruit and Vegetable Association representing growers and shippers of fresh produce.

MR. HADE: Kevin Hade. I'm vice president, category management for Ukrop Supermarkets.

MR. GARMON: Hi. I'm Chris Garmon. I'm an economist here at the FTC.

MS. CARVER: Karen Carver. I'm the CEO and plant manager of Elan Natural Waters.

MR. MCMAHON: I'm Jack McMahon, president of Gallant Greetings, a greeting card publisher.

MR. THOMAS: I'm Victor Thomas from the Stop & Shop Supermarket Company.

MR. HANNAH: I'm Scott Hannah, CEO of Pacific Valley Foods. We're a processor of potato and vegetable products.

MR. GUNDLACH: I'm Greg Gundlach, professor of marketing, Mendoza College of Business at the University of Notre Dame.

MS. MILLS: Pamela Mills. I'm with the Tortilla Industry Association and also a tortilla manufacturer.

MR. TADA: Pierre Tada. I'm the chief executive officer of Limoneira Company. It's a produce grower, packer, shipper, and also involved in frozen food processing.

MR. FLICKINGER: Burt Flickinger. I teach in the food industry management program at Cornell University and St. Joseph's University, and work with a lot of independent retailers and small manufacturers and agricultural-based cooperatives.

MR. EAGAN: John Eagan, vice president, general merchandise manager, Costco Wholesale in Los Angeles.

MR. NICKILA: David Nickila, Portland French Baker, Portland, Oregon, a small wholesale variety baker.

MR. SHAFFER: Greg Shaffer. I'm at the William E. Simon Graduate School of Business, University of Rochester.

MR. COHEN: I'm Bill Cohen in policy planning here at the FTC.

MR. BALTO: And I'm David Balto. Let me remind you, the members of the panel, of the rules. I will call on people periodically to be recognized. Please place your name card up. We have a lot to do today, so please try to keep your answers relatively succinct.

By the way, if Gus Doppes is in the audience, we have a place assigned for you up here at the table next to Pam Mills.

Let me begin by calling on Karen Carver, Jack McMahon, Pam Mills and Pierre Tada and ask you to give the audience a view on how slotting allowances affect your ability to compete, your ability to enter into new markets, your ability to expand and innovate.

Why don't we start with Karen Carver.

MS. CARVER: Thank you. In our industry, which is of course the water industry, the slotting fees present a major stumbling block for us to enter into any large distribution network. We have had limited success in our regional area, but when you try to expand outside of that the up-front price of each SKU, depending on flavor and size and everything, it may be the same product, but you have the slotting issue for every single flavor and every single size.

So for us to get into a large supermarket, you're talking $50,000 or better up front, which we cannot provide because of the high outlay of capital which we just don't have.

MR. BALTO: Karen, what is the amount per SKU per store that you typically face?

MS. CARVER: Typically the amount has been $5,000 for each SKU in the markets that we've tried to go into. Some are lower. The smaller they are, of course the lower they are, but if you have a large distribution, then they want a larger amount up front.

MR. BALTO: Jack McMahon?

MR. MCMAHON: The greeting card industry is a 7 and a half billion dollar market with two majors having 80 percent of the market. It's a very fragmented market with some 800 publishers such as ourselves.

We ourselves have lost a few pieces of business because we did not give a slotting allowance, and one piece of business was $5 million for a five-year contract which we passed on, and we lost another one for a million dollars. It's a very competitive market and yet we would be in the top ten of the publishers in the industry.

MR. BALTO: Karen.

MS. MILLS: Pam.

MR. BALTO: Sorry, Pam Mills.

MS. MILLS: In the tortilla industry our company in particular has been in business for over 43 years, so we have had market share, consumer demand, product quality, pricing, all of the above, but what's happened now is that we're being squeezed off the shelves because the dominant manufacturer pays so much money.

As far as other type of markets such as box stores, we were in one. The dominant manufacturer came along and paid a lot of money, and we haven't been allowed in that store since.

MR. BALTO: So in your situation there are pay-to-stay fees?

MS. MILLS: Oh, yes, annually.

MR. BALTO: And approximately how much per SKU are they?

MS. MILLS: In the tortilla market, it's nothing like SKUs. It's basically you pay five, six digit numbers for an annual program.

MR. BALTO: Pierre?

MR. TADA: Yes. I'm in the fresh produce industry, and one of the challenges of the products we produce is there's a time limit on the product. So there's tremendous leverage from the retail side if the product can't be sold. So you either sell it or smell it in our business.

Anyway, yesterday was an alien world that was being described by some of the folks on the other end of the value chain. Let's be real. It isn't just slotting fees for new products. It's pay-to-stay, and it has a tremendous impact on small growers and shippers who cannot afford to pay or are faced with the hammer of smelling their product at the end of the day.

So it's a very different world from our perspective. There's huge leverage against suppliers, even more pressure on trade allowances, and a conscious effort of retailers to push all costs of doing business back on the supplier.

MR. COHEN: When you say pay-to-stay, how frequently are you paying? Annually?

MR. TADA: Well, I got together with a group of CEOs who were fearful of showing up at this meeting for fear of retribution, but it varies from annually to the whims of the other side of this value chain.

MR. BALTO: Mr. Tada, how do you find the trend of slotting allowances changing over the past five years?

MR. TADA: That was also an alien world that was described yesterday. It's gotten much more intensive. Let's face it, some of the retail models that exist today no longer work, as evidenced by some of the changes in the channels. There is a conscious effort by retailers to push back the cost of business back on to suppliers, so it's much more intensive, and even moving towards a traditionally light area which is in the fresh produce area.

The only thing that saved us is most of the products are sold in bulk supplies, and they move around beating down prices, and they don't really commit to a particular supplier.

MR. AVERITT: Could I ask the manufacturers to help us put this in context? We've been describing so far starting allowance in absolute terms -- how large are they or how much are they per SKU store. To assess their impact on your capital requirements, what percentage do they represent of the capital costs of bringing a new product to market? How big a factor are they in the calculation?

MR. HANNAH: Yeah.

MR. BALTO: Identify yourself.

MR. HANNAH: Scott Hannah, Pacific Valley Foods. Correct me if I am wrong, this is what I was referring to yesterday where you take like a market like Seattle, take 200,000 in slotting, 150 in media, 150,000 in trade promotion. Is this what you're referring to?

MR. AVERITT: Well, that's certainly a long way toward what I had in mind. I was wondering if you could think of this in the context of all of the costs of developing a new product and bringing it to market -- such as the cost of your research or of setting up whatever manufacturing facilities you need? How big an increment would this make to your capital costs?

MR. HANNAH: Then I would have to do a little calculating and I could reply later. I did a real quick calculation just taking 30 second. Take slotting allowances alone: 35,000 supermarkets in the United States, give or take, some say 33,000, at $150 a store, one item would be $4.2 million up-front cost, immediate payment, no cash flow. Four items would be typical. You're looking at $16.8 million, and that is ridiculous. I'll answer your other question and do a little calculation.

MR. AVERITT: Thank you.

MR. BALTO: Do any of the other manufacturers have a sense of the degree that slotting allowances increase your cost of entry? Have we been talking about 10 percent, 20 percent? Or is this not a meaningful way of looking at it?

MR. DOPPES: Gus Doppes from California Scents. I believe the slot, if you take nationwide distribution, it would be in excess of 50 percent of the cost of bringing a product to market.

MR. BALTO: Any other of the manufacturers have a view on that? Are your figures different? We're just dealing with ball park figures.

MR. COHEN: You base that on national distribution. What has been the experience of the manufacturers at the table of distribution at less than a national level? Is that an alternative?

MR. DOPPES: That depends what markets you're in. If you go to the California market, LA, or New York or what have you, it can be higher than that. If you go to your secondary markets where there's not as many of the major chain players, then your cost would be somewhat less.

MR. COHEN: I guess what I was getting at: Is it a reasonable alternative to bring a new product into a region or just a certain fraction of the stores, of chains, or must it be nationwide?

MR. DOPPES: Well, with limited capital, you're restricted to a limited geographic area then.

MR. BALTO: Well, let me follow up on Bill's question. Don Sussman from Ahold described a scenario yesterday where they're willing to take on a new product by sort of trying it out in a few stores, seeing if it succeeds and then basing their decision partially on that.

Now, is that something -- I'm asking the manufacturers, is that something that you've seen out in the marketplace? Are retailers willing to do that?

MR. DOPPES: It's a rarity. And the reason for that is it takes as much of their manpower and time to set up a test as it does it to do their entire chain. All businesses out there are so -- the employees are -- their time is maxed out, so even if upper management might have a goal to bring in some smaller businesses, by the time it filters down to the buyer level -- "we have to implement the programs" and all -- they don't have time to do it.

And it becomes more of a monumental pain for them to try to accomplish it than to deal with their regular suppliers, so you can find that in a rare exception, but it's extremely rare, just due to the constraints on everybody's business.

MR. BALTO: Pamela Mills?

MS. MILLS: It's been my experience in looking for new business, such as in the box store industry where there's high volume, that as a small manufacturer we are basically used as the pawn to ante up the stakes. Once you make your presentation, you show them what you have, which is not heavily invested with capital, they're not very interested, but they'll use you against your opponent to get them to achieve their goal, as more money.

MR. BALTO: Are there ever situations where a manufacturer pays slotting allowances, and there's some kind of fraud that occurs, such as you pay the slotting allowances up front and then the product isn't actually taken for the period of time? Burt Flickinger?

MR. FLICKINGER: Thank you. Hopefully this will provide some perspective because there are there are many opportunities in terms of retail distribution, supermarkets, mass, club, convenience. If you look at a number of the success stories that we've worked on, both through the universities and clients, all these folks are represented in categories at the table here. Krispy Kreme Donuts and Bakery, just not a lot of money to spend, had gone bankrupt a couple times because of bad management, no slotting fees, but through good new management and public relations went multi-regional and then went national, and supermarkets were a big part of it.

Zatarain's leveraged seven times out of New Orleans, multi-regional and then went national. They helped develop the water category in the United States over the last 25 years from San Pelegrino. Evian from a single restaurant, and Starbucks, Rich's, Sorrento, Freezer Queen, all these guys started through supermarkets and got the support. There wasn't a lot of slotting allowance, and then they wound up going national.

And it was a grass roots effort with sampling and a lot of offer things that really helped drive it, and supermarkets were the partners.

MR. BALTO: Thanks, Burt. We're going to get to the story from the other side of the table in a few minutes. I wanted to focus initially on the impact on manufacturers, but that was very helpful.

There was a scenario painted yesterday that manufacturers seem to be -- I'm sorry, retailers seem to be relatively willing to negotiate slotting allowances. Let me ask the manufacturers and producers again to what extent is that true in the marketplace, and has that changed over time? Yes, Karen Carver?

MS. CARVER: We have had some negotiations with the retailers. They are willing to negotiate within a certain realm. You wind up with basically the same payout. It may just take on a different form as in trade outs, or I don't know how to explain it, but you were talking about the issue of will they work with you on regional basis or with smaller numbers of stores.

And we have not experienced that. It's been either an all or nothing, and it's not only the grocery stores but the convenience store chains unless you go with a small mom and pop chain that may have five or six stores, and then they're more willing to work with you, but if you get into the regional areas, then they want an all or nothing clause.

MR. BALTO: Can I ask the other manufacturers what you find in terms of the willingness to negotiate? Pamela?

MS. MILLS: One of my buyers said basically -- I asked him if this was negotiable, and he said only up.

MR. BALTO: David Nickila, what's your experience in terms of your ability to negotiate slotting allowances?

MR. NICKILA: Fortunately for us we've only had one case of this, although it's coming on the horizon because we've got other letters from the manufacturers, from the grocers, saying that they're going to standardize basically the two free cases to get into a new store. The two free cases per SKU which I stated yesterday was $568 for the SKUs that we were putting in this store.

And throughout the whole year we couldn't recover that, and right now the sales are even below what it would take to recover that. But we have gotten two other letters from a couple of the other chains saying that if this isn't acceptable or if this isn't what you're going to accept, please let us know.

So we're starting to face it now, and it's something that in the perishable industry we haven't seen before.

Very possibly the larger bakeries in our area -- we're a bakery about $7 and a half million. The other bakers we compete against in the supermarkets are about $150 million on up to about $600 million, so we're not in the same arena with them and are not able to pay the costs that I'm sure that they're paying to some of the chains.

But like I said, as of now because of our size, we hadn't seen anything until just at the end of 1999. And that's the reason I'm here, because I am concerned. Mr. Burt Flickinger just stated that, yeah, these big companies started out with grocer cooperation, and I made myself a note, that's like the old days, and like I said this seems to be going away.

With all the consolidation of the chains and so forth, I don't believe that it's going to get any better. It's going to be more difficult for a small bakery, any small company to go to a grocer, try to get their cooperation and develop business and develop sales.

I think these details of the wonderful Starbucks and everything else are a thing of the past almost.

MR. FLICKINGER: The Krispy Kreme example is within the last year.

MR. BALTO: Scott Hannah?

MR. HANNAH: Right here.

MR. BALTO: Actually I meant Tom Stenzel on that. I was looking over at Tom.

MR. STENZEL: Thank you. Tom Stenzel. I would like to add a perspective from the fresh produce side of the business. The first thing I would say is that the retail community is not monolithic by any stretch of the imagination. What we're probably talking about are the most egregious abuses that occur because those kind of stick in the craw of producers and manufacturers.

From our industry perspective, we would agree with Professor Gundlach's analysis that the fresh perishable side is much more moderate in the use of slotting at this point, but we see it coming to the industry, not so much in a new product introduction capacity, but clearly this pay-to-stay arrangement that several people have mentioned.

Whether it's an annual or a seasonal type arrangement, it's -- we're just starting the California tree fruit and grape season coming on now. Those suppliers of fresh produce are being asked to make substantial up-front cash payments in order to have distribution. The problem several people mentioned is in a commodity program, an easily substitutable market, there are 50 different grape suppliers who are eligible to choose from on any given day, so basically they are often played one off against the other.

I think from the perishable standpoint we see a very different dynamic, and it's kind of a unique situation in terms of the easy substitutability of our products.

MR. BALTO: Let me turn to Scott Hannah.

MR. HANNAH: An answer to your first question for David: The negotiating has gone down over the past few years on slotting allowances. In the frozen food business we find little or no negotiating. I want to go back, I borrowed a calculator from my wife so I could calculate Neil Averitt's question on capital.

If you go into only the Seattle market, for example, and you come out with not just a new flavor but a product you put a lot of R&D into over a five-year period, we've spent approximately $200,000 in R&D, and adding up all the other capital costs, slotting allowance would be 30 percent of those capital costs in the Seattle market.

If you expand out into a region, your R&D costs of developing a product of course are fixed. You've already spend the $200,000, but your slotting allowances have gone up tenfold. You've gone into ten Seattle type markets, which would include LA which is like 7 or 8 percent of the U.S., so now slotting allowance is 50 percent of your capital costs.

Is that the answer you're looking for?

MR. AVERITT: That's very interesting. Thank you. Are there some further implications that could be drawn from those figures? Do those tend to indicate that slotting allowances would be greater or smaller as a hurdle for smaller businesses to overcome?

MR. HANNAH: A small business as opposed to a large business, corporate business?

MR. AVERITT: Exactly.

MR. HANNAH: Again, the only thought that I could make on that would be that the slotting allowances for a larger company could be spread I think over a broad base of products and would not have to be charged solely to those new products.

MR. AVERITT: Would that be affected by what percentage of the product lineup of any particular company consists of new products, and what part consisted of existing items?

MR. HANNAH: Could you rephrase that?

MR. AVERITT: Would small companies, companies in your position, tend to be introducing new products more frequently? Would they be a larger percentage of your product lineup, and would you therefore be looking at slotting allowances more often than --

MR. HANNAH: Now I understand, exactly. Yes. As a very small company, to develop your market and expand, you would be developing more products trying to get more space, so it would be a higher percentage if that's what you're looking for. You don't have that broad base that you either bought or acquired to absorb those costs, so it would be a higher percentage.

MR. BALTO: Mike Whinston?

MR. WHINSTON: Mike Whinston, Northwestern University. I just had a question to follow up some of the comments that are being made about negotiations. A lot of the comments so far have been suggesting that the slotting fees are difficult because of capital constraints; that is, they raise the cost of getting to market.

I'm wondering, in terms of negotiation, the answers so far seem to be about the levels of slotting. But to what extent is there an ability to negotiate in terms of, well, maybe I won't pay you as much or as high a slotting fee but I'll give you other, better terms -- terms that are better, lower wholesale price, more promotion, that would be easier on capital -- that is, that are more sort of out in-the-future expenses.

MR. BALTO: Any manufacturer? Identify yourself.

MS. CARVER: Karen Carver with Elan Natural Waters. To answer your question, we have tried that as our first ploy every time -- that we'll give you a better product at a lower price, which spreads out that up-front money over the life of however long you're in the store, and they're not interested. That is an absolute. They're just not interested.

MR. BALTO: Do other manufacturers have experiences similar to Pam Mills?

MS. MILLS: My experience is that my company came together with two other geographically located companies to have the ability to serve over 350 stores with direct service delivery. We came up with a private label program for this particular chain of stores where we basically did their private label selling that product at our cost. But in order for the program to be successful, we needed to have our branded label product accompany that product with at least two-thirds of the shelf space.

So basically the private label was one-third, and our branded label was one-third, and we serviced these stores five days a week DSD accompanied by promotional items, discounts, ad rebates, demos in the stores, recipes, I mean, the whole gamut, and then it came down to net, net, net, what was the bottom line per unit cost in the system.

It was very successful, but when the dominant manufacturer did not receive the program, they were very aggressive with the independent chains and went after them specifically at those specific chains, and therefore the program is dying, and it's not supported by this group that we had joined.

MR. BALTO: So what did the dominant manufacturer do to --

MS. MILLS: Because there are a lot of different chains involved in this one association, and he went to them singly, to their corporate headquarters, and offered a lot of money directly. Basically it diluted because they added more displays into the grocery stores. It diluted and stagnated our sales specifically on the private label which was at cost.

I mean, you can't get any cheaper than that, and therefore it just stifled our sales.

MR. COHEN: You keep referring to a dominant manufacturer. Are you talking about a situation where we're really talking about only one company being on the shelves with the slotting, or is there more than one brand still appearing?

MS. MILLS: Well, the dominant manufacturer basically gets whatever they want. They have basically taken over the industry in the last ten years. They're controlling over 80, 85 percent of the marketplace or more.

MR. BALTO: So in effect are they buying exclusivity through slotting allowances?

MS. MILLS: Oh, yes.

MR. BALTO: Are there specific exclusivity provisions that are tied to the slotting allowances?

MS. MILLS: Yes, yes.

MR. BALTO: Let me ask you a question: I want to try to distinguish between up front cash payments and other types of things. I don't know if it's appropriate to do that or not, but to a layperson, when you hear that somebody requires free goods up front, that sounds sort of procompetitive. Someone is bringing on a new product. They're requiring the manufacturer to provide them free goods. That enables the retailer to offer a special attractive low introductory price.

And it sounds like that's something where everybody should benefit, the manufacturer, the retailer and the consumer. Is that the case? Scott Hannah?

MR. HANNAH: Scott Hannah, Pacific Valley Foods. Whatever you describe it, it's still a horse. It doesn't make any difference whether you give them a check for $50,000 or ship them a truckload of product and they deduct $50,000 from the first invoice, which is free goods. I don't see the difference.

And then to answer Mike's question earlier, no, there's no negotiating whatsoever anymore as far as term payment. You're paying term payment. You're already in a negative cash flow for the first year or two years anyway on a new product, with your trade allowances, your media advertising, your extra quarterly promotions paid.

And the slotting allowances is cash up front, and at $9 billion a year collected by the retailer for slotting allowances cash up front, it's a heck of a cash cow, and that's it.

MR. BALTO: Burt Flickinger?

MR. FLICKINGER: Thank you. About your and Neil's collective points in terms of capital requirements for small suppliers, within the last 14 months, the way Zatarain's did it was they went through the "all other market" and Green Grocers and DotComs, and then as they paid slotting allowances to supermarkets, through their old manufacturing plant in

Louisiana, they were able to get better manufacturing line time efficiency. This increased profitability, which allowed them to expand market by market throughout the United States, and it required limited, very limited cap ex.

They were competing against what some people would consider dominant manufacturers, Uncle Ben's, Lipton, and Quaker Oats with Rice-A-Roni, and they still became the fastest growing product in the category and with very limited budget, but just a very good strategic business plan in terms of rolling out across the country.

MR. BALTO: Thank you. We'll pick up on that later. Let me go back to the manufacturers. Are there situations where manufacturers pay to have you placed in a disadvantageous shelf location? We heard yesterday that those kind of things don't occur. Pam Mills?

MS. MILLS: They occur all the time. In one of the box stores that I had a contract with, where they discontinued some , when I brought up my contract, we did have a physical contract, I said, We have three years and we were only at year two. Basically he wasn't happy with that, and he put us in -- only three feet in a corner, and the dominant manufacturer came in, took the majority of all our space.

And so we had to work that little three feet. Luckily it was in the same town, so we worked that space probably like three or four times a day to keep our sales up, so we had to work twice or doubly hard as anybody else because we only had a little three feet, but we were moving the product.

MR. BALTO: Is there some point where space becomes so disadvantageous it's just not worth serving the customer?

MS. MILLS: Yes.

MR. BALTO: What's that kind of situation?

MS. MILLS: Well, when you're reset. Because annually with the dominant manufacturer, they give their new program for the chain stores, and basically we get a letter, You're going to get a reset on this date and then they show you the schematic, and really it's not negotiable at that point.

You just have to flow with it, and you get reset on that date. And if you don't show up, they'll just basically put your product in a shopping cart, and you have to take the credits out of the store, and, yeah, then it's not cost effective to take a product to market.

MR. BALTO: Gus Doppes?

MR. DOPPES: David, could I address an issue two questions back that you brought up -- on whether slotting allowances do lower the price of the goods or the prices to the retailer?

The simple answer to that is, no, because as Don Sussman I believe said yesterday, the chains use slotting allowances as a profit center. I can't speak for all areas of the grocery store and the different categories within it, but like in the air freshener set, everybody has a certain category margin that they want to make out of the products on this shelf.

So if you come in and your product costs $1, they're going to figure whatever their mark up is and say it's going to be 1.50. The slotting allowance that you pay has no bearing on what the price of the product's going for be once it hits the shelves. It's apples and oranges, so what the manufacturer has to do is to build that slotting allowance into his cost of goods that he's selling to the grocery store, so now maybe that product that he's going to sell to the grocery store is 1.50, and it's going to hit the shelf at $2.

MR. BALTO: David Nickila?

MR. NICKILA: You asked about space and so forth. Yes, these things are purchased, and the major suppliers, they do take position and move you into a worse position. Along with that I'll give you one example, which we have with this one chain of stores.

If you were in a deli with our bakery products, most of the chains charge 10 to 30 cents an item, which is okay. I can understand that. It's in a nice traffic location. Everything else to up-charge our product over what we suggest with a margin of 25 percent is fine, and it's within their rights, and I don't have a problem with that.

But then when you get your position moved down, the dominant supplier puts in a secondary item at 99 cents. Now, here's an item that's a two pound loaf of bread almost. It's 99 cents where they take one of our items, which has a wholesale of 1.64, normal retail of 2.19, most of the grocers mark it up to about 2.29, 2.39, and they mark it up to 2.99.

Now, they've taken that -- one day they all of a sudden up-price all your products, and then right next to you they're running 99 cents on all the major player's products.

So you tell me, do you think there is anything to that, any basis to that, that they make money and take over space?

MR. AVERITT: Mr. Nickila, could you explain a little more how the decision process would work there?

To what degree were those decisions being made by the retailer, and to what extent were those decisions being made by the dominant manufacturer?

MR. NICKILA: Okay. The decisions were made obviously without any consulting of our firm. We just showed up one day, and as our routes went out they went to all this -- the stores in this chain -- and they found out this was the new strategy.

MR. BALTO: Greg Shaffer?

MR. SHAFFER: Yes, David, I wanted to comment on a point that was made a few minutes ago. The manufacturer might not care how the deal is structured for the retailer, so you could give the retailer a wholesale price break, free cases of the good or a slotting fee. But I think in terms of economic effects there's a distinction.

A lump sum payment doesn't translate into a bottom line price reduction for the consumer. If you give the retailer free cases, the only way the retailer can make money off of that is if it sells the goods. If you give the retailer lower wholesale price, again the only way the retailer can make money is if it sells the goods.

So in terms of the economic effects, while the manufacturer may not care about the mix of promotional package that the retailer wants, I think it does make a difference for the consumer, and the distinction has to do with whether the payment is a lump sum payment or whether it's a payment that's tied to volume.

There's a key distinction for the consumers so I just wanted to make a point that the consumer does care.

MR. BALTO: Scott Hannah?

MR. HANNAH: Yeah, I'm going to object to the point of slotting allowances as cash up front. It's not the same as free goods. Correct me if you made that statement.

The turnover of groceries in cases -- if you ship a truckload of groceries to a buyer, we're not talking about a three, four, five-week risk of sale. That product is usually turned within a week, sometimes three days in the frozen food business, so shipping a truckload of free goods or handing the guy a $50,000 check to me is identical and should not be confused.

MR. SHAFFER: It would be identical to you, but it may not be identical as far as the consumer's point of view. If you give the retailer an up front money, the retailer has no incentive to lower its price to try to sell more. It's got the money. It's a lump sum money. There's no marginal effect. There's no variable cost effect.

If you give free cases, the retailer has to move that. That has a potential of lowering prices for consumers, so it may no make any difference for you, but in terms of the consumer it may make a difference. That was all I was saying.

MR. HANNAH: Again I'm going to have to argue with you on that. It's an accounting thing, and I'll talk to you in private about that, but it has to do with receivables, payables, cash. To me it makes no difference whatsoever.

MR. NICKILA: Excuse me, Greg. I stated yesterday that we had this opening, and their basic policy was two free cases of every SKU. Well, you say that we're not providing them the two free cases. They just charged us the value of those two free cases for every SKU, took it out of our AR payment, so that's cash up front. That's not passing on the consumer.

MR. COHEN: Just returning one more time to the viewpoint and perspective of the manufacturer, is there anything special about the nature of slotting allowances and that type of payment, as opposed to other forms of possible support, which makes it difficult to raise the capital?

We often hear that the capital market should work, and if you have a good product, somebody should be there to provide the money. Is there anything about the slotting allowances that makes that difficult?

MR. BALTO: Scott Hannah?

MS. MILLS: I was on the Shaffer question.

MR. HANNAH: Neil, is this similar to what we talked about a little while ago, on the capital for slotting allowances or advertising with small companies?

MR. AVERITT: I don't know. I guess I had understood the most recent question to be slightly different, to be sort of more, Can you go to either banks for loans or to the equity markets? If you do, are the markets going to respond differently if you're there for slotting allowance money --

MR. HANNAH: This is a very key question and a very critical one for the survival of small business in that a small business has basically two sources of cash -- his own pocket (or his relatives' pockets or friends' pockets), or cash flow from the bank. And banks do not finance marketing in any way, shape or form.

They finance machinery, automobiles. They don't even like to finance your office building. They finance cash flow, so the answer is large corporations can float stock. They can float bonds. They've got many other sources of capital, and if you put out a new stock issue I'm sure the stockholders don't care whether that money goes to buy machinery or pay slotting allowances. Does that answer your question?

MR. COHEN: Uh-huh. Thank you.

MR. BALTO: Are banks less willing to pay for slotting allowances, or just all promotion money --

MR. HANNAH: Banks will not pay any marketing expenses, no advertising slotting allowances, and I'll tell you my bank is Bank of America. It's not some smaller bank. It's Bank of America, and it has not changed. I've been with other large banks. They will just not pay. I would like to hear from some of the other panelists, but they don't pay for marketing. I can't go to my bank and say, I want to open up Denver, it's going to cost $400,000, and here's the payout. They would say, That's nice, go ahead.

MR. BALTO: I would like to turn to some of the retailers. We've got Victor Thomas from Stop & Shop, Kevin Hade from Ukrop's and John Eagan from Costco.

Let me say at the beginning that one of the examples that people pointed to us, about the egregious nature of slotting allowances on consumer choice, was the fact that no place in Washington, D.C. could you find this salsa, Fred Imus Southwest Salsa. And true enough, you can't find it in the District of Columbia any place you go. But if you go to Boston to Stop & Shop, you'll find this all over the shelf.

So with that let me turn to Victor Thomas of Stop & Shop. Why don't you tell us how Stop & Shop tries to attract small manufacturers outside of the process of using slotting allowances.

MR. THOMAS: Thank you. Basically Stop & Shop, like other retailers I'm sure, recognized that it's a business imperative to bring in small manufacturers, local brokers, local grocers, local producers. In order for us to survive going forward, we have to have companies that recognize exactly what the neighborhoods in which they attract customers want.

We can no longer depend upon the Krafts, the General Mills and the Procter & Gambles to foster our business growth in total. Neighborhood marketing is basically where every single retailer is going to have to go. You have a diverse customer population. You have a diverse customer base in every single one of your markets, so therefore you have to go after some of these small manufacturers.

We created a supplier diversity process out of a business need. It wasn't because of anything that had to do with any pressure from any outside resources. Basically we're looking for those small manufacturers to come in and help us do a better job of marketing and merchandising to our consumers.

As a matter of fact, the president of our company, Bill Greiz (phonetic), didn't wait around for a process to be created. He said, Look, why don't we just invite 20 small suppliers to come in, invite them to meet with our category managers, let them get a chance to stand up, talk about their products, talk about their services, and talk about the advantages and the uniqueness that they can bring to our retailers.

MR. AVERITT: Mr. Thomas, could I ask you a couple of questions about how that plays out on the ground? One would be: What degree of flexibility does this give Stop & Shop? How finely can you chop your supply line? For what units of stores can you buy?

MR. THOMAS: We have a total of a little over 200 stores and across the markets in Connecticut, Massachusetts, Rhode Island, New York, and you have ethnic differences as well.

MR. AVERITT: I mean, could you buy for a group as small as 20 stores or as small as five stores?

MR. THOMAS: Yes, we can buy for one store. If there is a unique product -- as a matter of fact there's a product called a coffee syrup that you can only sell in Rhode Island. It's something unique to that area, and there are three or four stores in Rhode Island where the shelf has maybe eight facings of this coffee syrup where you can't sell it in any other location. So, yes, we can do it as small as one store or as large as 200 stores.

MR. AVERITT: I would think there's sort of two competing trends at work here. One is a trend toward supermarket consolidation, which might tend to make people look at bigger suppliers. The other is sort of a managerial and computer-competence trend towards more flexibility. How do those two balance out?

Clearly you've got the capacity to be flexible in some cases. What percentage of the whole do those cases represent?

MR. THOMAS: Well, basically it's forcing us to be better micro-marketers. It's forcing us to actually go out and find more manufacturers and more resources at the local level.

MR. AVERITT: And, for example, would you know right offhand what percentage of your SKUs go to less than all of your stores?

MR. THOMAS: Offhand I wouldn't know what percentage. I mean, we carry thousands of SKUs. I can tell you that out of the hundreds of suppliers that we have in our database, I deal with over a hundred that are small suppliers. They supply some of those SKUs that you're talking about.

MR. BALTO: Victor, can you give us a little more detail about the program? How long has it existed? How many manufacturers are you currently bringing in? How regularly do you have programs to meet with these small manufacturers?

MR. THOMAS: Okay. Informally it started, like I said, with this initial business summit. The first one was in July of 1999, where we just invited 20 suppliers to come in and make presentations. Out of those 20 we actually made business relationships with 11 of those. We followed up with a second one in January of 2000, in which we invited another 20, and out of those we brought in another 11.

We're going to follow up again in July, and basically this summit is something that these manufacturers kind of got together and said, Can we come in and do a -- in the retail industry it's called a cutting, but it's basically a tasting. They want to come in and actually serve these products to our category managers, our senior management, and let them really try to the products and kind of get their opinions and get up and kind of talk about how well their business is doing at Stop & Shop.

The next summit is going to be in October. Actually the Connecticut Supplier Diversity Council is putting this together for us. They're going out and actually finding 12 suppliers that would like to come in and make presentations to Stop & Shop that are not doing business with Stop & Shop. And we're going to do that with the Massachusetts Supplier Development Council. We're going to do that with Rhode Island. We're also going to do that with New Jersey as well. So we're just going to go into each one of these markets and say, Look, our doors are open, come in, make a presentation. If you have a unique product we would like to talk to you about doing some business with us.

MR. BALTO: Do your competitors have programs like these?

MR. THOMAS: There are other retailers that have similar programs. I don't think they go to the level of Stop & Shop, but yes, there are other competitors. Wal-Mart has one. Target has one. HEB has one, to just name a few.

MR. BALTO: Outside of your program, what's your experience with the willingness to negotiate on the amount of slotting allowances?

MR. THOMAS: Actually, to tell you the truth we haven't talked about it. We talk about slotting in the context of they've asked me, What is slotting? Half of them don't know what slotting is when they first walk into our doors.

MR. BALTO: Half of the manufacturers?

MR. THOMAS: Half of the manufacturers or half of these small suppliers. The other half basically knew about slotting, when they asked the question, Well, okay, now we get to the point of how much is this going to cost me?

That's not even a consideration in my mind. What you need to do is come to the table with a unique product or a unique service, come to the table with something different. Slotting is not something that we discuss as far as whether it determines whether you get on the shelf or not.

MR. BALTO: Do you require some of these other things like free SKUs or a certain amount of up front product that's free?

MR. THOMAS: It's not a requirement. The requirement is that you're 51 percent minority owned.

MR. BALTO: Do you also have this for non-minority businesses?

MR. THOMAS: Yes. As a matter of fact we do business with over 80 local produce growers at Stop & Shop. 17 of those are either women or minority owned. The others are not. There's no slotting involved.

MR. BALTO: Let me turn to Kevin Hade who described the situation in Richmond at Ukrop.

MR. HADE: Thank you, Dave. Kevin Hade with Ukrop's Supermarket. I would first like to compliment what Victor is doing at Stop & Shop. It's probably an exception for a larger chain to be thinking that progressively. However, from an independent's standpoint, this is really how we do business.

I think, as a small local chain for 63 years, kind of how we differentiate ourselves from the large national chains is by providing additional variety to our customers and working closely with the local suppliers. If you date our organization back to the '30s and '40s probably it was primarily with local farmers thinking along those lines.

And of course as goods have become more sophisticated and packaged, we have small manufacturing businesses that pop up in our state, and we work very closely with all of them to put the product on the shelf. We actually can play a vital role in their long-term success by giving them that inroad or opportunity, whether we work them chainwide in our 27 stores or just in a handful of stores.

But consumers coming in, getting used to getting the products, then all of a sudden our competition sees that someone's buying that particular product, and all of a sudden it's showing up in other stores as well. It can be a very positive situation.

I can think of an example -- a Mrs. Fearnough's Brunswick stew product. I don't know if all of you are familiar with that, but it's a locally manufactured product. We started carrying it, and in Richmond it's a phenomenon. It's a very popular item in almost everyone's cupboards, and soon it actually grew out of the region even up here into the Maryland-Washington, D.C. area, so we've been very progressive in that area.

MR. BALTO: For these types of manufacturers, do you require slotting allowances or do you require other things such as a certain amount of free goods?

MR. HADE: No, we don't. And in fact, I would take it the other way. In some cases we're even investing in them to help them. Again we think this is a vital differentiation point for us as an independent retailer, a family-owned business, and we can't be Wal-Mart. We know that, but what we can be, we can understand our consumers and our marketplace. We know what they want. We know the people that live and work in our community and shop our stores.

And we think it's good business to help small manufacturers get started. In some cases I think the owners of our company have bent over backwards almost, to link small companies with the appropriate distribution channels or the appropriate consulting advice to help them get started, to take the unnecessary costs out of their business. I think it's something we've always done.

MR. BALTO: To get to the other side of the spectrum, let me turn to John Eagan of Costco.

MR. EAGAN: In the beginning of the club business, it was almost an imperative that we seeked out these small manufacturers. The supermarkets put a lot of pressure on the grocery industry as a whole, the larger manufacturers, to keep us out of products, so we encourage the small manufacturers to find unique items.

And the way we categorize items, or the way our selection process goes, is it has to have quality and it has to be a unique item to get in, first of all. Second of all, we look at what are they going to supply us -- to adequate supplies. And then the prices are considered.

We go so far now it's become part of our culture, we're seeking out these small manufacturers, these unique items. If we find a particular item in a restaurant that we visit or whatever, we will go and approach them to see if they can package it. We'll help them with the packaging. We'll help them with the manufacturing where we can. We'll give them manufacturers that we're aware of that do a quality job if they need a copacker.

In my California region -- Hawaii is part of that -- we have sought out probably 30 or 40 local manufacturers in Hawaii that service just one or two or four buildings over there, and we do it as part of the culture. It's ongoing.

And the fees, we really don't require any fees. We just want the best price that they can give us. To get these things started, demos in the club business is a big part of our business, and the tasting is almost required. If the manufacturer can't afford it, we do it ourselves. I'll pay for it.

MR. AVERITT: Could I get the views of the manufacturers on the points that were just raised?

MR. BALTO: Let's hold that question for just a minute. I wanted to turn to Burt Flickinger. One of the things that we've been interested in are stories where small manufacturers have been able to get to market successfully in spite of or with slotting allowances, and Burt had a couple stories that he wanted to relate to us.

MR. FLICKINGER: Thank you, David, and thank you, Neil, both.

Small manufacturers have worked very successfully through the State Boards of Agriculture and through the teaching universities, for example through Professor Anderson at Cornell University, and CoBank, which is the national cooperative bank for the grower producers. They've worked in New York state with the State Department of Ag, with Bruce Friedman in going to Topps, going to Price Shopper or going to Wegmann, setting up farmer cooperatives, and it's to the Ukrop's point that you need the farmer to be a successful point of differentiation.

And slotting is not a requirement because if you look at the average supermarket doing $5 million a year, the average Costco is doing $90 to a hundred million a year per store, 60 percent food, the new Wal-Mart Super Centers doing $65 million a year. You need the fresh new innovative product. You need the variety. You need the small suppliers to be successful and get consumer continuity and demand.

The Pennsylvania State Department of Agriculture is working very successfully through St. Joseph's

University in creating partnerships with Weiss and Acme and the independent supermarket chains supplied through wholesalers as well as the major chains and the other big box retailers.

And that type of cooperative partnership between the states, the universities and the chains has produced a number of farmer's markets and stimulated a tremendous amount of incremental business for the small business growers.

MR. BALTO: Okay. Go ahead.

MR. AVERITT: Let me see if some of those examples can be generalized or to what degree they can be generalized. We've just heard from several retailers, who appear to be particularly responsible retailers, indicating that they can provide small manufacturers with ways of bringing new products to market without large up-front capital requirements.

The small manufacturers can start evidently with a limited cluster of stores, and if the products work well, they can roll out from there.

What I would like to do would be to get the views of the manufacturers here as to how common an experience that would be. We've heard from some very responsive retailers. What about retailers generally? Do they show a corresponding willingness to buy for limited clusters of stores and allow you to roll out from there?

MR. BALTO: David Nickila?

MR. NICKILA: Yes, I want to address what John Eagan said from Costco. I've got to applaud Costco. I'm not here to endorse anybody per se, but when we started in 1985, Costco was one of our first two accounts. We had a chain of stores we delivered fresh bread to twice a day to get started, and then we asked Costco if we could get in there and showing them a 12 ounce baguette, and they said, no, you have to tape two of them together and we'll put it in the store.

But they showed that willingness to help the small guy from the very beginning. The buyer's name was Ed Dwyer. I'll always remember what he said, and this comes up about once a year, If you're not going to sell it here, you're not going to sell it anywhere.

But the main thing I want to say is that in 15 years, if we have price protection on an item and everything else, they pass it on to the consumer. They have not changed one iota, and I'll tell you what, some things are the same.

And to go along with that I also want to mention the fact that, when you look at an example like Costco, they really helped us when we got started, we try to do the same thing. We try to hold our pricing and keep the lowest price for the consumer that we can. We talk about we haven't had to face any of these major costs yet. They might be on the horizon, but we don't take pricing.

I'll tell you what we try to take and if things -- we've had gasoline skyrocket and everything else. We haven't taken any pricing. Many of the major bakeries look at any reason to raise prices, and they're obviously paying some other things that we're not paying.

We've tried to hold the line with efficiencies. And like I said I don't know if our 95 employees can get much more efficient, so we may have to take a price increase. We haven't taken one for three years, and the one prior to that was about four years, and like I said we've been that stable, and it's because we believe that we're trying to provide the best quality and service for the consumer, and we've been able to hold it up to this point.

But I want to say it's great to see a relationship that hasn't changed in 15 years.

MR. COHEN: I would like to throw this out to the manufacturers in general. We can talk about slotting allowances as payments to get your products on the shelves. I'm interested now in shifting to your experiences where you've come across payments in your brands being demanded, or being made, as a means of keeping others from having their products on the shelves. In other words, where you're buying not just your position on the shelf but you're buying exclusivity there. If not 100 percent, a percentage of exclusivity or a fixed, limited shelf space for your competitors.

What's been the experience in your various businesses?

MR. DOPPES: In the air freshener business, on the household side you don't see that. It's very prevalent on the automotive side of the air freshener business where companies are paying the retailers to have the exclusive right of the section, and we're not talking one or two SKUs. We're talking maybe 120, 130 SKUs where the dominant players will pay large amounts of money to keep everybody else out.

MR. AVERITT: Is the air freshener business one where in the absence of that kind of payment a retailer would normally want to have more than one manufacturer, or is it like some other products where maybe they want only a single supplier?

MR. DOPPES: Well, the household side of the business on air fresheners drives the business, and that's where the majority of the business is done, probably 70 percent of it. If it made economic sense, it would be done on the household side, but it's not, because there's so many products out there that generate large volumes of dollars that it just would not make sense for retailers just to have one household supplier.

The same is true on the automotive side, where the section would generate more money with three or four companies in there. But due to the cash payments that a few of manufacturers are making, they're getting the exclusivity, and the professor from Georgetown addressed it yesterday when he was talking about these large payments to stay in, and that's exactly what's happening.

MR. BALTO: Scott Hannah?

MR. HANNAH: This is to Bill's question again. Frozen food, frozen vegetables, frozen potato products, yes, you do have to maintain a level of trade payment as far as trade promotion, advertising, displays, TPRs, not necessarily to make the product move.

Some of your products are in the middle third, dividing a whole velocity up to the top third, middle third, bottom third. Take a product in the middle third. You can get into trouble if you don't commit to a quarterly amount of money that will go towards displays, outside displays, trade ads, shelf talkers, whatever. I'll get into the more serious nature of that when we talk about category management later, but I think that answers your question.

MR. BALTO: Tom Stenzel?

MR. STENZEL: Thank you. I really feel the need to go back to the concept of more than just access to the stores. I think the examples that were given were very good and accurate, but we're talking about many of the products that are already in the stores and then the demands that are placed on them. With all due respect to Burt Flickinger's comments, we're not talking about the six-week summer season for local tomatoes here. We're talking about 20, 30, 40 truckloads of tomatoes every week going into the store.

And I would ask the panel -- I want to give you three real examples that have occurred in the past year. One, a northeast chain that opened a new warehouse distribution center and then back-billed all of its suppliers their pro rata portion of the cost of construction.

The second example being another, different chain that was opening 20 to 25 new stores in this past year and sent a letter, Dear valued supplier, we're going to deduct $500 per store from your accounts because of the 20 to 25 new stores.

The third being most recently this fall in southern California, a remerchandising instance where the company through acquisition was merging several different formats and again charged a direct cash payment to all of its vendors in a form letter, Dear valued supplier.

Now, from our industry standpoint, again we're easily substitutable. When a produce company who may be in the market and have been a valued supplier says, No, I'm sorry, I'm not going to pay the $500 per store, they are moved out the next week, and with very little ability to negotiate. I do want to get that back on the table.

MR. BALTO: Pam Mills?

MS. MILLS: Can I add to that? Whether you want to pay it or not, they take it off your receivables.

MR. BALTO: Did somebody else want to comment on Tom's comment, because I want to push back on it.

I understand that this doesn't look particularly fair from the perspective of the manufacturer or the producer, but what we are concerned with from an antitrust perspective are things that harm competition and that will ultimately result in higher prices.

Why does it make any difference if a chain goes and sort of says, I want this pocket of money just because today's Sunday, versus they're just being harder in negotiating with you and just saying, Okay, instead of paying so much per bushel, I'm going to pay a dollar less a bushel?

Why does that make a difference to consumers here?

MR. TADA: Well, if anyone believes that pushing these costs back on the suppliers does not increase the potential for consumer prices going up is living on a different planet, because we're able to deliver product based upon our costs. In our view, it's one thing to have some of these allowances -- we call it a bucket of allowances, and you can call it whatever you want. Some of it is up front and some of it is back end and some of it is because it's Mother's Day.

Anyway, we feel that a lot of this is very arbitrary. Charge what the traffic will bear. It is unrelated to costs. It's prohibitively expensive for small companies. It stifles innovation, inhibits competition. It favors the big over the small, let's face it, and there is no accountability.

Does anybody here have real accountable, reliable information about what's really going on here?

I think the answer would be no because it is lost in the bookkeeping, but I think the main argument from an antitrust standpoint is it does stifle competition and increases prices to the consumer.

And the folks who are really at issue aren't the folks who are at the table today. I mean, think about Price Costco -- very innovative -- or Stop & Shop. The folks that are really at issue are not at the table today, and I think that's the point, and the folks who are most impacted by it are not at the table today for fear of being seen here.

So I'll just rest my comments there.

MR. BALTO: By the way, all those folks were invited. I want to come back to the competitive effects on entry and innovation, but I first wanted to break and give Mike Whinston, who's a very well thought-of professor at Northwestern University, a chance to make some remarks to us about how we should look at exclusivity. Then we'll tie that back in at the end with questions on entry and innovation.

Why don't you go up to the podium?

MR. WHINSTON: Thanks. David asked me to comment on the issue of exclusive dealing and exclusion, as well as more generally on some of what we've heard yesterday and today. My remarks will cover five topics.

The first is the question of what we mean by the word "exclusionary." Here I think it's important to distinguish between the common meaning of the word exclusionary and the usual antitrust meaning. Some of this has been coming up just recently in the discussion.

For example, consider an industry that requires a certain input for production. Suppose also that this input is very expensive. Then in common parlance, we might say that this high cost or the high cost of this input is exclusionary. Some potential sellers may find that it's unprofitable to be in the market because of the high cost of the input, but this differs from the usual antitrust meaning of the term, by which we mean practices employed by a dominant seller that serve to reduce competition from rivals.

This is not to say that public policy might not improve on the market outcome in the case of an expensive input. For example, the high price might be because of market power in the input market. But at least the usual policy approaches to such things come in the form of merger policy and price fixing enforcement rather than in monopolization cases.

The second topic concerns the need to consider the whole range of the deal. By that I mean as opposed to focusing on just one term of the deal, namely an up front fee or a slotting allowance.

The first reason concerns what exactly it is that may be exclusionary. For example, one might be led to say in a certain circumstance that high slotting fees are exclusionary when, in fact, it may actually be some other aspect of the deal that is exclusionary. For example, there may be an explicit exclusionary term, and the high slotting fee may actually just be the payment that's being made in return for this exclusion being provided.

The second reason concerns the effects of prohibiting a given practice. For example, in this instance where there's an exclusionary term and a high slotting fee is a payment for it, what would be the impact of saying you can't have slotting fees? Well, it may be that eliminating slotting fees actually has no effect on exclusionary conduct and the likelihood of exclusion because other payments may be substituted in response to an elimination of a slotting fee.

The payment may come in other forms -- for example, an annual payment. To take it to an extreme, an annual payment plus a termination fee is actually exactly equivalent to a slotting fee, okay? So it's important, I think, to consider the whole range of what the relationships are, the contractual relationships, whether implicit or explicit, between manufacturers and the retailer in thinking about these issues.

The third topic concerns the theory of exclusionary contracts. I think Steve Salop gave a very nice introduction to this yesterday, and here I want to just expand on his remarks in two directions.

The first concerns what kinds of exclusionary provisions we might see. In the purest form, of course, we might see a pure exclusionary term that says that a retailer, for example, won't carry the products at all of a manufacturer's rivals.

More generally, though, I think we can usefully divide provisions into two groups. First, a firm's contract conditions only on what it gets. For example, the firm might require a certain number of linear feet of display space or a certain number of aisle caps. In the second group, the contract conditions directly on what rivals get. We started talking about this a little bit earlier in this session.

One example, of course, is a pure exclusionary term, but other examples might include lower prices that are conditioned on the retailer achieving a certain share of category sales or the retailer providing a certain share of display space in the category to the manufacturer.

To the extent that you're paying for high market share, you're also paying to reduce the amount that your rivals are getting, because one way to have a high market share is not to give you more but to reduce what your rivals have.

I think in general we expect the first type of arrangement to be less effective at securing exclusion. For example, suppose that the first type is used, that is something that just buys a certain amount of space by a dominant firm in, say, laundry detergent. So this laundry detergent manufacturer might require that he gets a certain number of aisle caps at a certain amount of space.

In principle the rivals of this laundry detergent manufacturer then are free to, in a sense, buy space away from toilet paper or napkins. That is, there's lot of other space in the store that in principle could be reduced in order to increase the amount to these other manufacturers.

And that's why in a sense conditioning directly on what rivals are getting is much more effective at securing exclusion than is just buying a total amount of space.

Now, there are some exceptions, of course. In some cases there's special placement that's required for these rivals, so, for example, it may be a product that requires space at a checkout counter which may be very limited. If you buy that space there's no ready substitute. And yesterday we actually heard about dairy cases. You can't put your milk in, outside of a refrigerated case, and so at least in the short run that may be a constraint.

But I think actually the milk example kind of reinforces this idea of substitution because the one thing we heard yesterday was that supermarkets, because dairy products are selling a lot are trying to expand that space as fast as they can. That's really just a reflection of this idea of substitution.

So the second direction related to Steve's comments concerns what conditions permit such exclusionary practices to be successfully employed. Here Steve raised an important question which helps in guiding our thoughts. That is, why would retailers participate in creating a monopoly supplier? Answering this question I think can provide some guide to what conditions we might look for.

Steve's answer was that "preserving competition is a public good." Another way to put this is that retailers' decisions about exclusivity may in some cases have external effects on other retailers by affecting the level of competition that these other retailers face, and these effects may not be taken into account when the initial retailer agrees to an exclusivity provision. So in what kinds of situations might this be so?

Well, one example might be where economies of scale exist in production and distribution. For example, suppose you have to achieve a certain amount of sales to recover fixed costs of supply in a certain market or a certain region, and if a dominant manufacturer can secure a high enough fraction of outlets, it may not be profitable for you any more to be in the market or to consider entering the market.

That would be one example where a given retailer's decision to accept an exclusive, reduces the level of competition that other retailers are likely to face, and so that initial retailer may not worry about it, and so it may be easier for a manufacturer to be successful in this case.

Of course, another example of something like economies of scale exists on the demand side, which would be network effects. We've seen examples of that in a recent high profile antitrust proceeding.

As another example, we might have situations where reduction in available distribution curtails R&D development; that is, if you can't have distribution, maybe it's not worthwhile to develop better tortilla chips or another similar product.

Finally, a third example might be a situation involving brand loyalty, meaning shifts in share today can alter competitiveness tomorrow. For example, if I can reduce the amount of sales you have today, because of consumers tending to stick with things they have at tried and liked, maybe if I can get a high market share today, that may weaken my competitors tomorrow, and that may be a valuable thing.

Now some comments regarding these examples. The first thing is a critical issue in all of this, and that is how many outlets are really necessary for effective distribution. It depends a lot on the structure of the retail market. Is it enough to be in one or two stores, or do you really need to be in many stores in order to effectively distribute your products?

Second, even when these conditions exist, whether exclusivity arises will depend on part on the loss to the retailer due to reduced variety. It will be a balance between this loss to the retailer which would involve reduced variety, not having the profits on the product that's excluded as well as whatever effect the retailer considers reduced competition, against this gain to the manufacturer which includes both present sales and the future value of increased market power.

Generally we might expect that the less you have to buy, the fewer exclusives you really need to reduce competition. Also, as the retailer sector becomes more fragmented, the less the retailers consider this competition-reducing effect.

So I think just as an aside, merger policy enforcement at the retail level may be very good for reducing levels of charges -- reducing the cost of space per se -- but actually may go the other direction in terms of how easy it is for manufacturers to exclude rivals.

Finally, Steve mentioned the difference between short-term and long-run exclusive dealing contracts. And if you think about these examples, you'll see that the effectiveness of short-run versus long-run contracts may depend on the setting.

So, for example, in the brand loyalty case, even a series of short run contracts might be quite effective at increasing market power.

Finally two final but brief topics. I haven't mentioned efficiencies. Although I won't have time to expand on them here, I do want to note that there are a number of efficiency-based motivations for exclusive relationships, each of which has its own particular set of conditions under which it may operate.

And the final point is about the empirical evidence on exclusive contracts. A lot has been said both by Steve and myself about the theory, and that is at least moderately well developed, but empirical knowledge is really much less far along. In this regard I think it parallels our limited empirical knowledge about slotting practices, which has been discussed yesterday, and about vertical contracting practices more generally.

And I think sessions such as these as well as more scientific statistical studies are really very much needed in the area.

Thanks.

MR. BALTO: Thank you, Professor Whinston. Let me try to pick up on some of the questions that he's posed for us. By the way, at the end of this panel everybody will have a chance to add in any additional comments or pose any questions for us.

Is it the experience of the manufacturers and the producers that the trend towards consolidation is exacerbating the problem with slotting allowances? Pam

Mills?

MS. MILLS: Yes.

MR. BALTO: Does anybody have any examples along those lines?

MS. MILLS: I have an example. I don't want to say chains or anything, but we were in this one store for like 40 years, and when the consolidation happened and they had to buy the store that we were in for 40 years from another chain, basically we had to pay to stay, like new product introduction. And they're the new kids on the block, we weren't.

So that's a prime example. And the dominant manufacturer got the larger space too, and they had never been in that store, ever.

MR. BALTO: Any other examples? Scott Hannah?

MR. HANNAH: We had a similar type case where we had an item that was doing well, well being in the middle third of the velocity by a local chain, and the merger required a higher slotting allowance and/or discontinuance. We weren't up to the additional slotting at the time, so we had to walk away, lost the product.

MR. BALTO: Now, one of the questions that both Professors Whinston and Salop touched on are the costs you might incur in entering into a new market. You might not be able to enter a new product just in a relatively few stores, perhaps because of the cost of distribution or the cost of advertising, so you have to enter in a big way. Exclusivity provisions could serve as a significant impediment in that type of situation.

Do any of you have experience on this issue?

MS. MILLS: What I can say is that because of this new store that came into our market, I learned a whole new bag of tricks. Basically it kind of educated me to the new verbiage of rebates and percentage rebates, and it was just an incredible new verbiage I had never experienced before.

But bottom line is it's money in their pocket versus the manufacturers.

MR. BALTO: Besides price concerns, we're also concerned about the impact on choice or the impact on innovation. Again to the manufacturers and producers, what's the impact of slotting allowances on your incentives to innovate or your sense of product diversity in the categories that you're familiar with? Scott?

MR. HANNAH: Okay. The case scenario -- I have to admit we copied the idea from a company in the midwest, they're not in the West Coast -- was to leave some of the potato peel on the shredded hash brown, very simple. We sell a shredded hash brown that's in the top third, and the idea was to leave a little bit of potato peel on it, increase the vitamin content by triple.

It was a very minor change, but it would have required a whole new slotting allowance just to make that change in the same slot, so that's an idea where innovation is killed. The consumer loses. We lose. Everybody loses.

MR. BALTO: Pam, would you like to add to that?

MS. MILLS: I can add to that. Due to the recent resets different chains have placed us on, I had a product that I was actually developing, and I have artwork that's sitting there pending. I have a new product that I came out with, but since I'm limited to unlivable space, quote, unquote, of inches, I don't see the sense in putting the new product in. You follow the 80/20 rule. You put 20 percent of your product that gives you 80 percent of the return.

So basically you put your best foot forward, and you eliminate the choices to the consumer because I'm only limited to inches now, so I've had to take products off the marketplace, and I'm sure brand X was very happy about that.

MR. AVERITT: We've been talking so far mainly about supermarkets as the preferred outlet. Could we spend just a moment and consider alternative outlets? For example, Jack McMahon is in the line of business where evidently a lot of retailers will want to have only one supplier for greeting cards. I understood you to say earlier that they'll put that up for bid, and sometimes the bidding becomes awfully rich.

MR. MCMAHON: Right.

MR. AVERITT: If that happens, how easy or how difficult is it to find alternative outlets that are within your capital budget?

MR. MCMAHON: Well, there are a lot of new retailers coming out every day, but actually the small retailer really basically would receive no benefit. When I say no benefit, I mean no slotting allowance. The consumer does not benefit at all. Basically just the manufacturer benefits if you're not paying out any slotting allowances.

But for us to pay a slotting allowance, which we do not, it would have to be for a large chain. The small little retailer, five or six stores, would not benefit at all.

MR. AVERITT: But is this sufficient for you to remain a competitive presence in the market with these other opportunities?

MR. MCMAHON: Yes, because it's increased sales. You're always looking for increased sales certainly, but we find basically as far as the manufacturer, for slotting allowances, all we do is decrease our profits. It hasn't increased our profits. It may increase it from the standpoint of volume, yes.

MR. BALTO: What's the impact on prices?

MR. MCMAHON: Prices haven't changed. In our industry prices have been published, and they haven't changed in years, whether it's a 1.75 to 2.50 card.

MR. BALTO: Okay. Victor, to what extent is Stop & Shop sort of out there sad and lonely being the one innovative company that's seeking out small manufacturers and has a special minority advancement program? Or to what extent are there other retailers who are doing the same thing?

MR. THOMAS: There are other retailers doing it, although like I said they're probably not to the level where Stop & Shop is. We're certainly not sad about that. It puts us at a slight advantage. But again there are other retailers, and I think that retailers are becoming a lot more savvy, a lot more progressive and a lot smarter about doing business. I would hope that they would start to recognize that very quickly.

The demographics are changing so that they are going to have to.

MR. BALTO: Burt, you've been sitting there patiently.

MR. FLICKINGER: Yes, I would just like to thank you. I would like to complement what Victor Thomas and Professor Whinston said, that the chains that are inclusionary, as Professor Whinston said, have a strong competitive advantage. If you look at the chains with the highest dollars per square foot and the highest sales per store, specifically Pathmark, Stop & Shop, and H.E. Butt Company in Texas, they have the greatest amount of variety.

And if you look at the supermarket chains, they're now facing seven major channels to the consumer Neil's point is that there are many alternate forms of distribution, 24 hour food and pharmacy for all five major drug chains, that's new. Convenience stores are now convenience supermarkets.

Super Centers are new. Mass merchants, 40 percent of what they sell are items sold in supermarkets. Club stores, 60 to 65 percent of what they sell are items sold in supermarkets. Hard discounters, Aldy and Save-a-Lot and the supermarkets, accommodate the small suppliers and have increased the size of their store from 20,000 square feet on the average 25 years ago to today 35,000 square feet because there are 25,000 new items being introduced today versus one to two thousand 25 years ago. So they're taking on all the small suppliers, adding more variety to Professor Whinston's point about being exclusionary.

And in addition to that, there's the all other markets. Suppliers have tremendous opportunities. To Tom's point, we're not talking about the growing season. Mayor Brothers in Orchard Park, New York, a small apple grower, worked with Topps and the other major supermarket chains from cider to apple juice to bottled water, a category which now has 400 SKUs, highly competitive, but lots of opportunities.

Thank you.

MR. BALTO: Thanks.

MR. COHEN: One question for Professor Whinston. In your work on exclusive dealing, I would like to try to focus you on what you've done in thinking about anti-competitive effects. In particular situations it's pretty easy to determine an anti-competitive effect. They're difficult in their own right, but if it's price, we're familiar with dealing with that. But what if our concern is with variety and the exclusion's effect is to remove from the market one of the possible sources of variety?

How would you go about getting a handle on when this rises to the level of competitive concern?

MR. WHINSTON: I think it's a tough question. I agree about your comment about price. It isn't always the case that price rises. Take one example unrelated to the present case, like pharmaceuticals. When a generic comes in, often the branded price actually goes up. Suppose a pharmaceutical manufacturer could keep the generic out, it might actually price lower because it wasn't going to price to a small segment of the market anymore. It was going to price to everyone that was there.

But nonetheless we think keeping the generic entry is very important for welfare in a generalized sense because we're losing variety -- the variety being a low price in the case of a generic, variety in a sense of people who don't care as much about a brand name.

So I think it is a significant concern. In principle, we know how to measure welfare effects. The difficulty is actually considering what is the welfare loss from the loss of variety, and in distinguishing that from efficiency reasons that exclusives may be used.

MR. BALTO: Kevin Hade?

MR. HADE: We were talking about the role of helping small manufacturers, just to tag on to what

Victor was saying. It strikes me -- representing a retailer here today and listening to the plight of some of the manufacturers that are represented here at the table -- I think one of the things that's happening in our industry today is that you're seeing the shrinking basically of the independent retailer.

And I think for many years this was an industry where you had a lot of businesses that were regionally-based, that connected with small manufacturer, and I think the partnerships were there. In the case of what Stop & Shop is doing, I think that's unfortunately not the majority opinion of the major chains today.

I think they're an exception to the rule and again should be applauded for it, but if you look across this country, I think a majority of your independent grocers work overtime to help the small manufacturer get on the shelf because again our life blood is diversity of product, bringing choices to the market so that we can compete on variety against large chains.

And I think an issue that the Commission should consider is the impact the shrinking base of the independent may be causing -- it may be causing some pressure in this area.

MR. BALTO: We'll certainly get to that in the next panel. Pam Mills, why don't we give you the chance to make the last comment.

MS. MILLS: I just wanted to comment on product choices and the smaller manufacturer. Probably about a year ago, one of our chain stores, for whatever reason, I guess it was their business plan, but they deleted from their system over 20 tortilla companies. These are smaller companies that probably can service only maybe five stores in the particular area where they're located. This only proves to me that the shelf space is so valuable for the slotting fee money that they were in the way.

MR. BALTO: Even though we've run over, the manufacturers have traveled out here at great expense to themselves. If any of you have any final remarks you would like to make or any things you think we should consider, please do. Karen?

MS. CARVER: I just have one comment. The small manufacturer actually is facing two opposing sides in the marketplace. You have the large retailer who is benefitting not only from us being a small manufacturer, but the big manufacturer also reaping the benefits of being able to offer those large exclusive payments up front that we can't do.

So the small manufacturer only has the option of going to the smaller companies to do business with, so they can get their foot in the door. In some of your larger metropolitan areas there are no small grocery chains, so you are kind of left with the mom and pops. I just think that we have a person on both sides that we're fighting.

MR. BALTO: Well, thank you very much to the members of this panel. We've spoken with many people on both sides of the issue, generally representing small manufacturers and large and small retailers. We've been eternally grateful over the past several months that they were so willing to give us their time, and I'm very thankful to the people on this panel who came out and participated.

We will convene together at 10:20.

(A brief recess was taken.)

PANEL 3: POTENTIAL EFFECTS OF SLOTTING ALLOWANCES, CONCERNS OVER PRICE, CHOICE, AND INNOVATION

PANEL 3 MODERATORS

DAVID BALTO, FTC

MOLLY BOAST, FTC

NEIL AVERITT, FTC

PANEL 3 GUESTS

DON SUSSMAN (Ahold)

SCOTT HANNAH (Pacific Valley Foods)

JAY CAMPBELL (Associated Grocers)

RICH WARREN-BOULTON (Economist)

PETER DE LA CRUZ (Attorney)

TOM STENZEL (UFFVA)

AKSHAY RAO (University of Minnesota)

BOB HOUCK (CoAMS)

NICK PYLE (IBA)

BOB REYNOLDS (Consultant)

GREG SHAFFER (Economist)

GREG GUNDLACH (Marketing academic)

IRWIN STEINBERG (Tortilla Industry Association)

WINSTON WEBER (Consultant)

PANEL 3 GUESTS (Continued)

JOHN EAGAN (Costco)

J. MARK GIDLEY (Attorney)

PIERRE TADA (Limoneira Company)

MR. BALTO: We're beginning the third panel, the discussion which is going to deal with the issue of market structure, the potential for buyer power and the impact of slotting allowances on price, choice and innovation. We're primarily focusing, though, on the issue of whether retailers have buyer power.

Let me just say as an overview, for the non-antitrust attorneys in the audience, that there are volumes of antitrust works that are published on the issue of how power by sellers leads to anti-competitive effects, where that's monopoly power collusion by sellers. But there's a relatively much more discrete and limited amount of volumes published on the issue of monopsony power, the exercise of power by buyers.

Why is that? Well, Justice Breyer once said in an important case that the authors of the Sherman Act were primarily concerned that consumers receive the benefits of low prices. He instructed therefore that Courts should be hesitant, in fact very reluctant to act before they try to limit the ability of buyers to extract lower prices.

The panel today is going to deal with that issue of the potential of anti-competitive effects on the buyer side, an area that's not necessarily new, but where there's relatively less experience in the area of antitrust.

Let me again have us introduce ourselves in counterclockwise order beginning with Irwin Steinberg. Please identify yourself for the reporter and state what organization you're with.

MR. STEINBERG: My name is Irwin Steinberg. I'm a business consultant and the executive director of the Tortilla Industry Association.

MR. WARREN-BOULTON: My name is Rick Warren-Boulton. I'm an economist. I think we're reaching critical mass of boring economists, and I'm with MICRA, which is a Washington based antitrust consulting litigation operation.

MR. SHAFFER: My name is Greg Shaffer. I'm at the William E. Simon Graduate School of Business University of Rochester, and I'm another economist. I'm also a marketing person.

MR. EAGAN: John Eagan, Costco Wholesale, the vice president and general merchandise manager in Los Angeles.

MR. CAMPBELL: Jay H. Campbell with Associated Grocers in Baton Rouge. It's a retailer-owned grocery wholesaler.

MR. PYLE: Good morning, Nick Pyle with the Independent Bakers Association.

MR. DE LA CRUZ: Peter De La Cruz with Keller & Heckman.

MR. REYNOLDS: I'm Bob Reynolds, Reynolds Associates, food industry consultants.

MR. GUNDLACH: Greg Gundlach, professor of marketing Mendoza College of Business at University of Notre Dame.

MR. HANNAH: Scott Hannah, CEO of Pacific Valley Foods, Bellevue Washington.

MR. RAO: I'm Akshay Rao. I'm at the Carlson School of Management, University of Minnesota. I used to be an economist. Then I saw the light. Now I'm a professor of marketing.

MR. HOUCK: My name is Bob Houck. I'm with CoAMS. We manage and consult on trade advertising programs.

MR. TADA: Pierre Tada. I'm the Chief Executive Officer of Limoneira Company. We are a grower-packer-shipper of agriculture, and are also involved in frozen food processing.

MR. GIDLEY: Good morning. Mark Gidley with White & Case, Washington, D.C.

MR. WEBER: Win Weber, president Winston Weber & Associates. We consult with manufacturers and retailers.

MS. BOAST: I'm Molly Boast from the Federal Trade Commission.

MR. BALTO: I'm David Balto from the Federal Trade Commission, and sitting next to me is Neil Averitt. Don Sussman has just sat at the end of the table. He's with Ahold.

Again the ground rules are if you want to be recognized, you lift up your name card in a vertical fashion, and I will call on you. We have just about an hour and a half to go through today's topic, so let's try to keep our answers short and to the point.

Let's start off with a general question. Are slotting allowances a manifestation of retailer market power, and should the FTC be concerned about that as a problem? Peter?

MR. DE LA CRUZ: Thanks. I'm a secret witness since I don't have a card.

I think that the first two roundtables have really shown that we have a very rich and diverse industry, but I think based on the A.C. Neilson studies and some other written work, we're beginning to see that slotting allowances are becoming more common, and the costs are increasing.

And to the extent that those increases don't reflect merely a transfer of cost from the retailer to the manufacturer, then there's something else afoot that would tend to increase this.

One of the things that I think was kind of interesting is that it appears that the companies are striving to be the low cost providers and apparently tend not to charge slotting allowances. One would I think from the manufacturer testimony assume that the cost passed to the manufacturer raises their cost, so ultimately I think that it may have an adverse effect on consumer prices.

Although I think in fairness, we shall acknowledge the difficulties that makes the analysis complex. Yesterday there was reference to a competitor with Super Centers. I think if there is a competitive price driver, the question is whether greater efficiencies actually could be realized across the broader marketplace without the use of slotting allowances generally, and whether there's a transfer going on here that really is counter-competitive.

MR. BALTO: Win Weber?

MR. WEBER: I do not believe the FTC should be concerned about slotting allowances for a number of reasons. First of all, let's look at the influencing factor of buying power, however we wish to define buying power. Size is an influencing factor whether it's on the retailer side or supplier side.

We're talking brand loyalty or the lack of brand loyalty -- that is an influencing factor. We've talking about consumer demand, either existing consumer demand or future consumer demand, and we're talking about information or lack thereof or the availability thereof.

Those are all factors that influence the decision of a retailer -- who is a retailer who's going to be in business tomorrow -- because what we're really dealing with is the power of the consumer. Over 60 percent of all consumers today carry loyalty cards. That information is now accessible to the retailer. Retailers did not have this ten years ago.

The retailer today knows more about their customer than they ever have -- the buying behaviors of the customers, which one are their most loyal, which ones are their most profitable. I could build a very strong argument to suggest that with this power of information, the retailer today is more sensitive to the consumer, and future decisions will be geared more towards consumer needs than what slotting allowances can or cannot offer.

And therefore I think that the slotting allowance issue is relatively insignificant as it relates to how we're going to be serving consumers in the future.

MR. BALTO: Mark Gidley, you're sort of familiar with what we do on supermarket mergers. Should we be concerned with market power on the buyer side when we look at supermarket mergers?

MR. GIDLEY: Well, I think that one of the things that you've got to understand is the context in which supermarkets operate today. Today we face enormous cross channel competition from Wal-Mart Super Centers. Let me be specific about that.

We're blessed with the best economy in 30 years, I'm told every time I read the newspaper, and I believe it based on my experience on this planet. No unemployment, no inflation, no food inflation, and about 6 percent GDP growth.

Despite that, in the last year Jitney-Jungle, Bruno's and Schwegmann's have all declared bankruptcy. Now, these weren't some kind of fly by night supermarket chains that lost track of where they needed to be with a customer. These are the kinds of chains that have kind of a Stop & Shop loyalty.

They sponsored Little League teams. They were around for 50 or 60 years. They were institutions. It would be like Hechinger's here in Washington. They're gone or they're now in Chapter 11 and getting reorganized.

So we've heard a lot about what the manufacturers are going through, and I believe that many of them are cut on the scissors of trying to get their costs down, but so are the retailers. The retailers live in a world of 1 to 2 percent net margins, and if you compare that to the publicly traded manufacturers, the margins of the publicly traded manufacturers tend to be higher.

I'm not here to say that any one manufacturer has got too high a margin or that it's time to break up Wal-Mart, but I'm here to say that as Wal-Mart rolls out Super Centers across the country and moves from 180 billion in sales to 250 billion in sales, the question of slotting fees will become somewhat academic.

MR. BALTO: Scott Hannah?

MR. HANNAH: Thank you. I'm going to have to make a couple strong counterpoints here. I can't let this rest, Mr. Weber.

I'm going to go back to the first comment. Let's put this to bed right now about this net profit. Argue with me if you think I'm wrong. I've heard this before. The poor supermarkets only make 1 or 2 percent net profit. Manufacturers make 4 percent. It's like so what. It's the return on investment that measures this economy in the United States, and the return on investment is identical, so let's stop whining, please.

The second comment is the FTC should be involved in slotting allowances, Mr. Weber. It is anti-consumer. It is anti-small-business. It is in definite violation of the Robinson-Patman Act. I'm not a lawyer, but it's easy to read the act. It's easy to interpret.

There's no way these slotting allowances do not harm consumers, and they harm small business. Definitely the FTC should be involved.

Thank you.

MR. BALTO: Thank you. Thank you, Scott. Can I have a show of hands of attorneys in the audience who think that the Robinson-Patman Act is easy to interpret? (Laughter.)

Thank you. Scott, you're absolutely on the mark for 90 percent of the things you say. Win, would you like to respond?

MR. WEBER: Is this point counterpoint? We should get paid for this.

One thing that has frankly bothered me over the last two days is just the basic relationship between a buyer and a seller. As we look at that basic relationship, and as I listen to our retailer clients and I look at the side of our manufacturer clients, number 1, a buyer is going to look at the quality of the product.

The buyer has specifications. Whether you're a food buyer or an HBC buyer, whether you're buying cars, there are specifications for quality, uniqueness, consumer demand, service, support. There's no need for a retailer to buy a product if there is not a point of differentiation that brings value to the retailer's proposition to the consumer.

If in fact there is a value proposition there is a point of differentiation, and if slotting allowance get in the way of moving that product forward, I would agree there is a business problem in that situation. Unfortunately, if there's a small percentage of retailers who there are making decisions more on slotting allowance than they are on what's best for the consumer, so be it. It's a shame because that behavior should not be tolerated in the industry.

On the other hand, from a supplier standpoint I have no sympathy for suppliers who are just trying to put products in the marketplace that are me-too. You have the cost of replacement, the cost of duplication, and I think we're dealing with an issue here that has a responsibility on both sides of the buyer's desk. So let's think of that basic buyer equation.

Retailers are not just going to buy a product for the sake of putting it in.

MR. BALTO: I want to add to that by bringing in a couple producer's points of view, Pierre Tada and Irwin Steinberg.

MR. TADA: Well, first of all, I keep hearing the focus on new product introduction. The majority of the products my industry produces have been around for a long time.

MR. BALTO: Like tomatoes and cucumbers?

MR. TADA: And oranges and lemons and watermelon and you name it, so every time we hear about the new production introduction side I'm a little confused. We're talking about charging and extracting monies from products that have been around a long time. Well, gee, is a watermelon going to sell in the summertime this time around? I think we all kind of know the answer to that.

So I would like to focus on the fact that we're really dealing with a lot of mature products. What are the behaviors going along with dealing with mature products? As I mentioned in the last panel, the product that we produce, we sell it or we smell it. And as the power in one end of the channel continues to grow, there's one thing that is well known. If you don't get the sale today, the product probably doesn't exist a week down the road, so there's a tremendous amount of power leveraged back against the agricultural producer.

We looked at this very high profile antitrust case with Microsoft, and most of that was dealing with conduct and how conduct manifested itself in the marketplace. This is what I think we're really talking about: What is the conduct and how is it impacting competition?

I think the upshot of it is the majority of the folks in my industry, fresh produce, are small mom and pop operations. There's some larger operations. Even the larger operations pale in size comparison to what we're talking about. We have a very strong belief that we have to deliver on quality. We have to deliver on all the things that the consumer needs. That is a given.

What is not a given is an up-front extraction of monies not related to performance, not related to what is really going on, and that's the part we would like to further explore. We don't think it really helps on the consumer price side. It adds cost. You add cost, in the long run we feel it's going to add to consumer prices.

MR. BALTO: Irwin Steinberg?

MR. STEINBERG: Yes. Well, I would like to take great exception to Mr. Weber's comments as well. I think he's living in a fantasy world.

MR. WEBER: The fact is that I was called an alien this morning.

MR. STEINBERG: Same thing goes here. Let's exclude Stop & Shop and some of the good retailers who are at this table and around the country. There's a vast number of supermarket chains, mostly the larger ones, where the buyer's total obligation is to sales per square foot, not to the consumer and not to the quality of the product that he puts on the shelf.

And because of that, there has been, at least in the tortilla industry, definite exclusion of suppliers who cannot afford to come in with the right product.

We did a little survey before I came out here, and I want to give you the remarks of two of our member companies, and we represent most of the tortilla companies in the United States. One a small company in San Antonio. We asked, Do you pay slotting allowances and if so, how much do you spend?

And one answer came, We spend none because all local tortilla factories were discontinued by all supermarkets because one company agreed to pay between $12 to $15,000 per store for exclusive shelf space. That was Texas.

The second comment comes from a small company in Oxnard, California, which says, We have not been given the opportunity to pay for slotting allowances. This is not to say that we would be happy or willing to pay if asked. We, along with other suppliers, were just told not to leave any DSD product anymore, that only one supplier would stay. This was totally unexpected for us since we outsold the supplier that stayed. We lost all supermarkets and five warehouse clubs.

If in fact the mission of the Federal Trade Commission is to determine whether exclusionary practices are violations of the antitrust laws, then forget all about this other fantasy. There are retailers who are doing it, and there are retailers who are not doing it, and it's very clear at least from the tortilla business that they are.

I want to tell you a story, too, without regard to some of the members of the panel. There were two men in a hot air balloon -- I told this story to two people yesterday -- who came landing very hard on the ground in an unknown area because the hot air went out. A gentleman walked by, and one of the men in the balloon said to the gentleman, Where are we, and the gentleman said, You're in a hot air balloon. And this man in the balloon turned to his friend and he said, Just our luck, we have to land accidentally and meet an economist. And his friend said, Why is he an economist do you think? He says, Because when you ask him a question he gives you a perfectly sound answer that is totally worthless.

MR. BALTO: Even though Jay Campbell is the next person to have his hand up, I'm going to go out of order and let the two economists reply now, so why don't we start with Greg Shaffer and then to Rick Warren-Boulton.

MR. SHAFFER: Instead of providing an answer I wanted to ask a question, so I think I'm immune from this criticism at least in this comment.

May I ask a question on something that was said one comment earlier? The gentleman at the end -- many of the efficiency stories for slotting allowances pertain to new products, so I think it's important that we distinguish between payments that are made to get new products on the shelf, versus payments that established firms pay. One thing that you're saying is that they do exist, payments to keep established products on the shelf. Like the watermelon is not a new product.

Yesterday what I was hearing was that it's not very common, and they were called pay-to-stay fees. I was wondering just for the terminology point of view, what are these payments called? Do you use a different term than pay-to-stay?

Could that possibly explain why I hear some retailers saying, No, we don't ask for pay-to-stay fees, and I say you saying, Yes, you do pay them? I think this is an important question. It could be a terminology difference.

MR. TADA: It's kind of like asking what is the definition of sex, and we do you mean by --

MR. SHAFFER: Are you talking about lump sum payments, wholesale price discounts?

MR. TADA: Lump sum payments up front, arbitrary, not tied to cost, and it's for the privilege of continuing to do business, and this is not on new products. It's on existing products, and it exists.

MR. BALTO: And it's a payment?

MR. TADA: It's a payment.

MR. BALTO: I'm going to stick with the manufacturer's side. We will get to the retailer side. Nick Pyle?

MR. PYLE: Well, I'm going to echo a lot of the comments I've heard anti slotting fees. Our members feel very strongly about the FTC getting involved. We've looked at litigating, and it would cost a half million dollars. It goes to the issue of a fundamental shift.

There is market power. We've brushed briefly on buyer income. We've touched on that, and conduct, and conduct is critical because these are secretive payments, and we need a little sunshine, and that's why we want the FTC involved. These things are not tied to volume or price.

I think that's a good way to delineate what a slotting fee is, an entry fee. Now we're talking about pay to say. Pay to stay can be a warehouse fee. It can be an SKU charge. It can be the ubiquitous computer charge related to the takeover of a chain. They come hidden in all different ways.

MR. BALTO: Let me just ask, let me pose a problem we've struggled with. We've tried throughout our interviews with the 80 manufacturers and retailers to figure out who had power, and it seems in some respects arguments could be made on both sides.

From the manufacturers side they could be saying, We really have to be in every store, being excluded from any individual store would be so significant, we don't have a choice, we just have to be there.

On the other hand the supermarkets may claim that they are the people who have less power because when a consumer walks into their store, they don't expect to see just one brand of detergent or one brand of crackers. They want to see everything. They want to see a full variety of crackers.

So what's the answer here for these people who are in the market? Who is it that has power, and what's the kind of power relationship between manufacturers and retailers and how has it changed?

MR. PYLE: That relationship has changed a lot since the 1960s when the supermarket owners came to manufacturers and said, Give us things to fill the shelves. Now the relationship has changed where the buyer or the retailer is no longer a reseller of goods but is essentially morphed into a renter of shelf space.

MR. BALTO: Don Sussman?

MR. SUSSMAN: It's very much a mixed bag when it comes to power. It goes vendor by vendor, store by store. Yes, we ask for slotting fees for new products in most of our categories. When Starbucks coffee comes out in the supermarket, 12 SKUs, supermarket ready coffee, whole bean and ready ground and doesn't offer slotting fees, and we have a choice of either not taking it or taking it. We took it because we knew our customers wanted it, and it would sell. It was well supported. The brand was well known, and it was either have something that our customers wanted or not have it, so we took it without the slotting. In that situation I would say that Starbucks certainly has the power to impose their brand.

In other categories and other products it's not true, so it really depends. It's very much a case by case situation.

MR. BALTO: Jay Campbell, would you like to address this?

MR. CAMPBELL: I would like to dovetail it into your other question as well. You started by asking the question, Is slotting a manifestation of marketing power and should the government be involved? Now you have asked a question about, Has the market changed? Is there a new dynamic out there?

I think the answer is very clearly, we have seen a dramatic change in the landscape of the retail competition in the grocery industry over the last 25 years, and it has been caused by a variety of things. Number 1, it's a change in the consumer. It's a more demanding consumer, a more informed consumer.

We have also seen, particularly in the last 10 to 12 years, considerable activity in the merger and acquisition area. The merger and acquisition area has proliferated in our grocery business, and you have to stand back and wonder and question why that has occurred.

I would like to digress a moment. I've heard many comments made throughout this panel, not only this morning but even yesterday, that "I don't have access to the shelf." Well, there is no guarantee that anyone has access to the shelf. I think you have to earn your access to the shelf, not just through a payment necessarily, but through the consumer.

And it doesn't mean you get to go to the top chain in the country and have a guarantee to put your product on the shelf. You may have to start in a simpler mode to get there. There are no guarantees of success in business nor of any product or any competitor.

The question we have to ask is, Should the government even be involved in price, choice or innovation? I think you started, David, with your comment earlier this morning about how we want to see price, choice and innovation. Is that a governmental issue? I don't think it is a governmental issue.

I think that's a competitor issue. I think that's one of the reasons people are successful in the competitive marketplace is because they offer price, they offer choice, and they offer innovation to the consumer.

Let's go back to the merger and acquisition activity. One of the thing that Senator Bond said in his tape is that we're looking to see that we have enforcement properly of the antitrust acts the Sherman Act, the Clayton Act and the Robinson-Patman act.

What has happened in our marketplace? Why have we seen mega-buyers, power buyers occur? Could it be that we have a sequence of events that have taken place over these years where we haven't seen enforcement ensuring that all competitors in the marketplace have adequate disclosure or the permanent information they need to be a buyer and to be a seller in the marketplace?

And that would relate to products available, to pricing available, to packaging, to promotions -- and you can wrap slotting into promotions -- to pricing, and to payment terms. If those things are consistently supplied and offered to all competitors fairly and equitably in the marketplace and enforced properly, I don't think you would have seen the merger and acquisition activity that you have today and the rush to size.

Earlier the gentleman at the end of the table talked about Jitney-Jungle, Bruno's and Schwegmann, all in the south, right in my backyard. Jitney expanded through a leveraged buyout and bought Delchamps, went into debt to get bigger. Bruno's did a leveraged buyout to buy themselves out and buy more storage to get bigger. Schwegmann's bought National Tea in New Orleans to get bigger. The goal was to get bigger, to get clout, to get power and influence as it relates to the manufacturer community that they dealt with.

As we have seen the growth of mass discounters get larger, we have also seen the growth of major chains, in an effort to get larger for this level of preference that they feel that they can achieve.

My concern has never been with slotting allowances. If they're available equitably and fairly to each and all competitors in the marketplace, that is fine. If you are a small manufacturer, you may have to start out small. You may have to start with us poor independents or with the specialty stores or the gourmet stores or something else to get your product recognized because there is no right of recognition.

If I have an innovative product in my pocket right now I have no right to go to the largest chain and say, You must take it. I must prove it in the marketplace of public opinion with the consumer.

So I think what we need to do is narrow down the reality that the government shouldn't be involved in running our businesses. The government should be involved in ensuring that the playing field that we're on is fair for everybody to compete, and the consumer will make the choice for us on our products and the way we run our operations.

Thanks.

MR. BALTO: Thank you. We'll pick on some of those things a little later. I want to go back to my question, and I think Bob Reynolds was going to reply to it, about how do we look at the question of power between retailers and manufacturers.

MR. REYNOLDS: I think that one of the things that's been on my mind yesterday afternoon and this morning is that the manufacturers that we've heard from are relatively small and have relatively weak brand or fungible brand kinds of issues, and we have not really heard the point of view from the large-brand sellers.

I'm sure they weren't excluded from being here today, so I'm not suggesting that that's the case. However, one of the key differences between the no brand or the fungible brands, versus the large brands, is the amount of pre-selling that happens with these kind of things.

That comes to the marketing equation before the products ever get to the store. Are they pre sold? In the Starbucks environment that Mr. Sussman gave us down here, it was a situation almost of a must-carry for Stop & Shop, and they couldn't charge a slotting fee in that regard.

So it's really important, when we're looking at that power equation, that we keep that kind of issue in mind, as to the participation of the brand sellers in the marketing process.

One of the things with fungible brands is that they depend upon access to consumers in the stores as their primary means of communication with a consumer. You may have cents-off, but that again is probably a point of sale. I think that's a really important issue to understand when you start to try to pick apart the power equation and differentiate well marketed national brands versus fungible brands insofar as the retailer is concerned.

MS. BOAST: Can I ask a question? One of the things that it seemed to me was implied in Mr. Weber's earlier comments about information and loyalty cards is that with increasing information bases, consumer choices can be better predicted.

MR. WEBER: Yes.

MS. BOAST: Does anyone believe that this would lead to the demise of slotting allowances and render them unnecessary? And if so, are there any implications for market power analysis?

MR. REYNOLDS: Let me just respond to that quickly. The information is terribly important to the retailer power issue. The primary swing between manufacturers and retailers over the past 15 years or so is that the retailers control the most available sources of information.

That's the information that comes off the scanner, and whether in fact that impinges on whether there's slotting allowances or not would have more to do with how effective the retailer is at marketing products in the store.

The in-store marketing program has become very, very important in this regard. To gain access to those programs, whether it's a, quote, slotting allowance or whether it's some sort of a buy-in to a retailer program -- a club card program, a coupon book program or whatever it may be -- all of these marketing funds are pretty much fungible with one another. It doesn't really make much difference how the money has come to the retailer.

MR. BALTO: Rick Warren-Boulton, did you have an answer to the question we're dealing with right now?

MR. WARREN-BOULTON: I have got a number of questions. One is where there are other good jokes about hot air for attorneys. I didn't know there were a lot of hot air jokes for industry associations, but I'll think of one.

I think, going back to the question you originally raised, which I think we should want to address is this: Is there sort of a problem here, some sense of monopsony power on the part of supermarkets? Are slotting allowances somehow a manifestation of that monopsony power, and if so should the FTC or somebody be doing something about it?

I think to begin with in all this discussion, it's really crucial that people separate out whether they're talking about new products or established products, and I think everybody would agree here. All the efficiency defenses that I've heard over the last day from the panels have to do with the introduction of new products.

Now, that being said it's also true that to an economist, it's a barrier to entry in the sense that it's something which a new entrant has to pay that an established firm doesn't have to pay. So, strictly speaking, for those of you who are antitrust aficionados, it would qualify as a barrier to entry, but it's an unavoidable barrier to entry.

And I think, given the number of efficiency defenses for this, the chance that the FTC wants to get into the business of trying to do something about slotting allowances for new products strikes me as having such a high false positive rate.

So I think two things. One is I think we should be concerned only about slotting allowances for established products, and secondly, in terms of this discussion, I think people should almost identify which ones they're talking about because there's a "ships in the night" sort of element in this discussion that goes on.

So my comments have to do with monopsony power with respect to established products, and I think the thing to begin with here for an economist is something which we all know. That is that you're talking about a situation in which it costs something for a customer to visit a store.

Very few customers I know visit more than one supermarket. Some of them go to Costco or Price Club and then will go to a supermarket, but I don't know anybody who visits two supermarkets sequentially. So what happens is that for producers of a differentiated product, they're kind of stuck in a sense that people aren't going to move because of what the supermarket does.

If David comes up with a new product, Balto Baked Beans, and decides to sell this product, his problem is is the only way to reach me as a customer is to get his product at a Safeway down on Wisconsin Avenue. Otherwise he doesn't get to me at all, and if he's selling a differentiated product rather than a homogenous product, that means that that supermarket is a gatekeeper.

There's no other way to sell to me, and a sale that's not made to me is a sale that's lost. You cannot make it up by selling it to somebody else. So even if supermarkets are completely competitive, they still have a gatekeeper role here. But I don't think you want to confuse that with monopsony power. Monopsony power to an economist is an incentive to reduce your purchases in order to drive the price down, and that's why it reduces welfare.

That's not what economists think of the way supermarkets operate. We think of them as competing for customers on a bundle or an index basis. I decide which supermarket to go to, not on the basis of their individual prices, but on what I think the cost of the bundle that I'm going to buy there is, and supermarkets have an incentive to mark up prices, products differently, and this is very frustrating for a lot of manufacturers.

You manufacture pepper and demand is very inelastic. Your problem is your supermarket insists on marking up your product by some enormous rate and reducing your sales, and slotting allowances are very frustrating because slotting allowances give them even more of an incentive to do that.

You would rather give the supermarket a low price and no slotting allowance. You give them a slotting allowance, you have to give them a higher average or marginal price, and the result is they mark up your product even more so it drives you nuts, and that's quite understandable.

But that's sort of efficient pricing by supermarkets. While I'm sympathetic, there isn't too much you can do about it. So what do you worry about?

The only thing that I've heard in the last couple of days you want to worry about is a situation in which a supermarket may have an incentive to use this gatekeeper role to the detriment of consumers. The only good examples that are floating around are situations in which a dominant manufacturer essentially bribes, pays off, or makes a supermarket a deal, an offer they can't refuse, that is going to either increase the cost to their rival manufacturers or reduce the amount that the supermarket is willing to pay for those rivals.

And those are real stories, and I know a large number of them, but they're small, and by now, as Mike Whinston I think would agree, we probably pretty well know the things to look for to find those stories.

You know, there's situations in which the entrant would supply only part of the requirement for a particular store. They can't compete on an all or nothing basis and what the slotting allowances do is put the competition on an all or nothing basis. So that's a narrow set of circumstances in which you may want to do something, but it's not classic monopsony power by supermarkets.

MR. BALTO: Thanks. That's good. By the way, for these people interested in the gatekeeper concept, Daniel Savrin in our expert panel will be speaking about that concept later on this morning.

John Eagan, I see you wanted make some comments?

MR. EAGAN: Yes, on buying power. In my experience over the last 30 years, there has been a shift from the manufacturer to the buyer as far as who holds the clout, but it really is differentiated between the size of the manufacturer and the size of the retailer.

One of the largest package goods manufacturers in the country was very hard to do business with five, six years ago. I think they've changed now, where they have involved more of the retailer partners in the marketplace, not because they wanted to give up this clout, but the reality of it was that the retailers had the information better, and they had a better track on the business that they were doing. And also they were big buyers, they were volume buyers. And they became more important, so there's a difference.

There's probably a balance of power. When it comes to small manufacturers, the retailer probably has all of the power. If it's not wielded responsibly, you could hurt yourself and the manufacturer, and you don't want any things like that to happen. I mean, you take a bigger responsibility with the small manufacturers than you do with one of the majors.

MR. BALTO: By the way, can I ask the retailers, one of the questions that Salop answered yesterday that we always struggle with as antitrust attorneys is, Why would you want to enter into an exclusive arrangement with a manufacturer, especially a dominant manufacturer? Don't you want to keep options available?

Is that something you think about? Is that the right question we are asking? Don Sussman?

MR. SUSSMAN: Well, obviously we like to have competitors for our business. We want people to be very anxious to do business with us. We think in the long run that's good. There are times, though, when you don't need multiple items, and there's a big difference between duplication and variety.

We're not in the duplication business. Items are really fungible to the customer. We're not really giving them choices by having more and more brands out there that are less efficient. If you look at our dry shelves, we have to have a case and a half of every product out there to be efficient. You can't put a new case up until you've got the old case off, and you don't want to run out of stock.

It's much more efficient to have fewer items on the shelf than have more items. Everyone knows that, so the issue is, Where do you need more than one vendor, and where is it less efficient to have more than one vendor? Do we need more than one sugar vendor? I think not in most cases. In most cases we have a national brand, then a private label, because sugar is sugar, and we don't need five of them, and it's more efficient to ship full pallets of sugar to the store than it is to be shipping half pallets and breaking down pallets in our warehouses.

So there are times when it just doesn't make sense to devote this space and the inefficiencies to have more than one supplier on an item. We basically have one line on cake decorating. It's not that big a deal for us. It doesn't make sense to devote twice as much space and to have -- instead of having a hundred items of cake decorating having 200 so we can have two different people on the shelf. So we have to make choices.

MR. BALTO: Well, let me ask a different question. But first, did any of the other retailers want to add to that?

MR. STEINBERG: Can I ask Don a question?

MR. BALTO: Sure.

MR. STEINBERG: Don, I understand the rationale of having one private label sugar and one national brand sugar. Does the national brand sugar company pay a slotting fee to you?

MR. SUSSMAN: They might have paid one way back when, when they were a new item. I wasn't around then. Sugar has been around a long time. We only take it on new items.

MR. STEINBERG: Do they do it annually?

MR. SUSSMAN: No, they do not.

MR. STEINBERG: Thank you.

MS. BOAST: Does the national brand manufacturer supply the sugar for the private label?

MR. SUSSMAN: In some cases, not all. In some cases.

MR. BALTO: Let me pretend I'm not an antitrust attorney, but I'm just a consumer. If a chain merges with another chain, and it gets bigger and it can purchase more, it has more clout. My initial response is it's going to have more clout with the manufacturer. It's going to negotiate a lower price.

Fortunately we have these people at the FTC who make sure that the retailer market stays competitive, so ultimately if the retailer gets a lower price, I'm going to get a lower price too.

Peter De La Cruz, what's wrong with that scenario?

MR. DE LA CRUZ: Well, you're assuming perfect cost pass through, and I think from even the discussion we've had in the prior two panels, that it isn't clear that slotting fees or other types of fees get converted into lower consumer prices.

It's been a very nice discussion, we almost need the big chart on the wall here because I think if you're looking at this from purely an efficiency point of view, why even have two kinds of sugar? Why not have one brand of flour, one brand of sugar, one brand of coffee?

Then you're going to decrease it, and really what you're doing is you're trying to guess on a consumer dynamic, and what's necessary for your consumer dynamic, and you're actually reducing your efficiencies to be successful in this particular marketplace.

And so they're -- well, anyway, sorry, getting off the point there.

MR. BALTO: That's fine.

MR. REYNOLDS: Just to follow up on that, in some outlets we are in a one-brand kind of a situation. Costco I would suggest is probably offering one brand of sugar, and most retailers will offer one brand of corn starch. So what's so worrisome about this?

It is how the retailer chooses to do business, and if they choose to do business in an inappropriate way, they're going to be out of business because the consumers have lots of alternatives in almost every case.

MR. BALTO: Do any of other manufacturers or any of the consultants have a view about the question I posed to Peter De La Cruz? Scott Hannah?

MR. HANNAH: We're missing a little collateral point here. I'll give you a true case scenario. It's the best thing to understand. A very, very large box chain, not Costco, recently put up for bid a continuation of the vegetable supply program, and a company that had that business from day one, and the bidding went from 4 million, 5 million, 6 million, 7 million.

The existing party finally put up $9 million to stay. Everybody drops out. Small guys drop out. The biggest company comes along and says, We'll pay you $11 million to stay, true case scenario. They got the business. The other guy was kicked out. Is that monopolistic? You bet it is.

MR. BALTO: A couple things here, Scott. First, what do you think the ultimate impact on consumers was?

MR. HANNAH: The company that got it is going to have to charge higher prices to return that $11 million, so the consumer is not going to benefit by the most efficient company coming in on a day-to-day scenario, which maybe didn't have $11 million in their pockets.

MR. BALTO: If the $11 million was something else, if we're just talking about a discount, we're talking about a lower wholesale price, would that have made a difference to consumers?

MR. HANNAH: You're talking about up front capital versus cash flow. They're two entirely different things, and they can make or break a business. If somebody comes to a conglomerate and says, We need $11 million cash, check right now, that's fine, but if you can pay for that product over a year or two just by offering lower price, fine.

But again, okay, let me answer a question you probably have in your mind. That conglomerate does not have to charge that $11 million on that vegetable that they had in that store. They can spread it out over many divisions, many different products. A small company cannot do that.

MR. BALTO: While we go on to other speakers, why don't you figure out for us what per SKU per store that $11 million was. Pierre Tada?

MR. TADA: I think one of the points that was previously raised is, Does buyer power end up ultimately benefitting the consumer? Therefore, I have size, I can negotiate prices down, I can pass it along to the consumer, the consumer is better off.

I can say with virtual certainty in some of the commodities that I deal with that that is not the case.

I have just a recent case where prices went from -- I won't even mention the product for -- I just won't say it. Sales might go down starting tomorrow.

Anyway, the product basically went down by 75, 80 percent in the actual cost to the retailer, and the retailer did not drop the price at all. In fact, they raised the price in some cases, and in other cases it remained the same. I feel that if it was a lot more competitive at that end of the channel it would be different. You ask a retailer how do they go price their products, a lot of them focus on, What is my competitor charging?

And if the competitor isn't in existence or is not a force in that particular local marketplace, then their rationale for reducing prices is, Why should I? I have got a lower cost of product. I can increase my margins. I need to make my numbers for the quarter so I better go do that.

MR. BALTO: So, Pierre, you're saying that there are situations where the retailer gets a lower wholesale price, but you don't see it reflected in lower retail prices?

MR. TADA: Absolutely not, and you know, it's one thing to actually get a price driven down for whatever reason and have the consumer benefit. It's another thing to have the price driven down, and the consumer doesn't benefit. The supplier doesn't benefit because movement hasn't gone up because prices at the retail level have remained the same.

All it has turned into is margin for the retailer. There's no more availability. There's no price benefit for the consumer, and that's what I'm talking about as far as conduct.

MR. AVERITT: The FTC has got an active merger program that's trying to keep local metropolitan area markets competitive for supermarkets. Therefore, how can we test to see if the wholesale price reduction is or is not passed on to consumers, in some other form, in those supposedly competitive metropolitan areas?

If a supermarket is in a competitive area, might it not be forced to pass on the wholesale price reduction in the form of nicer lighting in its parking lots, for example, and how do we know whether this is true or not?

MR. BALTO: Pierre or Mark?

MR. GIDLEY: Let me address it. I'll hit both slotting and this exclusive question you posed and pass-through. First on slotting itself, there are real costs. There's both the cost on the shelf of putting the item up and the new product cost of introduction.

In terms of the merger activity, it's being driven by an SG&A gap, and I think the manufacturers need to appreciate what the supermarkets are doing today to address that gap.

Our problem as supermarket merchants are our customers are fleeing us. When a Wal-Mart Super Center opens, we lose between 50 and 25 percent of our business within a 10 mile radius. So you want to address the SG&A gap, and that SG&A gap is comprised of several differences.

One is we have unionized labor. They do not have unionized labor. We think that we get good service out of the union, and there are reasons to have unionized labor.

The second is we're carrying a lot more SKUs. We're willing to put Fred Imus up. In our core categories we don't tolerate exclusives. Let's take salad dressings because I looked at the planograms for Stop & Shop and salad dressing as a layperson, and I asked some questions. One question I asked was, Why so much space for Hellman's?

The reason is because of replenishment. Hellman's has a great brand. It flies off the shelf, so they get enormous facings. They don't pay any more for the facings, but they get enormous facing because they move the product with great velocity.

Fred Imus, he's got his brother's radio program, but he may only get one facing because that's the way the case breaks down, and it's a slow mover.

To attack the retail format that encourages 35,000 SKUs, versus a retailer format with 7,000 or 10,000, whatever Costco's got, I can tell you, I would stipulate Costco's business model is more efficient than the supermarket, but our problem is we can't lock the door on the consumer. We can't go back to Leave it to Beaver time.

We're back here in the year 2000, and customers will go to Costco once or twice a month, and they'll also go to a Wal-Mart Super Center, so part of our problem is you as manufacturers have to demonstrate what's the value.

If it's a category like corn starch or sugar, the consumer throws one in their cart, and then they'll throw it out when they move. They probably won't use the entire five pound bag where they live. On the other hand, in juices, here we are, we have a decent market share in Boston, Stop & Shop has helped introduce Nantucket Nectars, Fresh Samantha, Soby and Very Fine, and we also really took Snapple to a new level.

Snapple is carried by Costco, but they carry three SKUs. They have skimmed the three best Snappel SKUs. That's great, bully for them. People buy those case sizes at Costco, but if you want a retail format to put up ten SKUs of Snappel, you need supermarkets.

And it's an inherently less efficient model, and the manufacturers are going to have to offer real value. Slotting fees are one way of closing that SG&A gap, and people wouldn't be so passionate about it because it's real money out of your pocket, but it's also real money out of the retail format that's encouraging that SKU diversity.

MR. BALTO: Bob Houck?

MR. HOUCK: Yes. We've had a lot of talk primarily about the damage potentially or otherwise to small manufacturers of slotting allowances, but we really haven't addressed too much the damage to smaller retailers. These aren't necessarily through slotting allowances, but as Bob Reynolds said, the allowances are fungible.

In general, however, larger retailers get larger allowances and not simply proportionately larger, and there is a damage to the smaller retailer in that they cannot compete. In many cases they can't compete simply because they are not as efficient, but also they can't compete because they're not getting the same allowances. They're not getting fair pricing in effect, and there's a damage to the consumer there in terms of diminished choice.

MR. BALTO: I presume Jay Campbell will want to weigh in on this one. Jay?

MR. CAMPBELL: Frankly, the discussion that has taken place here recently is really about business dynamics. We all have to make that decision of what items we're going to carry, when we're going to carry them based on the consumer base that we have.

I have a retailer in south Louisiana that carries 75 different hot sauces. I can assure you there is nobody in their right mind that would carry 75 hot sauces including him, but he does it for image. It's a pure image ploy to show the consumer, Look how much stuff I have. It doesn't cost him that much to do it, and he's chosen to do that.

Is it a good business decision? He will have to make that decision, and if he loses money on it, that is a choice he has to make. I think we do that throughout all the categories and the products and the varieties that we carry, and many business competitors out there have chosen not to do that.

Now, I think frankly the breakdown comes between the publicly held world and the privately held world.

The publicly held world is held to a different scrutiny level because they have stockholders on the Wall Street including my 401 K, and I want you guys to make all the money in the world because my retirement plans are set.

So bully for you, make all the money that you can, and I think that's exactly what the publicly held world will do. The privately held world, which is the independent retailer, is going to do something different than that because he doesn't have to report to anyone. I think I said that yesterday. So the business dynamics are going to do that.

What concerns me, and I go back to what you just said, if those allowances, if those offerings, if those competitors got to the size they are, are striving to get to a size because there are preferences that are inequitable in the marketplace, that is where the FTC needs to involve itself.

It has a tool available to it in Robinson-Patman. It has a tool available that it can enforce without slotting guidelines, and it can go beyond slotting, into anything as it relates to products, to pricing, to packaging, to payment terms, et cetera.

So that would be the real key issue. Did a competitor get to a size in the marketplace? Are they maintaining that size through getting preferences from a manufacturer? That should be our concern through all of these discussions today, and not get caught off on the tangent of slotting alone.

MR. BALTO: Irwin Steinberg?

MR. STEINBERG: I would wholeheartedly agree with Jay. I think everybody, at least in the tortilla industry but probably the grocery industry, would say that every manufacturer should get on a shelf through innovation, through differential advantage, through pricing or service, and nobody's entitled to be there unless they can do that.

Again, from a retailer point of view, if he wants to carry one brand, no problem. That's his decision, and if he loses or wins by it, I don't see that as a problem either.

I think the FTC should focus solely on what Nick alluded to, and that is really blackmail. It is under the table payments for shelf space only, without regard to price, without regard to anything else. That is exclusionary, and clearly to me and the people I know slotting allowances paid in that respect raise prices to the consumer, because the company that's paying the allowance has to build it into their own profit margin. And at the same time hurts competition in that area.

And I think you should limit it to that.

Everything else is perfectly legitimate.

MR. BALTO: A question for Irwin and Nick Pyle: Is the problem with slotting allowances perhaps more substantial for manufacturers who can only sell their products in local markets, such as tortilla manufacturers -- that may be an incorrect fact -- or bakers? Does that sort of put you in a worse position than the national manufacturer?

MR. PYLE: Irwin and I share, our membership shares a lot of common characteristics. One of them is direct store delivery. One of them is being mostly family owned businesses.

We face unique geographic concerns because we are direct store delivery. Our bread is serviced on routes. Often when we approach a national chain or a chain in a market, our members are told, Well, you have to pay the slotting fee based on serving all our markets, you're buying that space whether you use it or not.

So where available they can expand their businesses, but often they're paying for space they're not able to use, if they're unable to negotiate a prorated amount for that.

Another area we run into, and Pamela Mills talked about this, is captive operations for baking and private label. When someone controls the private label baking for a supermarket chain, often that person then controls the rack plan or the schematic -- so who gets how much feet in the bakery aisle.

MR. BALTO: Don Sussman.

MR. SUSSMAN: Well, I just want to agree with what Jay said before about the fairness issue. I think slotting goes into all practices. To me it could be human resources. It could be costs. It could be many things that manufacturers offer retailers. Does Wal-Mart get more in certain areas than other people? It goes beyond just the grocery industry.

We're looking singling out one practice in one industry, but I think it really goes down to a total fairness issue, and ultimately I think it's the market decides, and the business model. There's different business models out there.

Costco keeps low SKUs but charges customers a fee for membership. That's their business model. Would the customers benefit if they eliminated that fee? Of course, but that's their choice to do it that way. We don't have a fee. We do have slotting allowances.

At the end of the day the customer will vote on variety, cost, efficiency. Not all retailers will make it. Not all manufacturers will make it. They never have, but ultimately I believe that the market works, and the customers will decide.

MR. BALTO: Win Weber?

MR. WEBER: Several of our clients are large manufacturers that are sitting in a closet with doors closed and lights out at the moment, but I could speak on their behalf, I believe. I think that our large as well as medium size manufacturer clients, as well as several leading edge retailer clients, all want a level playing field.

We must recognize, however, that when you're getting into the cost of doing business in terms of the efficiencies of distribution systems, Wal-Mart will be the lowest cost operator in the U.S., and everyone else is competing against that low cost. If anybody expects to be meeting Wal-Mart in terms of their efficiencies, they will not be able to do it, just because of critical mass.

Now move over to the allowance equation. I think everyone would rather work on a level playing field -- whether you call it display allowances, advertising allowances, slotting fees, however we want to serve them up. They just want to be in a fair game.

MR. BALTO: You mean from the manufacturer's perspective they want to be paying the same as every other manufacturer?

MR. WEBER: In any given category. I'm a large manufacturer, I do not want to be held hostage by one retailer and have to discriminate against another retailer, because I'm very vulnerable, particularly today when people are changing companies from company to company. If I just paid one buyer X dollars more than the guy across the street --

MR. CAMPBELL: Then you violated the law.

MR. WEBER: I've violated the law, number 1, and secondly, I have to put up with it in other ways, in retribution as he goes across the street, in terms of cost. Suppliers today would much rather have a level playing field in this whole allowance area, and the laws are already there to support that, I think as Jay has already said.

MR. BALTO: Maybe we can go back to that. I want us to spend a few moments just thinking about merger enforcement. Is the problem with slotting allowances -- and again I understand the points everyone has been making about all these other types of programs -- but is the problem with slotting allowances more significant because of the trend to mergers?

There's been a tremendous trend to mergers, something like 50 mergers that were announced just in the past year. We've brought a number of enforcement actions. The concerns over slotting allowances, are they increasing because of the current merger wave?

Jay Campbell?

MR. CAMPBELL: To answer your question directly, if a merger takes place and one of the merger parties seeks slotting allowances as a way to pay for the merger and gets preferences from manufacturers in the marketplace to the exclusion of others, they have violated the law. That should be a concern of the FTC.

If the other competitors in the marketplace are not getting the same allowance or opportunity, whether you want it as slotting or anything else, after the merger takes place, then they're paying for the merger with those bucks, pure and simple.

That's economics. It's unfair economics, but it's economics.

MR. BALTO: What's actually happening in the market? Are slotting allowances increasing because of mergers? Do people have any experience on the subject? Mark Gidley?

MR. GIDLEY: A couple of observations. The first is, and I found this very counter intuitive, I thought when one of my clients, Ahold, did these mergers, they would roll all the revenues together and just sit down and bludgeon people. That just seemed to me to be like the economic thing to do, the sporting thing to do.

That's not what they do at all, and it's taken a long time for them to beat in my thick skull that this is a local business and they have to have local buyers, so they have not centralized purchasing for 95 percent of what they put in the store. What they've centralized is really peripheral stuff. The core store offerings they keep at the same scale of the local chains that they acquire. So that's point number 1.

Now, they don't have to do business that way, but they think that they would lose a lot if they had somebody down in Atlanta making decisions on what to put up in Boston. Somebody in Atlanta would never have understood Nantucket Nectars and the fact that everybody who goes away on the Cape for three months would come back raving about these two guys selling nectar off the boat, but local buyers being in Boston could understand that phenomenon, and that's the Nantucket Nectar story, so that's one point.

The second point is that at this point in time you have zero tolerance in retail mergers. I don't know whether it's been stated or not, but as I digest your most recent activity, you're at zero delta meaning that within a geographic area very broadly defined, you cannot gain any market share, period. That's harsher than your own merger guidelines.

Now, I cannot name three manufactured good mergers that there are divestiture orders in for the last four years. I could list for the rest of the time slot all the enforcement actions in the supermarket industry.

I'm not here to say you're right or wrong. That's another debate for another day. I'm just observing that we have a lot of unnamed dominant manufacturers. They may have become dominant through their best products and superior brands. The antitrust laws say bully. If they became dominant solely as a result of merger, that might be something that the FTC would take a look at.

And I don't know that there any of those dominant manufacturers that have become so through manufacturing mergers. I just have not observed a lot of manufacturing-of-food-product merger enforcement activity. It's an observation.

MR. BALTO: Thank you. Other observations about the impact of mergers on slotting allowances? And does anybody here know whether other retailers have followed the lead of Ahold of keeping buying decentralized? Bob Reynolds?

MR. REYNOLDS: I'm not certain about this, but if you look at the Kroger mergers, the most recent of them, we're working with about four or five different store brands that they're dealing with. There are discernible different marketing programs, including, like in Arizona now, two brands in the same market with different buying responsibilities pulling out of different warehouses with different merchandising programs, with the Fred Meyer and what is it in Phoenix? Frye's.

Thanks for the help on that one. And then Ralph's in southern California, Ralph's is moving up there, Fred Meyer up in Portland all of which have different ways of running stores right now, so I think that they've adopted the decentralized program.

American Stores went to the centralized buying pre-merger. They decentralized, and now we're in an Albertson's situation with decentralized buying again. So I just don't think any particular conclusion can be drawn from that big firms mean centralized purchasing.

MR. BALTO: I don't know if anybody can answer this, but even if they don't centralize purchasing, can they still use the market clout of a bigger chain to extract higher slotting allowances post-merger?

MR. REYNOLDS: Bob Reynolds again. I think one of the main things they offer in a centralized situation is a much more powerful information base where they pull the information together in one place. They can in a sense leverage that information base both for more effective marketing towards consumers and a more effective buying back towards the vendor community as well.

MR. AVERITT: The point has been made several times that if the playing field can be kept reasonably level, it makes sense to allow businesses to pursue different strategies and consumers to make their choices about what model they want to see. That certainly has a lot to recommend it as a view when you can apply it on a national basis.

But for that approach to work it would seem like you would need a reasonable number of options in the market -- a reasonable number of suppliers, a reasonable number of retailers. The question was put by David a few minutes ago about whether that prior contingency is always true, or whether there are certain products that would trade in more local markets where retailer concentration might be higher.

Could we expand on that a bit? For example, how far are different types of produce items able to be shipped? Do you find yourself dealing with a significantly smaller number of supermarkets than the national manufacturer would? Or in the bread or tortilla businesses: Are any of you people looking at markets that are local in ways that make your business situation different?

MR. TADA: This is Pierre Tada. I think there's no doubt that the number of customers that we're selling to are shrinking, and it is shrinking because of competitive forces. I think what really goes on is competition happens on a regional basis, and pricing happens on a regional basis, and the whole competitive model is focused regionally, but the scale economies are really addressed whatever the system is, systemwide.

I think what I really am focused on is what are some of the behaviors, what are some of the competitive conducts that are going on that come with size? Is there abuse of power? Are there practices that ultimately favor certain suppliers and work to the detriment of consumers?

MR. AVERITT: What would be, for example, the four firm concentration ratio in your home region? What share of your market goes to your top four customers?

MR. TADA: Well, it depends on the region because -- and I won't mention any names, but it's really concentrated, three or four of the top retailers representing 60 percent of the market, 80 percent ranges in there, but most of the time it is on the low end of that range.

But, you know, again pricing oftentimes happens not according to the prices that they're able to extract from the supply side. It has to do with the competition in the marketplace, so they're doing store checks all the time. Okay, they're charging this, therefore I can charge that, and there's fewer competitive situations. I think it does have an impact.

But having said that, I think from the supplier side, we do have a responsibility to provide quality and service and consistency and at prices that allow the continued availability of products but are beneficial to the consumer. When it's not passed on to the consumers is where we start having an issue.

And there's a possibility that there's something in between that isn't allowing that to happen. I understand business, and it is a basket of goods. But when it starts happening more and more consistently, one begins to wonder what's actually going on, and there seems to be a fairly high correlation with increasing concentration at that level, that end of the chain, and there seems to be an increasing lack of correlation between supplier prices and what the consumer pays, and so there are things that are correlated and not correlated.

MR. BALTO: Mr. Steinberg?

MR. STEINBERG: Well, the tortilla industry is a little bit different in terms of distribution. It is largely regional, but in the west and southwest, most tortillas are distributed on a DSD basis, fresh, on the bread shelves or on end cap. If you go to the East Coast, if you go to the midwest and in the southeast, you'll find most tortillas in the dairy case refrigerated, and that's simply a measure of market size because of shelf life of a fresh tortilla.

There's not enough business in tortillas in the East Coast or in the midwest to justify DSD, although it is changing somewhat as many of you may know. It's the fastest growing bread product in the world. It's gone from $300 million to $3 billion in 1999, and that's a big jump in market size so it's becoming less of an ethnic food and more of a basic bread.

I believe Pam might notice a little bit more that the slotting allowance demands are largely in the West and Southwest where the market is very large. There are some slotting demands on the East Coast. I've heard from members who have complained about it, but it's certainly not as significant as it is in the West. I think it's related to the size of the market and the size of the market for a particular supermarket.

If you go into the barrio in Los Angeles or stores around there or in Dallas or where have you, there's much more demand for tortillas than there is in other places. And unfortunately a tortilla was viewed as a commodity up until 10, 5 years ago, so the market has just the option of saying, I'll put in the lowest price tortilla or the guy who pays me the most money.

MR. BALTO: Nick Pyle?

MR. PYLE: This is somewhat anecdotal, but I think it addresses the questions on both pay to stay and the originality. We had a baker who served out of Missouri 175 markets in the Illinois market. They were approached by this retailer after an acquisition saying that if they wanted to continue to do business they need to pony up $1,700 per store to continue to supply bread and rolls and $1,300 to continue to supply sweet goods.

MR. BALTO: Was this after a merger?

MR. PYLE: This was subsequent to a merger, and as a result it was $3,000 over 175 stores. That baker had to pony up over half a million dollars. Now, they recognized that it would take them roughly two years to make that money back, but it was cheaper for them to lose the money or take the loss, operate at the loss than to lose the volume and the economies of scale that they received from servicing that entity.

So here you have a pay to stay and you have a regional aspects of --

MR. BALTO: Was there some kind of exclusivity tied to that?

MR. PYLE: No, they were a national baker serving that account, and there were other regional bakers, but they were told that there was a baker from Ohio, and I've actually transfixed these states so it will be hard to figure this one out, but there was a baker from another state anxious to come in there that was not a regional -- very large regional baker, but not an independent baker, not one of our members, so we use this story a lot. But that's a good example.

MR. BALTO: Professor Rao?

MR. RAO: I've been listening to all this with a great deal of interest, and I notice the P word comes up a lot, power. And I've always thought that, as Mr. Weber pointed out earlier, information was a very important dimension of power, particularly in this industry. The data that I have suggests that as the retailer gets more informed relative to the manufacturer, so the asymmetry of the information between the two starts to play out, that's what has an impact on the slotting allowances.

So in terms of measurement of power, perhaps concentration indices need to be supplemented by looking at other things such as investments in information technology, access to Neilson data and the like.

The second thought that I had was that the FTC spends a lot of time worrying about whether or not prices are reducing, and I was thinking about a question that you raised earlier, David. As a consumer why should I worry if prices are dropping? One reason why I might worry is if quality drops, either commensurately or incommensurately, in fact more so, if prices drop. I'm not sure you can measure them on the same metric, but it is certainly something you want to bear in mind.

The third observation I had was the success of the new product. We're talking about slotting allowances, largely, and I'm going to defer to Greg Shaffer's distinction, that these are payments for new product launches where there is some uncertainty about demand. Nobody really knows for sure whether new product is going to work in large part because its success is contingent on the effort of the retailer, so the retailer can actually kill a very good product if something better comes along.

So to the extent that there is, and I'm going to use some jargon here, a moral hazard problem to the degree to which the retailer might put out the necessary effort, retailers would always prefer to get up front slotting fees than lower wholesale prices, because those would require them to put out an effort to make the money that they could make without having to put in the effort in the first place.

MR. BALTO: Why don't you explain what a moral hazard problem is and say a few more things about how it would fit the slotting allowance context.

MR. RAO: The unsanitized version of moral hazard is cheating. In other words, I promise to do something, it's a hidden action problem, I commit to doing something that I don't subsequently do. So the retailer commits to putting in a certain amount of effort on the part of the manufacturer's new product, and then things change. A better new product comes along, or the retailer is merged with another firm that has a different hurdle rate, and so forth. And so they do not fulfill their commitments as they had originally committed to, and as a result of which the new product fails.

To correct for all these things, you could certainly make the argument that failure fees are a potential signal, just like warranties are. They assure the retailer that if the product doesn't work, we'll pull it and we'll pay for it, but the reason they might fail is if the retailer does not put in the requisite amount of effort, and that is the basic idea behind moral hazard.

MR. BALTO: Okay, good, good. Don Sussman?

MR. SUSSMAN: Going back to the issue of supermarket mergers and buying, Ahold has a different model than many other supermarkets, but all supermarkets I think wrestle with the buying structure as you get larger and larger. Ahold has gone to market with five operating companies even though we know it's less efficient. We're duplicating buyers, we're duplicating category managers, we're duplicating overhead. We think it's the most effective way for us to sell the goods.

That might not always be true in the future, but we wrestle with the balance between being effective in terms of selling and knowing what our customers want at the local level, and being less more efficient.

Today a vendor has to call on us at five different places because we make five different buying decisions. We haven't found a better way of doing that yet. We might some day. It's always an evolution.

One thing I have found I've been doing this for about 20 years, and it's a lot easier to buy the product than sell the product. Ultimately if you don't sell the product and sell it at a profit, you're not going to get very far.

MR. BALTO: Scott Hannah?

MR. HANNAH: On the monopoly issue, again we commend the retailers here who do take on local items, but the trend is obvious. As the mergers continue, there's elimination of buying offices. There's an elimination of warehouses. In the frozen food business, some 80 percent of the products are sold through our contracted broker or sales agents.

These people have roles to try to keep up with the mergers and the buyers. The sales agents or brokers warn us severely: If we don't expand our distribution to keep up with the mergers and expansion in the supermarkets, we are dead. There's a case where mergers of supermarkets are really hurting small manufacturer.

You can't just pick and choose a market. It's impossible. And I've probably said this for about the eighth time, but the merger of the manufacturers again is detrimental with the slotting allowance to the small manufacturers. They big guys can take those slotting allowances and spread them out.

You've got 500 items in that supermarket, you can increase the price of like 10 cents an item, build a fund that will pay for a lot of slotting on some new products. You're a small manufacturer -- I've heard a lot of these bakers talk -- it is impossible to do that. You do not have the spread of a conglomerate to do that.

MR. BALTO: Let me ask the retailers. So far nobody has talked about -- nobody has suggested that buying is becoming more centralized. By the way, generally when we look at mergers, one of the efficiencies that the parties typically present to us is that they will be able to centralize buying. They'll be able to exercise more buying clout and get lower prices for consumers, and they do suggest that buying will be centralized, but let's assume that hasn't happened so far.

But if it does happen, what's the potentials? Let me just ask. Maybe you could clarify for us a little more. Why isn't it happening, and is it likely to happen more in the future? Either Don or Mark?

MR. SUSSMAN: First, I think it has happened. Really it's a business-by-business situation. What I was giving was the Ahold experience to this point. That's not necessarily the industry experience.

MR. WEBER: I think we've had significant centralization of buying, from a standpoint that prior to category management, that we'll get into later, each store made its own decisions some years back. We've moved from each store making a decision to, in some instances, regions of chains making the decisions for the stores. In other instances, it is no longer the store but a centralized buying decision at the corporate head office.

So I think that if we look at centralization, we have to start with the store, and not where we are today and look at it just through mergers. There's been considerable centralization of decisionmaking in this industry.

MR. BALTO: Anybody can answer this, maybe Peter De La Cruz or any of the manufacturers. To the extent that buying is becoming more centralized, what are the implications of that for product diversity and consumer choice? Pierre?

MR. TADA: First I wanted to touch on central buying and consolidation. I think with the advent of mergers, one of the key rationales put forth is that, yes, we can reduce our cost, centralize our buying, reduce overlapping administrative costs and so forth.

And the state of purpose of the buying office is, We're going to have to justify this merger, so we'll have to drive down the price of the products that we're handling, and we have to pay for the merger so we need to keep our margins intact or rising.

So there are some costs to the merger, and they're really facing the capital markets and the promises. I think we all understand that. And I think there is an impact especially to the smaller guys, and even to the larger folks, that that's actually going on.

I'll put forth the comment that what we're really dealing with is some radical changes in business models, not only at the retailing level but at the supplier level and globally. There are different competitive responses that happen related to these competitive forces. We talked about Wal-Mart and Costco, very different models in different ways, that have driven cost out of this system and efficiently handled products, and it's a new model, and then there's the rest of the industry that's trying to respond in different ways.

I would put forth that responding to that competitive force to the detriment of small suppliers, medium sized suppliers, is really not what was intended, I don't think. I think it's coming back to what I mentioned earlier, about behaviors and what's going on in the marketplace.

And I think ultimately some of the activity really does have a negative impact on consumers, and, frankly, a negative impact on consumers is a negative impact all the way through the system, including suppliers like myself.

MR. BALTO: Mark?

MR. GIDLEY: Very quickly. I think what's good about this dialogue, and I appreciate the FTC for creating this forum, is life is hell for the small and medium sized manufacturers. If we did have one of the unnamed dominant manufacturers here, they would tell you life is hell for them too. They would talk about what they've had to do, what cartwheels they've done for Wal-Mart and what kind of product support and cost Wal-Mart has imposed on them.

That's not necessarily bad for the consumer. I look at Wal-Mart or Costco and I marvel at what the consumer gets today. The consumer gets today unbelievable variety from the supermarket, extremely strong variety from Wal-Mart and a very low pricing from Costco so the consumer, I know, is winning.

I think everyone here, at least from the supermarket retailer side, we're losing. Our problem is our model goes back 50 years, and our current Super

Center model goes back 20 years. Is the sun setting on that model?

We can bring in some small slow movers, but we can't have a store of slow movers. Our stores are full. Our planograms are full. We're at 1 percent margin, so we're happy to bring in your extra SKU, but there is a cost to that extra SKU. We're bumping something that's a known.

So the business problem remains for the supermarket industry. We are high variety, high service, often unionized, 1 to 2 percent net margin, and our store is full. You have new products. If I understood the speakers yesterday, the number of new products has doubled. Again the consumer is not hammered. The consumer is benefitting from this explosion in ideas, and I heard earlier that there were these great products that didn't come to market.

I'm sure every company has got great products that didn't come to market. I'm sure somebody out there wants to sell blueberry corn flakes and then strawberry corn flakes and every infinite permutation of a type of cereal.

We have limited space. We made this enormous investment in the store. We're on the hook for a 30 year lease that cost us 10 to 20 million bucks per store, and we don't have that kind of Leave it to Beaver situation where that store has a guaranteed stream of income so our problem is extremely real.

And I think the manufacturers have really got to look in their souls and say, How do we add value to these guys that are getting sizzled badly.

MR. BALTO: Mark, that was a good articulation of the point of view, especially on new products, but I gather you would never advise a client to charge pay to stay fees. What argument you would make to justify pay to stay fees?

MR. GIDLEY: The easy answer as an antitrust lawyer is that I need facts. I can defend the known. I'm good but I'm not that good, so I can't defend the unknown. My client hasn't brought me a pay to stay contract. If they did, there might well be a defense, and I would want to know more about the circumstances, what the choice was being made versus staying. There could be an opportunity cost of that SKU staying.

That's not what my client does. My client, 99 percent of the time we're offering slotting fees only for a new product. Once you're in, you're in. So you need facts.

MR. BALTO: It's okay, Mark, you have until three o'clock, and then I get another bite out of you.

MR. GIDLEY: Sounds good.

MR. BALTO: Bob Reynolds.

MR. REYNOLDS: I have no instance of this actually happening, but let's say that a competing supplier came in, in a narrow product line, and we were offered an amount to make the switch, offered a big slotting fee. So the retailer sits there and says, Well, I'd just as soon keep my Kingsford corn starch on the line but I can't afford to do it unless I'm asking it to pony up some money to stay on the shelf.

Now, Kingsford then has the option of either paying that or seeing their brand going out of the store.

MR. BALTO: Okay.

MR. REYNOLDS: It's a business decision at that point.

MR. BALTO: I wanted to turn to Rick Warren-Boulton. Rick's actually given a good deal of thought on the monopsony side and mergers. Unfortunately he hasn't been successful recently in arguing those points with the antitrust division of the Justice Department, but I thought Rick could illuminate for us the kinds of circumstances where antitrust enforcers should be concerned about monopsony issues and merger policy.

MR. WARREN-BOULTON: I resent that. First of all, I should point out that we're doing very well in Microsoft, and secondly --

MR. BALTO: I don't think it's a monopsony claim.

MR. WARREN-BOULTON: Secondly is that we did do your office superstore merger in one. This is biting the hand that feeds you.

The question that you started off with was, What's the nexus or what's the relationship between supermarket mergers and these fees? There are three kinds of concerns that the FTC could legitimately have with respect to supermarket mergers.

The first is simple monopoly power. It's a perfectly legitimate concern, but it's very hard to see what slotting fees have to do with that.

The second is what you would call classic monopsony power, and that's the situation in which the supermarket is facing a seller who's very regional, has local transportation costs, and actually the supermarket looks at them and says, Gee, if I reduce the price that I'm willing to pay, this guy will in fact reduce the price, but he'll supply less, okay? That's our classic monopsony situation.

Now, I don't know how frequent that is. My impression is that classic monopsony power by supermarkets is a pretty rare event, and what's more, since the purpose of this discussion is not whether or not mergers create monopsony power, but what the relationship of slotting fees is, an economist would probably argue if a merger between supermarkets did create monopsony power, that a slotting fee is probably a less efficient way for that to be exercised than through simply driving the price. For the economist in the group, it's clumsy. It's first degree price discriminating monopsony.

What does that leave with you as a real concern with mergers? I think that the answer as I've been sort of plugging here, is that if your real concern with slotting fees is a narrow, limited set of situations in which a dominant manufacturer is basically bribing a supermarket to impose costs on rivals or to reduce the amount it's willing to pay, where the purpose is that the manufacturer is trying to preserve monopoly power, and Microsoft is a good example of that, perhaps in an extreme, what's the relevance of supermarket mergers?

And the only relevance I can see offhand is it does in principle make such a deal easier. If what you're trying to do is tie up 80 percent of the market under exclusives so as to drive out a rival that has economies of scale, it's probably easier if that 70 percent of the market is in the hands of ten supermarkets than 500 supermarkets.

That being said, though, we're talking simply about reducing what economists would call the transactions costs, that slotting fees will reduce the transaction costs of exclusion.

Secondly, if indeed the fact of the matter is that after a merger decentralized buying is maintained, it's hard to see how the merger is going to in fact reduce the transactions cost to a dominant supplier of putting together that critical mass.

So it's there in principle and perhaps it should be looked at. I would say that the first obvious thing to look at if one is concerned about this sort of thing is empirically to ask this question: If you look at the supermarket mergers that have gone through, is it a fact that after those mergers there was a significant increase in the slotting fees paid for established products?

I would look at it both as a time series before and after the merger and also as a cross-section comparing large supermarket chains to small chains. That's an empirical fact. If you do not find that to be true. . . that's a necessary but not sufficient condition for concern here, so before beating ourselves over the head it probably might be nice to sort of check out what is the critical necessary condition for an anti-competitive hypothesis.

MR. BALTO: Yes. Irwin?

MR. STEINBERG: Just a short story. There was a recent acquisition by a major supermarket chain based in San Francisco of a major supermarket chain based in Dallas, Texas, where I happen to shop and buy tortillas occasionally. I noticed prior to the acquisition there were probably four brands of tortillas in a given store -- one or two stores that I go to -- and now there are only two.

And those two brands in the stores in Dallas are two companies who are more or less national and who pay large slotting allowances to the San Francisco based company for their California activities. I don't know if it's a coincidence or not.

MR. BALTO: I wanted to end things with a simple and uncontroversial question that I don't think anybody would be interested in answering. What would happen if slotting allowances were banned? How would that affect retailers, manufacturers and especially consumers? Bob Reynolds?

MR. REYNOLDS: Virtually nothing would happen.

There would be a shift, and if you were able sufficiently to find and prohibit slotting allowances, there would be a shift in the way that monies were spent to different kinds of deals and allowances with the same result in terms of transfer of funds from the manufacturer sector to the retailer sector.

MR. BALTO: But would some of those be more efficient? In other words, if slotting allowances went into couponing or just a discounting off of list pricing, wouldn't consumers be better off?

MR. REYNOLDS: That's a matter of opinion and how the individual firms happen to account for the revenues. I know of some major chains who plow them all against cost of goods and some who don't, so you have to come up with that distinction before you can make that conclusion.

MR. BALTO: Peter De La Cruz?

MR. DE LA CRUZ: I would say just on couponing, that at least from the manufacturer's perspective, the coupon would be directly related to their product sale. And slotting allowances -- there's no necessary correlation between product promotion and the slotting fee you pay.

I just want to back up. I think one aspect of the merger analysis needs to be the impact on the supplier or manufacturer sector. I think Irwin's story sort of is a predicate for my remarks in that regard, in that generally I think the history of branded goods starting in 1890s has been an attempt by manufacturers to reach consumers directly. As stated earlier in the panel, because of the multiplicity or diminution of network advertising, and I guess the different kind of communications environment we live in today, that shelf facing or shelf space is a critical way for communicating with the consumer.

You can see a situation where you would have less competition at what I'll call a branded or primary goods level and actually weaken competition there, so you would have one or two dominant manufacturers with some private label folks, and typically the private label folks are cheaper because they don't invest in R&D, that sort of thing.

So I think one of the implications is not only health for the consumer directly in prices, but health long-term in the manufacturing and supplier side.

MR. BALTO: Nick Pyle?

MR. PYLE: Briefly I think that the entry fee would morph into some other thing like a computer charge or a computer set-up fee or something like that, or a warehouse fee or a stocking fee. Interesting, our bakers are often change charged a warehouse fee when we do direct store delivery.

If it comes back, we send it back and say we don't use their warehouse, it will come back as a computer charge or an SKU fee. It's interesting.

But you have to draw a very fine line for when you're paying a fee that's a lump sum that's not tied to volume or price. If you're doing something different, a facing fee to bring your product up to eye level or street money to put you in the middle of the aisle, that's different. That's value added, and you have to draw a line.

So I think the no-value entry fee lump sum is going to morph into something else.

MR. BALTO: Let's see. Pierre Tada I want to do the manufacturers first, and then the retailers and then the consultants.

MR. TADA: I think if the slotting fees were to disappear all of a sudden, and assuming it wasn't the water bed effect where you push it down over here and it comes up over there, that there would be more focus on the product and more sensitivity to the movement of the product and consumer prices, and I think it could actually bring consumer prices down.

I think it would encourage some innovation in competition, and I think the skew towards bigger will be a little bit more balanced to big and small.

MR. BALTO: Let's turn to the retailers. John Eagan, did you want to contribute?

MR. EAGAN: Yes. If they were banned, it would come away, it would come back as a different form. There's no way it's going to go away. They're not going to leave it with the manufacturers. They become dependent. The retailers become dependent upon it in my opinion. The best way to address it probably would be to give some guidelines, give the manufacturers and retailers some guidelines, and let us play on a level playing field, and investigate where there seems to be things that are going awry.

MR. BALTO: How many other business people here at the table think that guidelines would be a good idea? About four or five hands. Jay Campbell?

MR. CAMPBELL: The question would be what would happen to those funds and how would they end up back into the marketplace. If it stayed at the manufacturer level and went on their bottom line, fine, then your 401 K goes up and you're real happy. But if we believe it's going to go into the lower price of the product, I think we're being very naive.

I think the reality is if it goes to the power buyer disproportionately than the other competitors. Then you have a discriminatory impact, and I think that will be the real concern, and that should be the concern of slotting today. Is it disproportionately being distributed in the marketplace?

MR. BALTO: Don Sussman.

MR. SUSSMAN: I think there's a number of different scenarios. One is that supermarkets will make less money. In that case I would hope you would have room for me over at the FTC, David, because I don't know where I would be. So let's reject that one out of hand.

MR. BALTO: Absolutely, Don. You noted what the salary scale here was.

MR. SUSSMAN: So I think really what would happen is, first, some of that money would come back to the retailer from the manufacturer in other ways. Some of that money would be put into the manufacturer's pocket. Some of it would be spent on the customer, marketing to the customer. Some prices would rise.

If all that money doesn't come back to the retailer to protect our bottom line, there would be upward pressure on retail prices. It depends on the marketplace -- if we could get it or not -- but the bottom line is it's got to come from somewhere.

I also think there's going to be less items on the shelves. Today we take in thousands of items. There is real cost of putting those items through the system. There is really risk associated with discontinuing items. If new items come along without fees associated with them, there would be less reason to take items, take on the risk and take on the expenses, so I would see us taking on less items. There would be less reason to take on items.

MR. BALTO: Would your answer change if only pay to stay fees were banned?

MR. SUSSMAN: I guess as somebody who doesn't use those as a business model, and doesn't see the value in those, I have less problem with that. I guess I don't like the idea of being constrained in the way we do business. I like to choose. I would like to put that aside as a bad business practice that we wouldn't use because it's a bad business practice, but I don't like the government getting involved in how we run our businesses to the same extent as you probably would like to.

In terms of guidelines, I would have problems with guidelines because a store is not a store. There's a difference between a convenience store, a ma and pa store, a warehouse store, a Stop & Shop that is 70,000 square feet and has 30,000 customers going through it every week and does over a million dollars of volume.

So the idea of a guideline sounds reasonable in the broadest sense, but when it comes down to specifics, I would not want to operate within guidelines, and I would rather the market functions and let the customer decide whether we have an efficient and a good business model.

MR. BALTO: Mark, you get to weigh in on this question on the last panel. Why don't we turn to Bob Houck.

MR. HOUCK: There seems to be a general agreement that it would have to be made up in some way or another. I was just doing some quick math, and I think that the total grocery market is something in the vicinity of like $350 billion or something like that. The number has been adverted to here that slotting allowances are around 9 billion, which means that they are around 2 and a half percent of the total volume in the market, which I think is probably pretty much equivalent to the profit margin of the grocery business.

So the economists have told us that up front lump sum payments generally are not passed on to the consumer, that they tend to go to the profit. Well, that would mean that the slotting allowance is pretty much equivalent to the profit. If we took the slotting allowance away, it would have to be replaced with something equivalent and would have to be replaced with something equivalent that does not go to the bottom line or is not performance based.

MR. BALTO: Win Weber.

MR. WEBER: I believe that if we took the slotting allowance away, it would just be served up in another form, and the retailer will still manage their buckets of money however they financially account for their business. Some are true net cost operators who drop everything right down into net costs. Others put their monies in their various pockets.

I agree with Bob, to try to eliminate the slotting allowances will not change one iota the financial structure between the manufacturer and the retailer, other than the fact that the monies will be served up differently.

There is a perspective, though, in terms of pricing. I think we should keep in mind that Wal-Mart is spending slightly under $1 billion on technology this year. As a percent of $165 billion in sales, actually it's a relatively low percent versus what other supermarket operators have to spend.

That technology investment that Wal-Mart is applying is going directly back to the consumer almost by the dollar, either in service and price. The market right now almost has a retail price ceiling out there wherever there's a Wal-Mart Super Center, and in that context I think the issue of are consumers being served today, I think the market today is more competitive and serves the consumer better than it has in years.

And I think slotting allowances are such a small percentage of that total and so insignificant relative to the magnitude of what's going on out there today that I don't even see this as an industry issue.

MR. BALTO: Scott Hannah?

MR. HANNAH: Elimination of slotting allowances again would level the playing field. Slotting allowances right now are the primary reason I think that small, medium sized manufacturers are being driven out of business, vis-a-vis the tortilla industry down there.

If a retailer came to me as a small manufacturer and said, Well, we're going to have to make up the money in other ways like trade allowances, I would say great. You want to put up more displays in my product, more ads in your store, more coupons, that's excellent. I'm trying to reach the consumer, so the consumer wins. The consumer knows about a product.

Off-invoice allowances are very, very common. There would be more off-invoices allowances, deeper, which the retailers pass on so they would get a price advantage. That's a win/win situation.

MR. BALTO: I know we've gone over this, but this is an important point. I want somebody to respond to Scott's point, because a lot of other people have said, Oh, it doesn't make any difference ultimately to consumers where this money goes, and Scott describes the scenario where it really does make a difference if the money goes into slotting allowances or something else.

So what's the answer to Scott's comment?

MR. SUSSMAN: Well, there's a difference between spending the money on the customer and putting money in the retailer's bottom line. Running more volume can help put more money in the bottom line but not necessarily so. If you give me a thousand dollars and I put it in the bank, or you spend a thousand dollars on my customers, that's not the same to me in an economic sense. There is value to spending a thousand dollars on my customers but not necessarily dollar for dollar.

MR. BALTO: Thank you very much, the panel. This has been very informative. We get back together in an hour and five minutes. The closest place for lunch is The Top of the Trade, which as you will recall has fried chicken with homemade potato salad on the 7th floor. We'll start promptly at 1:30 on category management.

(Whereupon, at 12:10 p.m., a lunch recess was taken.)

AFTERNOON SESSION

(1:30 p.m.)

PANEL 4: CATEGORY MANAGEMENT AND CATEGORY CAPTAINS

PANEL 4 MODERATORS

MIKE ANTALICS, FTC

CHRIS GARMON, FTC

PANEL 4 GUESTS

JEFF SCHMIDT (Attorney)

CHRIS MACAVOY (Attorney)

BOB REYNOLDS (Consultant)

SCOTT HANNAH (Pacific Valley Foods)

BOB STEINER (Consultant)

GREG GUNDLACH (Professor, Notre Dame)

BART WEITZ (Professor, Florida)

DON SUSSMAN (Ahold)

IRV SCHER (Attorney)

WINSTON WEBER (Consultant)

KEVIN HADE (Ukrop's)

MR. GARMON: This is panel 4, the category management and category captains panel. The way we're going to work this panel, what we thought we would do first, after we have everybody introduce themselves as before, and hope that all the chairs and tables stay together --

MR. SUSSMAN: I didn't do it.

MR. GARMON: What I thought we would do is we'll go around and first try to define what category management is, what category captains are, and then we have a short video to show you, and then after the video, we'll talk about some of the potential antitrust implications of category management.

So starting with my right let's go around, and everybody say your name and your affiliation and what you do just briefly.

MR. ANTALICS: I'm Mike Antalics. I'm deputy director in the Commission's Bureau of Competition here.

MR. REYNOLDS: I'm Bob Reynolds, Reynolds Associates from California, and I work on marketing issues associated with the grocery business.

MR. MACAVOY: I'm Chris MacAvoy from the Howry, Simon, Arnold and White law firm. Our firm represents a lot of different interests, retailers, manufacturers. I personally represent a lot of retailers and have done work over the years for the Food Marketing Institute, which is a trade association of grocery retailers and wholesalers.

MR. BALTO: I'm David Balto, and I used to be employed as a moderator for the FTC.

MR. GUNDLACH: I'm Greg Gundlach, professor of marketing at the Mendoza College of Business at the University of Notre Dame.

MR. HADE: Kevin Hade. I'm vice president for category management for Ukrop Supermarkets in Richmond, Virginia.

MR. HANNAH: Scott Hannah, CEO, Pacific Valley Foods, Bellevue, Washington.

MR. SUSSMAN: Don Sussman, executive vice president of purchasing and supply chain for Ahold U.S.A.

MS. MILLS: Pamela Mills with the Tortilla Industry Association and also a tortilla manufacturer.

MR. STEINER: I'm Bob Steiner, for 30 years a consumer goods manufacturer in Cincinnati in a number of different industries, then a professor at the University of Cincinnati, and then came to the FTC and the Bureau of Economics, and now am just doing some writing and a little bit of consulting.

MR. WEITZ: I'm Bart Weitz; I'm a marketing professor from the University of Florida.

MR. SCHMIDT: I'm Jeff Schmidt with Pillsbury, Madison and Sutro, and I represent the Grocery Manufacturers of America.

MR. WEBER: I'm Win Weber, president of Winston Weber & Associates. We consult with both retailers and suppliers and are known as one of the three leading firms in the world in the design of category management.

MR. GARMON: And again, I'm Chris Garmon, an economist here at the Federal Trade Commission.

I thought we would start out today with a question to Don and Kevin. What is category management? How do you use it? Why do you use it? How does it benefit you?

MR. HADE: I'll go first. Again Kevin Hade with Ukrop Supermarkets. I guess I get that question a lot from consumers when I call them and ask them about a product. Vice president of category management means nothing to consumers. It's an industry word, and then I explain what I do, so I'll tell you what I tell consumers.

Primarily my responsibility with Ukrop's and our group is to manage the product assortment and merchandising strategy of our company. I think the word category management, how we interpret it and apply it to our business speaks to leveraging and the use of technology to manage product, price, promotion, et cetera.

I think this whole thing has really come about as the technology wave and information age has taken a foothold in our business over the last 10 or 15 years.

MR. SUSSMAN: Not much different, other than we would look at category management as a way of taking our large business, like our grocery business, and breaking it down to smaller business and having ownership of that business by a person or a team. That group then takes responsibility for understanding the customer better -- pricing, promotion, all the things that we do with that category -- but giving ownership to that business.

So we take a large business which is huge, which is 30,000 SKUs, and break it down into manageable chunks, adding people to it, adding information to it so they can make better business decisions. We think at the end of the day, we'll do a better job satisfying our customers' needs and running a business.

MR. GARMON: How does that differ from what happened before category management came around?

MR. SUSSMAN: Well, for us what you had was a lot of specialists. You had one group of people that just did replenishment, another group of people that just worried about shelf allocations, other people who just did negotiated deals and other people who planned promotions, and what we've done is we try to shrink it down and give kind of a cross-functional view to a smaller group of people.

So the same person making the planogram decision makes the assortment decision, makes some of the pricing decisions, and certainly makes the promotional decisions. The same business was being done, but rather than having specialists do it, we've given ownership to a smaller group of people to make more of the decisions for the category.

MR. GARMON: So would it be fair to say that responsibilities are now delineated by category and before they were delineated by task?

MR. SUSSMAN: Absolutely. For us that's true.

MR. GARMON: My next question I would like to direct towards Bart Weitz. How is category management used in other retail trades, to the extent that it is?

MR. WEITZ: Well, let me give an anecdote. My coauthor and I wrote a retail textbook that's used in a lot of universities, and my coauthor is more familiar with the apparel industry and department stores, but he wrote the chapter in which you would include category management under merchandise management.

He was totally unaware of what category management was, because in a department store everything is managed by category management, where in the Gap you will always see category management, and it's really very unique that this has come late to supermarkets.

I think that in addition to this cross-functional integration, category management really means sort of. We're going to manage, let's say, the detergent category as a collection of products and sort of try to find a global optimum rather than making deals with each brand on a brand-by-brand basis. And as I said, in department stores and in apparel stores, that was always done that way.

The other thing that's a little bit different is that in a department store, you would never sort of say, Well, Liz Claiborne, I want you to come in and organize the women's category for me. I mean, the buyer or the people in merchandising for Women's would do it, and it's fairly unique to the supermarket industry that you would have such things as category captains.

MR. GARMON: Before we get into category captains, specifically how does category management benefit you as a retailer? Does it increase the revenues of a particular category, and if so, is it mainly in terms of movement, or is it in terms of the prices that you can charge? Maybe, Kevin, you can start.

MR. HADE: Great, I will. Thank you, Chris. Kevin Hade again with Ukrop's.

First I just want to tack on to a comment earlier as well, How does product category management differ today versus maybe 10 or 15 years ago? I didn't have the privilege of being around 10 or 15 years ago at our company in this capacity, but one of the things I think has changed a lot was, if you look at our industry as a whole, it was a very instinct-based business for many years, where people made decisions by the gut, grew up in the business and knew what to do, et cetera.

And I think today it's just become so much more sophisticated you can no longer do that, and I think there's a big flow in that direction.

To tack on to your current question, I think we're looking at how to maximize profitability. I don't think it's about how to charge more for products or do that type of thing. We look at a plethora of data in making decisions, marketing data, scan data, data provided by the vendors in the area, as well as we have a loyalty card so we understand what individual households are purchasing.

We mesh all those factors together to try to maximize consumer satisfaction as well as profitability so we can compete against larger companies. I think that's what we're doing today, and that's probably the difference in our business.

MR. SUSSMAN: I just want to add, there's a long-term planning aspect of category management that didn't exist before. Their planning was usually ten week cycle for most supermarkets. Every week you do the next week ten weeks out, and it was almost a week by week struggle.

Category management really steps back and looks at a category over a period of time. You do much more planning, long-term thinking about the category so that's something that's helped our business.

In terms of what the benefits are for the retailers, we look at it as sales, customer satisfaction and then profits leading from that, and they come from all different ways. There is a cost element that could be there, but the bigger piece is the selling element in terms of having the right products on the shelf, the right price and right assortment, so we look at customer satisfaction and sales.

MR. GARMON: Maybe to make things more concrete, since category management seems to be a very theoretical topic, let's take two categories. I've been in the grocery store recently. Cereals I often see are arranged by brand, Kellogg's, General Mills and Post. In one store recently I saw that salad dressings were arranged by types, French all together and Thousand Island and so forth.

In making a decision like that, just in terms of product placement, how would you use category management to decide whether to place things by brand or by flavor? Either Kevin or Don?

MR. HADE: I'll try to take a stab at that. I think as I mentioned before, category management is not about -- I think I'll use my analogy again. I think 15 years ago some guy would have come in and said, Hey, I think I would like to try it this way and see what happens.

I think today's business is much more sophisticated. I think you have the ability to try things and measure the results. Sometimes you can -- you have the data. Maybe it's been tested somewhere else, and a vendor is coming to you and saying, Listen, on a national level we're recommending you shift to this type of merchandising segment and we can show you the data to support. We think we can increase your movement, profitability, by a certain percentage.

At that point in time, if we were swayed by that argument, we would probably make a decision to test it in our environment and see if we achieve some of the results. Again within the category management system today, we have the ability to look at different specific goals we were looking for as a result of the change.

Maybe it's not all just about driving profitability. We may want increased penetration of a certain type of cereal within our top two or three deciles of consumers. I mean, we can select the criteria we're looking for to measure the success of that change, implement that change, and then come back and post-measure that.

If we haven't achieved that, we keep working at it. I think as Don alluded to earlier, this isn't about a one-time fixed category management. We are constantly evaluating strategically the short-term and the long-term. And the environment is constantly changing, but within each one of these subcategories you have to constantly be thinking about how the environment is changing in your area.

MR. SUSSMAN: In terms of how we set an aisle up, one of the bases of category management would be the consumer decision tree. That's trying to understand how consumers in a category think about the category, how they shop it, how they're segmented in terms of their needs, and how the products themselves are segmented.

The consumer tree can be based on interviews, an understanding of the customer through market research. It can be based on empirical evidence in terms of how people purchase. Often we turn to our vendor partners if we're using vendor partners, or at least vendor input, for their view of how they see the customer.

And in the case of Stop & Shop we use multiple vendors -- and I'm sure we'll get into that issue -- to understand the views. This is how the customer wants to shop it, how should we organize ourself to fill their need?

Now, sometimes we try things that fail. Sometimes things seem intellectually obvious but the customer rejects them. One of our competitors set their soda aisle by flavor and said, Okay, all the orange sodas will be in one section. It makes sense if you want an orange soda. Very confusing for the customer. Six months later they reset it.

It made sense intellectually, and certainly people think about it differently. They don't know always know that Coca Cola has an orange soda, so the answer to your question is the consumer's decision tree, multiple inputs to that, and then once we decide how the customer wants to shop, then we try to figure out how to satisfy their needs.

MR. GARMON: Bob, you had a --

MR. REYNOLDS: I was going to use that very same example of the difference between Stop & Shop and Shaw's soda set, which I saw four or five years ago when the Shaw's set was all by flavor.

MR. SUSSMAN: I was holding back.

MR. REYNOLDS: But it was interesting, I'd never seen it that way, but you also have to understand that Shaw's is heavily dependent on their private label program, and this was a way to demonstrate the difference between price of national brands versus private label in the soda sector.

So the point is that if Shaw's and Stop & Shop were both using a high-power category management program, and they both were at the time, it doesn't guarantee the sets are going to look the same because there's differing philosophies in the process as well.

MR. GARMON: Now, we have heard a few comments about supplier inputs, and I wanted to talk about category captains. If either Bart or Don or Kevin could tell me what is a category captain and why are they used? Maybe we can start with Kevin.

MR. HADE: Sure. Primarily, as we alluded to earlier, category management is a segmentation of segments of the business, so to speak. Within say the grocery category, we may break that down into maybe 100, 120 sub-segments or sub-categories.

The use of the category captain usually entails looking within the vendor community and selecting either the primary vendor or secondary vendor and assigning them the status of captain of the category.

Let's use the example you brought up, Chris, earlier about cereal. In that case you're going either to the vendor or the broker who represents that particular segment, whether it's Kellogg's or Post or General Mills. In fact that person theoretically is the main conduit between the vendor community and the retailer. That doesn't mean that we don't meet individually with each of the vendors.

What it does mean is when we make a decision to potentially rework a set in a particular area, in this case again cereal, taking the internal structure of Ukrop's, we would communicate to the captain that, Here are some things we would like to see done within the set. We would like to add the following products, we think we would like to take the following products out. Can you work out with the other vendors in this set a way to do that and bring that recommendation back to the team?

And they would work collectively with people, with our staff, et cetera, so maybe it's an added service that the vendor community is providing the retailer. They are very focused and knowledgeable about cereal, much more than we could be.

We can't afford to have a category manager for 140 categories in a grocery chain our size. Certainly I don't know where that breaks out. I mean, we have one category manager for our grocery business who has to manage all those subcategories.

We're very dependent on that information, and I think it helps build our relations with our vendors.

MR. GARMON: Are category captains needed for category management? I would like Don to --

MR. SUSSMAN: At Stop & Shop we don't have category captains or partners or any lead manufacturers. When we started the process a couple years ago, we did rely on, if you will, a partner in each category, and that was both for information flows, which they have available to them, at least they had available to them that we did not have, as well as expertise that they would bring to the party.

Today in Stop & Shop we have our own information sources. We still are relying on the vendor for market research and customer issues, but we don't rely on any one. We look to validate it and take input from all our vendors in a category, or at least many of the vendors in a category, so we don't think we need it.

We don't think it's good for our business at Stop & Shop. We still have -- some of the Ahold companies are still more relying on vendors. Our goal is to get everybody off of reliance on vendors and just using multiple vendors for the customer input.

MR. GARMON: On that topic, I can send the question to either Bob or Winston or Bart, do you think the use of category captains is sort of a transitional device in category management? Do those companies, whether in other retail trades or in grocery stores, to get started using category management would need a category captain, but then eventually would not? Yes?

MR. WEBER: I think first of all we, even though we're involved with retailers and suppliers we don't agree with the word "category captain" to start with. I think it has some implications that an individual or a company actually has control of a category, and in any progressive, successful retailer today, the category managers are taught to listen to all suppliers because that's how they make the best business decision.

A lead supplier let's say, which you were referring to, Don, a lead supplier is used or possibly identified for many reasons -- their available resources, their position in the category in terms of their knowledge of the consumer, and et cetera and et cetera, et cetera. They can be an important resource to that category manager to help the category manager make good business decisions.

The retailer has certain information that the supplier does not have, which is basically POS data, internal research. The supplier has certain information that the retailer doesn't have -- new product introduction plans, advertising plans, is advertising going to increase this year or decrease this next year.

By aligning this information, both parties are better able to align their strategies, their tactics, and, if they can do that, the consumer is ultimately going to benefit from better business decisions. So I do not look at the captain as a transition person at all, or a lead supplier as transitionary.

Worldwide we have yet to find one supplier, or one retailer rather, who could support category management the way it's written in the textbook. This is not saying the textbook is right, because the textbook records a highly complex process with many templates and so forth, but if we were to follow the textbook of category management, there's not a retailer in the world including Wal-Mart that could truly marshal the resources themselves without some type of support from a supplier.

However, recognizing that over 90 percent of all retailers say they're following the textbook, but practically speaking only 10 percent are close to following the textbook, I think we do best to look at this as category level planning. Taking the word "category management" out of it for a second, we recognize that we have a broad range of applications to a basic business planning process called category-level planning that we're allowed to do today because we have the technology available to give us information down to the category level, SKU level.

Ten years ago we never had that information any lower than the department level, and so it's a matter now of taking the technology and information we have available and applying that to help us make hopefully better business decisions, and the point you were making at Ukrop's, moving from that gut-feel, relationship-selling environment to where we've moved much more toward a fact-based decision making environment today.

MR. GARMON: Yes?

MR. WEITZ: I think there's actually no issue that sort of managing at a category level is better than managing at a brand level, and having cross-functional integration is better than not having that integration in terms of an efficiency argument.

I guess the issue is whether you want to reject the word "category captain" or not. It's a broad spectrum of the influence that one manufacturer might have in terms of influencing how that category is managed for a retailer. So you see actually in the Ahold case that they move from starting out with having the manufacturer have a lot of influence, to moving to a place where the manufacturer -- the key manufacturer or the dominant manufacturer -- doesn't have that much influence. All the players in the category have an influence in the decision, but the decision is made by the retailer more than the category captain.

And if you look at it from that perspective, I think that dominant manufacturers want to have their products sold more than their competitor's products sold. Now, of course, if they abuse that they'll be thrown out as being category captain, but ultimately it would seem to me that the retailer has to take more and more of that responsibility.

So I would contend that this idea of having the dominant manufacturer have a lot of influence over what items and what promotions are made in the category is actually decreasing over time.

MR. GARMON: Let me go to Kevin for just one question on that. How do you choose your category captains? Since you mentioned before that you really can't follow the Ahold model here, you're too small to do that, how do you choose your category captains and how do you determine whether they're giving you advice that's not biased?

MR. HADE: First let me speak to another question. In looking at this in a cyclical standpoint, I believe that potentially this type or way of doing this is maybe a step in the process. We are an organization that's relatively new to this type of thinking. This type of thought I think has been embedded at the vendor level for many years, and this is almost like a transfer of information of how we think and how we analyze categories, et cetera.

And I think early on in your life cycle of this process you probably are more dependent upon the sophistication of thinking from the vendor community. So if we come back here five years from now, and I hope we don't have to, then we might have a different answer, maybe closer to what Ahold did today within that thinking.

Getting back to your most current question, it's not a one size fits all by category criteria, and it's not that biggest guy always gets it, et cetera. I think just as important is that factor of trust. How well do we know this particular vendor? What has been their performance for us in the past?

As we've testified in a couple of the other sessions today, I think relationships are very important to our company. We're not just about the short-term, and I think we're fortunate to have a number of people that we've worked with for many years, we have a lot of trust with, and they don't abuse that.

I think there are checks and balances within the system that, should they attempt to abuse their empowerment in this particular case, they're going to find themselves on the outside looking in. Again we have checks and balances in the system where we can make that work.

But I think it's a mixture of having a certain amount of knowledge and business volume within the category, but probably more importantly how good do we feel about how well this person really understands the business.

MR. GARMON: Win?

MR. WEBER: I was just responding to the dominant manufacturer theory which I knew you were going to get me on here. First of all, let's recognize that category management is a retailer-driven process. Therefore, the retailer, the category manager, is in fact the decision maker, and that category manager has performance measures that are sales, profit, ROI, whatever those measures may be.

If a category manager delegates the decision authority of that category to a supplier, they are going to be relatively ineffective and ultimately make the wrong business decisions because they'll be making decisions in favor of the supplier as opposed to the consumer and so forth.

I think it's important, though, to recognize that in any selling situation, both sides at the buyer's desk carry biases into that equation. Every supplier representative walking into a category manager's office has a paycheck that has the name on that paycheck of their company, and the buyer is sitting there with their paycheck.

That's what the negotiation planning process is all about. It is recognized that there are biases. That's why it's important, as I think as Don mentioned, to teach category managers to listen to all suppliers. You cut through those biases so, hopefully, as a retailer, you're making the right business decision for the right reasons. So I am less concerned about the dominance issue as long as I've trained category managers to manage the business well.

I would also admit that there are certain retailers I've heard of in the industry who hand a category over to a supplier and say, Manage this for me. That is not effective business management from a retailer standpoint, and I think it's very dangerous for a retailer to pursue that course.

MR. GARMON: Bob?

MR. REYNOLDS: Most of what we've talked about so far has been talked about from a single brand perspective. But the reality is that the people who function as a category management representative are often brokers, who will be dealing across several lines and have built trust with the retailer across several lines, and may in certain circumstances be even officed for a certain portion of the week within that retailer account situation.

They apply a lot of resources against this process, and so let's don't just all think in terms of its the P&G guy or the Coke guy who is a corporate representative of those firms that plays that function. Very often it's a broker kind of a situation.

The other thing that I always tell my clients who are interested in marketing effectively in this business is that they have got to know the retail part of the business. They have to know their lines better than the retailer does in order for them to be effective against their categories.

So everybody in order to be effectively marketing their own products -- should be effectively vying to be the category captain. If they have that mindset, whether they actually get into that position, they're going to be better off in marketing their own products.

MR. GARMON: Bob Steiner.

MR. STEINER: I would like to put this, if it's not out of order, in a little bit of a historical context. Before there was category management, you read a lot about channel partnerships which were individual partnerships between a manufacturer and a retailer and really pioneered by Wal-Mart and Procter & Gamble in 1985.

And there was the wonderful idea behind this, a revolutionary idea concerning relationships. If the manufacturer and retailer could get together, trust each other, and analyze the whole cost structure and the channels of distribution, that in that fashion they might be able to take costs out of the whole channel from the manufacturer to the wholesaler to the retailer.

That was a great idea because it wasn't integration. It wasn't franchising. It wasn't vertical restraints. It was a new concept. And so you saw literally hundreds of these channel partnerships developed, and a lot of them were very successful in doing this and reducing cost.

But then I guess there came to be too many of these partnerships. I know K-Mart had over 300. VF Corporation had over 300, and when Procter went to category management from brand management I think that helped. At the same time the Food Marketing Institute was trying to help the supermarket industry recapture market share and had their efficient consumer response model, and this model also was based on categories.

And so now you had these individual partnerships, vertical partnerships morphing into a whole category vertical relationship. In the FMI write-ups, you see, as Win said, they're extremely complex and very driven by data and systems. It's very hard to operate them, and you can see that in practice. But they all relied on this vertical relationship and the fact that the manufacturer could bring to the party a lot of things that the retailer couldn't, and vice versa, so it made a good marriage.

But then what concerned me, there is this efficiency, and you can read the trade press and see a lot of examples, I don't know if they're all true, all over the world of real savings that were extracted in the channels of distribution. But you also seem to have in some cases, I know not in all cases, a very worrisome structure in which you have a category captain from a dominant firm. And category captains must be valuable because they're being auctioned off recently, and you read about that in the trade press.

The category captain may be making decisions on the planogram and on what SKUs will be selected, and since a Procter & Gamble or a General Mills can bring to bear a lot of really expert people, well educated in consumer behavior, et cetera, and a small number of categories, and the retailer has 250, if he's a supermarket, different categories, and his category manager who interfaces with him isn't going to be as well informed. He can't possibly be. He's got too many to handle.

MR. GARMON: We'll talk about the possible use of category captains excluding others after the video.

I wanted to put out one more question before we go to the video, and that is sort of relating category management back to what we've been talking about these past two days, slotting allowances.

What's the relationship between category management and category captains and slotting allowances? Particularly for Don and Kevin, how do you choose which products to take? Is that primarily based on your category management processes, or is it primarily through the use of slotting allowances, and what relationship do slotting allowances have with category management?

MR. HADE: I'll take that one. First of all again, I think it's going to depend on the company. Speaking about our company, again as you've heard us say in a couple of the other sessions, we're an independent grocer who has to compete against large companies. We do that by offering variety. And offering the products our consumers want.

Again, in many ways, we like to use our size to an advantage. By being smaller we can get to know our consumers on a more intimate basis. I can tell you the selection for products at Ukrop's Supermarkets is not driven by slotting allowance. It's driven by what we think our consumers want to purchase.

I think -- again as I mentioned in some of my opening remarks -- we have a tremendous amount of data available at our fingertips from scan data, but also understanding our household purchase data, it is very important to us what our top decile customers are buying.

We do not want to lose those shopping baskets, and we may elect to carry an item, say in the cereal set, that on paper isn't the best deal, just to look to the cereal category. But when you go and run a cross reference on that particular SKU and find out that of those few boxes you're selling, they're in some of your better customers' baskets, that's not something we want to take off the shelf because we don't want to send them somewhere else.

I think the basis for making decisions is that our company is not driven by whether someone's going to pay us a fee to come into our store. Generally speaking anyway, we're not a company that views those fees as a profit. Our charges in that area are pretty small and really are set up to just cover our expenses to make the changes, so that would probably again favor our decision in that area.

But again our basis for carrying products is what we think we'll sell in our marketplace.

MR. GARMON: Don, what's the relationship between slotting allowances and category management at Stop & Shop?

MR. SUSSMAN: Well, first of all we don't use category captains so that's really a non-issue for us. But first of all our category management is -- we have teams. There's a category manager, and they have a buyer or multiple buyers, depending on the portfolio that they're managing, and so they operate as a team.

At this point we've written category plans for virtually every category. We've been in it long enough so we're in the refresh side for virtually the first time out. We have a strategic plan for that category, and as new products are offered to us, depending on how that item matches our plan, it's up to the buyer and category manager to take the presentation, and then bring it to the buying committee with your own recommendations.

And the category manager has the ability to override the buying committee because we think ultimately it's the category manager that needs to make these decisions.

I'll give you an example. A category plan, say for paper, can center around larger sizes because they're more efficient to handle in the store, and we also pantry-load the customer, meaning we get a chance to sell them more at a time. So with that we might be bringing in large sizes. Large sizes that are usually club store packs usually don't have slotting fees.

If that category manager wants to bring those items in as part of their plan, they bring it to the buying committee, state their case, and they do have the ability to override the buying committee. The buying committee is made up of their peers. It's other buyers and category managers who just challenge each other.

So ultimately slotting for Stop & Shop is an input into the process. It's not ignored, but it's not the only determinant of getting in or out. Items that have slotting are often rejected. Items without slotting can be accepted, but obviously we want slotting so we try to reward people that give it to us.

MR. GARMON: One -- Bart.

MR. WEITZ: One way of looking at this might be this. First of all, category management I think is much more exclusive than slotting allowances in terms of the products that it deals with. Slotting allowances, as we talked about, are mostly related to new products, although we've indicated that there are other allowances for existing products.

But I think conceptually one way of looking at this might be that they're both trying to sort of accomplish the same thing in determining what SKUs you're going to stock in the store. But category management is a much more proactive approach towards it, where slotting allowances conceptually more of a market-driven mechanism.

If you pay me more, I'll put you in the store, and so you're sort of allowing different bidders to bid for that space, as opposed to you figuring out what the space ought to be, how the space ought to be allocated more appropriately.

MR. WEBER: I look at category management on a much broader scale. I start with the strategic plan of the retailer. Within the strategic plan of the retailer there's a market position that comes out of their marketing plan, whether it be Costco that says they're going to have a limited assortment, larger sizes or what have you.

There's a framework, and the strategic planning purpose is to guide the allocation of resources across the business. We have the luxury today of driving this type of process down deeper into the business. Don mentioned category plans at Stop & Shop. Well, the component of those plans, he has category roles, and a signature or a priority category may state its strategy as a broad assortment for a lot of good reasons.

By the time he gets down into a fill-in category -- shoe polish may be one brand -- they develop decision guidelines by category role type that provides a framework for the allocation of resources against the business. That means the category manager then is going to be working within that framework which means the breadth of variety, the amount of promotion, the pricing strategy, the space management strategies will differ across that store based on the relative importance or lack of importance of that category to the total. The retailer today is trying to get a much higher return on one of their most key assets, which is the store, which is critically important, the key asset next to the consumer obviously.

So there's a framework here, where this is by no means an open discussion that suggests I can do this or do that, an assortment. The category managers are working within a relatively tight framework that they've helped develop and that has been approved by the senior executives.

MR. REYNOLDS: Chris, one point here? I understand there are certain categories that retailers do give over entirely to an outside vendor, kitchen gadgets for instance. It's a rack jobber that comes in and decides what is going to go on the rack and services it, towels, some candy kinds of things, et cetera, magazines.

MR. GARMON: On that point I want to leave enough time for a discussion of the antitrust implications of category captains. I think the video -- I haven't seen it, as much as I know about it -- goes to that point. So why don't we show the video now, and then I'll come back to Greg and Bob again. And we'll talk about some of the antitrust implications of category management.

(Whereupon, the videotape was then played.)

MR. GARMON: That was sort of an extreme example. Professor Gundlach, you had a comment.

MR. GUNDLACH: The comment really regards an earlier discussion. I think it's important to get on the table, and perhaps some of the people can respond to it, is this: What is the private label mix in here? We've been talking about decisions regarding the entire category, and the objectivity surrounding that, and the use of a category captain to help in that process.

How does that relate to the store brands? Are they considered in this process? Are they off the table, on the table? Perhaps someone could illuminate on that.

MR. SUSSMAN: They're very central to our category plans. At Stop & Shop the category manager has ownership of the private label within their category. It's up to them to figure out the role that private label is going to play within the overarching private label guidelines that we have, but also to increase the variety, decrease the variety. It could well be that we have many price brands that are less profitable to us than our private label, and some of those will drop in order to promote our private label.

So it's very central to our category plans, and they're a major element of our plans.

MR. WEBER: What Don is saying is not just Stop & Shop. All of our consultants we compete against, we all suggest very strongly that private label be a part of the total planning process responsibility of the category manager. And if it's not, then you're really not in category management.

MR. SUSSMAN: There are times when our private label actually turns out to be on an A, B, C basis less profitable, and we drop it. It doesn't have a role in that plan. There are other times when, again, we want to promote it and grow it as bigger percent of our total.

MR. ANTALICS: Before we move on, whoever represents the party on the tape, if you won't mind spending a few minutes with me afterwards.

MR. WEBER: They're all wearing stripes.

MR. ANTALICS: I thought what we would do to start off the second part of our discussion here, and maybe if we can hear from Scott and then Pam, I don't care in which order, some of your thoughts on what you've heard. We've heard some of the benefits up to now of category management. I am wondering if you had any other experiences.

MR. HANNAH: Yes, I'll give you a very direct experience. We lost distribution, I made notes -- in Cincinnati, Denver, Salt Lake City, and Los Angeles -- because we did not have a broker that was strong enough representing us on category management. The brokers, as Bob Reynolds has said, the sales reps are the ones that do the category planning, not the retailers, in these markets. They make recommendations -- sorry to disagree with Winston again but it's not retailer driven.

MR. WEBER: You're just building our counterpoint argument.

MR. HANNAH: Exactly. It's not retailer driven. The retailer might have overall broad goals, but the actual schematics, digital shelving, everything, are with the big brokers, big sales agents. What happened in our case and what does work if you're careful, let's say Safeway for example, they'll go to the strongest frozen vegetable broker and make him responsible for the whole planogram on frozen vegetables.

He'll go to the other broker representing potatoes, french fries, make him manager for that category, and what you have is mutually assured destruction. If these guys aren't fair the retailer won't buy it, but also if they try to screw the other guy they're going to get hosed themselves on their open products, if you follow.

What happened in the markets where we lost was we did not have a broker that was involved in category management, and we were like the little companies that got kicked out on the slide presentation. So category management is very valuable and I think a real asset, but you have to be careful where you sit in the power struggle of things. Thank you.

MR. WEBER: Can I counterpoint just for the heck of it? As we consult with our manufacturer clients, the broker is the extension of their selling arm, and it is their responsibility to select those brokers or those sales organizations that can meet the requirements of the customers or potential customers.

If a broker does not understand category management and doesn't know how to work within it, it's not the retailer's fault. It's the supplier, and that's their responsibility.

MR. ANTALICS: Pam?

MS. MILLS: It's been my experience with category managers that we're never asked our opinion. That's not even part of the program. What I found in our market area is the category managers are all part of their full program with the slotting fee monies, where they're basically a labor force for the chain store.

For instance, Safeway came out with a big reset program where they brought in these new display racks. And in these display racks they implemented or placed within the most valuable real estate on that display rack, where it's at eye level for the consumer on the right and left-hand side of this four by three schematic.

And that one side is the area that my product is usually placed on, so I lost two whole rows at eye level. The competitor was able to reduce my shelf space to I call it unlivable living conditions and unlivable space. Basically they put together the reset plan based upon space to sales, based upon your sales data, all sales data, put in their space program, take it to the buyer, and they're like, It's a go, and the next thing I know, I got this reset schedule, and I'm going, What?

And it takes months and months to get anything reversed, corrected, changed. What I come back with is photos of the category showing that it's brand X that's driving the category so to speak, as they say.

When I come back to my photos, their space has no product on the shelves whatsoever, so how can they be driving this category? They're selling air, and I'm left with this inches of unlivable space, and the category captain basically can put a new rack in, take a new rack out, change a rack to another location because they're considered God.

MR. ANTALICS: So in your case the category captain, it's the dominant manufacturer in your category?

MS. MILLS: Correct.

MR. ANTALICS: And what access do you have to the retailer then, once the retailer decides to go with the category captains's recommendation or plan?

MS. MILLS: I just fit the schedule. It's done. It's not up for negotiation whatsoever. After that then I have to start bringing my numbers in and showing how brand X is not doing a very good job, and so it may take maybe a year later, but that's all lost sales, lost.

MR. ANTALICS: Let me just open up a question to the whole group here. What's your experience as to how often decisions are made in a product group by one particular company, by the dominant company, for example?

MR. HADE: I'll take that. At Ukrop's it's never done by one company.

MR. ANTALICS: Give us an example. Will you call in all of the companies in a category or a select few?

MR. HADE: I'm discouraged at what Pam is sharing because we would not do that at our company that way. I'll tell you it's a tough decision. A category manager, that's a tough job because you're a hero to one person and you're a bum to three other people almost every day, because you have to make touch decisions.

However, you run into situations, like we saw on the video, where at some point it doesn't make sense to maybe carry six lines. Maybe you need to cut back to five. That's from a SKU rationalization standpoint, but any time we're going to be looking at a reset in a particular category, we're not going to do it with half the people involved.

Even if it involves having a tough heart-to-heart discussion with a company, we might say, Listen we're reevaluating this business, and one of the things we've got here is we're seeing that X number of your products fall in the bottom 20 percent of the movement here, and we're having a hard time justifying you staying in this particular segment of the business. Can you tell us, if you were us, why we should keep you in this category. And we give that vendor the opportunity to make a compelling argument in that particular area.

Ultimately they may stay, they may go. But we feel it's important to have a dialogue with everyone involved in the process when we make a change.

MR. ANTALICS: Don?

MR. SUSSMAN: I'm pretty cynical by nature, and I think most people act in their best interest. If you ask a vendor to do an analysis for you, they usually have the end state in mind and work backwards, and very few large manufacturers will cut their open space back and tell you you should keep smaller people on the shelf because they have legitimate variety. And very few small people will say, We're really not adding anything to the category and you're out of stock on your fast mover so throw us out. So that's why we have to make those decisions.

MR. ANTALICS: Win, how about your experience? How often do you see one dominant manufacturer making the decisions for the whole category?

MR. WEBER: I've never see it in the U.S., Asia, Latin America or Europe. That doesn't mean it doesn't happen on the exception basis, because I think in this industry, a lot of things can happen on the exception basis.

I was listening to you talk, Pam, and I was thinking that could have occurred, that situation, without category management and before category management. We had space management and space management technology before category management started rolling in, and the same situation of getting the technology to a supplier to work with you could have occurred.

So it was behavior that could have been pre- or during category management, and in a small percentage of times, hopefully, those are the behaviors of the exception rather than the norm in the industry. I would hate to see us thinking that those exceptions are normal behavior.

I think there's another thing to take into consideration which is an industry problem. That is the store execution issue in the grocery business today, the part-time labor issue. The turnover issue, the execution at store level is not the best, even with the best retailers today. It's a real bear.

And if you're sitting there and a category manager commits to a given planogram of a given assortment and a given position of products and facings, boy, if you're 80 percent there in 80 percent of your stores, you're on the high end in many instances. You guys may correct me, but it's a real tough one right now. That's why there's studies going on in the industry, both industry sponsored and independent, as to how we can work on the execution piece of the business.

So there is an issue out there that exists to varying degrees, but common across the industry, on store execution.

MR. ANTALICS: Greg, you had something?

MR. GUNDLACH: We've been talking about the objectivity surrounding category management and the fact that retailers will often consult several manufacturers. Just one query, how often do the manufacturers come up with the same result?

In other words, do the same recommendations come from different manufacturers, or are there different things happening and different data being utilized to make or craft those decisions?

MR. ANTALICS: Kevin, what do you see when your various reps come into the store? Do they come up with the same plan or a similar plan?

MR. HADE: It varies by category and I think it speaks a little bit to the working relationship of the players involved. If we've got a particular category where the five vendors involved have known each other for many years and have a good working relationship, they can look at the data and see the same thing, that these five or six products are going to have to go to make room for something else. And there's not a lot of hardship over that type of decision.

On every occasion do they always match up? Of course not. Every one's out there fighting for their own best interest a little bit, and I think that's where a good category manager has to step in and look at the recommendations across the board and weigh the arguments presented to them and make a decision that's in the best interest of the retailer and ultimately of the consumer.

One of the other questions we had from the panel today was, How do you make decisions on what products to sell? Again, at Ukrop Supermarkets our motivating force is to put products on the shelf that our consumers in our market area want to buy, and that's what we try to convey to our vendors and that's what we're collectively trying to do. We have to make tough decisions every day.

We do it, and we go, and we move from that point, but we encourage that type of teamwork, but I think it's Pollyannish to think that everybody is going to present the same plan. I don't think it's going to come out that way.

MR. ANTALICS: Do the vendor reps negotiate among themselves? Are there discussions among the vendors?

MR. HADE: I wouldn't call it discussions. Again how our organization would work, let's take a cereals set for example. If we decided that it was time to take a look at the planograms in that particular area, our category manager has a person that works for Ukrop's who kind of sits in with that group and ultimately will help with the execution of the planogram changes. So we'll have representation from Ukrop's Supermarket as well as representation from all the vendors involved in that set.

Someone mentioned private label earlier. Also our person is there representing our interest because we're a vendor too. We're trying to sell product on the shelf as well, and I think there is input. We'll look at the data. There will be some discussion on -- everyone has an opportunity to say, Hey, we realize that we've got to create this much space in this particular area, what's got to come out of the set?

And there's give and take there, and then ultimately when we've reach an accord, that is presented to the category management, and that particular person either approves or disapproves of how that works.

In some cases they don't have all the information they probably need. Again I come back to some of the instances I mentioned earlier. I'll give you a good example. Kellogg's may even be telling us, We want you to stop selling our nine ounce sizes of corn flakes, we're putting all our money this year into larger sizes.

We have a large population of elderly consumers who like small sizes, even if they have to pay more per ounce, and we don't want to take them off the shelf because when we do, they complain, and they've been some of our best lifelong customers, and here it is the actual vendor is telling us, we don't want you to sell our product. In some cases we decide we still want to because our consumers know it's available. We should try to get it for them. I think that's an opportunity we all have to face.

MR. ANTALICS: Well, mechanically how does this work? Will the vendors come together with a plan? Will you get them all in the same room, or are these individual discussions? How does that work?

MR. HADE: I think it would probably be more like what you have here. We announce that we're going to take a look at this particular opportunity. Everyone is given the same amount of information. Everyone is given an opportunity to provide their input based on the information we've given them on how they would do that.

And there may be some general dialogue once everyone's provided an individual opinion amongst the team of all the vendors and also the representation from Ukrop's. Then there would be some type of compromise or formal agreement, the final planogram recommendation so to speak, and then that would go to the category manager for his or her approval.

MR. ANTALICS: But this is everybody sitting down in the same room just talking it through?

MR. HADE: It could potentially be that way, yes.

MR. ANTALICS: I'm sorry, Pam, you have something?

MS. MILLS: I have a real life story to tell you guys. When we got reset recently in one of our major chain stores, we got the schematic, the dates, okay? Well, simultaneously another chain store was resetting at the same time-- and who knows if that was planned or not -- but in one of our chain stores, we couldn't get our people there at the scheduled time, at the scheduled date. So that was another problem.

But in this one chain I finally got an appointment with my buyer to discuss with him what were the ramifications of the reset to our company, and what it did to our sales, and what it did to reversing our sales to a point where it wasn't cost effective to take the product to market. But it took me a month to get in to see him.

I took in photos. I took in documentation. I took in how much basically linear square footage we were given, which was less than 10 percent, and brand X had all the space. And he goes, Well, you know what, you call up your category captain and you have him discuss this with you and see what you guys can work out.

So he calls me up and he says, Okay, he goes, Let's meet at this store, which is an hour away, at three a.m. And I'm like, Three a.m.?

MR. ANTALICS: You said meet with the category captain, and this is your competitor?

MS. MILLS: Yes, to discuss our space and at three a.m. I go, Well, how about six. He goes, No, no, no, my schedule is too busy. I can't make it at six, and he goes -- well, I go, How about this day. And he's like, No, no, no, if I can't get this date it's going to be like in two or three more weeks, and I'm thinking this guy wants to drag this out.

So finally I go, I'll get back to you on that. So I'm thinking to myself later it's like, Okay, if I don't make this time, I'm not going to get what I want, so, okay, I'll get to that store. I called him back, I'll be there at three a.m. The day before the meeting he calls, Oh, I can make it at five a.m. and I have to drive an hour so imagine what time I'm getting up.

So we go to the store. He's got his sales rep there. I've got my sales rep with me. It's an end cap display, and they had other products lined up on the wall there which were covering up my inches. I'm like, What's this, why is this product covering up my product? He goes, Well, I don't know about that. He goes, Well, we're going to put in another end display.

And he goes, What is it exactly that you want? I want these two top shelves back, and I want to come all the way out to the end on a four by three. He goes, Can't do that. I go, Why not? He goes, Just can't do that. I go, Well, if you're not going to give me back the two top shelves and then we come back all the way to the end, then let's not talk any further. He goes, Fine, then.

So then I go, Okay let's go to another store, and he goes, Nope, we can't agree now, so why bother. I go, Okay, I'll take my digital camera with me and I'll take pictures at that next store. He didn't go. We went to those stores. They had two end cap displays. They had absolutely no product on them, but my little product on my little inches was full to the brim because we went there every day to get those minimal sales, okay?

So I had all these digital photos because he was too lazy to go. He probably knew there wasn't product on the shelves. And he's driving the category, selling air, so anyway I get back the buyer. I go, Buyer, we just can't agree. I go, I think we're going to have sit down and talk. And he goes, Okay, I'll get him on the phone and see when we can all get together.

So, okay, go in there. We all get together, guess what? My category captain brought in his big boss to deal with me, and so it was like the two of them, brand X, me and my buyer, so I basically told them they had placed me in unlivable space. The category captain does not want to give me this much space, this is what it's done to my sales.

Obviously from the pictures they're selling air, not really driving the category, so can we make some changes, and at that time we agreed. We agreed to get the two top shelves back for me, and then one of my giving back to them was, Well, you can have the front corner representation.

I just wanted to have liveable space. I understand the heavy hitter. They can do what they need, and they were just having a fit. And I'm like, What is it with you? Why can't I have liveable space when you guys have all this that you're not even getting the product to market on, what is your problem?

And they're like, This is our space and we just don't want to give it up, and then so it started getting really heated. So then my buyer says, Okay, she's going to get these two top shelves, and you guys get the front facing on the front corner, and we all agreed. Okay.

Then it came down to implementing the program. I mean, for us we've been in a position where --

MR. ANTALICS: Before you get into the implementation, Pam, let me ask Win a question. Win just --

MR. WEBER: I have five answers.

MR. ANTALICS: You told me everyone has access to the retailer in your experience. What's your experience been with respect to negotiations among vendors as to what the appropriate category ought to look like?

MR. WEBER: Well, there are a couple issues here. Number 1, it's almost to the retailer's disadvantage to put two suppliers in a room to develop a category plan because that can negate the negotiating leverage the retailer has on one supplier versus the other.

You're not going to handle -- you're not going to share trade allowances because that is a point of negotiation, so a retailer is disadvantaged by putting two suppliers in a room.

Second, in terms of new products, seldom will one supplier sit in a room and share the new product information with their peers in the category, for all obvious reasons. So to me this whole issue of two suppliers sitting in a room, before we get to the story, doesn't happen with any retailer of any substance or size or ethical value whatsoever in this industry.

I was listening to your story, and I started as a retail salesman in this business, and I've gone through exactly what you've gone through. I've negotiated the shelf. I've been hammered. I've had bosses. I've been there three in the morning. That was 1963. Things have changed.

And hopefully what you're explaining is a very small percentage of a total today because that was the behavior in the industry. I know like at Stop & Shop, and most other retailers today, your space management groups have tight control, and they're the ones that are actually ultimately making that decision; is that correct?

MR. SUSSMAN: That's correct.

MR. WEBER: I apologize for speaking for you.

MR. SUSSMAN: That's correct. We don't have our vendors deciding what space to utilize in our store. That's our decision. When we actually go to a rollout of a planogram and the vendors are participating, I won't say that they don't ever get to a store where the planogram doesn't exactly fit the physical constraints of that store, and they ask people whether there's jockeying gone on.

But for the most part our vendors are professional and they act in a professional manner. I guess that's not always true in every vendor, but we're responsible for the planogram. We're responsible for the space. It's our space. We built the store. We're not giving up the control to anybody.

MR. ANTALICS: Kevin, let me ask you: Do the category captains come in with recommended pricing and promotions in your experience?

MR. HADE: In terms of just for their products or all products?

MR. ANTALICS: In any respect.

MR. HADE: Let me answer that question and I'll also speak a little bit to what Win was talking about. I disagree with the things he was saying about new products, et cetera. I want to make it clear generally what happens in our particular situation. We've talked about a collaborative group getting together. That's after each has individually met with a category manager and we've decided which products we think can sell in our supermarket.

While we may have a general idea what needs to come out, and we may share that with them, we give them an opportunity to share some feedback and come up with a different compromise, so we're not putting anybody at odds well in advance of when the product's going on the shelf. It's already been said, this is going in, so no one is at a disadvantage in that particular standpoint.

When our vendors are together, we're not talking about pricing. Again, all of our pricing and trade promotion, that's all done individually with our vendors meeting with our category manager, whether it's ad planning for the upcoming period, and our two primary vehicles of advertising are a monthly program and a weekly program in which we encourage our vendors to participate.

But what we're really talking about when we're working on shelf planogram sets, et cetera, is to speak just primarily to where the products go, et cetera. There's no discussion about what the GP is on this particular item, et cetera, and from that standpoint and motivation of what the retail price should be across this particular area, et cetera.

We have that information at the category management level, and certainly when the presentation is made back to our category manager, they're going to take that into consideration. We are going to want to take advantage of an appropriate eye level spot. We're also going to want to place private label in a favorable location.

All those factors come into play before the final agreement is done. And really the other piece is an input phase, and I think that's an important part, too. We view our vendors no differently really from our customers. We're a golden rule company. We want to treat our vendors like we ourselves would like to personally be treated. That may be again pie in the sky, but we try to make that happen.

MR. ANTALICS: I want to get to Bob and then Don here with a comment on that.

MR. STEINER: I think compared to slotting, which we've been talking about, the opportunity in category management for efficiencies is much greater, and really that is one of key purposes of it. Also the possibilities of collusion because of the structure are much greater.

Whether they happen or not, I don't know, but it seems to me that when you read about this in the trade press, you read two things. One is that the big mantra is trust, that all people at all levels have to trust each other about shared information, not giving it away.

This is information that, in the old days when I was at an industry meeting and anybody talked about price, our attorney would get his hand up and say, You can't talk about price at an industry meeting. But now we have this shared information, which is the way that you get a lot of these efficiencies.

And it's the way that, when you have one manufacturer and one retailer, probably can't be abused. But when the structure is that you have a category captain, which as I said is frequently auctioned off and is generally in the control of in many cases the large manufacturer then several things happen. First of all, I've read about this, and there are people on the firing line that have much more than firsthand information, but you read the small manufacturer that says, I have enough trouble getting my items sold to this big chain without having to go through the category captain who's my bigger competitor and who doesn't want my stuff out there. This is just another barrier to the entry as far as I see it.

You also have the possibility that as part of his responsibility, in at least recommending a fairly comprehensive category plan that includes the SKUs that are carried, includes pricing, includes planogram space allowances, the category captain, to do his job right for that retailer, has got to have a lot of information from his competitors, and I would say probably more information than we ever were able to get in the past.

I don't know how that plays out in different cases, but you can see the possibility of mischief in this situation. Furthermore, the category captain's domain can be very broad. He can be the captain over a number of competing retailers, and so you would wonder from a retailer's point of view, What about this shared information? What about the possibility of collusion in some form between retailers through the enabling of the category captain. What about vertical restraints that could possibly be anti-competitive?

It almost can be made to sound like a corporate state or something like that, where you have all the manufacturers getting together through one manufacturer. And I'm sure it doesn't happen like that all the time, but there is the possibility of that.

You also see something else that is potentially troubling. You read the trade press, and you are see you're going to get rid of this adversarial relationship that has always bedevilled manufacturer-retailer relationships. We're going to replace it with a relationship that is a cooperative. Again that has many benefits from the point of view of efficiency, because to get rid of redundant kinds of costs in the distribution channel, to work together on a just in time basis, and all those things, you can see that if it's too adversarial you can't get the benefit of that.

On the other hand, if you're in too-close cahoots and you give up all vertical competition, that could be a problem, too. So I think it's a big world, and we know from what we've heard yesterday and today, there are many different examples of all kinds of different structures.

But it seems to me it's something that the Commission has got to keep its eye on. It's also something that may lead if done right to tremendous efficiencies that can't be generated any other way.

MR. WEBER: Can I respectfully agree?

MR. ANTALICS: I think Don had a comment first, and then I'll get to you right after that. Let me just add one additional question for you so you can consider that in your answer too.

MR. SUSSMAN: Lose my thought right now.

MR. ANTALICS: How often do you hear from your category captain, This is a good plan to use these recommendations, this is what the retailer down the street is going to be doing as well?

MR. SUSSMAN: That's not something -- quite honestly I'm not close enough to the -- first of all, we don't have captains or partners, so the question is how much feedback do we get from the vendors. I'm not at those meetings on a regular bases. I couldn't tell you, so I really don't know. I couldn't give you an answer to that.

The point I was going to make, though, is that category management is not a fixed either-in-or-out position. It's very much an evolutionary way of doing business. It's a set of guidelines and principles that's constantly changing. It's evolving at each of our own companies, let alone as an industry, and it will be different years from now or even next year than it is today.

And category management does not guarantee against bad management. There is no end to the horror stories that we can have of bad management out there. They existed before. Unfortunately they'll exist in the future. I think some of what we're talking about is throwing out the baby with the bath water with category management.

We think it's a superior way of doing business than we did before business, but we also know it will change and it won't be the way we do business in the future. Nothing ever stays the same.

Part of the problem in the film we saw was that there was a buyer who is given a change of title to category manager and expected to do new work. It doesn't work. You've got to train people. You have to give them information, resources and the ability to make good decisions.

You can't just say, One day you're a buyer, next day you're a category manager, because that's what happens. They go to a vendor and say, Help me, I don't know how to do this myself.

MR. ANTALICS: I wanted to get to Win, and then I wanted to hear a little bit from our attorneys who so far we've kept muzzled, so they can give us some ideas on how to stay out of trouble here.

MR. WEBER: I think the efficiency argument is a very strong argument and support that wholeheartedly. If we look at the U.S. economy right now, and look at the fact of collaboration across industries, whether it be auto or computer or what have you this has been one of the key factors driving our economy at the level it is.

I'm not an economist so don't throw theories at me, but the reality is efficiencies working together has driven a lot of cost out of the U.S. system right now.

I wanted to clarify one thing, and that is the issue of auction. We're acutely aware of maybe two or three retailers who do in fact auction off the category captain position where the supplier has to pay for it.

That is a rare, rare case in terms of paying for it. The criteria is usually more like the criteria that's been discussed earlier in terms of how one is selected, because auctioning off may not give you the right relationship with the right supplier to truly serve the consumer, and that's a key issue.

In terms of sharing, our retailer clients, and those who are not our clients that we know, do not like to be working with a category captain or a team that also is working with a competitor. They feel it's actually a conflict from the manufacturer side in terms of working with both retailers at a strategic level so closely.

The only time that we end up with the same team or same group working with competing retailers is when it's inefficient for the supplier, because there's not enough work for one team just to work with one retailer, and just so the economies of the structure of the supplier result in potential conflict where there is a one supplier team working with two competing retailers. That can happen.

In terms of sharing of information, if any supplier walks into any retailer captain and is sharing information from a competing retailer, that category captain is not going to be a category captain because that category captain, you know, is sharing your information with the competitor, and there is a natural human safeguard in this whole process.

MR. ANTALICS: Bart?

MR. WEITZ: I want to go back to a point that Mr. Sussman made. I think one has to be cynical about this in the sense that the reason that allowing one manufacturer to manage the category is not in the retailer's best interest, is because that one manufacturer is going to be biased. I think that the case that Ms. Mills brought up was very salient about how this person that's the dominant manufacturer in tortillas actually might be doing something that's very dysfunctional for the retail chain.

And my feeling, although this doesn't really help your day-to-day business, is that ultimately that category manager is going to recognize that that dominant tortilla manufacturer is not acting in the store's best interest, and that dominant manufacturer will have much less influence over time. I mean, you'll win out because you'll show them the pictures.

I think it's unfortunate it's going to take maybe a year for that to happen from your point of view, but the system will work out.

MR. ANTALICS: Let me ask --

MS. MILLS: May I say something real quick?

MR. ANTALICS: Sure, real quick.

MS. MILLS: I must say I haven't been reset yet, and it's still, what? It's been months now.

MR. ANTALICS: Let me throw this out to Irv and Jeff and Chris. Having heard all of this, can you give us any of your thoughts, first as to maybe some bright lines as to where people ought to be, which side they ought to be on just to stay in the clear? And maybe give us some idea as to some of the tensions you've seen in dealing with clients, where you see them coming close to the line.

MR. MACAVOY: I think some of the tensions have been well identified by the prior speakers. It's been mentioned a couple times that there is a tension here of communication and trust and opportunity for mischief, as one person put it.

I guess the first takeaway I have is the great challenge of training. Don mentioned how foolish it would be to just throw somebody into a new job responsibility and say, Here do it, and some of you may have seen the tape and said, Gee, that's crazy, that could never happen, and then maybe now you're thinking, Gee maybe it could, after hearing some of the discussion.

There is a great challenge here of legal training. Maybe the first takeaway or advice I would give people out of this is when you are doing your antitrust training make sure you have the category managers there. They're in that key intersection of the company.

MR. ANTALICS: Irv?

MR. SCHER: I've counseled in this area. I don't think there's any reported litigation. I haven't been involved in any litigation. And it's been on the vendor side, and I always make it clear to my client, my advice first and foremost is that what you're doing is only recommending. The retailer must make the decision in each of these areas. That's the number 1 rule.

The second rule is the confidentiality of the information that you're giving back and forth to that retailer. As Win said, if you're a retailer and find out from that vendor information concerning your competitor, you're not going to want that vendor to be your category manager anymore.

Third, I counsel my clients not to seek any information concerning the retailer's plans concerning the retail prices and promotions of its competitors. That's information that we shouldn't have in advance, no matter where we obtain it. We certainty aren't going to allow them to obtain it from their competitors, and they shouldn't do that indirectly by obtaining it from the retailer.

Next, no joint activities, no co-captaincy. If the retailer wants to get information from two suppliers, wants to have two category captains, he should do that separately. That should be the retailer's decision, but we're going to do this one-on-one.

Next, no recommendations to exclude another brand. As has been made clear here during this conversation, it's usually the largest company that becomes the category captain, and sometimes that can be a dominant company in a particular product category, and it's just an absolute no-no to make a recommendation that excludes another brand.

Now, all of this becomes touchy when you factor in private label. I've been hearing that private label is part of the plan. It's the natural feeling of the vendor that he doesn't want that retailer to be in private label. If the retailer is going to be in private label, we would like that retailer's price to be as high as possible. Maybe we even want to coordinate our promotional activities.

Well, that retailer has become a competitor, and that becomes a very touchy, sensitive area for the vendor, and frankly it's a difficult one to counsel on, and the way I try to do it is to say, Well, that retailer as a private label seller is the same as another brand manufacturer, and you've got to handle it the same way, very difficult.

MR. ANTALICS: Jeff, any thoughts?

MR. SCHMIDT: Mike, my thought is really we can make this more complicated than I think it really is. It seems to me that all the antitrust concepts that we saw on the video, that Irv and Chris have shared, apply whether we're talking about category management or not. There is no category management exception to the antitrust laws, and I think if you recognize that, that these things are fairly straightforward.

I think you really have to be an extreme cynic, though, to think that the move toward category management, which at least in my experience is basically a move of the industry away from assertion-based strategy to fact-based strategy, doesn't reap enormous benefits for the industry and ultimately for the consumer.

And absolutely we have to do it within the parameters of the antitrust laws, but of course.

MR. ANTALICS: On that note -- okay, a final concluding comment. Go ahead.

MR. REYNOLDS: I've been troubled by the nature of the conversation, hearing that in fact a lot of people think about grocery stores as being food stores, or food and soap, and they're not. Grocers routinely give over large portions of their stores to a category captain with absolute or almost absolute control.

I made a little list if the retailers argue with me they certainly can -- but I'm thinking about greeting cards and books and magazines and kitchen gadgets and toys and pet toys and foil wrap and films and batteries and specialty foods and hosiery and sporting goods and continuity kind of promotions, where you choose the vendor and the vendor does in that space what they want to do once you've made the selection up-front, but day-to-day they make all the decisions.

MR. SUSSMAN: I would challenge some of those categories but I think the principle holds. You're right. Once we choose greeting cards, we might choose Hallmark to be our partner, but we might also insist on having some boutique spinners in the store as well, but within the Hallmark space they're deciding what cards go where. They manage that 100 percent. We don't try to tell them which St. Patrick Day's card to put in what pocket.

So I think the principle that you're talking about is correct, but some of those categories we are taking control of, magazines, books. We are now starting to decide what titles will go in one place on the rack ourselves, but I think still the vast majority of retailers in those categories are handing that off to somebody else.

MR. REYNOLDS: I was just guessing what it might be maybe, and it seems to me it may be 20 percent of the play space in the store is in categories like these.

MR. ANTALICS: Irv and then Chris and then we'll get Bob and any final concluding comments so we don't go over.

MR. SCHER: There may be a miscommunication here. If we're talking about rack jobbers, that's a middleman, a distributor who probably has everybody's product or all the products he wants to carry, and he is given that space or that category by the retailer such as in magazines and in some of the categories you've talked about.

MR. REYNOLDS: I wasn't thinking from an antitrust point of view. I was just thinking that the discussion in the broad sense has gone to individual slots on shelves, and retailers don't decide on every individual slot on the shelves. They sell sections as well.

MR. SCHER: But the issues that we've been talking about don't come about when you're dealing with -- the antitrust issues when you're dealing with a rack jobber.

MR. GARMON: Chris?

MR. MACAVOY: Just quickly. I associated myself with what Jeff Schmidt said on the other end. Done properly, legitimately, with antitrust training, category management can be and should be a terrific thing. It is very pro consumer. It's very efficient. And it would be a bad thing if somehow the takeaway from this program is that, hey, this is a hot area, let's stay out of it, particularly because done legitimately and properly it really has, as has been put here, the promise of getting some of the seat of the pants decision making out of the industry.

And to the extent slotting allowances are for some retailers, sort of a seat of pants, gee, it's there so I'll ask for it or it's there so I'll take it, category management can get that kind of decision-making out of the process, and hopefully for those people who are concerned about slotting allowances make it fade as an issue.

MR. ANTALICS: Bob?

MR. STEINER: One comment or one question on the last thing. You frequently see literature about people who are champions of category management against slotting fees and say that's a way to not translate consumer preferences into the SKUs that you carry. That distorts the process, so in a sense -- but they can be combined, too. But there is at least in the product category management area basically a thrust for efficiency, I think, which is good.

Another question I had on the list, Bob, that you had. I've read that Kraft in the freezer compartment and Phillips Morris in the tobacco area have long essentially been category captains who have pretty much complete control of SKUs.

Is that correct or not?

MR. ANTALICS: Scott?

MR. HANNAH: I can't address those companies directly, but I'm afraid we're getting off the track here and attacking category management. We're not. I think it's an excellent idea as a small manufacturer. The gentleman down here said the opportunity for mischief exists, and that's the key issue. Please don't forget that.

We're talking about antitrust issue, and if you're not a major player, or as Bob said if you don't have a major rep, a broker representing to you, you're going to be in big trouble, even if you have a top selling item. Why? Because that item will wind up behind the hinge in the freezer door cabinet. And the next time around, all of a sudden, sales are down as done sales go.

So please don't lose sight of what we're talking about here. A lot of that video was very, very true. Thank you.

MR. ANTALICS: Thank you everybody for your participation. I think we've learned a lot.

MR. GARMON: We'll meet back in ten minutes to start the next panel at three o'clock break here.

(A brief recess was taken.)

ROUNDTABLE 5: POLICY RECOMMENDATIONS.

PANEL 5 MODERATORS

DAVID BALTO, FTC

SUSAN DESANTI, FTC

PANEL 5 GUESTS

JEFF SCHMIDT (Attorney)

CHRIS MACAVOY (Attorney)

MARY SULLIVAN (Economist)

RICK WARREN-BOULTON (Economist)

BOB SKITOL (Attorney)

RICHARD STEUER (Attorney)

DAN SAVRIN (Attorney)

GREG GUNDLACH (Marketing Economist)

RON BLOCH (Attorney)

ALAN SILBERMAN (Attorney)

J. MARK GIDLEY (Attorney)

IRV SCHER (Attorney)

MR. BALTO: It's three o'clock, and we're ready to start our final panel. We really appreciate all the attention people have given us. Just a few housekeeping notes. A variety of you have seen this large package of documents in the back that looks like it's a lengthy paper by Steve Salop. It actually includes paper from Bob Skitol, including the petition from the Independent Baker's Association and a paper by Alan Silberman and a paper by Dan Savrin.

You can expect in the near future that the papers presented here will be posted on our web site. Sometime relatively soon we'll post the names of all the speakers, and hopefully within a few weeks we'll actually put a transcript up here.

Today our expert policy panel really is one of the most impressive groups of antitrust lawyers and economists I can imagine putting together. I have to wonder in putting together this workshop why it is that of the businessmen we called, a large number of them weren't able to make it, but the lawyers and economists all seemed to be readily able to make it. I don't understand this phenomena.

Anyway, we're under a very tight schedule. We have a set of questions for each of the speakers. Why don't we again begin by introducing ourselves starting with Mark Gidley.

MR. GIDLEY: Hi. Mark Gidley, White & Case Washington, D.C.

MR. BLOCH: Ron Bloch, McDermott, Will & Emory, Washington, D.C.

MR. GARMON: Again Chris Garmon, Federal Trade Commission.

MR. MACAVOY: Chris Macavoy from Howrey Simon.

MR. SCHER: Irv Scher, Weil, Gotshal & Manges.

MR. WARREN-BOULTON: Rick Warren-Boulton, MICRA Washington, D.C. I gather there's nobody here who isn't from Washington, D.C.

MR. SILBERMAN: Alan Silberman, Sonnenshein, Nath & Rosenthal, Chicago.

MR. SKITOL: Bob Skitol, Drinker, Biddle & Reath, Washington.

MR. STEUER: Richard Steuer from Kaye Scholer in New York.

MR. SAVRIN: Daniel Savrin from Bingham Dana in Boston.

MR. AVERITT: Neil Averitt from the FTC.

MR. SCHMIDT: Jeff Schmidt, Pillsbury Madison & Sutro.

MR. SULLIVAN: Mary Sullivan. I'm an economist at the U.S. Department of Justice, antitrust division.

MR. GUNDLACH: Greg Gundlach at the University of Notre Dame.

MS. DESANTI: Susan DeSanti, Federal Trade Commission.

MR. BALTO: David Balto, Federal Trade Commission. Since Dick Steuer hasn't been here before, I will tell him that the way you're recognized in this forum is by lifting up your name card and putting it vertically.

We're going to look at four categories of issues today. The first is the issue of market structure, buyer power and merger enforcement. The second is what's a good slotting enforcement action. The third is what kind of enforcement action should we consider in the category management area. And finally, what if anything should the FTC do in terms of guidelines and future studies?

To sort of pose the market structure buyer power issue, I've asked Dan Savrin to go and present some ideas that he's developed at much greater length in a paper in the Boston College Law Review. Dan.

MR. SAVRIN: Thank you David. I guess David wanted to make sure everyone was kept on their toes, because he's asked me to start off by talking about something arising out of a Finnish supermarket merger.

But the European union has looked at issues in a much more concentrated market than we have, and has identified a number of concerns that it has with regard to market structure and retail power. The question that I pose, at least posed as part of the beginning of this session, is whether U.S. antitrust laws, as both interpreted and enforced, ought to address issues of retail buyer power and the gatekeeper roles of large retailers in the overall retail marketplace. For today's purposes we'll focus on grocery, obviously.

The issue was, What is a gatekeeper? In looking at the market in Finland, the European Union identified the gatekeepers as large retailers who essentially performed a gatekeeper function by having dominance over both the procurement and the consumer marketplace.

And in that capacity they identified the retailers as really having the ability to exercise market power to determine who among the producers have access to the retail marketplace, the terms in which they have access, and basically leverage over those suppliers. At the same time the consumer wasn't necessarily a beneficiary of that retailer power, which is generally a primary assumption in our antitrust analysis of buyer power in the United States.

They also looked at the issue of increasing consolidation and increasing private label issuance. The powerful retailers not only exercise the ability to control and constrain supply in the consumer marketplace, but were essentially both a buyer and a competitor of their suppliers.

So with that all said, the question is: Do those issues apply to the U.S. marketplace? And there are a number of changing dynamics in the U.S. marketplace which bring that issue to the fore, most of which have already been discussed here today.

Among those issues are the increasing consolidation in the U.S. marketplace. When I wrote or sat down to start writing the paper which David mentioned, about four years ago, the top four competitors in the U.S. supermarket marketplace had about 25 percent of the overall market. Today according to Supermarket News that number stands at about 42 percent of the market retained by four firms.

In that time period, Wal-Mart was denoted as the third largest grocer in the United States. Today Wal-Mart is denoted as the second largest grocer in the United States, some 1/10th of 1 percent behind Kroger. The question then arises as to whether we need to look at buyer power and market consolidation issues and figure out whether the retailers both in grocery and elsewhere are functioning as gatekeepers in the U.S. marketplace and controlling both the procurement marketplace and the consumer marketplace. Is that an issue that needs to be of concern, today or for the future?

MR. BALTO: Let me first ask, what did the EC characterize as a gatekeeper? What are the characteristics that they look to to say that these firms would serve in this gatekeeper role?

MR. SAVRIN: Well, they looked at the overall market and the general market share, and made determinations by looking at the actual supply chain to figure out whether individual suppliers had appropriate alternatives available to them other than the potentially merged entity. I should note in that scenario the merged entity had like 55 percent of the overall Finnish market.

MS. DESANTI: So is that analogous to the exclusive-dealing type of analysis -- the sense of focusing on market share? Or what other questions beyond that were asked?

MR. SAVRIN: Well, they focused on market share. They also focused on exclusive dealing, but they looked quite closely at whether the supplier had an alternative outlet and looked at whether, if they allowed the merger to go forward, there would be no alternatives for suppliers other than that market. If that company, the potentially merged company, was the only source for purchasing or the primary source of purchasing they determined they essentially had power over the procurement marketplace.

MS. DESANTI: Could you explain, was the harm articulated in terms of harm to the ultimate consumer in the marketplace or harm to the supplier?

MR. SAVRIN: In the European Union analysis they looked at it in both contexts. I in my comments focus much more on the consumers, since that's much more of the U.S. orientation.

MR. BALTO: Of course we looked at a similar concept in terms of the significance of a single retail chain and its ability to exercise power on the buy side in the Toys R' Us litigation. In the Toys R' Us litigation there were some critical factors that suggested that it was relatively essential to the large manufacturers to be able to sell a number of their toys through Toys R' Us. And Toys R' Us was a much more significant distributor because it was much larger than the other chains.

Rick?

MR. WARREN-BOULTON: I guess to an economist it seems to me that in a sense it's misfocused, if indeed you accept the proposition that the fundamental thing of concern is attempts by dominant manufacturers to use control over downstream stages to exclude rivals, whether you think of that as the Microsoft case or others.

The critical issue is whether or not those gatekeepers are the only way to reach a particular group of customers. It doesn't really matter how many customers there are. In other words, the idea that the share that that small group of gatekeepers would account for is large, is irrelevant. You can enter into exclusionary contracts with hundreds and hundreds and hundreds of tiny little gate keepers. Certainly OEMs qualify in that characterization.

So the necessary condition for these kind of contracts to be used exclusionarily is not that those downstream firms have a large share of the market. It is simply that they happen to be the only way to reach a particular group or group of customers. But they don't have to have a large share.

And this is not something to be confused with other monopsony power or monopoly power on the part of the retail level. If you used those guidelines in Microsoft and asked, "Are the OEMs gatekeepers," there would have been no OEMs that are that size, and you would have thrown out the Microsoft case.

So it's not the share of any individual or the concentration of the retailers. Simply the question is, Can you enter into a contract with a large enough group of them so that you can foreclose rivals from access to customers?

MR. SAVRIN: If I just can respond quickly, I think in the retail marketplace, as opposed to the manufacturing and maybe the software marketplace, you would have to have critical mass either within a region or nationally in order to be able to essentially perform a gatekeeper function.

I think that differs from other markets.

MR. BALTO: Is there a suggestion by anyone that we have the potential for gatekeeper problem here in the supermarket industry. Bob Skitol?

MR. SKITOL: I think the gatekeeper power in and of itself is not necessarily bad or anti-competitive or something that causes a slotting allowance to be anti-competitive. I think buyer power is important -- is a necessary but not sufficient condition to slotting allowances being used in a way that is anti-competitive at the retailer level.

And I think market power at both levels, at the retailer level, and at the manufacturer level, are probably necessary but not sufficient conditions to slotting allowances creating an anti-competitive effect or exclusionary effect at the supplier level.

MR. BALTO: Let's hold that thought for when we get to what would make a good slotting allowance enforcement action. Let's just stick with merger enforcement. Based on the panel just before lunch, does anybody think that the FTC needs to ramp up its efforts at looking at the buyer power issue in supermarket merger enforcement, and if so, why? Yes, Chris?

MR. MACAVOY: Just to respond to that. I think it is an issue that is already being looked at, is my experience having been in investigational hearings and supermarket mergers. This is not a brand new question, but it is something that is being asked about the monopsony issue.

One thing, and I think you alluded to it this morning, that perhaps gets attention is that sometimes the efficiency claims that are brought in sound like they're premised on buyer power. Somebody might come in and say, We're going to leverage our size and to lower prices and go on to explain why that's good for consumers.

Well, that kind of presentation naturally leads to some questions about, Gee, is there a monopsony issue here? In my view those things are like unicorns. It's not really out there, but the questions are pertinent questions, and they are being asked. I think they should be asked.

MR. BALTO: Ron Bloch?

MR. BLOCH: I think that there is a very, very distinct need for power buyer policy and merger policy beyond that. If you look at the half dozen firms that today account for somewhere between 40 and 50 percent, which by the way is a level of concentration at the national level that this country has never seen before in the grocery industry, with the exception of one of those top firms, there's only one of them that got there through its own internal expansion.

The rest of them got where they are today through a series of very large mergers and acquisitions. Basically the Commission's traditional approach, which I don't say is the wrong approach, but looking at the seller side, focuses on overlaps of stores in particular geographic markets. To get a deal done you have to sell off enough of those stores to eliminate the anti-competitive effects in those markets.

But the buyer effects, the effect that it has on creating the kind of retail organizations that we have heard for the last day and a half to varying degrees do have the ability and in practice exercise their power by obtaining preferences of one kind or another, whether it's slotting, whether it's promotional allowances, whether it's special prices, special packaging. That doesn't seem to filter into the merger analysis, the buying side of the equation. I really think that this is something that should play a larger role in merger analysis.

And there's an anomaly here. We sit here for two days talking about the exercise of buyer power, and when there is a merger that takes place, the Commission has a policy. It's not a rule, but it's just an internal policy that requires, to the extent possible, that all the stores in a given geographic market be divested to a single firm.

In a market where there are a significant number of stores to be divested, that policy favors inherently strengthening the power buyers that we've been talking about. I think that's kind of an anomalous result. Again it requires some sort of harmonization of the policy toward power buyers and the way the merger process functions.

MR. BALTO: Alan Silberman?

MR. SILBERMAN: The question it seems to me, is not whether you should consider buyer power in a merger. It's how you look at it. Do you look at it over some period of time, projecting into the future, recognizing as we've heard for the last day and a half that there's an incredible velocity of change in the distribution system and that the snapshot you take today may not really be very accurate?

Do you look at without imposing one model or bias and say, This is the way competition is supposed to take place, or all preferences are necessarily bad. The problem we have here is that while we don't like it, competition is not neat. Competition doesn't work out to be everything in nice orderly rows.

It's more like Dupont Circle was before they built the underpass under it. Ultimately I think what you will come to after you consider all this is a recognition that what you're really talking about is not structure but behavior, and that you have other legal avenues for dealing with behavior, and therefore really when you get all done, it doesn't have a major effect on your merger analysis.

MR. BALTO: Dick Steuer?

MR. STEUER: I think in a real sense the gatekeeper function is being factored into merger analysis, in terms of looking for local monopoly power or at least market power, so that again it goes back to the notion of the strength of consumer preference, consumer loyalty to a particular seller.

If there are supermarket chains that are merging, giving them strength over particular markets where they have an enormous market share and there's a strong consumer preference for shopping in that kind of an outlet, then they very well may have the kind of power that you can be concerned about. But I think that's part of the traditional analysis already in looking market by market, which is normally what's done in acquisitions of this kind, and also what was done in Staples.

MR. BALTO: Mark Gidley.

MR. GIDLEY: Very briefly. First I will echo what Ron said, that I think in divestitures you want to look long and hard at some of the smaller chains buying stores. It can be an excellent chance for them to pick up some stores at 10 cents on the dollar.

The second observation I would make is that you mentioned that there are four firms, and one has gotten there by organic growth. It is going to continue to put enormous pressure on this industry. The consolidation wave is not something that is just the design of investment bankers. The consolidation wave is response to a 1,400 to 1,600 basis point gap in sales, SG&A gap that is owing not only to unions but also to the number of SKUs that the supermarket industry carries.

In terms of the gatekeeper function, if you were to do 10-K studies, I think you would find that mom and pop, ethnic, health-food stores are often the incubator for the pure startup. That was true of Nantucket Nectars. It's also true of, for instance, Snapple. Snapple then becomes extremely well distributed when they break into supermarkets. They can break in at five or ten stores. Soon they take over the full chain of the supermarket.

There's actually some free riding going on in terms of the gatekeeper function, because once the supermarkets assist Snapple in becoming a well recognized national brand, someone like Costco can free ride on the development and promotion of Snapple and skim the best SKUs.

Is that right? Is it wrong? Is it moral? Is it immoral? It's just competition, but merger enforcement I think already does but must continue to take into account this enormous gap. If it's the contention of the FTC staff that my client or some of the other supermarket chains are buying at exactly the same price as Wal-Mart and getting all of the benefits as Wal-Mart and getting all the category management support for free that Wal-Mart gets, you know, that would be very surprising to me.

MS. DESANTI: I think it would be useful -- I would like to just ask Dan to expand a little bit more on the point of when buying power can end up harming consumers in the marketplace. It's something you said you focused on in your article. The monopsony issue is something that's gotten less attention in antitrust. One of the things that is difficult about it is sometimes buying power can in fact reduce prices to consumers, so the question then becomes what's the line over which it needs to go in order to result in consumer harm. We'll start with Dan and then others may have observations on that as well.

MR. SAVRIN: I think you have to look at the marketplace. In grocery today, I think Mark makes two good points in terms of the other parties that are out there -- the clubs and the Wal-Mart enterprise. You need to take those into account in order to determine whether there really is a gatekeeper role, and whether there is a reduction in price, an ultimate reduction in price to the consumer overall.

When you get to other markets, and grocery I think may be heading that way with consolidation, you can look at other marketplaces where there is greater concentration, where you do have an operation like Toys 'R Us which is the place where companies have to be. We generally assume that if a company has buyer power, it can in fact reduce the price take it pays and will tender that reduced price over to the consumer.

If you get somebody who is in a gatekeeper role, the question is, Do they really need to do that and do they do that? Because it seems that if they've got control, significant control over the procurement market and they're the place for the consumer to get the products, the question is, Do they need to do that functionally?

And if they do, then we know that the consumer is benefitting. But they may not have to do that, and they may not do that, and in the Toys R' decision there were some allusions to whether or not that was the case. The question is in that scenario or other scenarios that are similar, does the consumer benefit from it or does the retail merchant just benefit from the gatekeeper power, and not need to pass on any of those benefits to the consumer?

MS. DESANTI: Rick?

MR. WARREN-BOULTON: Yeah, I think, following on, that we have two concepts that are very, very different. We have a concept of buyer power and a concept of monopsony. The reason why people confuse them is that both buyer power and monopsony lead to lower prices to the supermarket, but that's where the resemblance ends, because you have a different quantity effect.

In buyer power, what happens is they negotiate a lower price and they buy more. The monopsony, they buy less, and that's why they get a lower price. So if you wish to distinguish between buyer power, which is good for consumers, and monopsony which is bad for consumers, what you need to ask is the question, When you have had mergers -- and certainly the FTC can answer this question -- if you look at mergers and you say, We identified those areas where we were concerned or were potential candidates for buyer power and monopsony, look at what happened after the merger.

For that group of products, did the prices of those products relative to other prices of supermarkets rise or fall? Did the output or sales of those products rise or fall? If the prices of those products fell relative to other products and the output of those products rose relative to other products, what you've got is buyer power.

If the prices rose relative to other products and the output fell relative to other products, what you've got is monopsony power. Rather than worry about which head of the pin you're on, it seems to me that's a question, that now you have had enough experience with supermarket markets, that you can actually answer quantitatively. It's not that hard to do.

MR. BALTO: Ron Bloch.

MR. BLOCH: Rick took the words right out of my mouth. It seems to me that what you really need to look at is what happens to prices after the merger, compare them to prices before the merger, and see whether any of that lower acquisition price is passed on to the consumer, or does it drop to the bottom line for the benefit of the investors.

And you're not going to learn that in a workshop. You've got to send out some subpoenas. I think that's what's really is missing from the equation here.

MR. BALTO: Let me go on to the next topic. We would like the panel to tell us what would be a good slotting enforcement action. In doing so we would like to get a picture for us and the audience about what kinds of slotting activity we should be most concerned about. Can we also make an effort to describe types of slotting activity that we really shouldn't be concerned about at all, that might even fall into a per se legal category.

So let me open it up generally. What are the factors the FTC should look at for finding a good slotting allowance case. Greg?

MR. GUNDLACH: Well, I'll speak mainly to the analytical framework that I think has come to the table over the last couple of days. I think that provides you with a basis for understanding what a good slotting case is. If we're attempting to understand what slotting fees are and what their effects are, I think the first thing we need to do is come to terms about what we care about.

Over the last two days there's been considerable discussion of different criteria that we care about, things like efficiencies, things like price, things like process of rivalry, things like innovation, choice, fairness. I'm not sure all of those criteria are complementary, so I think we need to wrestle with what we are interested in.

And having decided that, I think the next challenge for us is to attempt, for any particular case, to organize the facts in a way that reveal the issues. As we've seen over the last two days, there have been some things that allow us to do that.

I think the first thing we might be looking at, maybe not necessarily in this order but an important factor is, Who's motivating the arrangement? The last two days we've talked about upstream effects, and we talked about downstream effects. The type of exclusivity on the part of the manufacturer being a downstream effect, and we've also talked about an upstream effect as it relates to retailers and monopsony power and their ability to leverage their place in the marketplace and obtain these fees from manufacturers.

I think in addition to that factor we need to consider the dominant factor. Are we dealing with dominant firms either at the manufacture or the retail level, and how does that mix? The presence of dominance obviously creates tension for the process of competition.

I think in addition to that, a third factor is what type of fee do we need to understand? What type of fee are we dealing with? We've talked about the issues that are confronted when we deal with a fixed fee, an up-front fee as something that's differentiated from a fee that's tied to volume or a fee that's spread over a period of time.

In addition, what has emerged over the last two days is another factor, and that is whether or not we're dealing with a new or an established product. The pay to stay fee is one for an established product, and we should be aware of the differences that are there, particularly as they relate to efficiencies when we distinguish between a new product type of scenario and a fee for an established product.

I think beyond that, one of the things that's revealed to me is we don't know much about the structure or process of the arrangement. In terms of where we go from here, understanding exactly what happens when that fee is paid, where it goes, how it's accounted for and what types of efficiency outcomes are achieved are things that we need to get inside that black box and begin to understand.

Finally, then, other practices. We talked about category management. I imagine there's a lot of other things that blend into the negotiation between the manufacturers and the retailers. I think that's an important thing to put on the table.

MR. BALTO: Well, from this side of the table you can see that nobody is interested in responding. Why don't I start off with Alan Silberman, and why don't we try to focus on the taxonomy that Greg has prepared for us.

MR. SILBERMAN: Taxonomy. That sounds like a barrier to entry. I'm going to steal Rich's thunder because I think he said it this morning, and he said it correctly, that the fundamental issue is the situation where dominant manufacturers engage in conduct that is an attempt to do something that's almost a bribe to raise rival's costs. I don't know that I would call that slotting allowances, but that seems to me to be the focus.

I would add to that, possibly more broadly echoing Steve Salop, that manufacturer-initiated strategies on exclusive dealing are worth some look at, and possibly also the question of action by retailers which has the effect of denying information to other manufacturers. That comes out of the category captain area.

What I would exclude from enforcement activity for all sorts of reason are the things that are the more classic slotting allowances -- the one time payment demanded by retailers for access, other sorts of things like that, the bidding situations. That's the way I would cut it.

MR. BALTO: Can you elaborate on those last two? What's the one time fee and what's the bidding?

MR. SILBERMAN: Well, the classic slotting allowance that I think we really are talking about is the situation where you have new product access, and there's an up-front payment for access for the new product. I know that there are smaller people that said, Gee, I can't afford it, but as long as there's a competitive market functioning, that is not going to be problematic in terms of the big picture. Sure, it's going to affect various individuals, but it's not an area where I would place a great deal or, for that matter, any enforcement action.

The bidding situation is what you kept trying to push people to -- or whoever, I'm not sure if it was you. But it was a question of pay to stay, that is, are there situations where a retailer has said -- and this can be any retailer large or small -- The time has come to take a look at this set and say, I would like to get new proposals simultaneously.

That bidding process is going to result in price changes. It's going to result in all sorts of things. I would not be concerned about that. It sounds to me to be exactly what competition is all about. I would worry about the other things.

MR. BALTO: If professor Salop was here he might disagree.

MR. SILBERMAN: I think he would.

MS. DESANTI: Alan, can I ask you one follow up question? Is it possible for a slotting allowance to be used as a strategy by a dominant manufacturer as an attempt to raise rival's costs, and what are those situations?

MR. SILBERMAN: I don't think so, for two reasons. One, I would use the phrase slotting allowance only where it's demanded by the retailer, and therefore I would distinguish from the manufacturer-initiated situation. So, no, it wouldn't be that kind of a situation.

Number 2, I look at the slotting allowance, or more precisely the new product introduction cost item, as being a one-time short-term event. Therefore, it's a lousy strategy to raise rival's costs. If someone really wanted to do that, they would do something else.

MR. BALTO: What if it wasn't requested by the retailer? What if you had evidence it was a manufacturer inspired strategy?

MR. SILBERMAN: Then I think it moves to a different category. One of the premises, certainly developed in all the long written stuff that I have, is that we ought to stop talking about the word slotting allowance, and we ought to be more precise and talk about different categories.

Where you are dealing with manufacturer

initiated conduct, I will pay you. I haven't heard of anybody who offers to pay not in return for something, so there must be something that's coming back. Okay, now what is it? Is it exclusivity? Is it creating some barrier to a designated competitor? There's some reason.

Those are things that now call for further analysis. They still may not be improper, but they move away from the first category.

MR. BALTO: Irv?

MR. SCHER: Well, I just want to add a little to what Alan said, because I agreed with everything, and the last part. An auction for scarce shelf space hardly violates the antitrust laws, and there's a meeting competition defense built into the Robinson-Patman Act, so that certainly is not a practice that the Commission should challenge.

In addition, I cannot fathom a secondary line antitrust case coming out of a situation like McCormick, which I am an outsider to and just read. The lesson I took away from that case for my clients is if you're going to drive your competitors out of business, and can stay above cost when you do it, then do it quicker by giving the lower price to everybody rather than discriminating against some.

MR. BALTO: Rick?

MR. WARREN-BOULTON: This is just perfect. I'm seeing attorneys with whom I'm in agreement. I would only add one more condition to this. I think, based at least on this end, that what we would do is just safe-harbor any new product. In other words, we're only talking about established products, and then what are the hoops that you would have to run through at the very least?

The first is that it's really not a slotting allowance. It's an ongoing payment. It's not a one time matter, so first it has to be something that's initiated by the manufacturer. This is something that's being initiated by the retailer. This is not something of concern.

Secondly, it has to be initiated by what we would call a manufacturer with monopoly power, the ability to raise prices and exclude rivals. This is how they exclude rivals.

And third, the exclusion has to make sense. In order for exclusion to make sense, a necessary condition has to be that when you look at the downstream firms, if you like bidding on an all or nothing basis, it's difficult or impossible for the small firms.

It's got to be the case that the small firm --

the rival -- would find itself at a competitive disadvantage if they had to bid for the whole rather than a part of it. That was true of Microsoft. That's a very small number of cases. You narrow yourself down to a set of cases where you can, in fact, argue that there really is a potential competitive harm. If you satisfy all those criterion, you bounce back and say, Well, is there an efficiency defense on the other side.

But I think to run through at least those three hoops -- initiated by the manufacturer, manufacturer with monopoly power, and that the characteristic of the downstream firm is that the rival cannot compete on an all or nothing basis as opposed to for a part of their business -- those are three necessary conditions, not sufficient but necessary conditions for there to be harm.

MR. BALTO: I want to try to get joinder on Rick's three points. Is there anyone who disagrees with Rick's three points?

MR. SKITOL: I think everything so far is ignoring the Robinson-Patman Act. Discrimination is a factor that is relevant.

MR. BALTO: Let's set that aside. We want the scenario for a Sherman Act case. Is there anybody --

MR. MACAVOY: David, let me just add one thing.

I agree completely with the comments that have been made that a bidding context ought to be outside of our area of concern. But on the question of, Well, a distinction ought to be made between new and existing products, you just need to be careful about how you're defining new.

The comment was made a couple of times today that, Hey, watermelons have been around forever. True. Branded produce has not been around forever. There's a reason why you're seeing a lot of the tension and friction coming out of the produce sector.

It is because that is now becoming a branded sector with all these prepackaged products, the wonderful salads, et cetera, so we need to be careful. I'm not sure we can develop a workable definition of new product.

MS. DESANTI: Bob, let me ask you, just looking at it as a Sherman Act issue, and leaving aside the for the moment the Robinson-Patman Act, do you agree with the criteria that have been set out here, and if not why?

MR. SKITOL: Not entirely. If we can broaden the scope, though, to not just the Sherman Act but to Section 5 of the FTC Act questions, I think there are other circumstances beyond Rick's criteria where slotting allowances can cause accumulative anti-competitive effects upstream and potentially downstream also, and that ought to have legal ramifications.

You could have a situation where a manufacturer gladly pays an excessive slotting fee for a new product entry without an explicit exclusivity quid pro quo, but with an exclusionary effect, and it has an exclusionary effect because the amount is excessive. If the fee was a fee that bore some reasonable relationship to new product introduction costs, I would say safe harbor, close the books, don't even look at it.

But if it's a situation where the amount of the fee, and we've heard lots of examples in the last day and a half where this is the case, if the amount of the fee is way beyond any conceivable cost justification, then the efficiency story doesn't apply. We don't have to worry that we are interfering with an efficient practice, and the payment is likely to be entry-barrier-raising vis-a-vis smaller rivals. Then the situation is worth a close look as to whether there is at least, if not an explicit exclusivity quid pro quo, then at least something implicit or an exclusionary anti-competitive effect from it that warrants enforcement concern.

MR. DESANTI: Am I right in taking from what you're saying that what would signal to you, as a potential problem, is the size of the fee as meaning effectively that exclusivity would result? This rather than an enforcement action directed at, There is too high a fee, because in general antitrust doesn't get to say, Well, those are high prices, we don't like them, I think we'll attack them now?

MR. SKITOL: No, no, but this is a context of market power being exercised at both levels in a mutually reinforcing manner. It's an artificial one-time payment. That's another differentiator I would draw. I think it's important to distinguish between the flat one-time payment unrelated to volume versus a slotting fee that is in the form of a per unit discount.

I would basically exempt or immunize the per unit discount from any serious scrutiny. The difference between the two is it's the huge excessive one time flat payment unrelated to volume that causes the real problem for smaller manufacturers, versus the per unit discount which even small manufacturers ought to be able to afford over time.

And secondly, the per unit discount is much more likely to end up translating in to a downstream lower price to the consumer. So there is the potential offsetting good from the consumer standpoint versus the flat payment unrelated to volume is much more likely to go into the retailer's bottom line.

MR. BALTO: Okay. Is there anybody else who disagrees with the three set of points that Rick Warren-Boulton made? Neil?

MR. AVERITT: I don't exactly disagree with them, but it does seem to me that the real world may be in some respects a little more intractable and a little more ambiguous than some of the tests that were suggested seem to count on it being.

It would seem to me, first of all, that it may be hard to draw a distinction between up front payments and payments over time, at least for certain product lines where a manufacturer's product line may change from year to year as new products are introduced and old ones are phased out. So the distinction between pay to stay and up front may begin to get a little blurry.

It may also get to be a little blurry whether a particular payment is actually instigated by the manufacturer or the retailer. There's probably a certain amount of tacit bargaining that goes on there, and how that affects the ultimate answer, I don't know, but it may affect the ease of applying certain tests.

MR. BALTO: Mary Sullivan, are you going to agree with Rick?

MS. SULLIVAN: First I'm going to say that there's always ambiguity in these issues, and that's why you usually have to hire economists to help you think about them.

MR. WARREN-BOULTON: My kind of gal.

MS. SULLIVAN: I don't really want to challenge the criteria, but I do have a question that Rick might be able to help me with. It seems that the theory that you're using to evaluate whether these fees are anti-competitive are the basic raising rival's cost theory, or that is a theory. That's the one I was thinking about.

And I know, according to this theory and maybe other theories, that retailers can certainly benefit from the fees as well as manufacturers. So if a retailer can look at a situation and say, Hey, maybe I could get this one manufacturer to pay me a fee and it could exclude this other one and I would be better off, then why wouldn't a retailer in that situation initiate a fee?

MR. WARREN-BOULTON: I guess a couple of things. One, I think there is a raising rival's cost, and there's a variant of Steve's thing which is reducing rival's revenues, is you're willing to pay less for the rivals. Are you referring to the idea that retailers as a group like slotting fees, but they're higher in marginal price to everybody, and so they're more likely-- a form of implicit exclusion among retailers which is not --

MS. SULLIVAN: I wasn't really thinking of that. I was just thinking that with an exclusion theory you can have a manufacturer who can pay these fees to exclude a rival, but sometimes in order to do that, the manufacturer would have to cut the retailer in on the deal, making the retailer better off.

Now, if the retailer can anticipate that then why couldn't the retailer have the idea just as easily as the manufacturer and initiate the fee first?

MR. WARREN-BOULTON: The gain here is monopolizing people other than the retailer. The gain comes from the third parties. That's essentially where you're getting. You have an implicit agreement, I think, in most of these models between a manufacturer and a retailer that says, Okay, retailer, you will do something that doesn't appear to be in your best interest. You will sort of help me exclude a competitor, and I will pay you off for doing that.

MS. SULLIVAN: Right.

MR. WARREN-BOULTON: And the reason I can do that is there are third parties out there that are going to be facing higher prices who are not being paid off. The point is that if I can get a critical mass of retailers to go along, if I can get enough OEMs to go along with me so I can freeze out an operating manufacturer, to randomly think about this.

The point is that's in the interest of every single one of those OEMs to accept that bribe even though they may see as a group they will probably be a little bit, not much, a little bit worse off if they all accept it, but it's not too hard to get people to sort of go along with this when in fact they are not united.

That's the odd thing about the EU proposal we started with. If a retailer had 100 percent of the market, he wouldn't agree. It's in fact critical that he has a small enough share that he says to himself, It makes sense for me to sign on, even though the system-wide effects of this from the point of all retailers is bad.

So it's a combination of having a manufacturer with market power and a retailer who doesn't have market power but is a gatekeeper that I think is the critical element here. I don't know if that's --

MR. BALTO: Rick, that's it.

MS. SULLIVAN: Sure.

MR. BALTO: That's an interesting structure, but something I don't see here is, What's the evidence of anti-competitive effect that's necessary? Ultimately I have to go to my bosses and say, We should do this, and they're going to say Why, how are consumers affected? So what should we look for as evidence of anti-competitive effect?

MR. WARREN-BOULTON: I think that the answer is that you have rival manufacturers who are able to compete on a level playing field. They go to the retailer, and they say, I'm willing to supply a product at the same price, equivalent quality, and if the retailer says, Nope, I'm not willing to do that because if I start buying some of my requirements from you, either my costs aren't going to change as was the case with CP licenses, or there's going to be some retaliation from the dominant manufacturer. I have some contract here under which what I have to pay the dominant manufacturer goes up when I start dealing with you.

I would handle it in the way we handle all these exclusion cases, and by now we've accumulated quite a set of them, so we really know what they look like. It becomes possible to deal with this, not just deductively like economists, but inductively. We have a large enough set so we can look at the common characteristics.

MR. BALTO: Does everybody agree with Rick's observations on the evidence of competitive effect? Dick?

MR. STEUER: There seems to be something of an inconsistency between that last point and the point made earlier, that all quantity discounts are always lawful. I think this goes, David, to the article you recently coauthored, that in some instances some types of graduated discount schedules can result in exclusion, depending on market shares and depending on the power of the product itself. This is the subject of quite a bit of litigation right now.

I guess one point I wanted to make, that I think is being lost a little bit in terms of how to structure an investigation, is to look at exactly what is being paid for. It seems we've talked about three things that could be paid for. One is favorable placement. One is entry, and the other is exclusion.

In terms of favorable placement, there are two ways to sell products in this world. There's push and there's pull. What retailers have to sell is pull, and what manufacturers can buy elsewhere is push. I think it's important to recognize what exactly is being paid for, what other ways are there to sell products.

And kind of a neat way of looking at this is in terms of placement. Just think about, not somebody who's got a limitation of physical space, but Internet sites that are also functioning as retailers, and also in effect take slotting allowances to give favorable positioning, except they have infinite space, and it's an interesting contrast with what happens in the physical world.

MR. BALTO: Since you mentioned placement, Irv Scher is involved in some really interesting litigation involving tobacco companies. Part of what we asked the earlier panels about was, Are slotting allowances or promotional payments ever paid to provide for advantageous or place rivals in disadvantageous shelf space? I think Irv has something to contribute on this subject.

MR. SCHER: Well, let me say that I'm of course biased. I represent one of the plaintiffs in that case in the tobacco industry. Let me just tell you what the claims are.

The claims are that a dominant manufacturer with more than a 50 percent marker share, and a 35 percent brand, where the next brand has about 8 percent, is using that kind of dominance to essentially exclude competitors. There's no claim of below cost pricing, claims of in the Godfather sense an offer that couldn't be refused by the customers.

Most competition in this industry now has gone to the pack market, because cartons are so expensive that the only place where there's a brand versus brand to get brand switches is in the pack outlets. The pack outlets are basically not the supermarkets. It's the convenience stores and the gasoline dealers.

I'm going to go back to the plan as it was originally adopted because it's been modified a few times, as it was challenged. The plan offered what they call in that industry "buy downs" which are promotional pass-through funds -- I'll give you 50 cents a pack and you pass it through to the consumer.

There's tremendous price competition in this particular market at the retail level. You've got mobile consumers. You've got very heavy in-store advertising. There's very little other advertising that's permitted any more in that industry, so it is a special category.

The Phillip Morris plan said to the retailers, If you give me my space to share -- which is noted in the article that you and your colleagues wrote -- then I will give you the better buy downs. I have very low buy downs. I have higher buy downs.

You really want the higher buy downs to be competitive with the other retailer, so it becomes something you really need. Therefore if you give me my space-to-share, which sounds logical, I'll give it you to. However, there were some add-ons.

One add-on was that the space had to be the 50 percent -- which is their market share -- of the visible space. If you've ever been in a convenience store or a gas station you know that the cigarettes are behind the counter. That's being caused by regulation, fear of theft, various factors.

So they said, We want 50 percent of the visible space. And we want all of the products, to get this money, to be laid out horizontally, not vertically. So therefore when you walk in to a convenience store, what you see is a sea of Marlboro country, a sea of red because everything else is in the lower half below the counter. That was one of the claims.

Another claim was that although the competitors could do what they want with their open space, there were some limitations. What they couldn't do is have a sign up for a promotion, for example, for more than 28 days.

If you're going to have a promotion, Mr. Competitor, you have to take that sign down and do something else. It's unclear whether it's another brand, another company, after the 28 days. In addition, three weeks out of every quarter, Mr. Retailer, you cannot price-promote any other product.

So those things go a little beyond space for share, and there are other things, but the basic claim is that they are exclusionary, creating market foreclosure. The other guys, the other three are fighting to pay more for worse space, and that's raising rival's costs and then some.

MR. SILBERMAN: Good case. The last part is a good case.

MR. BALTO: What do you mean, Alan? You said the last part is a good case. You mean those last two non ancillary --

MR. SILBERMAN: As he got to the add-ons I got really interested. I mean, the first part of the description almost sounds not too much different than saying either space allocation is driven by IRA data or Nielson data. It's pretty neutral. You have 50 percent of the sales, you get 50 percent of the space. That doesn't trouble me very much.

Saying that I'm going to make available a promotion to you, and having gone to all the expense of promoting it, I don't want to be hidden -- that doesn't bother me. When we see it in a bigger context, I think he's got an interesting case.

MR. BALTO: Can you explain, Alan, those first two things that you said didn't bother you? Why didn't they bother you? Why should we as antitrust enforcers not be bothered?

MR. SILBERMAN: The decision by a retailer, even if it is induced not by payment but by persuasion and so on to say, This product placement will be most beneficial for you, here's the data that support it, that is a decision that a retailer is entitled to make, entitled to change from time to time if it doesn't work. You ought not care about that part of the decision at all.

The next part of it that is the -- what was the next part of it?

MR. BALTO: Telling you you couldn't advertise or --

MR. SILBERMAN: No, no, no. The next part of it was the promotional payment. I as a manufacturer have the perfect right to say to somebody that, I want my expenditure to be used in an effective way, and if you're not going to be effective or you're going to be less effective, I'm going to -- subject to the Robinson-Patman Act -- I'm going to moderate the promotional benefit that I'm giving you. That doesn't bother me.

What begins to bother me is the ancillary activities that very much sound like preventing my competitor -- not just doing a better job promoting, but preventing my competitor from coming up with something that will allow it to market its products.

MR. BALTO: Good. At this point I would like to turn back to Bob Skitol's idea that we should look at these problems under Section 5. Is there anybody who disagrees with the idea he posed, of slotting allowances causing problems in less concentrated markets if you look at it under Section 5 theory?

MR. GIDLEY: I have a problem with that. You know, I agreed with a lot of the discussion and stifled myself to the group's mutual benefit, but it seems to me that slotting allowances for new products really ought to be per se legal. There's real costs, that's conceded by all, and there are really opportunity costs that are extremely difficult to quantify.

So now the next topic could be, Let's regulate the form or the amount of the new product slotting allowance. Let me take that topic on. I think if the FTC were to engage in that, it would lose its soul. I think that you would have an infinite level of Rule of

Reason challenges to every new product introduction slotting allowance.

You can take anything and put it under a Rule of Reason microscope. If you wanted to you could say Costco's membership fees should be analyzed under the Rule of Reason. Does it cost them 35 bucks to take my picture? No, it cost them a quarter. Okay. So now there is what, $34.75 has been extracted from millions of people like the Gidleys.

What do I say? Oh, my goodness, I'm not letting my wife renew? I think it's been a wise rule to say, It's really not a good use of our enforcement resources to look at that, even if that seems facially high and that you have to go out as a family and buy by 5 or 600 bucks worth of stuff to enjoy the benefit of the great cost reductions that that great procompetitive merchant has.

That's the way it goes to market, and I don't think the antitrust laws as a per se matter say that's good, bad or ugly. I just think you can't inquire on that level or we wind up doing 35,000 Rule of Reason cases.

MR. BALTO: Bob?

MR. SKITOL: The Costco membership fee doesn't even begin to be a barrier to entry by smaller rivals.

A multimillion dollar slotting fee does, and that's the difference.

MR. GIDLEY: It's a barrier to entry to consumers.

MR. SKITOL: Well, I think Section 5 of the FTC Act should be concerned about serious artificial entry barriers being introduced into the equation without any efficiency justification.

MR. GIDLEY: And my very short answer to that would be that slotting allowance have existed for at least 30 years, which tends to indicate to me that it's a practice that goes back way before this retail merger wave, and that it's probably inherently procompetitive, and it supports great variety in these stores, and that would definitely be part of a rule of reason attack.

MR. BALTO: Alan?

MR. SILBERMAN: First of all I don't think Section 5 of the Federal Trade Commission Act stands for the proposition that when you have ambiguous behavior that you wouldn't address under the antitrust laws because the effects are not clear, that you should therefore say, Now I can use Section 5 to get in to the same subject.

The proposition that you have barriers to entry here, that have really affected overall competition in a relevant market as opposed to individual competitors, I don't think that proposition can be sustained empirically. If you had that proposition, you wouldn't need Section 5.

So I don't think Section 5 is the answer on either of those points. The only place I would put Section 5 in is for the people who complained about the situations where retailers took deductions from invoices.

There I think you can make a very interesting argument that it's an unfair act or practice in commerce, that the retailer knows that no individual supplier is able to challenge it, even though it probably violates the UCC. It's a contract breach, but nobody is going to be able to sue, and they're taking advantage of that, and there I would think maybe the Commission can use Section 5.

MR. BALTO: Rick?

MR. WARREN-BOULTON: I guess, to me, I look at this, and the criterion really are pretty clear. You have to have what I would call monopoly power at the manufacturer level, and by that I mean not just market power, not just a Herfindahl over 2000. I'm talking about unilateral ability of a dominant manufacturer to raise prices and exclude rivals, and that is an absolutely essential prerequisite.

If you don't use that as a screen, please, you'll make my day. What can I say? From an antitrust consultants point of view, that would be terrific, but it's the sort of thing that will make Bill Baxter roll over in his grave. It is an essential screen.

On the other hand, I don't think you need any screen in terms of market power for the retailer, but you really do need a monopoly power at the manufacturer's screen before you get any further.

That being said, of course it's a barrier to entry. Stigler would say it's a barrier to entry. Barrier to entry is something the entrant pays and the established firm didn't pay. Well, most of the established firms came along at a time when there weren't barriers to entry. There weren't slotting fees, so is this a cost that entrants are paying today that established firms didn't pay way back then? Yes. Are there rents to established firms as a result? Is there anything we should do about it? No.

MR. BALTO: Rick, if you had Irv's tobacco case but the manufacturer imposing it only had a 30 percent market share, but was effective at imposing those restraints, including the two restraints that Alan doesn't like, would you be concerned?

MR. WARREN-BOULTON: Well, remember the definition of monopoly power. It's the ability to raise prices and exclude rivals. You just said to me, Let's assume they can exclude rivals. I would say they've got monopoly power. I mean, his case fits the characteristics. It's not a new product, unfortunately. It's a very established product. It's initiated by the manufacturers.

It's at least a dominant manufacturer that appears to have the ability to exclude. The downstream firms are ones where the rivals want to have some space but not all. They can't go to the convenience store and say, Take me instead. Marlboro is essential, at least some Marlboro is essential for every convenience store.

And if you wanted to add another criterion, if you look at the payment, and it looks like it's a payment for exclusion -- if you want to add that as a fourth criterion, so it fits.

MR. BLOCH: I would like to ask Rick a question if I could, David.

MR. BALTO: Sure.

MR. BLOCH: When you said a minute ago, Rick, that you weren't worried about having a screen at the retail level, did that mean that you aren't concerned at all about a retailer's power in a market, or that you aren't looking for them to have monopoly power like you would at the manufacturer level?

MR. WARREN-BOULTON: Oh, no. I think the FTC is looking at supermarket mergers. Looking at monopoly concerns by supermarkets is I think perfectly legitimate and even classic monopsony power issue. But if the issue is slotting allowances, are we interested simply in the role of slotting allowances and how that affects the analysis?

Then I guess my answer is that the only way -- I think I mentioned this before -- the only way which mergers among supermarkets affect slotting allowances' ability to be used as exclusionary devices is if it makes the kind of multi-outlet agreement easier to negotiate. It's easier to negotiate with one big supermarket than with 20 little ones.

That's a transaction costs story, and it's their concern.

MR. BLOCH: I think I agree with you but for very different reasons.

MR. BALTO: Let me give Bob Skitol a chance to reply to that, and then I hear the voice of Congressman Patman in the background asking a question.

MR. SKITOL: I hear the voice of Brandeis in the background.

I don't think there's a major difference between Rick and me. It's just that I think Rick ought to be at least a little open to a scope for Section 5 that's at least a little broader than Section 2 of the Sherman Act.

There are situations, and I think the slotting fee phenomena generally in the grocery industry is such a situation, where there is a cumulative exclusionary impact at the supplier level as a result of multiple anti-competitive abuses of slotting fee practices on the part of numerous different firms, each of which has market power but not monopoly power.

I may be right or wrong factually, but just for the moment assume that there is a record showing that there is a general slotting fee problem in this industry, that there are lots of abusive uses of slotting fees. The problem is it's very difficult to attack the problem under the Sherman Act because there's no Phillip Morris. There's no one firm with clear monopoly power that's guilty of all the abuses.

Rather, in any given sector, in any given product category there may be three different firms. No, let's make it simpler. Let's say it's a product category with two dominant firms, each of which is making abusive uses of slotting fees to raise entry barriers against smaller rivals but neither of which has market power, so neither of which is reachable under Section 2 of the Sherman Act.

Yet each of them is engaging in conduct that contributes to an exclusionary effect on smaller rivals, and that cannot be justified on efficiency grounds. Why can't we use Section 5 of the FTC Act against both of those firms?

MR. WARREN-BOULTON: I agree with the economics. I can't answer why we should use Section 5. I plead not being an attorney as my defense.

MR. GIDLEY: It might not help you.

MR. WARREN-BOULTON: The scenario set up is one which certainly an economist would agree with. It's shared monopoly.

MR. BALTO: Just to change statue slightly. What about Robinson-Patman enforcement? Is the slotting allowance problem one that's more appropriate or as appropriate for Robinson-Patman enforcement, and what are the kinds of Robinson-Patman enforcement that are appropriate? Ron?

MR. BLOCH: I think the focus on slotting allowances is misplaced. We heard time and time again today and yesterday that if you push down slotting allowances, you're going to get something else popping up under another name.

The general agreement that I heard primarily today was on the need for a level playing field, and that is a statement that came from somebody purporting to represent manufacturers. It came from retailers, large and small. It came from the only wholesaler who was on the panel this morning.

If the need for the level playing field is as universally accepted as we heard today, it seems to me that you can't avoid the discrimination that exists in the marketplace because large customers are able to get a bigger slice of the total bucket of funds that manufacturers have available. Others get a disproportionately small share, and a third group gets nothing.

If you want to deal with the problem of competitive advantages and disadvantages in the marketplace, in the grocery industry, and do something to attempt to level the playing field, then Robinson-Patman has to be part of the equation.

There's no avoiding it unless you want to say, Well, then just bring Robinson-Patman cases under Section 5 of the FTC Act because nobody likes to mention the word "Robinson-Patman." I don't have any inhibitions about it whatsoever.

The bottom line is that if you are focused on slotting allowances, you are looking at one symptom, and you are ignoring the disease. If the disease is going to be attacked, then you have to look at the whole sphere of discrimination that exists today in the grocery industry, and I submit to you there's plenty of evidence to suggest that it is worse today than it was when the Federal Trade Commission wrote its report back in the late 20s that ultimately led to the passage of the Robinson-Patman Act in the first place.

MR. BALTO: Let me just ask one question, Ron. What if we concluded that the really most egregious aspect of slotting allowances was that it deterred entry, particularly for small manufacturers, and raised the cost of expansion? It seems to me that bringing Robinson-Patman Act cases against dominant manufacturers would just be basically telling them, When you go and you adopt a strategy to drive these small people out of the market, be sure to offer the same slotting allowances to everybody, big and large, and that wouldn't solve the problem at all. In fact it might make it worse.

MR. BLOCH: It probably would solve the problem because I don't think there's a manufacturer that has the money to abide by the stature.

MR. SKITOL: Yes, that's the point for them. It would make that form of predation a lot more expensive.

MR. BALTO: Alan?

MR. SILBERMAN: The Robinson-Patman Act, as you suggested earlier, is a simple statute, and everyone knows what it means, and of course it's got to be part of the equation because all laws have to be part of the equation. But there's some things I think we ought to recognize that it doesn't mean. It doesn't mean that there is always a level playing field or that everybody has a right to be on it, and it doesn't mean that there's some standard of fairness that gets superimposed just generically over behavior.

There is a level playing field in some sense, but what we are talking about here, by and large, are pricing situations in which we have tests of injury to competition. We have recognition of functional differences between firms. If we go to the suggestion that what we're really dealing with here are leases of shelf space, then we have to deal with the fact that the transaction is probably even outside the statute because the 7-Eleven is leasing one type of product whereas the large supermarket is offering for lease a different type of product.

You have meeting-competition in which the way the law has developed, I think correctly, is that a person can elect to meet competition in some but not all situations. That is not a level playing field. That can happen, does happen.

So, yes, the statute applies, but unless we're going to write half the statute out and simply say it's a level playing field, be fair, love one another statute, which may have been its intent but it's not its words, then it doesn't do a great deal to deal with this problem.

MR. BALTO: Chris MacAvoy?

MR. MACAVOY: I'll respond I guess both to Ron's point and to the theme that we did hear, and I heard this a lot in the last two days too, about people in various positions saying we want a level playing field.

I think everybody understands that can't be delivered. It can't be delivered by Robinson-Patman or by the FTC under Section 5. I mean, there is still this overarching problem that companies that have bigger budgets for advertising, that have more established reputations, that are out there doing product testing, they're going to be at a different places in that playing field.

That's just the way it is in a competitive system. So although you heard the rhetoric of, We want a level playing field, I think most people realize that it's not going to come out of this and shouldn't come out of this.

MR. BALTO: Irv?

MR. SCHER: I'm going to start by quoting from a great antitrust scholar. He said that the Robinson-Patman Act was the misshapen progeny of intolerable draftsmanship coupled with wholly mistaken economic theory.

The last time that the Federal Trade Commission actively enforced the Robinson-Patman Act was in the 1960s. I was there. I don't know how many others around the table were. I was there. Let me tell you, it retarded new forms of competition, this act of enforcement of the statute.

The Commission would not recognize efficiencies, to the great dismay of Phillip Elman, who was a great antitrust lawyer and Commissioner. It protected inefficient forms of distribution. It led to price rigidity and even price coordination. I was there when some 200 apparel manufacturers lined up to agree to a consent order so that they would be able to stop paying the advertising and promotional allowances that were being demanded by apparel retailers.

I think it would be a great mistake for the

Commission to do so, to start enforcing it actively again, particularly in this area, because, as has already been said by some, an up-front slotting payment not related to the sale of products, that goes into the corporate treasurer of the retailer, not only I believe is outside the scope of the Robinson-Patman Act, but the Supreme Court has told us it doesn't create antitrust injury in the Truett Payne case, so therefore there really can't be a private suit in that kind of situation.

And the last point I want to make is the Supreme Court's view of the Robinson-Patman Act. Again I'm going to quote from two Supreme Court decisions: "Interpretations of the Act should not extend beyond the prohibitions of the Act, and in so doing help give rise to a price uniformity and rigidity in open conflict with the purposes of other antitrust legislation.

That's from one of your cases, the A&P case, and from Gypsum, the Supreme Court stated the Robinson-Patman Act" should be construed so as to ensure its coherence with the broader antitrust policies that have been laid down by Congress.

MR. BALTO: Well, that was very articulate, Irv. You'll rest assured that I spend all of my free time going through old files looking at old cases that possibly we could resurrect and bring again.

MR. BLOCH: David, could I just respond to one point that Irv made?

MR. BALTO: Sure.

MR. BLOCH: That is that slotting allowances may be totally outside the scope of the Robinson-Patman Act. I find that kind of an interesting, if not contradictory statement, because in the McCormick case that we talked about earlier today, the Commission said that was price discrimination, and they came out with a 2(a) complaint.

MR. SCHER: Involving 2(d) and 2(e) practices.

MR. BLOCH: That's another whole day of discussion that I don't think is within the scope of the workshop, but I agree with you 100 percent. And in addition, they not only challenged the practices that were obviously under 2(d) by the language of the complaint, they didn't enter any 2(d) relief, but that's another story.

MR. BALTO: Let me go to one of the ultimate questions. If slotting allowances are a problem -- I am going to ask Rick this question -- what would the appropriate remedy be, if we find a violation?

MR. WARREN-BOULTON: Can I quickly comment on this?

MR. BALTO: You have one minute.

MR. WARREN-BOULTON: One minute. I'm not going to say anything about Robinson-Patman because it's a mystery to me. Where slotting allowances have come in, however, I think has been in situations where there have basically been auctions -- actions to be the only supplier of a particular product to a supermarket.

That's the only situation in which as far as I know slotting allowances have intersected with the Robinson Pattman Act. These are auctions. They're bidding markets. You know, it doesn't make sense to think of it in terms of -- By definition the prices are going to be different because it's a bidding market, so I find it incomprehensible why anybody would think that that doesn't do a meeting-competition defense.

And I think it's fundamentally unsound to bring, should we say a Robinson-Patman case alleging secondary line injury, when you're really worried about primary line injury. If you're worried about primary line injury, face it. I think that's really the answer to the second question, which is that you should treat slotting allowances as just yet one more possible vehicle or mechanism under which a dominant manufacturer can or can't exclude rivals.

It's one of several. Market-share discounts are the other category. You can't ban slotting allowances. I think what you have to do is narrow the criterion down sufficiently narrowly so you have a set of guidelines that get you into a very, very small number of good cases. I think that the guiding principle would be Bill Baxter's old principle which is, First do no harm.

MR. BALTO: Any other thoughts on the issue of remedy, what an effective remedy would be in the case where we found a slotting allowance problem?

MR. SKITOL: Incarcerate.

MR. BALTO: Of the enforcement --

MR. WARREN-BOULTON: Eat the product.

(Laughter.)

MR. BLOCH: David, how do you answer that question without knowing exactly what kind of problem you've found in this case? We've been discussing for two days, and I think that there are probably dozens if not hundreds of different kinds of problems that have been identified under this general rubric of either slotting allowances or, if you apply that narrowly to the new product introduction, to pay-to-stay, whatever it happens to be.

There's just dozens and dozens of problems that have come up here, and to say Well, what's the right remedy, I want to know what problem you want to fix.

MR. BALTO: Let me change the subject just briefly, and turn to category management. The last topic we'll get to will be the potential for guidelines and future study.

Are there any thoughts, based on the panel we just did, whether you think there's a problem with category management, what it might be, and how the enforcement agency should look at the practice?

MR. SCHMIDT: David, I have a thought.

MR. BALTO: Yes.

MR. SCHMIDT: It seems to me that what we heard on the last panel is that, as a general matter, category management is a positive for the industry. There are general problems that exist, that can exist in category management as they can exist with any other conduct.

And to the extent that there's an opportunity for additional training, as Chris suggested, I think this is an area where some informal guidance through speechmaking on Commission officials' part would be particularly appropriate.

Just some reminders, I think is what's necessary here. But I would just encourage you not to dampen something that is really a very significant positive within the industry by trying to do too much on the antitrust side.

MR. BALTO: Any other comments in this area? Chris?

MR. MACAVOY: Just I want to repeat that done correctly, it really does have the possibility of causing some of the slotting things to wither away, and therefore I think ought to be encouraged and certainly not dampened.

MR. BALTO: Would the two of you say that both slotting and category management try to address the problem of an information imbalance between manufacturers and retailers?

MR. MACAVOY: Well, yes, to some extent I agree with that. I think category management addresses that and is perhaps more positive and collaborative, collaborative in the good sense way. That's one of the main reasons why I think it ought to be encouraged. It is premised on information sharing.

Where there's information sharing there is need for antitrust counseling. But it really gets sharing of information in a positive way when it's done right.

MR. BALTO: That brings us to subject of guidelines. The Independent Bakers Association along with two other associations have submitted a proposal for guidelines. Alan Silberman has prepared a paper in which he's provided some thoughts about guidelines. I want to give each of them some time to talk about what they've submitted and their thoughts about what the best approach is in terms of guidelines.

Bob?

MR. SKITOL: You want me to start first?

MR. BALTO: Sure.

MR. SKITOL: I think there are a couple fundamental reasons why an FTC initiative to issue enforcement guidelines is a desirable thing to do for the guidance of the industry.

The first is, I think the record accumulated in this workshop, building upon the record from the Senate hearings and lots of other sources, indicates that there is a problem to be addressed here. We've heard a lot about slotting allowances being used in a wide variety of circumstances, not all good, not all bad.

But I think we've heard enough over the last couple of years in particular to know that there are lots of situations out there where slotting allowances are being misused with anti-competitive impact. This industry is now in a sort of anything-goes Wild West environment that is not good for the future of competition in this industry.

Second, and closely related to the first, one of the reasons why it is Wild West is because there is widespread disagreement and confusion throughout the industry over what the rules are, or indeed whether there are any rules.

At one extreme, there are lots of people in this industry who I think honestly believe, and have long believed, that the law doesn't apply to slotting fees. Slotting fees are per se legal. In fact at the Senate hearings a couple of witnesses basically said that relying on snippets and misinterpretations of things that different FTC officials have said over the years. That's just not true.

On the other hand, at the other extreme, there are people in this industry convinced that slotting fees in every shape and form and size are per se illegal. In fact, if one looks at some interpretations -- you know, I'm really disappointed, Irv and Ron, you guys talked about Section 2(a) and a lot of things. You didn't talk about Section 2(c) of the Robinson-Patman Act, and the fact is that there are precedents out there that, if you believe them to be valid interpretations of Section 2(c), illegal brokerage, would indicate that all slotting fees, particularly the one time payments for new product introduction, are illegal per se.

Well, that's ridiculous. That's not a good place for the law to be or a good place for people in the industry to think that that's what the law is, particularly when there is so much use of slotting fees going on out there.

FTC guidelines could serve the purpose of clarifying where the line is between lawful and unlawful, promoting an industry consensus toward a thoughtful and appropriate middle ground. There are lots of situations -- I mean to take the basic dichotomy that we started out with yesterday that Greg laid out from his survey, that there are efficiency stories and there are market power stories, and how do we distinguish the one from the other? That is something that a thoughtful set of FTC guidelines could do for the industry.

Now, as far as what the guidelines would do, I interpret everything that Rick Warren-Boulton has said today to be an endorsement of the particular proposed set of guidelines that we've come up with. They're not exactly, but pretty close to what he is advocating, I think.

We're not in favor of rules or anything intrusive. We're in favor of general guidelines, setting forth general principles with safety zones being exceptionally broad, and the actual indicia of enforcement concern being relatively narrow.

We start out by suggesting that these guidelines, and enforcement concerns generally about slotting fees, should only apply in situations where retailers and/or manufacturers involved in the practice have market power. Here I appreciate the point Rick was making about why do you need market power at the retailer level.

I think you do for a scenario that says there's going to be an anti-competitive effect at the retailer level. We'll come back to that in a second.

Our proposed guidelines draw a distinction between slotting allowances in the form of flat payments unrelated to volume, versus the per unit discounts. For the flat payment type, we've got major safety zones that basically say even the flat one-time payment deal ought to be presumptively lawful if it bears some reasonable relationship to new product costs, to the relevant costs involved.

And in that circumstance, there might still be a situation where , even though it's reasonable in amount, it's being used in a discriminatory manner. It's appropriate to look at the competitive implications of any discrimination that's involved or any exclusionary understandings. But the basic point is if there's some reasonable relationship to costs, it's presumptively lawful.

Then we say that if you're talking about the volume-related discounts, something that is really a whole lot more like regular price competition that we ought to really stay away from, then their our guidelines say, Hey, in that area it doesn't matter if it's related to costs or not, leave it alone, presumptively lawful without regard to relationship to costs.

Again, though, keep an eye on and recognize that even there that kind of allowance could run afoul of the Robinson-Patman Act. The Robinson-Patman Act is still on the books, and notwithstanding what most lawyers and economists think about it, it's the law of the land, and the industry ought to respect it.

Then we go on, and we talk about the importance of looking at exclusionary understandings and exclusionary effects. We talk about the payments for preferential shelf space and similar benefits, and that also should be renewed as an area of FTC enforcement concern because it's already in the Fred Meyer Guide's after all.

Those kind of payments are part of the overall competitive problem that exists in this industry that we've heard about in the last couple days.

Beyond all of that, the final note in our petition is that there's much too much secrecy about all of this, that it ought to be the case that manufacturers and retailers have some obligation to be public about their slotting fee policies, and how do we bring that about? Well, I think the FTC ought to consider dusting off its broad authority under Section 6(b) of the FTC Act and send out special reports to the 25 or 50 largest supermarket chains in the country, and the 25 or 50 largest grocery manufacturers in the country and get the information, get the goods, all of the hard data on exactly what's going on, write a report and make it public.

MR. BALTO: Thank you. By the way, I don't want to scare the business people in the audience, but when Bob started mentioning special reports, all of the lawyers at the table started to smile.

Let me turn to Alan Silberman, who also submitted written comments about the idea of guidelines and study.

MR. SILBERMAN: I fear you'll think I'm a little bit schizophrenic. Having said early on that I didn't think that it's a serious issue in terms of enforcement, at the same time I see some room here for guidelines, but they're guidelines of a different type.

If the standard for whether or not time should be spent on guidelines is the standard that Chris MacAvoy suggests -- that is, it's to act in a situation where the cop has not been on the beat -- then no, we don't need guidelines. The cop is on the beat. This workshop, if not also the McCormick case, shows us that.

If the point of it is to deal with the situation that there's a Wild West situation out there, as Bob suggests, the answer is no, there is no Wild West.

If the point of guidelines is to seriously work changes in the law, which is what I think the petition would suggest, not only in substantive law but also in a number of procedural points, I would of course be very much opposed to it.

So why do I think is room for guidelines? It goes back to what Bob Pitofsky said at the beginning of the workshop. There is a concept, you'll remember it from your conversation with Justice Brandeis -- there is a concept that says that the Commission is designed to give advice and guidance and improve the level of discourse on antitrust issues, that it has a didactic function as well. That I think guidelines can serve to move us ahead, to get us away from this talking about slotting allowances as a broad category, this aggregation of the topics, and begin to channel the discussion of both competition issues and policy and economic issues.

I think it would do so not just by getting us off the generic term slotting allowance, but also getting us to a point where we would recognize that what we are dealing with here is basically matters of price behavior, not promotional behavior, at least certainly in the new product introduction area. Therefore it gets us into meeting competition, functional differences and things of this sort, and could explore those topics, recognizing that our understanding today of meeting competition, for instance, is far different than it might have been 20 years ago.

We've heard testimony or comments during the last day and a half about how when you're competing for shelf space you're not merely competing against the same bottle of pickles or carrots or whatever -- that in fact the entire store from time to time is being maneuvered. You have the bidding competition situation we've talked about.

These are all areas that can be clarified. And existing legal principles about exclusionary conduct, about conspiracy, about other aspects of antitrust -- that those are sufficient already to deal with certain types of behavior that people around the table have thought of as slotting allowances.

I think the value of that kind of presentation, while perhaps not a guideline -- and by the way, this function could be performed by a Commission decision not to issue guidelines that has exactly the same content. In other words, it is entirely possible to perform the didactic role without going through the laborious process of negotiating, agreeing, getting the staff and everyone else to agree and getting the Commissioners to agree on guidelines, and rather to talk more generally why in certain areas guidelines are not necessary, but the didactic role here is crucial.

There are two areas where Bob and I think are on near common ground, not exactly but close. One, I do believe that there is an area for getting better empirical data here. If you go back to the literature, you go back to the 1975 period, and you find people saying, We don't know, we don't have real good information. We still have that. You had that in 1990. You have it now.

There is some empirical information that it would be really good to collect. I think part of the function there, while I would not make public a lot of confidential details, could be to give those category managers and other people in the retail and manufacturing side the data to help counter the bean counters.

In other words, there's a great deal of behavior here that is being driven, not by good marketing decisions and by and for marketing decisions, but by accountants who have decided that this goes to the bottom line this way, this goes that way, classify this that way, and everyone around the table keeps saying, Well, look, because of that price doesn't change.

That's nonsense in a broad sense. It's probably very true in a daily sense. One of the things the Commission does is help raise the level of business behavior, and it can do that with information.

The one point where Bob and I agree partially is on transparency. I believe that transparency extends only on the terms on which firms negotiate various kinds of, quote, slotting allowances and so on, not to the actual end results of negotiations.

Bob would go all the way, but I believe that the Commission could express somewhere along the way a preference, not to say that the opposite is illegal or deals in inference the other way, but a preference for transparency.

If indeed the things we were talking about here really do promote effective functioning of the marketplace, then there should really be no problem about saying, We negotiate or we don't negotiate or people come and can make a presentation and get in on 20 stores in the city, things like that. Those things ought to be out in the public.

MR. BALTO: Ron?

MR. BLOCH: Some day maybe guidelines of the kind that Bob has proposed might be appropriate, and maybe even those guidelines. I think we need some evidence beforehand to show that market power exists both at the manufacturer level and at the retail level at 20 percent market share in virtually all markets in order to establish the kind of a bright line test that is contained in the guidelines. I don't think there is much evidence to support that 20 percent test yet.

And whether this is the right time to issue guidelines, it seems to me that the Commission needs a tremendous amount of knowledge, understanding and experience with the subject of the guidelines. The subject of the guidelines is slotting allowances. If the FTC had that level of knowledge, understanding and experience, we wouldn't have been here for two days.

This is the beginning of the learning curve, and the beginning of the learning curve is hardly the time to issue guidelines in the form that you have proposed, which will be argued as the state of the law any time an issue of this nature gets before a judge.

And the Commission needs a much greater level of knowledge and understanding before it comes out with that kind of a concrete legal-and-illegal pronouncement.

Specifically I think there are a few other problems with these guidelines; namely, they cover much more than new product introductions. If you look at the language, it deals with acceptance, stacking, display and other favorable treatment. Well, that creates a tremendous overlap with the existing Fred Meyer Guides, and I don't think we need that kind of overlap if we're dealing with what is supposed to be a different problem.

I think that today the 20 percent guideline for market power, the line between when you can and when you can't is basically arbitrary. It doesn't have any factual support, and I don't know of a single case that suggests that anybody either at the retail level or at the manufacturing level had market power at 20 percent.

MR. SCHER: Toys R' Us. 17 percent.

MR. BLOCH: 17, all right.

MR. BALTO: But much higher in certain metropolitan markets.

MR. SCHER: It was a national market in the case.

MR. BLOCH: Let me get to what I see as probably an overarching point about guidelines. Guidelines -- and I think our experience has proved this -- guidelines really are worthless if they just sit out there in a book as words on a page. For them to have any effect whatsoever, they need to be enforced.

Now, look at the status today of the Fred Meyer Guides. There hasn't been a case to enforce those guides since 1990 when the Commission went through a very expensive revision of those guides with public comments and all that goes with it, and they have been nothing more than words in Part 240 of the Federal Regulations, 16 CFR if I recall correctly.

Why in the world would the guidelines that you are proposing, or any other guidelines to define the conduct that's illegal and what is legal, why would they be given any more attention than the Fred Meyer Guides are given to date? They are, to be brutally frank, the biggest joke in the grocery business that exists, because the FTC has shown no intention whatsoever of ever enforcing them.

Well, unless the Commission intends to enforce slotting allowance guidelines there's no point in bringing them out. There's nothing to be gained as a practical matter by going through the exercise.

So I think what we need, if there are problems to be addressed, competitive problems, whatever they are, by guidelines, the first step is, Bring some cases to show the world on a litigated record, Here's the problem, it causes competitive injury. And then when you build up a backlog of that kind of experience like we had with advertising and promotional allowance, it went to the Supreme Court, we had the development of some jurisprudence and then came the guidelines.

I think that's the proper approach, if and when guidelines to deal with slotting allowances or anything else are to be promulgated. In the meantime, I think if there are problems to be addressed because they injure competition, then the approach for now is to bring a case or a series of cases.

MR. BALTO: I have to step out of role and reply to Ron. I'm the person that receives the various complaints, requests for investigations, enforcement action in the Bureau of Competition, and we do not receive complaints in the area of the promotional programs covered under the Fred Meyer Guides.

Yet at the same time I observe that there are lots of programs going on in this area. There's lots of counseling that goes on in this area, and we did go and talk to people, including the lawyers at various manufacturers, in the course of our interviews.

I guess my assessment would be that this is a good example of where the private bar serves an important role through guidance in making sure that their clients stay within the lines. If someone has a good matter that they believe violates the Fred Meyer Guides, bring it to my attention. We'll look at it immediately. Dick Steuer?

MR. STEUER: I think it would be a mistake to bring out guidelines in this area, actually now or ever, and the reason I feel that way is that the notion of slotting allowances is really a misnomer. It includes things that are very well addressed in other areas of the law, particularly exclusive dealing but also the Robinson-Patman aspects, and it's organic.

I had a colleague who used to compare this to a game called whack-a-mole. As soon as you knocked one down another would pop up. Guidelines simply are not nimble enough to change the way the case law can, and to the extent that there were problems here, most of the problems we talked about involve exclusivity, some Robinson-Patman.

These things can be addressed on a much more immediate basis. There are too many things going on under this category to really be a category, any more than left handed distribution restraints would be. You've got customer initiated programs, manufacture initiated programs, placement programs, entry programs, exclusion programs.

I think that it simply doesn't lend itself to guidelines, although I must disagree with Ron. I think that the Fred Meyer Guides are an area where, although maybe they don't come up in litigation very often, I think in offices all over corporate America these things are referred to every day, and you get feedback on it all the time.

MR. BALTO: Chris MacAvoy, I don't think you're about to welcome the guidelines.

MR. MACAVOY: On that latter point, some of you may have seen the little ABA Antitrust publication, it's a brief guide to the Robinson-Patman Act, that is the largest selling publication that the ABA Antitrust Section has. It's a fact of life to comply with the Robinson-Patman Act for businesses all over the country.

On guidelines, I agree that I don't see the desirability, the wisdom of guides in the sense that Bob Skitol has proposed. Alan Silberman's idea of something having a more didactic function, maybe, although I'm very interested in the comment he made right at the end about how we need more transparency.

I represent a trade association of retailers. I see Jeff Schmidt down here who does work for a manufacturer's trade association. I know at our meetings we don't talk about slotting allowances. We don't put our slotting allowance policies on our web sites. The Commission expressing a preference for transparency, that doesn't give my guys antitrust immunity, so I mean, that's just a baseline problem for us.

People say, What is your trade association client's policy on slotting allowances. There isn't one for good reason.

MR. BALTO: By the way, in the middle of Steve Salop's paper, there is a discussion of why horizontal agreements to control slotting allowances should be analyzed under the Rule of Reason.

Alan?

MR. SILBERMAN: I probably ought to amend my position to be one for seeking guidance rather than guidelines, but I think we should recognize that we all pay a price when there's a lack of adequate guidance. We have to remember that it is not merely the Federal Trade Commission that enforces the law or for that matter the Federal Trade Commission, the Department of Justice and even State Attorneys General. There are various state statutes -- some generically worded like thou shall do no bad thing, which is in fact a statute in several states -- that lead various individuals to say, Well, this is a bad thing, let's go ahead and litigate it.

Let's have a jury decide in some state court in the middle of one of the 50 states. There are even some states that have statutes that could be interpreted to say, sort of following along with what Chris is saying, that every buyer and seller should announce the terms of every transaction that they make, even if they're perfectly lawful, even if they're meeting competition or whatever else, so that the world knows about them instantaneously, a process which I think would easily be characterized as an invitation to conspire.

But there are state statutes which some lawyers would interpret as saying, If you don't do that, it's secret and secret is wrong. There's a little theme of that in Bob's guidelines.

Now, that's what happens when you have a void, so we've got to fill the void. We have to fill it with good data. Ron, absolutely right about that. But we ought to recognize that right now we have a big void.

MR. BALTO: Rick?

MR. WARREN-BOULTON: I guess several points. First of all, I think like every single person around this table, I think that guidelines would be desirable if I wrote them.

MR. SKITOL: Most of us think you should write them.

MR. WARREN-BOULTON: The problem is what do we do if we can't write them. Do we want the FTC to write them? People may have missed that of the four criteria we discussed, the case against McCormick would have flunked two of them. So the guidelines I would write would clearly state that -- McCormick would not have been accused of anti-competitive behavior through offering slotting allowances.

And so I think to your point, when you don't trust individuals to do it, the other way to do it is you go through the extraordinary expense and time-consuming process of litigation. I mean, it's sort of like the quip about democracy. It's just horrendous, but everything else is worse. It's a very expensive way to get out guidelines through litigation.

So you really have to mistrust the analytical process a great deal to decide to go that route. You may well be right, and I share your concern about bad guidelines, so clearly I think we would all agree that bad guidelines are worse than no guidelines, and my guidelines are better than no guidelines.

The second thing to say is I think there's now I think a real consensus in the economics profession that exclusion is a real concern and a real problem and Chicago is dead on this issue. And so I think there's a real problem here that needs to be addressed. That's a plus.

Another plus, point 3, is that I think you really can come up with a set of narrowly defined conditions which will lead you to a fairly small set of cases where in economist terms your false positive rate is low. You have a fairly low chance of convicting the innocent, okay?

But the other point, which somebody made over here, which I think is really very true, is this is not a slotting allowance issue. This is a generic problem of exclusion by a dominant manufacturer, and slotting allowances are just one manifestation from it. Someone said organic. I don't remember who said that, but that was really quite good. One of the problems is, as with most kind of vertical restraints and other things, if you ban one kind of vertical restraint you'll get another.

Well, it turns out that for nearly every anti-competitive act I know there's at least a dozen ways to do it. You're missing out on some, give me a call, and I'll give you another seven or eight ways to do it.

So the question I think the FTC has to address is, do they want to write what are basically exclusion guidelines or is there something separate here about slotting allowances truly?

That being said, I would also say finally, I think one of the functions of the FTC is there are empirical tests you can do. We've talked a lot about stuff. There are hypotheses floating around all over the place. Most of those hypotheses are testable, and it seems to me that it would be very worthwhile to answer some of the questions that are floating around.

The two that came up just this afternoon are, What happens when you have mergers? Do you get more slotting allowances or less slotting allowances? When can we distinguish between mergers creating buyer power, which is good, and mergers creating market power -- so these are all subject to empirical verification.

It seems to me that one of the functions, maybe even before guidelines are issued, would be to sit down and say, What are the testable implications of the various theories, and let's go ahead and test them because certainly you have data. You have IRI data, you have Nielson data. This is not hard to do. It doesn't take an economist. It doesn't even take a rocket scientist. Even an economist can do this sort of thing. I think it's a research agenda that you're looking at.

MR. BALTO: By the way, for an economist you don't seem to count very well. After we're done I'll explain that McCormick does meet all four of the standards that you've articulated.

Jeff Schmidt?

MR. SCHMIDT: David, I share the view that guidelines are not necessary here, really just quickly, for two reasons. One, the point has already been expressed that the existing legal tools are adequate to deal with the problem. But one point that I don't think has been adequately emphasized is, I see a tremendous effort within the industry working on this as well as a number of other problems within the grocery industry, work that's gone on between manufacturers and their trading partners on the retail level on a one-on-one basis.

We had a panel talking about category management, which really is an outgrow of that joint industry effort to try to get to a more fact based analysis and a more efficient way of conducting business. I think a tremendous amount of work has gone on with respect to activity based costing which also will be helpful on this. All of this at least suggests to me that the industry, for a number of reasons, is really beginning to tackle and may well be well on its way of tackling this as well as other issues that can create problems within the industry.

MS. DESANTI: I would just like -- Bob, go ahead. You want to respond to some of these points that have been made.

MR. SKITOL: I'm going to stand on the petition we filed as a basic response to most of the comments that have been made on the other side and I won't repeat. But to make one point that there are various and sundry ways of providing public guidance, this is one of the points I agree with. One of them is whatever it is that the Commission staff decides to do in the aftermath of this workshop by way of a written report, I think that you guys have really done a tremendous job of collecting information and perspectives over the last couple months and over the last couple days.

And whether or not in the aftermath you and the Commission ought to proceed with the research agenda and/or to proceed with guidelines of the sort that my clients are urging, at a minimum I would respectfully urge that the Commission staff and the Commission prepare and issue a public report setting forth some findings and conclusions and perspectives that have come out of this workshop. I have feeling if that report is done in a thoughtful way, the report in and of itself will be an important form of public guidance that the industry will appreciate.

MS. DESANTI: Thank you, Bob. I guess I want to put this whole discussion that we've been having for the last half hour or so in the context of the limited resources that the FTC has. You're right, Rick, it may be that even economists can do the kinds of data collection and data analysis that are necessary to answer some of the empirical questions that come up, but it costs money, and we are all faced with a question of, compared to what?

Compared to investigations? Compared to guidelines? I personally have way more experience than I ever wanted to get in drafting guidelines and negotiating guidelines, and it's a hugely costly process in terms of staff, time and effort, in terms of data collection, empirical study, research. So I'm interested in the views of all of you. If you only had to choose one of those directions to go in, because you have limited resources, and we are after all still in the midst of a merger wave, where would you go?

MR. WARREN-BOULTON: Can I make a comment? There's an inexhaustible supply out there writing Ph.D.s and looking for good topics. This a cheap free labor, and I think one possible solution to this is in fact for the FTC to sort of contact its, shall we say, academic network and say to them, Look, here are ten terrific Ph.D.s topics. Those of us who are academics for many years know that there are hundreds and hundreds of kids who are thrashing around sleepless nights, What the hell am I going to do for a topic?

And you have some great topics. It would be a little slow, going in the wrong direction, but it's real cheap.

MR. SKITOL: But how about if the Commission helps out the academics with some subpoenas for serious hard data?

MR. WARREN-BOULTON: You don't need that, IRI and Nielson all that data is out here.

MR. SKITOL: That doesn't give you serious cost information about --

MR. WARREN-BOULTON: Okay, yes.

MR. BALTO: Can I turn to our two other

economists. First Mary Sullivan.

MS. SULLIVAN: I think the data-collection aspect of the study is a little more difficult than you think just going in. I think getting the scanner data is one thing, but going in and trying to collect information on the fees and other variables you might need could be a little more challenging than a graduate student could start with. So I'll say, having thought about doing slotting allowance studies for a long time and having done one, I'm pretty pessimistic, and think maybe the FTC should be in charge of at least the data collection.

But having listened to the panels for the past couple of days, there are three basic kinds of studies I would do if it were up to me. I think one of the big policy issues concerns whether slotting allowances or these fees are mainly a phenomena of new product introductions or whether they involve other things that happen after the new products is introduced.

I know one of the great stylized facts of marketing is, over the past 20 years, the sort of percentage of what manufacturers pay for advertising and promotion has gone much more towards promotion and away from advertising, so it seems like a lot of different kinds of fees have increased.

So I think one good study would be just to look, maybe at the category level, at fees that are paid for new products versus fees that are paid for products that other stages in the life cycle, older products according to their performance or expected performance or things like that. This would just let us see, Well is there really a problem? Are fees really important in other stages of the life cycle other than when new products are introduced? I think that would be really useful.

There are a couple other studies that I think would be really interesting. One of them basically would have to do with understanding retailer's buying decision, What makes a retailer decide to accept a new product, and how do the fees affect that, and are small manufacturers somehow disadvantaged? So do small manufacturers with products that look like they're going to be very successful, are they less likely to be than established manufacturers' products? Just things like this would be things that we would need to understand.

The third study I would do concerns understanding product failure. I think product failure is a rather ambiguous term, but what you want to look at is, What are the circumstances under which a retailer decides to take a product off the shelf, and is that related in some way to fees that were paid by other manufacturers, and are there dominant manufacturers, and how many manufacturers are there in the category?

So those are the three basic studies I would do. Again, I'm sort of the pessimistic about the data requirements, but you'll worry about that.

MR. BALTO: Greg Gundlach?

MR. GUNDLACH: I want to make a couple comments just with regard to where we go from here. I think the acknowledgment that the lack of information that we have really sets the agenda. I think it's in a sense premature to talk about guidelines until we know what we're talking about, and in that respect, research is needed.

The amount of research we have right now is much about anecdotals. It's much about opinions of manufacturers and players in the industry, and there's very little hard empirical data out there that helps us either at the academic side or in the professional arena.

The challenge, however, the wall we face as a research group in trying to gather this data is the cooperation to obtain that data. Until that wall is broken down we are not going to be able to some of these empirical questions that we've been talking about for the last two days.

As far as where we go, if we get over that hurdle, I think getting descriptive data so that we have a sense of what these different fees are and how they are played out in the arena is very important. I think, as many have talked about today, there's a variety of different theories out there that we can begin to test through a rigorous econometric and other means, and so heading in those three directions I think would be helpful.

MR. BALTO: Mark Gidley?

MR. GIDLEY: I'm not in favor of guidelines, as you might have suspected. I do think that the conference has been worthwhile, and I think that it's very likely, knowing how prolific you are, David, and that's to your credit and the Commission's lucky to have you, that at a minimum we're doing to see at least one grumpy speech out of the FTC about slotting allowances. You snicker, but that gets faxed to every client. It's disseminated to every category manager.

Those things filter down, so if nothing else I know that you're a bright fellow and you have enough material for at least one grumpy speech, and that will start a dialogue, and the speech is a far cry from guidelines, but if you make a mistake in guidelines you start freezing retailing and retail formats.

This country is blessed with the best retailers in the world. We have Home Depot, Wal-Mart, Costco, all these wonderful retail formats. They're invading Europe. You don't see European manufacturers coming in here with the exception of Trader Joes and Aldy's, that is basically all we're getting from Europe. And Europe is much more regulated. They regulate hours. You have to about open at seven in the morning. They prevent discounting. They prevent big box stores, so I think you have to be very careful before we tinker with the playing field.

The third thing I would say is I think it's important that whatever speech, position, thoughts, the Warren-Boulton school of sort of the monopoly dominant manufacturer, whatever you ultimately conclude is your biggest law-enforcement problem, I would make sure that the guidance is universal, that it can work in all retail formats.

There's no reason to limit it to supermarkets. Supermarkets are converging with other retail formats, and if you want to look at buyer power, there are two national hardware chain. We've got scores of supermarkets chains. If you believe office superstores are a separate market, we have three of those. I understand drug stores have used slotting allowances for many years.

So I think that your guidelines are going to be interpreting laws that apply to all retailing, and they have to be able to withstand the rigor of working in those markets, and I know that you've groaned when I broaden this debate, but honestly the law is the law. Your policy, your Section 5, your Justice Brandeis kind of concept of this place, has to work across all American retailing, and I would say, First do no harm. Start putting out in the public record some of the things that concern you.

You spend a lot of time with us. I don't think you begin to understand our business. That's not a criticism, but it's highly complex behavior you're dealing with.

MR. BALTO: Irv Scher?

MR. SCHER: I want to say a couple things. I agree with virtually everything Mark said, but I also agree with Ron that the way to go here probably is with cases, and I would commend to the Commission an article called Tom, Balto and Averitt, Anticompetitive Aspects of Market Share Discounts, et cetera, because I think that's what we've been hearing from the economists today. Exclusionary conduct, vertical exclusionary conduct by dominant companies, is what the Commission should be looking at, and under basic Sherman Act rule of reason concepts, exclusive-dealing rule of reason.

MR. BALTO: Chris MacAvoy.

MR. MACAVOY: The call has gone out from a couple corners here for more data and a couple of people said, Hey, send them subpoenas. I don't want to get carried away with that type of thing. Mark Gidley and I have both gone through a number of second request compliances in supermarket deals. They cost about 750,000 to a million dollars a pop for a regional supermarket deal.

MR. BALTO: Are there any lawyers here who can undercut that price?

MR. MACAVOY: I have an outline of questions that I use to prepare for investigational hearings in supermarket mergers. It's not an outline that's changed much over the years, but I have in the last year or so added a section on slotting allowances as we start to get asked those questions in hearings.

The second requests get longer every year. I would be dismayed, although part of me would be delighted, to flip over the next second request I might receive and see "Part 5 -- Slotting." I'm very sympathetic to the statements made about the lack of resources to do this kind of thing, but it costs somebody money when subpoenas go flying.

MR. BALTO: Does anybody have any additional comments they would like to make?

Well, I wanted to thank everybody for participating and listening so patiently. This has been a fantastic experience, one in which I think the Commission staff has learned a great deal. I want to thank all my colleagues.

I want to thank especially the over 80 manufacturers and retailers who were able to provide us information on a voluntary, confidential basis, and a number of them who walked us through their stores. I most of all want to thank every one of the businessmen who, at their own expense, and on their own time, came out to join us for the past two days. Thank you very much.

(Time noted: 5:10.)

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

CASE TITLE: SLOTTING WORKSHOP

HEARING DATE: JUNE 1, 2000

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

DATED: JUNE 19, 2000

DEBRA L. MAHEUX

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

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

DIANE QUADE