ENFORCEMENT POLICY REGARDING SLOTTING ALLOWANCES

Christopher J. MacAvoy
Howrey Simon Arnold & White, LLP
Washington, D.C.

Federal Trade Commission
Workshop On Slotting Allowances
May 31 – June 1, 2000

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The Federal Trade Commission's enforcement policy regarding slotting allowances is robust, clearly articulated, and appropriately focused on protecting consumers rather than individual competitors. There is no need for new federal guidelines or a tougher enforcement approach. Advocates of a more restrictive approach to slotting allowances – chiefly small manufacturers complaining of difficulties distributing their goods – have not shown that slotting allowances are responsible for their problems in the marketplace. A ban or restriction on slotting allowances would not improve the situation of small manufacturers, but would chill a legitimate form of promotional spending, to the detriment of manufacturers of all sizes, as well as retailers and consumers. Federal guidelines, such as the enforcement guidelines that have been proposed by the Independent Bakers Association and two other associations, are unnecessary, unworkable, and anticompetitive.

I. BACKGROUND

Slotting allowances are not new. They have been around at least since the 1970s, and have been a frequent object of study in academic, marketing, and legal circles.[1] A tremendous amount has been written and said on the subject. From this welter of dialog and dispute, certain facts have emerged as more-or-less undisputed:

- Grocery products are not placed in stores on consignment. Supermarket operators pay for products and assume the risk that consumers will buy them.

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[1] In 1995 testimony, the Independent Bakers Association said that slotting fees appeared in the late 1970s, and had their origins in a bidding war between cigarette companies for space on aisle-end display fixtures. Nicholas A. Pyle, Vice President, Independent Bakers Association, Statement Before the Federal Trade Commission Hearing on Global and Innovation-Based Competition, November 8, 1995, 1-2.

- Space on supermarket shelves is finite. When a retailer adds a product – whether it is an entirely new item, a line extension, or simply a new package size – it must remove or reduce the space allocated to some other item, and hope that the lost sales will be offset by the new product's. When a retailer takes on a new product, it incurs out-of-pocket costs as well as opportunity costs.[2]

- A large number of new grocery products are introduced each year. Recent FTC testimony noted that "[t]he average supermarket stocks 30,000 items, but fully 100,000 grocery products are available from manufacturers, and another 10-15,000 new ones are offered each year."[3] The Independent Bakers Association, an ardent opponent of slotting allowances, testified to the FTC that "[t]he industry experiences approximately 10,000 new grocery introductions a year . . . ."[4] Figures as high as 20-25,000 new products per year have been given elsewhere.[5]

- A high percentage of new products fail. Sources cited by the Food Marketing Institute put the failure rate for new products in the 70-80 percent range, while the Independent Bakers Association told the FTC in 1995 testimony that "less than one-tenth survive 12 months in the marketplace."[6]

- In recent years grocery manufacturers have been shifting money away from direct consumer advertising and marketing, and in particular away from media advertising, and into trade promotions, *i.e.*, promotions designed to influence purchase decisions in the store. This trend reflects the declining impact of television networks and the proliferation and fragmentation of product information through cable channels, magazines, and the Internet.[7]

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[2] There is dispute over the justification for giving slotting allowances for items that are variations on existing products. Line extensions and new package sizes carry out-of-pocket costs and economic risks. Each new flavor or package size is a unique SKU. It must be added to the warehouse, distribution, and pricing systems, and shelves must be re-set in the warehouses and at the stores to make room. It cannot be presumed, moreover, that new varieties or sizes of existing products will be as successful as the original variety or size, or contribute as much profit as the product they replace on the shelf.

[3] "Slotting Allowances and the Antitrust Laws," Testimony of the Federal Trade Commission before the House Committee on the Judiciary Hearing on Competitive Issues in Agriculture and the Food Marketing Industry, October 20, 1999, at 5.

[4] Pyle, *supra* n.1, at 2.

[5] Research conducted by Prime Consulting Group for a 1997 report entitled "Efficient New Product Introductions – Myths, Facts & Opportunities" arrived at a substantially lower figure, by employing a narrow definition of "new product" which excluded line extensions, seasonal products, and new package sizes.

[6] Pyle, *supra* n.1, at 2. Using a restrictive definition of new product, Prime Consulting Group arrived at a 25 percent failure rate. Prime's research also found, however, that by the 39th week after being introduced, 42 percent of new products had declining sales.

[7] In 1968, manufacturers spent 72 percent of their advertising and promotion dollars on direct consumer promotions such as network television advertising, with 28 percent going to trade promotions. According to Cox Direct 20th Annual Survey of Promotional Practices, by 1997 this ratio had changed markedly, with trade promotion spending accounting for 50 percent of the total. Over this span, media advertising fell significantly and by 1997

- Slotting allowances are an aspect of competitive rivalry among manufacturers. With shelf space being scarce and many thousands of existing and new products vying for places, slotting allowances are one factor in the negotiation between manufacturer and retailer. Other factors include: the product's wholesale price; the anticipated retail price; the expected contribution to profit; the product's track record or lack thereof; the promotional effort that will be put behind the product, by the manufacturer acting directly or in cooperation with the retailer; and whether the product fits with the retailer's strategic objectives.[8] A critic of slotting allowances told the FTC that the store-admission process is "highly negotiable and competitive," and slotting allowances are themselves a "very negotiable" part of the process.[9]

Beyond this, however, lie areas of sharp disagreement, including the following:

- Slotting allowances are often said to be on the increase in the grocery industry, but the evidence is mixed. Some prominent manufacturers, such as Procter & Gamble and Campbell's Soup, reportedly do not offer slotting allowances,[10] and some retailers, including some of the very largest chains, eschew all forms of promotional funds but instead bargain for a "dead net" low price. Moreover, retailers are increasingly applying activity-based cost analysis to the new item introduction process, and are employing sophisticated category management techniques to guide their assortment decisions. Slotting allowances may decline as the use of these disciplines spreads.[11]

- Opponents of slotting allowances often claim that they result in higher retail prices, but this has not been established. The relevant question, of course, is whether slotting allowances cause retail prices to be higher than they would be if slotting allowances did not exist, in a world where shelf space is finite. Moreover, the argument that slotting fees cause higher retail prices is inconsistent with the argument that discrimination in the granting of slotting allowances harms smaller retailers. The

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accounted for only 26 percent of the total. Source: Oral Testimony of Timothy Hammonds, President, Food Marketing Institute, before the House Committee on the Judiciary Hearing on Competitive Issues in Agriculture and the Food Marketing Industry, October 20, 1999.

8 Prepared Statement of Timothy Hammonds, President, Food Marketing Institute, before the House Committee on the Judiciary Hearing on Competitive Issues in Agriculture and the Food Marketing Industry, October 20, 1999, at 6.

9 Pyle, *supra* n.1, at 2, 3.

10 Testimony of Nicholas A. Pyle, Vice President, Independent Bakers Association, at the Federal Trade Commission Hearings on Global and Innovation-Based Competition, November 8, 1995 (hearing transcript).

11 Much of the recent attention has focused on the produce industry. This is not surprising: new value-added, branded and pre-packaged produce items are being offered at a rapid clip, outstripping available shelf space. According to *Supermarket News,* "the roster of products vying for a spot in the produce section is growing faster than the amount of store real estate allocated to produce." The explosion of new offerings is said to have "made the retail produce executive's job one of the more challenging – and at times frustrating – in the store." *Supermarket News,* "Room to Grow – It's What Produce Departments Need As Varieties, Value-Added Items and the Vanishing of Seasons Turn Them Into Cornucopias," October 11, 1999, at 1, 3.

concern over such "secondary-line" injury is premised on the favored retailers' passing on their allowances in the form of lower retail prices.

- Critics of slotting allowances assert that the "merger wave" in the supermarket industry has led to an increase in "buyer power," which in turn is driving an upsurge in demands for slotting. This claim generally is coupled with suggestions that the FTC is being too easy on supermarket mergers. There is little question that the balance of power between retailers and manufacturers of branded products has changed in recent years, but this is due to a variety of factors, of which size is only one. Other factors include the dramatic growth of private label products and retailers' increasing access to and mastery of scanner data and other measures of product performance. The latter development, in particular, has put retailers in a better position to bargain with vendors. FTC supermarket merger enforcement can only be described as zealous. Vigorous FTC investigations, often involving massive document requests and investigational hearings, are common even for relatively small regional acquisitions. The Commission has been very aggressive in its divestiture demands and is exacting in its scrutiny of proposed buyers of divested stores. This year's high-profile collapse of the Ahold/Pathmark transaction in the face of FTC opposition and the record-setting 144-store divestiture obtained last year in the Albertson's/American Stores transaction belie any suggestion that the FTC is being "soft" on supermarket mergers.

II. CURRENT FTC ENFORCEMENT POLICY IS ACTIVE AND WELL ARTICULATED

Though the FTC's enforcement attitude towards slotting allowances has evolved somewhat over time, one theme has been consistent: an unwillingness to condemn the practice in the absence of evidence of harm to consumers.

In 1989, the Chairman wrote to Congress on behalf of the Commission that "slotting allowances and other promotional pricing may benefit consumers by facilitating the introduction of products desired by consumers and the reduction of retail prices."

In 1991, the Director of the Bureau of Competition said that "it is still perfectly permissible to pay an allowance to secure specific shelf space for its promotional value."[12]

In 1995, then-Bureau of Competition Director Bill Baer, appearing on ABC's *20/20* program, said that slotting allowances are "legal in most situations. . . . The question is, do these slotting allowances really drive prices up for consumers? If they don't – and I'm saying I don't

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[12] Kevin J. Arquit, Director, Bureau of Competition, Federal Trade Commission, "Antitrust Analysis of Slotting Allowances," before the National Grocers Association, November 12, 1991, at 15.

see any evidence that they do – although we are open to looking at it – then I am not sure there is a problem."

In 1996, the FTC Staff Report on the Hearings on Global and Innovation-Based Competition said: "The hearing testimony did not provide any allegations of harm to consumers as a result of slotting allowances." It added that "although the FTC heard general complaints about slotting allowances, no small manufacturer to date has provided evidence that suggests the possibility of harm to consumers, although this agency remains open to receiving such evidence."[13]

The FTC's enforcement approach recognizes that the term "slotting allowance" applies to a wide range of practices, "the legality of which can be determined only in light of all the surrounding facts and circumstances."[14] In its recent testimony before Congress, the Commission said that among the questions that need to be answered when evaluating a particular practice are the following:

- "Is it a payment simply to be carried somewhere in the store?
- Is it for a fixed amount of shelf space?
- Is it for preferential display – the end-caps or eye-level shelves?
- Is it for the right to be the exclusive, or nearly exclusive, supplier in that product category?
- Is it for the right to control what other products in that category will be allowed on the shelves?
- And is it for a long or short time?"[15]

The FTC's enforcement program, as described to Congress, has several prongs, the first being an active merger enforcement effort at the retail level as well as the manufacturer level.[16]

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13 "Anticipating the 21st Century: Competition Policy in the New High-Tech, Global Marketplace," May 1996 (Vol. 1), at Ch. 5.

14 "Slotting Allowances and the Antitrust Laws," Testimony of the Federal Trade Commission before the House Committee on the Judiciary, October 20, 1999, at 2.

15 *Id.* at 4.

The extraordinary vigor of the Commission's supermarket merger enforcement program has already been noted.

Second, the government actively pursues agreements among retailers and manufacturers that arguably injure competition and consumers. The Commission's recent testimony made clear the broad scope of its inquiry in this regard:

> "[I]f a dominant manufacturer, in exchange for slotting allowances, secures promises from a large number of retailers not to carry the products of its competitors, competition might be seriously harmed . . . . Similarly, if a dominant manufacturer or a small group of manufacturers were able to secure exclusive arrangements with all the desirable retailers, thus forcing other competitors to use only less desirable retailers, they might be able to raise prices because they would face less effective competition. Even without 100% exclusivity, a manufacturer or group of manufacturers might be able to marginalize their competitors and lessen the competition they face through partial exclusivity requirements that, for example, guarantee the manufacturer (or the group) a large percentage of shelf space or give it a veto right over other manufacturers' products."[17]

The FTC's recent *McCormick* case shows its commitment to enforcement in this area. Contradicting those who believed FTC enforcement of the Robinson-Patman Act was an empty threat, the *McCormick* complaint alleged that a spice maker with a high market share violated the Robinson-Patman Act by granting discriminatory discounts to retailers. The aggregate discounts allegedly received by the favored customers were said to include "up-front cash payments similar to slotting allowances," free goods, off-invoice allowances, rebates, and performance funds. In addition, supermarkets allegedly were required to allocate up to 90 percent of their shelf space in the category to McCormick.[18] Published reports indicate that the FTC is continuing its investigation of McCormick by focusing on whether the company had agreements with retailers that gave it the ability to control retailer shelf space and exclude competitors from stores.

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16 *Id.* at 7-8.

17 *Id.* at 4-5.

18 *McCormick & Co.*, FTC File No. 961-0050 (complaint and agreement containing consent order).

Finally, the FTC's well-known *Fred Meyer Guides*, which provide practical guidance on Robinson-Patman compliance and set forth the Agency's enforcement positions, deal explicitly with slotting allowances. They warn that "[t]he discriminatory purchase of display or shelf space, whether directly or by means of so-called allowances, may violate the Act, and may be considered an unfair method of competition in violation of section 5 of the Federal Trade Commission Act."[19] The ways in which slotting allowances might violate the Robinson-Patman Act have been noted with regularity by Commission officials,[20] and slotting allowances have figured in several private suits under the Act.[21]

In sum, the FTC's enforcement approach regarding slotting allowances is firmly grounded in appropriate legal and policy considerations. It is, moreover, an active policy. The notion that the Agency is taking an "anything goes" approach to slotting allowances and related practices has no basis.

III. PROPOSED "GUIDELINES" ARE UNNECESSARY, UNWORKABLE AND ANTICOMPETITIVE

The Independent Bakers Association and two other trade associations recently submitted a petition asking the Commission to issue and enforce guidelines on slotting allowances in the grocery industry. [hereinafter "Petition"] The proposed guidelines are unnecessary, unworkable, and anticompetitive. They would chill legitimate behavior and subject the grocery industry to deadening regulation.

To a large extent, the Petition is based on the false premise that there is no "cop on the beat" when it comes to slotting allowances. But perhaps the biggest problem with the proposed guidelines is that they cannot achieve what small manufacturers say they want: "a level playing

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19 Guides for Advertising Allowances and Other Merchandising Payments and Services, 16 C.F.R. §240.9, example 5 n.1.

20 *See, e.g.*, Arquit, *supra* n.14; Mary L. Azcuenaga, Commissioner, Federal Trade Commission, "The Robinson-Patman Act: A Perspective from the FTC," before the ABA Antitrust Section Program on "Living With the Robinson-Patman Act," May 13, 1993, at 18-19.

21 *E.g.*, *Hygrade Milk & Ice Cream Co. v. Tropicana Prods.*, 1996-1 Trade Cas. (CCH) ¶ 71,438 (S.D.N.Y. 1996).

field" in which their products stand the same chance of gaining widespread retail distribution as products offered by larger, better established competitors. In a world without slotting allowances, manufacturers with unproven products and few resources for advertising and promotion would still be at a disadvantage in the competition for shelf space. This point was acknowledged by Bill Baer, the Director of the Bureau of Competition, during the Independent Bakers Association's testimony at the 1995 Global and Innovation-Based Competition hearings. Commenting on proposals to ban slotting allowances, Baer said:

> If the fundamental problem here is basically the bargaining relationship between retailer and supplier and there is some market power there on the retailers' level, is that really going to solve the problem? Or is this going to be the equivalent of that old study in the late '60s, early '70s when, in order to deal with the increasing crime in Manhattan, more police were put in the streets and the result was more crime in the subway; they put the police in the subway, and the stats showed, you know, the crime went back up on top? And I'm not necessarily saying here it is a crime. But what I'm trying to understand is whether . . . given that nature of the relationship where there seems to be a bidding war for shelf space going on, what would economic theory suggest is likely to happen if we ban one manifestation of that relation?[22]

The Bureau Director and the staff returned to this theme as they questioned the IBA's witness:

> MR. BAER: You're not objecting to a bidding war, if I hear you right, as long as it's fair, that is, everybody gets a chance to bid for shelf space? Or is that an over-simplification of your remarks?
>
> MR. PYLE: I think that's a fair assessment, that what we want is a level playing field.
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> MR. DANIEL: [W]hat it sounds like you're saying is that the small bakers just cannot afford to get into the larger chains, and they say they can't pay the fee required of the supermarket.
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> MR. PYLE: Or they refuse to.
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> MR. DANIEL: Or they refuse to. That is also consistent with the bidding market that you described as a level playing field, that you're not being

22 Transcript of November 8, 1995 hearing.

> discriminated against in the sense of being unwilling to be offered that space, but that you're just simply unable or unwilling to pay the price that appears to be necessary, or at least the supermarkets claim, which is the price for the space. I'm trying to get a handle on whatever indicators we might be able to learn from the bakers and others to distinguish between the bidding market and the anticompetitive outcome?
>
> MR. PYLE: That's a very good question. I'll have to get back to you on that.

The guidelines that have now been proposed by the IBA apparently represent its response to the question left hanging in 1995. The proposed guidelines seek more than an opportunity to compete for shelf space; they ask the Commission to regulate the terms of that competition by declaring presumptively unlawful payments that do not have a "reasonable relationship" to the costs associated with the retailer's "acceptance, stocking, and display processes." [proposed guide 3] This definition of costs, it should be noted, appears to be limited to the retailer's out of pocket costs. As the Commission has recognized, however, these are not the only relevant costs: "Taking on a new product confronts the retailer with not only the actual costs of restocking shelves, changing labels, and reprogramming scanner equipment, but also the potential costs of product failure and being left with unsold inventory. Moreover, taking on a new product often means that some other product must be dropped from a store."[23]

In its 1995 FTC testimony, the IBA proposed that retailers and manufacturers adopt a "code of ethics" regarding slotting allowances. The antitrust implications of an agreement among competitors not to give or accept slotting allowances are obvious. Given that slotting allowances are an element of competition between manufacturers and negotiation between trading partners, an agreement among competitors to forebear from giving or accepting them would likely share the fate of an agreement not to engage in couponing or some other form of promotion.

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[23] "Slotting Allowances and the Antitrust Laws," Testimony of the Federal Trade Commission before the House Committee on the Judiciary, October 20, 1999, at 5. University of Michigan economist Greg Shaffer made the same point at the 1995 Global and Innovation-Based Competition Hearings. He added that "it just doesn't make sense to say that these things have to be cost-based, however you define costs."

The proposed guidelines seek to achieve through quasi-regulation a result that manufacturers and retailers probably could not lawfully achieve on their own: industry-wide adherence to "benchmarks" or "standards" regarding the granting and receiving of slotting allowances. To effectuate to this, the guides call upon manufacturers and retailers to disclose publicly their slotting allowance policies. With unconscious irony, the Petition says that "adherence to these disclosure principles could count in some manner as a plus factor on behalf of the adhering party in any challenge to its policies." [Petition at 16]

Another highly regulatory aspect of the proposed guidelines is the unique evidentiary rule they would establish for finding an exclusive or semi-exclusive dealing agreement. Under the proposed guidelines, the existence of an "exclusionary understanding" between a manufacturer and a retailer would be presumed if the retailer accepted the manufacturer's slotting allowance "and thereafter refuses to accept a competing product 'without a demonstrably valid business justification, or imposes materially disproportionate terms' as a condition of acceptance without justification." [Petition, at 14.] This standard, which is not based on case law, is at once vague and deeply intrusive. Uncertainty about its scope, together with the incompleteness of the proposed cost standard, would chill manufacturers from offering and retailers from accepting slotting allowances. That, of course, may be the intended effect.

CONCLUSION

The U.S. grocery industry's innovation, efficiency, variety, and low prices are the envy of the world. Though they are potentially subject to abuse in certain circumstances, slotting allowances are consistent with this picture; indeed, they are indicative of a highly competitive market. Proposals to ban or sharply restrict slotting allowances are unwise. The IBA's proposed slotting allowance guidelines, if adopted and enforced, would start the industry down the road of stifling, public utility-type regulation. They should be rejected.