Draft in Process

PRELIMINARY OBSERVATIONS CONCERNING THE POTENTIAL FOR "SLOTTING ALLOWANCE" GUIDELINES

Alan H. Silberman

Sonnenschein Nath & Rosenthal

Chicago, IL

The opinions presented in this draft are those of the author alone and are presented in order to stimulate discussion, recognizing that others (including but not limited to colleagues and clients) have views which may differ significantly in approach and result from those expressed herein.

A review of current speeches, panel discussions, articles, legal publications and testimony referencing "slotting allowances," demonstrates that the term is used to encompass a wide range of situations with potentially different standards of legal analysis and results. The term has been employed in a manner which exceeds the elastic limit of semantic utility.

"Slotting allowances" seems to be the term of choice when referring to

(1) payments demanded by retailers for access for new products;

(2) payments demanded by retailers for allowing the introduction of products which are already on-the-market but are new to a particular retailer;

(3) promotional programs which accompany new product entry;

(4) responses made to retailers' requests for plans for potential realignment of space devoted to various product categories or brands;

(5) responses to retailers' requests for proposals seeking bids from competitors in circumstances where it is likely that only one or two bids will be successful;

(6) manufacturer-initiated strategies to obtain or induce exclusive dealing arrangements;

(7) retailer-initiated "pay-to-stay" activity;

(8) manufacturer strategies to offer payments designed to raise rivals costs;

(9) arrangements in which shelf space is, in effect, "leased" to a manufacturer in return for up-front consideration; and

(10) retailer-initiated demands for allowances (or other types of wealth transfer) which are not directly linked to any sale, but reflect the request to make payments in the interests of maintaining "good relations" – to name just some examples.

In light of the number of different situations being addressed, one of the primary objectives of any Guidelines addressing the subject should be clarification of the analytical confusion fostered by the imprecise nature of the term "slotting allowance." Guidelines should assist in the development of sound legal principles by focusing and framing the terms of the ongoing discussion concerning these matters. Additional introductory comments are presented below.

General Introductory Observations

1. Any Guidelines should recognize that certain types of manufacturer-supplier or retailer-purchaser conduct do not belong in the "slotting allowance" category, because they are addressed by application of more general antitrust principles or other standards. For example, actual exclusive dealing agreements, whether initiated by a supplier or by a purchaser, are subject to analysis under antitrust principles relating to exclusive dealing. The methods for evaluating foreclosure in a relevant product and geographic market are well-established and precedents, such as the Commission's decision in *Beltone Electronics Corp.*, 3 Trade Reg. Rep. (CCH) ¶21,934 (1982), or *Omega Environmental, Inc. v. Gilbarco, Inc.*, 127 F.3d 1157 (9th Cir. 1997), provide sufficient guidance. Arrangements between buyers and suppliers which involve purely promotional activity in the resale of products are governed by a well-developed body of legal principles and precedents. Similarly, to efforts by some retail customers to obtain payments from suppliers unconnected to a sale or promotion based on an interest in supporting the relationship matters are more properly addressed by referring to other legal principles relating to unfair acts or practices and possibly ordinary contract law (when deductions are unilaterally taken from invoices).

2. In discussing these issues, it is important to distinguish carefully between new product introduction arrangements (whether they involve a wholly new product or a product new to a particular resale venue) and other activities. The source of any particular practice (i.e., whether it is initiated by the retailer-purchaser or by the manufacturer-supplier) should also be a relevant factor.

3. The discussion needs to include specific consideration of the existence (or non-existence) of substantial consumer welfare concerns. It should not attempt to present what

buyers, suppliers or regulators may believe constitutes optimal efficiency, good business judgment or "unfairness."

4. It is essential to obtain better factual data from both retail-purchasers and manufacturer-suppliers. Of course, care should be taken to focus and limit information collection in order to promote better understanding of the competitive circumstances surrounding these topics. In addition, details of individual company transactions should remain confidential. For example:

a. It would be desirable to obtain basic information from food retailers covering a recent one-year period which identified the new products added and products deleted; specified whether these products were introduced (or sold) on a national, regional or more localized basis; provided an indication of the sales volume involved; and provided data, for each new product, identifying any upfront payment (or equivalent) given in order to obtain authorization for the new product opportunity and/or whether there was any profit guarantee, product failure fee or other arrangement made as a condition of authorizing a new product introduction opportunity. Also, it would be useful to obtain information as to whether financial arrangements required in connection with authorizing a new product introduction are published to potential suppliers and whether information as to the circumstances as to when and how such requirements will be waived or modified.

b. On the manufacturer-supplier side, it would be useful to have information as to the new product introductions during the same period; whether the introductions were national, regional or on some more localized basis; the total amount budgeted the manufacturer-supplier for the new product introduction; the proportion of this amount (if any) constituting payment for the new product introduction opportunity; the sales achieved by the product during the first year of sale; and whether the product has continued to be offered for sale. It also would be useful to obtain data for the same period as to new products that a manufacturer-supplier was ready, willing and able to offer for sale, but for which it was unable to obtain any distribution; the amount of projected first-year volume; and the amount (if any) which the manufacturer-supplier had committed to support of the new product introduction); and whether that commitment was communicated to potential retailer-purchasers in various segments of the retail business.

The Commission has authority, under §6(b) of the FTC Act, to require a special report from persons and firms in the manufacturer-supplier and retailer-purchaser categories. Publication of such information will facilitate further discourse and appropriate decision making. In addition, publication of such data may make the market function in a more efficient manner than it does without this information.

5. Any Guidelines which are developed should deal separately with: (a) new product introduction opportunities; (b) retailer-purchaser initiated programs in connection with space allocation and/or "category management;" (c) manufacturer-initiated proposals to expand shelf-space or avoid reductions in shelf space; and (d) retailer-purchaser programs involving what may properly be analyzed as a "lease" of shelf space.

Each of these presents different issues.

A. <u>New Product Introduction Opportunities</u>

In order to improve the quality of discussion and analysis, references to arrangements made in connection with new product introduction opportunities should be carefully defined.

A "new product introduction opportunity" should be defined to refer to a product that is wholly new to the market or new to the customer in question. In both instances, the product has not previously been on the shelf and its introduction is likely to require realignment of existing purchases and/or products. The definition of "new product introduction opportunity" should be limited to retailer-established requirements for either: (a) a short-term adjustment in price (or in a price-equivalent, such as the provision of free product) as a condition of authorizing a new product introduction; or (b) a requirement by a retailer (other than a short-term adjustment in price), involving arrangements for a profit guarantee, failure terms, or other arrangements to reduce the risk of loss in connection with the new product introduction opportunity. The reference to short-term is intended to address the period of time during which the prospects of the new product as a permanent shelf item are less certain (recognizing that the prospects of almost all products today are uncertain to some extent). That period is probably no longer than six months (and possibly less).

With respect to this topic, it is important for Guidelines to address a number of specifics.

1. Arrangements Should Be Analyzed As A Price Reduction.

New product introduction opportunity arrangements are "price" terms. While a manufacturer-supplier's response to a retailer's requirements may include provisos conditioning the short-term price adjustment on a commitment involving promotional activity in order to assist in making the introduction successful, such ancillary terms should not change the arrangement into one which involves promotional payments in connection with the resale of products. The impetus for the arrangement is the requirement that access to the retailer-purchaser is available only when financial terms are offered. Under these circumstances, it is natural for a manufacturer-supplier to want to gain some additional benefit (such as a commitment from a retailer that it will support the new product introduction). This aspect of the arrangement, however, should not obscure the fact that the dominant nature of the transaction is access, not promotional activity for resale.

2. Meeting Competition.

Guidelines should explicitly address the scope of a manufacturer-supplier's ability to rely on the fact that it is meeting competition. Whether considered from the standpoint of a defense to a price-discrimination claim or in light of some other statutory concern, Guidelines should recognize that in pursuing a new product introduction opportunity, a manufacturer is – in a practical sense – competing against the full range of product offers available to the retailer-customer on a reasonably contemporaneous time frame. All of these offerors are seeking shelf space. Shelf space is generally fungible. Guidelines should recognize that a firm which is engaged in a pro-competitive effort to compete would generally be expected to respond to this broad range of competitive market forces and that such responses are both pro-competitive and lawful.

3. Functional Differences Among Retailers.

While it may not be necessary to acknowledge functional differences which separate some retailer-purchasers from others (because a full analysis of any competition issue can be completed without reaching this issue), Guidelines should allow for recognition of the fact that in a new product introduction situation certain categories of retail outlets are able to provide significant differences in function during the initial product introduction period. When products are introduced on a regional or national basis, certain types of retail outlets are able to provide broad-based data in a short time frame which provides insight into the saleability of the product and consumer response to various price levels. Other outlets are unable to provide data of equivalent scope and value. Suppliers' ability to obtain such data promptly on a broad basis enhances both entry and competition. Indeed, it would be useful to explore the proposition that the use of large retailer-purchasers as "beta test" sites for new products provides benefit to manufacturer-suppliers of all sizes and also benefits smaller retailers (who thereby avoid purchasing new items which have a high failure rate).

Another aspect of possible functional difference involves an understanding of whether different types of retail venues have different risks associated with new product introduction. Guidelines should allow for the possibility that the risks associated with new product introduction and new product failure are different in different categories of retailers. For example, a small convenience store may not take on a new product in the first stage of distribution; (or its risk of loss may be minimal because it does not allocate signficant shelf space and has minimal costs); a specialty food store may have different risks, and they may vary with the product category. Guidelines cannot, therefore, adopt a "one-size-fits all" approach, but must allow for free play of competitive market forces which arise from differences in types of retail stores.

4. Injury To Competition.

Guidelines should make it clear that terms relating to new product introduction opportunities will raise competition concerns only when there is proof that the arrangement is likely to result in an injury to the competitive process with a substantial likelihood of consumer injury. As noted above, the arrangements are sometimes linked to ancillary promotional terms. However, the injury to competition test should not be discarded simply because a manufacturer-supplier's response to a retailer-purchaser's requirements for new product introduction opportunities include these ancillary promotional requirements.

Proof of injury to competition involving other competing retailers in connection with a new product introduction (as defined above) should require substantial proof that any differential between competing retailers involves no functional difference, no meeting competition defense, and actually causes impairment of the disadvantaged retailer's ability to maintain its existing competitive position in the sale of its overall product line at retail and that the retailer has no ability to obtain comparable goods.

A showing of injury to competition at the manufacturering level should be based on substantial proof that a competing manufacturer of a commercially-acceptable new product is ready, willing and able to meet all of a customer's requirements (including delivery and field support requirements and commitment of a reasonable level of funds to support the new product introduction) and is foreclosed from opportunities in a relevant geographic market, or that the terms agreed to by the manufacturer-supplier are below direct cost and meet standards applicable to improper predatory pricing.

A showing of the likelihood of consumer injury in connection with a bona fide new product introduction should be based on substantial evidence that the short-term arrangements with respect to new product introduction opportunities are likely to lead to a substantial reduction in competition in the overall market in which retailer-customers re-sell their products. This effect may be shown by proof that the arrangement was the proximate cause of a reduction of competition between retailers or by evidence that the opportunity for product distribution in the relevant geographic market by an otherwise-qualified manufacturer-supplier which would have existed but for the new product introduction arrangements in question has been foreclosed and that competing manufacture-suppliers have thereby gained power to raise price to the detriment of consumers.

Guidelines should also recognize, in connection with any assessment of injury to competition, certain product categories may be sold on a basis that is economically comparable to a consignment arrangement. In such circumstances, only those products which are resold within a specific time frame are actually paid for by the retailer-purchaser. The manufacturer or its wholesaler bears the risk of loss; the retailer has to consider its lost opportunity cost based on the profit potential of one product as compared to another. Thus, while the retailer-purchaser is still concerned about the costs of new product introduction, the presence of any injury to competition should be seen as doubtful: there is no significant competitive effect as between retailers and since these product delivery and return terms are common to the product lines in question, there is no likelihood that they reflect any form of predatory conduct at the manufacturing level.

5. Potential Relevance of Facts Concerning Duration and Amount.

Guidelines should be premised on the assumption that both the duration and amount of a new product introduction opportunity payment are logically related to the new product introduction. There is no mechanical standard for either factor, and the choice between one approach (e.g., one which looks at costs and risk over a broad range of products and/or is applicable to all new product offerings) and another (e.g., one which stratifies costs by types of products and/or has various exceptions) is a matter on which individual retailer-purchasers would be expected to exercise independent business judgment. However, when the required amounts are "excessive," or where they cannot be logically described as "short-term," they may not be bona fide new product introduction arrangements. In such circumstances, Guidelines should preserve the opportunity to treat the terms as evidence of retailer market power to impose non-competitive charges on suppliers or as evidence that the arrangement is part of some other strategy which may have antitrust implications, either because it could not be maintained without horizontal collusion or because it may reflect some form of coordination between supplier and purchaser with an anticompetitive objective.

B. Programs Initiated By Retailer-Purchasers In Connection With Reallocation of Shelf Space Or "Category Management."

1. Competitive Bidding.

Guidelines should recognize that retailer purchasers are not obligated to deal with all suppliers, or even all qualified suppliers. "In a competitive market, a rational retailer may be able to maximize both margin and profit by deciding that it will stock" 2 or 3 rather than 3, 4 or 5 (or more) products in a category . So long as there is competition in the retail market, the price charged to consumers will remain at competitive levels. The retailer retains the ability to change its decisions, thereby enhancing the impetus for competition between manufacturer-suppliers. In these circumstances, even though a supplier may expect the retailer to maintain its decision for some period, there is no exclusive dealing agreement in place. When discussing such arrangements, Guidelines should be careful not to legislate a form of antitrust concern that is not supported by current law and precedent.

When retailers invite proposals looking to select a limited number of products in a category, the process should be analyzed, for antitrust purposes, as a competitive bidding situation. Guidelines should not create an obstacle to a fully-competitive response by a manufacturer-supplier, subject to established antitrust principles precluding predatory pricing behavior.

2. Meeting Competition.

Bidding processes can be simultaneous or sequential, sealed or negotiated. In all cases, the process is likely to involve pro-competitive activity. Guidelines should assure application of meeting competition principles to this activity.

3. Exclusionary Effects of Unilateral Retailer Conduct.

Retailer-purchasers are not public agencies. They are "facts" in the competitive market to which manufacturer-suppliers must (and are entitled to) respond. Accordingly, Guidelines cannot properly require retailer-purchasers to consider all "qualified" bidders or to make decisions on the basis of pre-ordained objective factors, nor should they visit potential consequences on manufacturer-suppliers who respond competitively to these stimulii. At the same time, one can guess that data may show a positive correlation between the degree of openness and transparency which accompanies announcement of a space-allocation process and the degree to which the process actually enhances consumer welfare. Thus, it would not be inappropriate for Guidelines to reflect a preference for retailer space allocation processes which are open to all who wish to make proposals, even though no presumption of illegality attaches to the converse approach (i.e., a process which involves only firms selected by the retailer-purchaser).

Whether the terms of space allocation decisions made by a retailer after a bidding process should be made public is a separate question. Where a supplier meets competition, it is not obligated to offer the same terms to other purchasers who did not utilize a bid process. There is no basis for imposing that obligation on successful competitors. Doing so would chill the competitive bid process to the ultimate disadvantage of consumers.

It is initially "exciting" (even romantic) to approach this issue in a spirit of "competitive re-engineering" in which Guidelines are thought of as a way to "level the playing field" and put all would-be suppliers "on the field." However, antitrust concerns with entry and barriers to entry are not part of a welfare scheme to provide work for suppliers. "Entry" is a factor which provides insight into whether there will be sufficient competition between firms to allow competitive forces to function for the benefit of the consumer, taking account of the structure of a specific market. Where data show that competition at the manufacturer-supplier level leads to more and more new products; that competition at the retailer-purchaser level keeps price, quality and service competitive; and that consumer price levels have not been adversely affected, the fact that individual would-be "players" do not "make the team" (or the team they wanted to make) is not an indication of competitive dysfunction. Indeed, there are undoubtedly potential entrants who do not have the correct mix of product, service and price to be considered; and there are others who are "on the playing field," but are playing in a different game in the same overall relevant market. Guidelines do not lend themselves to addressing these types of issues. Moreover, one suspects that data, if collected, would show suppliers have alternate routes to the consumer.

4. Other Retailer "Category Management" Activity.

One assumes that a competitive retailer-purchaser will regularly analyze data concerning product movement, return on its investment and other factors. Thus, some form of ongoing "category management," as to product acquisition, space allocation and placement on the shelf, is an integral part of the retail business. In small retail stores, category management is accomplished by entrepreneurial intuition and, given space limitations, probably focuses on a very small number of product categories (particularly those directed to the local consumer market). In a larger-sized venue, and particularly in a regional or national chain, it is undeniably a more complex process. Guidelines should identify those aspects of that process that are seen as unlikely to involve any form of antitrust concern, such as decisions made unilaterally by the retailer, including decisions made after soliciting input and recommendations from one or more manufacturer-suppliers.

Guidelines should also identify the areas which do raise possible antitrust concerns. These may include (a) coordinated recommendations from competing manufacturer-suppliers; (b) limitations which may prevent some manufacturer-suppliers from providing input by denying them access to information being made available to others; (c) arrangements which require competitors to funnel comments through one designated firm (which is also a competitor); and

(d) furnishing advance competitive information obtained from various manufacturer-suppliers to one preferred supplier. Even if evidence today does not establish the existence of these issues as current concerns, it is appropriate for Guidelines to alert the business community to these concerns.

C. Manufacturer-Supplier Initiated Proposals For <u>Expanding Shelf Space or Avoiding Shelf Space Reductions.</u>

When a manufacturer-supplier seeks to induce its retailer-purchaser customer to expand the space devoted to its products, the common result is that the space devoted to a competitor's product is reduced. Where this competition occurs on the basis of usual price, service, and quality considerations, including analysis of data as to consumer preferences and buying behavior, there is no possible competition concern. Guidelines should make that clear. Similarly, when expansion or reduction of shelf space is the result of a retailer-purchaser management decision, involving either bidding proposals or unilateral category management, the competition concerns should be limited to those identified above.

However, manufacturer-supplier initiated proposals which involve outright payment for additional shelf space or payment to avoid reduction of shelf space should be identified as a separate category requiring more specific analysis. An offer of a payment by a manufacturer for exclusivity or partial exclusivity may reflect pro-competitive behavior, if it is consistent with antitrust principles regarding exclusive dealing and predatory pricing. It may reflect appropriate defensive competitive behavior, meeting the competition of another manufacturer-supplier. But there also may be factual circumstances in which it appears that the offer is made in order to prevent competition on the basis of quality, service and price from functioning. Normally, one would expect that a retailer-purchaser would not be indifferent to these concerns and would have no reason to support a manufacturer-supplier initiatied strategy which is aimed at impairing a rival's ability to compete. Where, however, this occurs, it may raise issues under either the Sherman Act or § 5 of the Sherman Act, or both.

Here, again, Guidelines may play an important role. Even if there is little empirical evidence raising concerns that such behavior is now occurring, a discussion of these concerns in Guidelines is helpful in emphasizing the fact that activities with similar effects (*i.e.*, there is a reduction in space and/or the number of manufacturers) do not have the same analytical status. Guidelines can serve to identify the point at which pro-competitive activity ends and arragements raising antitrust concerns begin. Guidelines can emphasize that changes in allocation of shelf-space or reduction of the numbers of different brands offerred is a wholly-normal event in the competitive market when it is undertaken by the retailer-purchaser in its quest to meet consumer demand and achieve a profit. Guidelines can also set the framework for analyzing proposed exclusive agreements by identifying the factors traditonally applied to gauge foreclosure and enhancement of market power, or the factors traditionally applied to assess claims of predation. And Guidelines can articulate potential concerns and related issues which arise when a manufacturer-supplier adopts its own program aimed at exclusion without regard to performance.

For example, a manufacturer-supplier may decide to offer a price and/or promotion program to retailer-purchasers who carry its brand exclusively (or carry only one other branded product in a category) for some period. Guidelines can identify the fact that an exclusive dealing issue is some times presented by these facts (based on traditional antitrust concerns about undue foreclosure in the relevant brand product and geographic market) and that the arrangement (as to both price and promotional terms) is also subject to analysis under the Robinson-Patman Act so that, absent a "meeting competition" defense, the price terms will normally have to be available to all competing purchasers purchasing on the same basis, and the promotional aspects of the arrangment will likewise have to be offered in accordance with the statute.

D. What If The Arrangements Are Characterized As A Lease of Shelf Space By The Retailer-Purchaser?

In an economic sense, a retailer-purchaser faced with risks that products will be put on the shelf and will not sell in a manner which maximizes profit potential of its facility is disaggregating its function into two different categories: it is providing a facility to manufacturer-supplier in the form of shelf space and it is participating in the re-sale of product.. If distribution of products by manufacturer-suppliers to retailer-purchasers is analyzed from this perspective, it may provide a means for distinguishing between arrangements which are competitively beneficial or neutral and those which are problematic.

A manufacturer-supplier's willlingness to incur a fixed up-front cost for shelf space may reflect a strong commitment to the success of the product because it moves more of the overall cost to the "fixed" category, which can only be recovered if the product is successful on a long-term basis. This may reflect a benefit to smaller manufacturer-suppliers as well as larger ones, inasmuch as it is tangible proof that the manufacturer-supplier shares the same long-term profit objectives as its customer. Similarly, a manufacturer who is unable to make this commitment may need to find a different point of entry for its product offerings (including possibly another location in the retail store) until such time as its credibility can be established.

Analyzing the transaction in this manner also reflects the reality of the retailer's business. Shelf-space in a national or regional chain store is a "product" that is not identical to proportionate shelf space in a 900 square foot shop. Access to that space is not sold on a "per foot wherever located" basis, any more than space in a premium shopping mall is sold at the same price as space in a low-traffic strip mall.

However, at the same time, such data focuses on the manufacturer-supplier's stragtegy with respect to its actual and potential competitors. If a manufacturer offers a fixed payment which is unreasonably disproportionate to the total, it may suggest that the manufacturer is trying to exclude rivals who are less-well financed (or raise their costs) and avoid competition on the basis of quality, service and price. On the other hand, the product line may be one which has traditionally been sold on the basis that the retailer's downside risk is minimal (as in the case of freely-returnable perishable goods). In that case, there is probably no adverse inference to be drawn. Existing legal principles can be applied to these activities. Guidelines can provide examples of how principles might be applied in hypothetical (but more practically-focused) situations. For example, if a manufacturer-seller offers products with a fixed payment for shelf space and a per-case price component that is not likely to lead to a profitable overall transaction, it is a below-cost sale. If the terms are set at levels which may preclude smaller efficient competitors, there may be an inference of predatory conduct (depending, of course, on the presence or absence of other factors needed for a complete analysis).

Conclusion

In the final analysis, Guidelines are a paradigmatic example of the role which the creators of the Federal Trade Commission envisioned when they described an agency that would be able to provide guidance to help the business community better understand antitrust law and policy. In some circumstances, Guidelines serve to explain how particular situations are likely to be analyzed and to state the enforcement intentions of an agency. In other circumstances, it is sufficient if Guidelines serve to guide the business community and their counsel by identifying more clearly those areas which are unlikely to be of concern and those which are seen as more problematic. Moreover, it is essential that we recognize that guidelilnes adopted by a federal competition agency can (and should) have an effect on cognate legal issues which often arise under state antitrust law (and in state law non-antitrust contexts.) Even though Guidelines are not statements of "law" and are not pre-emptive in their application, they provide context, guidance and direction to the analysis of competition questions which arise outside of the FTC forum. That, too, is consistent with the objectives which underlie the legislative purpose of the Commission.

14100398