

**Opinion of Commissioner Orson Swindle,
Concurring in Part and Dissenting in Part**

In the Matter of

TOYS "R" US, INC.

Docket No. 9278

I concur in the Commission majority's determination that respondent Toys "R" Us, Inc. ("TRU"), entered into a series of anticompetitive *vertical* agreements with various toy manufacturers, and I join in the portions of the Commission's order aimed at proscribing the vertical restraints. In my view, however, the evidence does not support the majority's finding that some toy manufacturers entered into an anticompetitive *horizontal* agreement, and thus I dissent from my colleagues' conclusion that TRU orchestrated such a horizontal combination.

The evidence shows that club stores loomed as a small but growing threat to TRU's status and self-image as the leader in discount toy retailing. By dint of its powerful position as the indispensable retail outlet, TRU induced a number of key manufacturers to accede to its plan to choke off the supply of desirable toys to the clubs. Pursuant to TRU's vertical agreements with Mattel, Hasbro, Fisher Price, and others, certain manufacturers began to make toys unavailable to the clubs -- or available to them only on economically disadvantageous terms -- and the clubs' once-growing share of toy retailing began to shrink. A new channel of toy distribution that promised deep discounts for consumers was imperiled in its infancy, and TRU was spared downward pricing pressure from the clubs. The evidence suffices to establish that the series of vertical agreements between TRU and certain manufacturers had a significant adverse effect on competition, and I agree with my colleagues that TRU has not presented persuasive business justifications to the contrary.

The argument for a horizontal combination, on the other hand, lacks a firm foundation. As the majority makes clear, each manufacturer that entered into one of the vertical undertakings bowed to TRU's power in the market for toys. The majority opinion, true to the evidence in this case, casts TRU in the unmistakable role of the nation's preeminent year-round, full-line toy retailer -- the one customer whose patronage many manufacturers considered essential to survival. It is entirely plausible that particular manufacturers would react to pressure from TRU by deciding -- *on their own* -- to disfavor the club stores. No inference of horizontal agreement is necessary to make sense of the manufacturers' actions.

Ironically, it is precisely the plausibility of the vertical theory and the strength of the evidence underpinning that theory that undercut the majority's finding of a horizontal conspiracy among toy manufacturers. There is strong, clear evidence that TRU entered into a series of vertical understandings with toy manufacturers to cut off supply to the clubs. There is a paucity of evidence -- direct or circumstantial -- that the manufacturers developed among themselves a scheme to boycott the clubs.

In laying out the evidence of a horizontal agreement,⁽¹⁾ my colleagues portray TRU as the communications hub of a conspiracy involving multiple manufacturers. These

manufacturers purportedly used TRU to signal to one another their views and intentions about whether -- and under what conditions -- they would sell to the clubs. The majority infers from the record that the manufacturers used their direct *individual* communications with TRU as a mechanism to reach a common plan to boycott the clubs. Pursuant to this supposed scheme, TRU shuttled the manufacturers' fears and concerns back and forth until a horizontal consensus emerged.

The majority's view would be more plausible if we had stronger direct evidence⁽²⁾ showing a meeting of the minds among the manufacturers. But virtually all of the evidence on which my colleagues base a finding of horizontal agreement comes from the mouths of *TRU executives*. With only one inconclusive paragraph of their opinion⁽³⁾ devoted to evidence of direct manufacturer-to-manufacturer communications, the majority's finding of a horizontal agreement rests precariously on evidence that certain manufacturers asked TRU for assurances that other manufacturers would not renege on a commitment that they had made, not to one another, but *to TRU*.

Given the tension between the vertical and horizontal theories in this case, it is not surprising that the proof of the horizontal case is weak. Consider the vertical story: TRU was the toy retailing leviathan without whose business many manufacturers could not survive. TRU's very indispensability gave each toy manufacturer every incentive -- every *unilateral* incentive -- to knuckle under to TRU's demands regarding the clubs.⁽⁴⁾

On the other hand, consider the thrust of the horizontal case: that TRU coordinated an agreement among the toy manufacturers to restrict their supply of toys to the clubs. Without convincing evidence of an agreement among the manufacturers, the majority opinion relies on the premise that such an agreement was necessary to execute TRU's scheme. This conclusion disregards the ample reasons that each capitulating manufacturer, *acting on its own*, had to obey TRU. TRU's hammerlock on the manufacturers made a horizontal agreement among the manufacturers simply unnecessary.⁽⁵⁾

The majority places considerable weight on individual manufacturers' efforts to learn from TRU what their competitors might do about TRU's club policy. It seems natural, however, for any manufacturer contemplating a commitment to TRU -- *i.e.*, a vertical agreement -- to want to know its competitors' likely responses to TRU's demands. It seems equally reasonable to expect TRU to try to soothe an apprehensive manufacturer with reassurances about what other manufacturers will do. TRU's efforts to reassure manufacturers that they were on "a level playing field"⁽⁶⁾ are consistent with a purely vertical interpretation -- that TRU was trying to coax reluctant manufacturers into agreements *with it*. TRU had to offer "bait" to induce a manufacturer to agree *with TRU* about the club policy, and that "bait" was a comfort level about what other manufacturers would do. The opinion does not convincingly reject the vertical explanation for what occurred.⁽⁷⁾

The majority also says that "the record shows that a uniform, joint reaction to TRU's policy was a necessary element of each manufacturer's decision to restrict sales to the clubs. Each was simply unwilling to go forward with the proposed policy alone."⁽⁸⁾ But in the context of this case, a manufacturer's unwillingness to go forward alone simply indicates its need -- before entering a vertical agreement with TRU -- to ascertain whether

TRU planned to apply the same policy to other manufacturers. It does not necessarily show that that manufacturer reached any horizontal understanding with its competitors.

Moreover, the majority implies that each conspiring manufacturer was intent on achieving a uniform response *among all manufacturers*, rather than just among its direct competitors. A toy train probably does not compete with a Barbie doll, and a Barbie probably does not compete with toys for two-year-olds. As my colleagues seem to recognize,⁽⁹⁾ a manufacturer of infants' and toddlers' toys is likely to be largely indifferent to whether a manufacturer of older children's toys abides by TRU's policy, and thus a manufacturer is unlikely to care whether toy producers in general arrive at "a uniform, joint reaction to TRU's policy." It taxes credulity to assert that "a uniform, joint reaction" was vital from each manufacturer's perspective.

Other evidence further undermines the theory of a horizontal boycott involving the manufacturers. For instance, when certain manufacturers went back on their commitment to TRU and sold product to the clubs behind TRU's back, TRU tried to bring these wayward firms back into line with the club policy. If there really was a horizontal agreement to boycott the clubs, why was so much prodding and cajoling on TRU's part necessary to secure obedience? The answer is that the commitments all ran vertically, not horizontally. The glue that held TRU's scheme together was each manufacturer's individual decision not to cross its most important customer's interests.

A recent appellate decision helps illustrate the problems with the majority's finding of a horizontal conspiracy. In *Rossi v. Standard Roofing, Inc.*, No. 97-5185, 1998 U.S. App. LEXIS 21911 (3d Cir. Sept. 9, 1998) -- cited at several points in my colleagues' opinion -- the court of appeals considered plaintiff roofing distributor's allegations that it was the victim of a boycott organized by its direct competitors (and including certain manufacturers of roofing materials). The court of appeals determined that Rossi had presented sufficient evidence against two of its horizontal competitors (Standard Roofing and Arzee Roofing Supply) and against manufacturer GAF Corporation to survive those defendants' motions for summary judgment.

The evidence of horizontal conspiracy in *Rossi* stands in stark contrast to the evidence in the present case. Rossi was a price-cutting distributor who earned the enmity of its direct competitors, including Standard and Arzee. Standard and Arzee instigated and orchestrated the boycott, including persuading key supplier GAF to withhold product from Rossi. The court of appeals describes in detail the substantial proof that Standard and Arzee agreed *between themselves* to design a plan that would remove Rossi as a threat to their pricing equilibrium and prevailed upon GAF to go along with their plan.

In contrast, the evidence against TRU and the toy manufacturers on the horizontal issue is much less substantial. The prime mover behind any plot against the club stores was unmistakably TRU *acting alone*, rather than (as in *Rossi*) the victims' direct competitors acting in concert. *Rossi* would be a good model for finding a horizontal agreement in the present case if, for example, we had evidence that TRU conspired with Wal-Mart, Target, or other retailers to deprive the clubs of desirable toys. But that is not this case. Instead, we have good evidence that toy manufacturers capitulated one-by-one to TRU's threats and pressure, and we have essentially no evidence that the manufacturers reached an agreement among themselves. The inquiries and reassurances between TRU and the toy

manufacturers, on which so much of the majority's horizontal conclusion rests, do not suffice to plug this evidentiary gap.

In summary, I agree with my colleagues' condemnation of the vertical restraints in this case. Further, I do not take issue with the principal thrust of the majority's legal analysis. I am simply unable to find a horizontal boycott on the basis of this evidence. The gaps and ambiguities in the record require that I dissent from the conclusion that TRU orchestrated an anticompetitive horizontal agreement.

Endnotes:

(1) Slip op. at 29 *et seq.*

(2) I recognize, of course, that direct evidence to prove a boycott can be hard to come by, and the law permits us to establish an unlawful horizontal agreement circumstantially.

(3) Slip op. at 33.

(4) *See id.* at 6, 70 *et seq.* for the majority's discussion of TRU's importance as a purchaser from the major toy manufacturers.

(5) My colleagues also assert that TRU's "'club policy' was squarely *contrary* to the independently determined business interests of the toy manufacturers." *Id.* at 57. That is true only if one disregards the great pressure that TRU brought to bear on the manufacturers -- pressure that derived from any rational manufacturer's weighing of the clubs' tiny position in the market against TRU's overwhelming presence. Once the club policy was in place, TRU's formidable power in the toy market clearly made compliance with the policy in each manufacturer's *individual* self-interest.

(6) *Id.* at 31.

(7) Other portions of the majority opinion suffer from similar problems. A Mattel document [redactions] does not necessarily prove that Mattel entered into an agreement with any of its competitors. The quoted statement could just as well simply mean that Mattel conditioned acceding to TRU's demands on an understanding that Mattel's competitors would not sell to clubs. Further discussion in the text (*id.* at 31 *et seq.*) shows that TRU ably played manufacturers off against one another but does not necessarily prove that the manufacturers agreed among themselves on a course of action. [redactions]. Footnote 30 discusses various manufacturers' efforts to monitor what their competitors were doing about the clubs -- efforts that one would expect the manufacturers to undertake in contemplation of bowing to TRU's pressure, irrespective of whether they formed a horizontal agreement.

The opinion's observation that "the toy manufacturers did not adopt the 'club policy' until they knew or had been assured of the others' responses" (*id.* at 62) shows consciously parallel, but not necessarily collusive, behavior. If a manufacturer, *acting alone*, wants the comfort of knowing that TRU is applying the same rule to all manufacturers, then naturally the manufacturer will balk at adopting the club policy until TRU gives it the desired reassurance.

(8) *Id.* at 29.

(9) *Id.* at 2-3.