PUBLIC VERSION

BEFORE THE

FEDERAL TRADE COMMISSION

In the matter of:	)
	)
Toys "R" Us, Inc.	)
	)
FTC Docket No. 9278	)

January 3, 2014

PETITION OF TOYS "R" US, INC., TO REOPEN AND MODIFY FINAL ORDER

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INTRODUCTION

Pursuant to Section 2.51 of the Rules of Practice and Procedure of the Federal Trade Commission ("FTC"; "Commission"), 16 C.F.R. §2.51 (2011), Toys "R" Us, Inc. ("TRU"; "Company"), hereby petitions the Commission to reopen and modify the Final Order entered by the Commission on October 13, 1998, in *In the matter of Toys "R" Us, Inc.*, FTC docket number 9278 ("Order").

The Order was entered as a remedy following the Commission's determination that, in the 1990s, TRU had used its significant market power to orchestrate a "hub-and-spoke" conspiracy among its suppliers in order to restrict the supply of toys to certain warehouse clubs. The Order prohibits, at Paragraph II.A., entering into any "agreement or understanding" with a supplier to limit supply to a competitor; at Paragraph II.B., "urging, inducing, coercing, or pressuring" a supplier to do the same thing; at Paragraph II.C., asking a supplier "to furnish information to respondent relating to any supplier's sales or actual or intended shipments to any toy discounter"; and, at Paragraph II.D., "[f]acilitating or attempting to facilitate agreements or understandings between or among suppliers relating to limiting the sale of toys and related products to any retailer(s)."

But obvious changed circumstances demonstrate that the Order, which is fifteen years old, has outlived the threats to competition against which it was designed to guard. Namely, the primary factual underpinning for the Order's extensive prohibitions on purely vertical conduct—the assumption that TRU possesses market power—is no longer true. The emergence of Walmart and Target [redacted] in toy retail, as well as the [redacted] expansion of competition from online retailers, particularly Amazon.com, has reshaped competition among purchasers and sellers of toys. [redacted] When a non-dominant firm like TRU is prohibited from using commonplace, procompetitive vertical restraints to enhance its competitiveness, neither competition nor consumers benefit.

TRU does not seek to modify or set aside the Order's core prohibition: the prohibition in Paragraph II.D. on facilitating, or attempting to facilitate, unlawful collusion. But TRU notes at the outset that there has been no allegation that the Company has attempted to engage in such conduct since the 1998 decision. Nor is there any reasonable probability that any such conduct, if attempted, would be successful.

But the competitive burdens imposed by the Order's other provisions are heavy. Paragraphs II.A., II.B., and II.C. foreclose much procompetitive and competitively neutral conduct. And the broad language of these provisions exposes TRU to the risk that the Order could be interpreted to prohibit conduct such as TRU asking a supplier about its distribution plan for a product, or agreeing with a supplier that TRU will be one of a small number of retailers to carry a particular product, or complaining to a supplier about competitors' violations of the supplier's own retail policies. Further, the Order's document retention provision, Paragraph IV.B.—even as interpreted by agreement with staff—requires, as a practical matter, that the Company must preserve every single email communication sent or received by hundreds of employees. Such obligations are no longer necessary.

In summary, and as described in more detail below, the Order imposes heavy burdens on TRU and precludes TRU from engaging in conduct that is legal under the antitrust laws, that its competitors use routinely, and that presents little or no danger to competition, while offering no competitive benefits to offset this harm – especially given the significant changed circumstances in the marketplace over the last fifteen years.

For these and the following reasons, therefore, TRU petitions the Commission to reopen and modify the Order on the grounds of: (1) change of material fact, because TRU no longer holds market power; and (2) public interest, because the Order's restrictions on TRU's ability to compete harm competition and are not justified by a countervailing competitive benefit. The modification requested by TRU will preserve the Order's core prohibition, along with an appropriate document-retention obligation, while eliminating the additional provisions that are not only unnecessary but have become actively harmful to competition.

* * *

TRU hereby requests that certain information provided in this Petition and the accompanying declarations be treated by the Commission as strictly confidential and not be made available to the public, pursuant to Section 21 of the FTC Act, 15 U.S.C. § 57b-2, and Sections 4.9, 4.10, and 4.11 of the Commission's Rules of Practice and Procedure, 16 C.F.R. §§ 4.9, 4.10, and 4.11.

Portions of this Petition contain commercially and competitively sensitive information relating to TRU's business and business practices, disclosure of which to the public will prejudice TRU. Accordingly, to maintain the public record, TRU is submitting this petition in two versions—one that includes confidential and proprietary information (the "Confidential Version") and another that has certain confidential and proprietary information redacted (the "Public Version").

RELIEF REQUESTED

For the reasons described below, TRU requests the following relief:

1. That Paragraphs II.A. and II.B. of the Order be set aside.
2. That Paragraph II.C. of the Order be set aside.
3. That Paragraph IV.B. of the Order be amended to limit the scope of the Company's recordkeeping obligations to communications sent or received by Company officers (i.e., Vice-Presidents and above) within the Merchandising organization.

If the preceding relief is not granted, TRU requests in the alternative such relief as the Commission may deem fitting and just.

ARGUMENT

I. BACKGROUND

A. Factual Background

1. Toys "R" Us

Toys "R" Us is a global retailer dedicated to toys and other products for babies and children, headquartered in Wayne, New Jersey.[1] The products sold by TRU include, among many others, toys, games, electronics, video games, clothing, children's sporting goods, furniture, baby gear and other juvenile products, and consumables such as baby formula, diapers, and candy.[2]

TRU competes directly with a wide array of companies in a variety of sectors. Its competitors include department stores and general retailers such as Walmart, Target, Kmart, Kohl's, JC Penney, and Amazon.com; mass-merchandizing stores for baby and child products like Buy Buy Baby; drugstores such as CVS and Walgreens; "big box" retailers like Sports Authority and Best Buy; supermarkets (especially for consumables) like Harris Teeter, Kroger, and Safeway; warehouse clubs like Costco, Sam's Club, and BJ's; and specialty stores that focus on specific types of children's products (including, for example, video games, software, sporting goods, and apparel) such as Modell's Sporting Goods, GameStop, Children's Place, and Gap Kids. TRU faces strong competition from both online retailers and "brick and mortar" stores in each of these areas.[3]

2. The 1998 FTC Decision

The Order was entered by Administrative Law Judge Timony in an Initial Decision dated September 25, 1997, from which TRU's appeal was denied by the Commission on October 13, 1998.[4] The Commission found that TRU had adopted a "club policy" to respond to increasing competition from warehouse club stores and that this club policy violated Section 1 of the Sherman Act, 15 U.S.C. § 1.

The key facts found by the Commission were as follows. Discussions with suppliers regarding a club store policy began in 1989, in which "TRU made various general representations about not buying from manufacturers that sold to clubs."[5] In 1992, TRU informed its suppliers of a new policy, pursuant to which the suppliers would not provide "new or promoted product" to retailers unless the retailer carried the full product line, TRU was to be given first refusal on all "specials and exclusives" that were to be offered to the club stores, and "[o]ld and basic product should be

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[1] *See* http://www.toysrusinc.com/.

[2] Declaration of Richard Barry ("Barry Decl."), ¶ 3. *See* http://www.toysrus.com/category/index.jsp?categoryId= 2273442 (listing all categories of product).

[3] Barry Decl., ¶¶ 4–5.

[4] *In the matter of Toys "R" Us, Inc.*, 126 F.T.C. 415, FTC Docket No. 9278 (F.T.C. 1998).

[5] *Id.* at 539.

in special packs."[6] Following this announcement, "TRU and its key suppliers eventually worked out a compromise whereby each manufacturer agreed with TRU that it would sell to the clubs only highly-differentiated products (either unique, individual items or 'combo' packages of two or more toys) that were not offered to any other outlet including, of course, TRU. The details often varied from toy manufacturer to toy manufacturer, but the core of the arrangement was consistent."[7] The Commission concluded that TRU had entered into vertical agreements with its suppliers to deny supply to the club stores,[8] and that TRU had also facilitated a horizontal conspiracy among its suppliers, pursuant to which the suppliers agreed to restrict supply to club stores so long as their competitors did the same ("essentially an agreement to boycott the clubs").[9]

The Commission found that TRU's facilitation of a horizontal agreement violated the Sherman Act on both a *per se* and a rule of reason analysis.[10] It also found that the vertical agreements between TRU and its suppliers violated the Sherman Act.[11] In reaching these conclusions, the Commission expressly found that TRU possessed "market power as a purchaser and seller of toys."[12] The decision described TRU as "a dominant toy retailer,"[13] with "a dominant position in buying and selling toys[.]"[14]

Accordingly, the Commission entered the Order in the form that it had been entered by the ALJ, "requiring TRU to cease this law violation and to refrain from similar conduct in the future."[15] The ALJ's Initial Decision did not discuss the Order in detail, but explained that "[e]ach of the provisions [in the Order] addresses conduct that might be used by the respondent to perpetuate the restraint."[16]

The United States Court of Appeals for the Seventh Circuit affirmed the Commission's decision on August 1, 2000.

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[6] *Id.* at 539–40.

[7] *Id.* at 540.

[8] *Id.* at 541–50.

[9] *Id.* at 551–60.

[10] *Id.* at 574–612.

[11] *Id.* at 569–74, 612–14 ("We conclude therefore that each agreement in the series of vertical agreements, standing alone, even without the evidence of horizontal agreement among many of the toy manufacturers, violates § 1 of the Sherman Act upon a full rule of reason review").

[12] *Id.* at 592.

[13] *Id.* at 612.

[14] *Id.* at 594.

[15] *Id.* at 614.

[16] *Id.* at 495.

3. Changes in the Toy Retailing Industry

(a) Overview

In 1998, reviewing evidence from the early and mid-1990s, the Commission expressly found that TRU exercised market power in relevant markets as a purchaser and seller of toys.[17] The Seventh Circuit, affirming, commented that TRU was "a giant in the toy retailing industry[,]" and a "critical outlet for toy manufacturers."[18] But this is demonstrably no longer true. The report attached at Exhibit 2 to the Declaration of Mary Coleman, Ph.D. ("Coleman Report"), outlines the principal changes in competition among retailers of toys and children's products since the FTC and Seventh Circuit decisions. As the evidence, including the Coleman Report, amply demonstrates, TRU today does not exercise market power.[19]

Specifically, and most significantly, since the Commission's decision [redacted] Walmart and Target have overtaken TRU in competitive strength and market share, with Walmart dwarfing TRU in size.[20] In fact, Walmart replaced TRU as the leading retailer of toys in the United States in 1998.[21] And other prominent retailers, including Amazon.com, contribute to an unprecedented level of retail competition.

This competitive change has dramatically increased the intensity of price competition on toys. Retail prices for toys declined by a third between 2003 and 2010.[22] [redacted][23] Industry analysts correctly reached this same conclusion nearly 10 years ago. One industry report put it concisely: "We have significant doubts about [TRU's] ability to compete with discounters like [Walmart] and [Target] in its current form."[24] And in the words of another:

> We believe what is occurring is that retail market share is continuing a multi-year shift from Toys "R" Us to more cost effective retailers Wal-Mart, Target, etc. . . . We would remind investors that in the early 1990's Toys "R" Us forced several toy competitors, Child World, Kiddie City, etc. out of business. In our opinion, the same thing is occurring here, only with other players and different roles.[25]

[redacted] during the 2012 holiday season. [redacted] TRU reported that same store

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[17] *Id.* at 613.

[18] *Toys "R" Us, Inc. v. Fed. Trade Comm'n*, 221 F.3d 928, 930, 935 (7th Cir. 2000).

[19] Exhibit 2, Mary T. Coleman, Ph.D., Competitive Analysis of Toys "R" Us, Inc. ("Coleman Report"), ¶ 26 and *passim*; *see also* Barry Decl., ¶¶ 4–11; Declaration of Gerald Cleary ("Cleary Decl."), ¶ 7–13; Declaration of Paul Desiderioscioli ("Desiderioscioli Decl."), ¶¶ 4–8.

[20] Coleman Report, ¶ 16, Table 5 and *passim*.

[21] Coleman Report, Table 1.

[22] First Research Industry Profile, Toy & Hobby Stores, July 25, 2011 at p. 5.

[23] Coleman Report, ¶ 9.

[24] *See, e.g.*, Morgan Stanley Equity Research, *Retail, Vendors: Toys*, September 10, 2004 at p. 2.

[25] A.G. Edwards, *Toy Retail Pricing Survey: St. Louis: September 2004*, October 8, 2004 at p. 2.

sales (that is, sales at stores open at least one year) declined by 4.5 percent in the [redacted] November-December months.[26] TRU was challenged in particular by [redacted] Walmart [redacted].[27] As the chairman of the New York-based national retail consulting and investment banking firm Davidowitz & Associates put it, "Wal-Mart decided toys are a great price football for Christmas. They were out there pounding away on Toys, and they have much more price leverage than Toys."[28]

(b) Sales data: share of "all traditional toys" market

These assessments are supported by quantitative information from the toy industry, as Dr. Coleman's analysis demonstrates.[29] The following table shows the [redacted] changed circumstances since the mid-1990s, assuming a single market for "all traditional toys" (which was the market definition adopted by the Commission in the original case[30]):

Table 1: Share of "all traditional toys" (1993–2012) (TRU, Walmart, Target)

	1993 market share	2012 market share	[redacted]	[redacted]
TRU	[redacted]	[redacted]	[redacted]	[redacted]
Walmart	[redacted]	[redacted]	[redacted]	[redacted]
Target	[redacted]	[redacted]	[redacted]	[redacted]

Sources: Toy Manufacturers of America (1993-1997 data); NPD Group(1998-2012 data)[31]

[26] *Unhappy Holidays for Toys 'R' Us*, Bergen Record (Jan. 11, 2013), available at: http://www.bloomberglaw.com/ms/document/MGGW356LJLDS.

[27] Ann Zimmerman and Shelly Banjo, *Rivals Object to Wal-Mart Ads*, Wall St. J., Jan. 3, 2013, available at: http://online.wsj.com/article/SB10001424127887323689604578219703156296568.html.

[28] *Unhappy Holidays for Toys 'R' Us*, Bergen Record (Jan. 11, 2013), available at: http://www.bloomberglaw.com/ms/document/MGGW356LJLDS.

[29] Coleman Report, ¶ 10 *et seq.*

[30] *In the matter of Toys "R" Us, Inc.*, 126 F.T.C. 415, 593, FTC Docket No. 9278, (F.T.C. 1998) ("The record supports the conclusion that the relevant product market is all traditional toys."). Note that this definition excludes numerous products that TRU and its competitors sell (such as food, clothing, furniture, juvenile items, and so forth), in which there has never been any suggestion that competition was threatened (even back in the 1990s)—yet all these "outside the market" products are nevertheless covered by the Order.

[31] Greg Johnson, *The Game Has Changed: It's Toys R Us, or Them*, L.A. Times, Dec. 13, 1998, *available at* http://articles.latimes.com/print/1998/dec/13/business/fi-53526. Associated Press, *Wal-Mart Takes Lead in U.S. Toy Sales*, L.A. Times, Mar 30, 1999, *available at* http://articles.latimes.com/1999/mar/30/business/fi-22372. Press Release, NPD Reports Top Ten Traditional Toy Retailers (Apr. 3, 2001), https://www.npd.com/press/releases/press_010403.htm. NPD data is based on survey responses from nationally representative samples. Beginning in 2008, NPD's data is combined with data from a Nielsen/IRI joint venture household panel. These two data sources are projected and weighted to yield estimates representing 100% of total traditional toy retail sales. Shares include online sales.

[redacted] And financial analysts predict that life will only get harder for TRU:

> In the past decade, discount department stores have emerged as top hobby and toy retailers. In particular, Walmart has evolved as the top retailer of children's toys, accounting for more than a quarter of the entire toy market. The national scale of department stores has enabled their dominance; since they purchase in bulk, they are able to achieve significant cost savings. In addition, department stores can bypass wholesalers and purchase directly from well-known manufacturers like Mattel and Hasbro, eliminating the margins associated with middlemen. As a result, department stores have been able to operate with lower price markups and have passed these savings down to consumers in the form of heavily discounted prices. Over the five years to 2011, this factor has increasingly attracted consumers away from traditional hobby and toy specialty shops to these large external retailers.[32]

(c) Sales data: share of specific product categories

An examination of competition within individual product categories—of which NPD identifies eleven—presents the same picture. As noted above, TRU carries a broad range of products for children and babies, and faces formidable competition in each category. This includes competition from specialty retailers who focus their product selections and resources on a single category. For example, in the "sporting goods" space, TRU faces significant competition from sporting goods stores such as Sports Authority and Dick's Sporting Goods, each with more than 450 stores.[33] Dr. Coleman identifies additional examples in her report.[34]

The following table summarizes this information, showing market shares by category in 2002 and in 2012.

[32] IBISWorld Industry Report. Hobby & Toy Stores in the US (45112). July 2011 at pp. 7-8.

[33] *See* http://www.sportsauthority.com/corp/index.jsp?clickid=botnav_aboutus_txt:

See http://www.dickssportinggoods.com/corp/index.jsp?page=aboutUs&ab=Footer_AboutUs.

[34] Coleman Report. ¶ 12.

Table 2: Share of individual toy categories (2002 and 2012) (TRU, Walmart, Target)

TRU		
Category	**2002**	**2012**
Infant Preschool	[redacted]	[redacted]
Dolls	[redacted]	[redacted]
Arts & Crafts	[redacted]	[redacted]
Outdoor & Sports	[redacted]	[redacted]
Games & Puzzles	[redacted]	[redacted]
Building Sets	[redacted]	[redacted]
Vehicles	[redacted]	[redacted]
All Other Toys	[redacted]	[redacted]
Action Figures	[redacted]	[redacted]
Plush	[redacted]	[redacted]
Youth Electronics	[redacted]	[redacted]

Walmart		
Category	**2002**	**2012**
Infant Preschool	[redacted]	[redacted]
Dolls	[redacted]	[redacted]
Arts & Crafts	[redacted]	[redacted]
Outdoor & Sports	[redacted]	[redacted]
Games & Puzzles	[redacted]	[redacted]
Building Sets	[redacted]	[redacted]
Vehicles	[redacted]	[redacted]
All Other Toys	[redacted]	[redacted]
Action Figures	[redacted]	[redacted]
Plush	[redacted]	[redacted]
Youth Electronics	[redacted]	[redacted]

Target		
Category	**2002**	**2012**
Infant Preschool	[redacted]	[redacted]
Dolls	[redacted]	[redacted]
Arts & Crafts	[redacted]	[redacted]
Outdoor & Sports	[redacted]	[redacted]
Games and Puzzles	[redacted]	[redacted]
Building Sets	[redacted]	[redacted]
Vehicles	[redacted]	[redacted]
All Other Toys	[redacted]	[redacted]
Action Figures	[redacted]	[redacted]
Plush	[redacted]	[redacted]
Youth Electronics	[redacted]	[redacted]

Source: NPD Group. [redacted]

The data show that TRU's loss of competitive position is consistent across product categories. [redacted]

[redacted]

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[35] Coleman Report, ¶¶ 13–17 and Tables 2–5.

[redacted]

[redacted]

In summary, TRU has lost ground to Walmart and Target across the competitive landscape. And in 2013, Walmart is the [redacted] market leader, with TRU and Target sparring for [redacted] second place. [redacted]

- [redacted]
- [redacted]
- [redacted]

In its original decision, the Commission relied in part on market share data for several individual cities in the United States to support the conclusion that TRU held market power.[38] But, while TRU has been unable to obtain recent data for individual cities, regional and sub-regional data are available from the NPD Group,[39] and these data further confirm how [redacted] the landscape has changed. [redacted]

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[36] Coleman Report, ¶¶ 13–14 and Tables 2–3.

[37] Coleman Report, ¶ 15 and Table 4.

[38] *See, e.g., In the matter of Toys "R" Us, Inc.*, 126 F.T.C. 415, 532, FTC Docket No. 9278 (F.T.C. 1998).

[39] The Commission cited to NPD Group data in the original decision. *See* 126 F.T.C. at 530.

Table 3: TRU, Walmart and Target: 2012 Shares by Sub-region

	Sub-Region	[redacted]
Central	**East North Central**	[redacted]
	West North Central	
Northeast	**Middle Atlantic**	
	New England	
South	**East South Central**	
	South Atlantic	
	West South Central	
West	**Mountain**	
	Pacific	

Source: NPD Group.

(d) Store footprint: current situation and trends

Other sources of information confirm the swing away from TRU and toward Walmart and Target. [redacted][40] The Company's annual filings for FY 2012 state that TRU operated 875 stores. Target has more than twice as many (1,778 stores). Walmart has more than four times as many (3,719 stores).[42] [redacted][43]

[40] *See also* A.G. Edwards, *Toy Retail Pricing Survey: St. Louis: September 2004*, October 8, 2004, p. 2. ("We believe what is occurring is that retail market share is continuing a multi-year shift from Toys "R" Us to more cost effective retailers Wal-Mart, Target, etc. We believe the Toys "R" Us downsizing is merely a reallocation of retail market share within the domestic toy industry.")

[41] Source: TRU 10-K report filed March 29, 2013, available at www.sec.gov.

[42] Source: Walmart and Target 10-K reports filed in 2013, available at www.sec.gov.

[43] *See* Coleman Report ¶ 18 and Table 6.

(e) Online competition

The preceding analysis has considered Walmart and Target. But the competitive field facing TRU is much broader, and the scope of relevant changes since the entry of the Order extends far beyond the [redacted] expansion of these two competitors. Most notably, the importance and strength of online competition has exploded since 2002.[44]

The sales data tell a clear story. Online sales, as a proportion of total toy sales, have almost tripled between 2002 and 2012 [redacted] For the past two holiday seasons, Amazon.com has had a "Price Check" app which allows customers to free-ride on the availability of a physical product in a brick-and-mortar store.[49] This free app is still available for download on iTunes and other mobile platforms. Using this Amazon application, consumers can now "price check" a product in an instant—while at home, at work or while shopping in a TRU store—and place an order for prompt, and often free, delivery with greater ease. [redacted] News reports suggest that even Target has had to take more proactive steps in an effort to reverse this trend: Target reportedly sent letters to its vendors urging them to provide the company with unique products or more competitive pricing.[52]

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[44] Coleman Report, ¶¶ 19–21 and Tables 7-8.

[45] Coleman Report, Table 7.

[46] NPD does not have sales data for Amazon.com between 2001 and 2005.

[47] Barry Decl., ¶ 11.

[48] *See* http://www.amazon.com/gp/help/customer/display.html?nodeId=468512.

[49] *See* http://www.amazon.com/gp/feature.html?ie=UTF8&docId=aw_ppricecheck_iphone_mobile.

[50] *See generally More evidence of "Show-rooming" Effect*, RetailingToday.com, Feb. 16, 2012, http://www.retailingtoday.com/article/more-evidence-show-rooming-effect (A ClickIQ survey showed "that 67% [of the respondents] have shopped online as well as in brick-and-mortar stores during the past six months. When this group was asked if they have researched a product at the local retail store and then made the purchase online, 46% indicated that they have done so.").

[51] Barry Decl., ¶ 11.

[52] Ann Zimmerman, *Showdown Over 'Showrooming': Target Asks Vendors for Help Keeping Comparison Shoppers*, Wall St. J. Jan. 23, 2012, *available at* http://online.wsj.com/article/SB10001424052970204624204577177242516227440.html.

[redacted]

(f) Juvenile products

According to NPD, there is limited juvenile product market information available. This market includes products for children from soon-to-be-born babies to toddlers as old as two. NPD conducted a test study of this market in 2011. [redacted]

[redacted]

(g) Significance as a distribution channel

The Commission's Initial Decision was premised, in part, on the conclusion that TRU was an indispensable distribution channel for toy manufacturers. The Commission found in 1998 that "TRU buys about 30% or more of the large, traditional toy companies' total output, and is usually their most important customer[,]"[54] and that "TRU accounted for more than 30% of toy purchases in areas of the country where it did business, and 40 to 50% in many cities."[55] Commenting on the Company's importance at the time to its suppliers, the Commission found:

[53] Coleman Report. ¶ 21 and Table 8.

[54] *Toys "R" Us, Inc.*, 126 F.T.C. at 532; *see also id.* at 533 ("Even TRU recognized the large degree to which its suppliers had become dependent upon TRU.").

[55] *Id.* at 599.

> The evidence is clear—indeed, TRU does not really contest the point—that TRU had sufficient market power to induce the toy manufacturers to bend to its will with regard to their sales to the clubs. That such a wide range of toy manufacturers, all with serious reservations about the wisdom of discriminating against the clubs on toy sales, fell in line when TRU asserted its demands is proof in itself of TRU's extraordinary power to coerce its suppliers.[56]

Similarly, the Initial Decision discussed in particular TRU's importance to the largest toy manufacturers in the United States.[57] It concluded that "[t]oy manufacturers would have difficulty finding alternative buyers to replace TRU."[58]

<u>But the situation is very different today</u>. TRU does not exercise any significant amount of market power *vis à vis* its suppliers and cannot "bend [them] to its will." Unlike in the mid-1990s, TRU's principal retail competitors now exceed it in size and store footprint. The Company's suppliers can choose freely from a wide range of distribution options, including Walmart, Target, Amazon.com, other large retailers like Kmart, direct online distribution, licensing arrangements with other manufacturers (which facilitate access to Walmart and Target), and a range of other solutions that have combined to eliminate any market power that TRU once had held over suppliers.

In the attached declaration, Gerald Cleary, a former Executive Vice President of Mattel, provides a supplier's perspective on TRU's position in the modern competitive landscape. As he explains, TRU's significance as a distributor of toys has been [redacted] reduced since the mid-1990s.[59]

Cleary's declaration confirms that, from a supplier's perspective, there are many alternatives to TRU. For example, larger manufacturers typically deal directly with Target, Walmart, and other large retail outlets like Amazon.com.[60] Smaller manufacturers can work with independent distributors—often through a network of sales representatives—or can enter into a licensing agreement with a larger supplier.[61] And, of course, manufacturers of all sizes can and do sell direct to consumers if they choose, through a company website.[62] This matches the experience of TRU merchandising personnel, whose supplier negotiations are not at all consistent with any significant degree of market power.[63]

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[56] *Id.* at 596.

[57] *Id.* at 484 ("In 1994, TRU had 29% of the sales of the top ten traditional toy manufacturers. TRU purchased 28% of Mattel's toys, 28% of Hasbro's toys, 31% of Little Tikes' toys, and 48% of Tyco's toys. TRU has 35% of Fisher-Price's sales. . . . TRU's average market share for four years from top ten firms is [figure redacted]. For the seven traditional manufacturers, the average share is [figure redacted]. These shares were growing, indicating that manufacturers were becoming more dependent on TRU.").

[58] *Id.*

[59] Cleary Decl., ¶¶ 7–9.

[60] Cleary Decl., ¶ 17.

[61] Cleary Decl., ¶¶ 18–19.

[62] *See, e.g.*, http://www.lego.com; http://www.littletikes.com; http://www.calicocritters.com/.

[63] Barry Decl., ¶¶ 8–9; Desiderioscioli Decl., ¶¶ 7–8.

Publicly available sales data tell the same story. The largest toy manufacturers in the United States are Hasbro and Mattel, and the picture that emerges from their distribution data is a familiar one: TRU's share of their total distribution has undergone a marked decline in the years since the mid-1990s, while the shares of Walmart and Target have increased [redacted]

As Dr. Coleman's report demonstrates, from 1995 to 2011, TRU's share of Hasbro sales has declined [redacted] Meanwhile, Walmart's share increased [redacted] over the same time period [redacted] Hasbro did not report Target's share of its sales until 2004, but from then on, Target's share of Hasbro's sales has generally exceeded TRU's share. Nor is TRU still the leading distributor of Mattel products. In fact, Walmart has been a more significant distributor of Mattel products than TRU for the past ten years. Between 1995 and 2010, TRU lost [redacted] share of Mattel's distribution [redacted] while Walmart's increased [redacted] (rising from 12% to 19%). Mattel did not report Target's share of its sales until 2000, but from that point forward, Target has steadily accounted for an 8-10% share of Mattel's sales.[64]

(h) Conclusions

In light of the foregoing and of the data collected and analyzed in Dr. Coleman's report, the following conclusions may be drawn regarding TRU's current competitive position.

- As a retailer, TRU does not have—under *any* reasonable market definition or in any product category—the kind of share that would suggest that it is a "dominant" retailer with significant market power as a retailer of toys.[65] As the Commission has recently observed in the context of an order modification proceeding, the existence of a "modest market share in any putative relevant product market" is enough to create a *prima facie* indication that a firm lacks market power.[66]

- Walmart and Target enjoy [redacted] advantages in toy retail. Their broad store footprint, low cost base, and ability to "loss-lead" by pricing toys at or below cost in order to drive

[64] Coleman Report, ¶¶ 22–24 and Tables 9–10.

[65] We are not aware of any federal antitrust case that stands for the proposition that a market share in the 20–25% range is evidence of market or monopoly power. *See, e.g., Rebel Oil Co., Inc. v. Atlantic Richfield Co.*, 51 F.3d 1421, 1438 (9th Cir. 1995) ("It is true, as the district court stated, that numerous cases hold that a market share of less than 50 percent is presumptively insufficient to establish market power. . . . When the claim involves attempted monopolization, most cases hold that a market share of 30 percent is presumptively insufficient to establish the power to control price.") (citations omitted); *AD/SAT v. Associated Press*, 181 F.3d 216, 229 (2d Cir. 1999) (stating that a thirty-three percent market share "does not approach the level required" to demonstrate even a *dangerous probability* of obtaining monopoly power) (emphasis added); *Yoder Bros., Inc. v. California-Florida Plant Corp.*, 537 F.2d 1347, 1368 (5th Cir. 1976) ("Because the correct product market was ornamental plants, and Yoder's share of that market was approximately 20%, we hold that as a matter of law Yoder could not have been guilty of monopolization."); *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 424 (2d Cir. 1945) (noting that "it is doubtful whether sixty or sixty-four percent would be enough [to constitute a monopoly]; and certainly thirty-three percent is not") (Learned Hand, J.).

[66] *In the Matter of Nine West Group Inc.*, 2008 WL 2061410, at *8, FTC Docket No. C-3937 (F.T.C. May 6, 2008).

traffic—[redacted]—all present [redacted] challenges to competitors who are attempting to win or preserve market share in toy retail markets.

- [redacted]

- The significant growth in online retailing, notably [redacted] of Amazon.com, appears likely to continue and to intensify price competition among toy retailers.

- TRU is no longer the largest distribution channel for the United States' two largest toy manufacturers, and its distribution share has fallen to less than 15% of the total sales of each manufacturer. [redacted]

- [redacted]

- As a result, TRU does not possess any significant market power as a toy retailer, either as a supplier to consumers in downstream retail markets or as purchaser in upstream wholesale markets.

II. Legal Standard

The Commission will reopen and set aside or modify an order or order provision on two grounds.

First, an order will be modified if the entity subject to the order makes a "satisfactory showing that changed conditions of law or fact" so require.[68] Such a showing is made when a request to reopen identifies significant changes in circumstances and shows that the changes eliminate the need for the order or make continued application of it inequitable or harmful to competition.[69] Pursuant to FTC Rule 2.51(b), the necessary showing must include affidavits or declarations setting forth admissible facts.[70]

Second, an order will be modified if, "although changed circumstances would not require reopening, the Commission determines that the public interest so requires."[71] As the

[67] Barry Decl., ¶ 9. [redacted]

[68] *See* Federal Trade Commission Rules of Practice § 2.51(b), 16 C.F.R. § 2.51(b).

[69] 15 U.S.C. § 45(b); *In the matter of Conoco Inc. and Phillips Petroleum Co.*, 2011 WL 5881166, at *3 (F.T.C. Nov. 16, 2011); *In the matter of Agrium, Inc.*, 2011 WL 1055392, at *2 (F.T.C. Mar. 18, 2011).

[70] 16 C.F.R. § 2.51(b); 28 U.S.C. § 1746.

[71] *Conoco Inc. and Phillips Petroleum Co.*, 2011 WL 5881166, at *4; *Agrium, Inc.*, 2011 WL 1055392, at *2; *see also* Federal Trade Commission Rules of Practice § 2.51(b), 16 C.F.R. § 2.51(b).

Commission has recently explained, the burden is on the petitioner to make a "satisfactory showing" of a *prima facie* case that modification is in the public interest.

> This showing requires the requester to demonstrate, for example, that there is a more effective or efficient way of achieving the purposes of the order, that the order in whole or part is no longer needed, or that there is some other clear public interest that would be served if the Commission were to grant the requested relief. Just as for petitions based on changed conditions, this showing must be supported by evidence that is credible and reliable.[72]

III. THE ORDER SHOULD BE MODIFIED

The Order should be modified for the following two reasons.

First, the Order should be modified in light of significant changed factual circumstances. The Order's prohibitions against a broad range of vertical conduct and vertical communications are premised on the Commission's holding in 1998, based upon facts from the mid-1990s, that TRU exercised a significant degree of market power at that time. But following the dramatic changes in competitive conditions in the toy industry, TRU no longer has market power as a purchaser or seller of toys. This change eliminates the competitive threat against which the Order was designed to guard, and warrants modifying the Order by eliminating the prohibitions on vertical conduct.

Second, the Order should be modified in the public interest. The Order is broad and vague, and it restrains TRU from a great deal of vertical conduct which is procompetitive or (at worst) competitively neutral. The restraints impede TRU in competing with Walmart, Target, Amazon.com, and other competitors. This harms the public interest by denying consumers the benefit of full competition. Because TRU does not possess market power, the Order no longer protects the market against anticompetitive conduct. Thus, the Order causes consumer harm without commensurate benefit. It should accordingly be modified in the public interest.

A. The Order Should Be Modified in Light of Changed Circumstances.

The Order—like the Commission decision and the opinion of the Seventh Circuit—rests heavily on the determination that, at the time of the conduct at issue in the 1998 decision, TRU possessed significant market power.[73] For example, the Commission referred to "TRU's considerable market power,"[74] found that it "does have market power as a purchaser and seller of toys,"[75] and

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[72] *Conoco Inc. and Phillips Petroleum Co.*, 2011 WL 5881166, at *4; *Agrium, Inc.*, 2011 WL 1055392, at *3.

[73] Commission Opinion, 69–71; *Toys "R" Us, Inc. v. Fed. Trade Comm'n*, 221 F.3d 928, 940 (7th Cir. 2000) ("The attempt to use its market clout to harm the warehouse clubs lies at the heart of this case, and so it is easy to see why the Commission chose to prohibit reliance on the supplier's practices *vis à vis* the clubs as a reason for TRU's own purchasing decisions.").

[74] *In the matter of Toys "R" Us, Inc.*, 126 F.T.C. 415, 574, FTC Docket No. 9278, (F.T.C. 1998).

[75] *Id.* at 592.

described it as "a dominant toy retailer[.]"[76] The Commission also commented that "TRU's market share is extraordinarily high for a retailer" and that it "enjoys a dominant position in buying and selling toys."[77] In particular:

> In just the localities that it serves (and where toy manufacturers depend on it for distribution), TRU buys and resells 32% of all toys sold. In many local areas (where retail competition is focused) its market share is much higher. In 18 metropolitan areas, it accounts for 35% to 49%, and in eight other cities plus Puerto Rico, its share was greater than 50%. Cities where its market share exceeds 40% include Los Angeles, Chicago, and New York. TRU is invariably the largest customer for traditional toy companies' output. As we have discussed, toy company executives describe TRU as irreplaceable.[78]

The Commission concluded that TRU's market power not only made its vertical agreements anticompetitive, but also enabled it to facilitate agreement among its suppliers: "As a single, dominant, multi-brand retailer, TRU is . . . able to use its power to enforce collusion among its various suppliers."[79] The Commission expressly raised the prospect that the presence of an "adequate substitute" in the market would likely extinguish these competitive concerns: "The presence of a strong competitor which offers the manufacturers adequate substitute distribution for their products would be expected to check any attempt to exercise this power."[80]

The finding that TRU held significant market power underpins the Order. The prohibitions in Paragraphs II.A.–II.C., in particular, address purely vertical conduct, which could harm competition only if imposed by an entity with market power. As the Commission has observed in a previous order modification case: "When market power either does not exist or cannot be sustained, anticipated efficiency gains are the only rational basis for a manufacturer to impose a vertical restraint."[81]

Because TRU no longer enjoys market power as either a purchaser or seller of toys, the Order should be modified, consistent with Commission precedent. In *Culligan*, for example, the Commission set aside an order when the respondent's market share fell from 30% at the time when the order was issued to less than 15.6% at the time of the petition.[82] The Commission expressly concluded that in light of new entry and Culligan's declining market share, "Culligan,

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[76] *Id.* at 612.

[77] *Id.* at 594.

[78] *Id.*

[79] *Id.* at 595.

[80] *Id.*

[81] *See, e.g., In the matter of TEAC Corp. of Am.*, 104 F.T.C. 634, 1984 WL 565360, at *2, FTC Docket No. C-2752 (F.T.C. Nov. 16, 1984); *see also id.* at * 3 ("[E]ven in a somewhat concentrated market, if the firms actually using the vertical restraint at issue do not collectively possess and are not likely to secure market power, then the restraint is unlikely to facilitate the creation or maintenance of market power.").

[82] *In the matter of Culligan, Inc.*, No. 6673, 113 F.T.C. 367, 1990 WL 10012596, at *3, FTC Docket 6673 (F.T.C. May 14, 1990).

therefore, appears to lack market power" and that the order should be set aside.[83] Likewise, in *General Motors Corp.*, an order was issued in 1984 that limited the scope of a joint venture between GM and Toyota in light of the competitive significance of those two firms at the time.[84] But over the following nine years, "significant new entry and expansion in the automobile industry . . . occurred in North America" and GM's market share fell from 44.4% in 1984 to 34.6% in 1992.[85] Both of these figures—44.4% and 34.6%—are *much* higher than those held by TRU in today's toy retail markets. The Commission found in *General Motors* that "[i]n the face of such entry and expansion, the joint venture is unlikely to create or facilitate the exercise of market power" and, as a result, "continuing the restrictions in the context of the changed conditions may hinder the ability of the joint venture to respond to consumer demand."[86] TRU is similarly situated.

More generally, when the factual predicate of a Commission order or order provision has changed or disappeared, Commission precedent compels the elimination of that order or provision.[87] This is particularly true when—as in this case—significant changes in competitive conditions in the relevant market have eliminated the threat to competition that existed when the order was issued. For example, in *Penn Traffic Co.*, the Commission granted a petition to set aside a divestiture obligation in an order, in light of increased competition in the relevant market (in particular, new entry by Walmart).[88] In that case, the Commission specifically noted that "the additional competition from a large competitor, such as Wal-Mart, is sufficient to remedy the competitive concerns that the order is designed to address."[89] Similarly, in *Arkla*, the Commission found that "[t]he entry and expansion that have occurred since the order was issued have substantially reduced concentration in the [relevant market]," and accordingly granted a petition to set aside a divestiture obligation.[90] And in *Levi Strauss & Co.*, the Commission

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[83] *Id.*

[84] *See In the matter of General Motors Corp., et al.,* 116 F.T.C. 1276, 1280, FTC Docket No. C-3132 (F.T.C. 1993).

[85] *Id.* at 1281–82.

[86] *Id.* at 1284–85.

[87] *See, e.g., In the Matter of White Sands Health Care Sys., L.L.C.*, No. C-4130, 2005 WL 2395787, at *3 (F.T.C. Sept. 20, 2005) (setting aside a provision of an order on the ground that the "factual premise underlying the requirement that Mr. Laurenza [the petitioner] comply with [the relevant provision] no longer exists"); *In the matter of Agrium, Inc.*, 2011 WL 1055392, at *3 (F.T.C. Mar. 18, 2011) (setting aside an order and explaining that "the fundamental premise to the Commission's Complaint [a proposed transaction] is now effectively a nullity."); *In the matter of El Paso Energy Corp. and The Coastal Corp.*, No. C-3996, 2010 WL 4028093, at *3 (F.T.C. Oct. 8, 2010) ("The Commission previously has modified orders to eliminate a divestiture requirement when a respondent subsequently sold off one of the 'offending assets' that prompted the divestiture in the first place") (citations omitted).

[88] *In the matter of the Penn Traffic Co.*, 123 F.T.C. 57, 61, FTC Docket No. C-3577 (F.T.C. 1997).

[89] *Id.*

[90] *In the matter of Arkla, Inc.*, 119 F.T.C. 413, 417, FTC Docket No. C-3265 (F.T.C. 1995).

modified an order "[i]n light of the competitive developments" in the relevant markets.[91] Other Commission decisions make the same point, but we do not attempt an exhaustive survey here.[92]

The competitive changes described above not only eliminate competitive concerns about TRU's vertical conduct—they also dispose of any serious risk that TRU could, by the exercise of market power, coerce its suppliers into denying supply to low-priced retailers. In the original decision, TRU was found to have secured its suppliers' participation in the horizontal agreement by the exercise of its market power. As the Commission put it, "[a]s a single, dominant, multi-brand retailer, TRU is . . . able to use its power to enforce collusion among its various suppliers."[93] The Commission continued:

> The evidence is clear—indeed, TRU does not really contest the point—that TRU had sufficient market power to induce the toy manufacturers to bend to its will with regard to their sales to the clubs. That such a wide range of toy manufacturers, all with serious reservations about the wisdom of discriminating against the clubs on toy sales, fell in line when TRU asserted its demands is proof in itself of TRU's extraordinary power to coerce its suppliers.[94]

By contrast, in today's market, the presence of Walmart and Target demonstrates that TRU is no longer a dominant retailer of toys. The concern that TRU could restrict price competition in retail markets by threatening or coercing a supplier is no longer credible. As the Commission presciently commented in 1998: "The presence of a strong competitor which offers the manufacturers adequate substitute distribution for their products would be expected to check any attempt to exercise [market] power."[95] These "adequate substitute[s]" are now clearly present, in the form of Walmart, Target, and Amazon.com, and TRU should be permitted to compete freely with them.

B. The Order Should Be Modified in the Public Interest.

The "public interest," as that term is used in order modification proceedings, presumptively favors competition.[96] Restraints on competition harm the public interest by depriving consumers of the benefits—lower prices, better products, increased innovation—that flow from maximum

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[91] *In the matter of Levi Strauss & Co.*, 118 F.T.C. 1218, 1225, FTC Docket No. 9081 (F.T.C. 1994).

[92] *See*, e.g., *In the matter of U.S. Pioneer Elec. Corp.*, 115 F.T.C. 446, 458, FTC Docket No. C-2755 (F.T.C. 1992) (noting that "there have been numerous new entrants into all the markets for consumer electronic products since the Commission issued the order in this case" and granting order modification).

[93] *In the matter of Toys "R" Us, Inc.*, 126 F.T.C. 415, 595, FTC Docket No. 9278, (F.T.C. 1998).

[94] *Id.* at 596.

[95] *Id.* at 595.

[96] *See, e.g.*, *In the matter of Conoco Inc. and Phillips Petroleum Co.*, 2011 WL 5881166, at *5 (F.T.C. Nov. 16, 2011) (granting petition to modify order in the public interest and commenting: "the modification will enable ConocoPhillips to compete for additional marketers in those two states thereby injecting additional competition immediately without jeopardizing the effectiveness of the remedy"); *In the matter of RHI AG*, No. C-4005, 2004 WL 342978, at *3 (F.T.C. Feb. 17, 2004) ("[M]odification of the Order to enable NARCO to use the License likely will promote the public interest by increasing competition further in the relevant market by adding a new product to the market.").

competition. A Commission order, or order provision, that restrains competition will be in the public interest only if and to the extent that the benefits of preventing or deterring relevant anticompetitive conduct outweigh the losses to competition and consumers caused by the restraint. The Commission will set aside orders (and order provisions) which "unnecessarily inhibit[] respondent[s] from engaging in conduct which, in and of itself, is innocuous and may, in certain circumstances, be procompetitive."[97] For example, in *Nestlé Holdings*, the Commission granted a petition to modify an order, explaining: "holding [the petitioner] to the [strict terms of the order, as issued], with the resulting disruption to its operations and ability to compete, would likely diminish [its] competitive effectiveness. It is therefore in the public interest to make the change to enable [the petitioner] to continue to compete in the market without disruption of its operations."[98] In *William H. Rorer, Inc.*, the Commission set aside fencing-in provisions of an order when, "[a]lthough these provisions were justified at the time the [o]rder was issued, their continued existence puts respondent at a disadvantage with respect to its competitors by increasing its compliance costs unnecessarily."[99] And in *Readers' Digest Association*, the Commission eliminated an order provision when "the costs that the [provision] imposes on respondent appear to outweigh any consumer benefits [that it] may confer."[100] The same logic compels modification in this case.

For the following reasons, modification of the Order is in the public interest.

1. Harm to competition

The provisions of the Order harm competition by prohibiting TRU from engaging in various types of procompetitive conduct that are lawful under the antitrust laws and freely available to (and used by) TRU's competitors of all sizes. Denying them to TRU harms competition, and consumers, by creating an inequitable competitive disparity between TRU and its stronger competitors.[101]

In particular, the fencing-in provisions in the Order are broad, vague, and burdensome. These provisions make it harder for TRU to compete vigorously and respond to its more powerful rivals. Even on its face, the Order prohibits a great deal of procompetitive conduct (including in particular most forms of vertical restraints) and requires burdensome recordkeeping. And the

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[97] *In the matter of Occidental Petroleum Corp.*, 101 F.T.C. 373, 1974 WL 175259, at *1, FTC Docket C-2492 (F.T.C. Mar. 9, 1983); *see also, e.g., In the matter of Removatron Int'l Corp., et al.*, 114 F.T.C. 715, 719, FTC Docket No. 9200 (F.T.C. 1991) (setting aside order provision when "continued application would be inequitable or harmful to competition").

[98] *In the matter of Nestlé Holdings, Inc., et al.*, C-4082, 2005 WL 1786402, at *3 (F.T.C. July 15, 2005).

[99] *In the matter of William H. Rorer, Inc.*, No. 8597, 104 F.T.C. 544, 1984 WL 565350, at *3 (Sept. 14, 1984).

[100] *In the matter of the Readers' Digest Ass'n*, No. C-2075, 102 F.T.C. 1268, 1971 WL 128725, at *2 (Sept. 30, 1983)

[101] *See In the matter of Nat'l Fire Hose Corp.*, No. C-2935, 1978 WL 206076, at *10 (F.T.C. Nov. 1, 1978) ("The Commission has long recognized that an order should be modified or vacated if changed circumstances of fact or law place a party to the order under restrictions not applicable to other members of the industry. Fairness and the public interest require that the Commission apply its policies consistently and uniformly among all the members of the industry.").

vagueness of the Order imposes additional compliance costs, as TRU tries to discern (and teach its employees) exactly what is and is not prohibited by the Order. For example:[102]

- Paragraph II.A. prohibits TRU from entering into agreements with its suppliers "to limit supply or to refuse to sell toys and related products to any toy discounter." We understand that this provision, as interpreted by Commission staff, prohibits any agreement with restrictive effects (*e.g.*, agreeing with a supplier that TRU will be one of a small number of retailers to carry a product exclusively), notwithstanding the Order's specific provision permitting TRU to enter into fully exclusive agreements.

- Paragraph II.B. prohibits TRU from urging "any supplier to limit supply or to refuse to sell toys and related products to any toy discounter." Commission staff have suggested to TRU that this provision could be interpreted to prohibit any conduct with actual or possible restrictive effects (*e.g.*, asking a supplier to let TRU be the exclusive retailer to sell a product nationally, while preserving relationships with existing independent local retailers, or complaining to a supplier when one of TRU's competitors violates one of the supplier's policies).

- Paragraph II.C. prohibits TRU from asking a supplier "to furnish information to respondent relating to any supplier's sales or actual or intended shipments to any toy discounter." Commission staff have suggested to TRU that this provision could prohibit even questions that are normal and procompetitive—indeed, essential—from TRU about a supplier's distribution plan for a product.

- Paragraph IV.B. requires TRU to retain "all records of communications with suppliers of respondent relating to any aspect of actual or potential purchase or distribution of toys and related products, and records pertaining to any action taken in connection with [Order compliance.]" This provision requires, as a practical matter, that the Company preserve every single email communication sent or received by hundreds of employees.

The competitive implications of each of these provisions for TRU (including the benefits of the conduct precluded by each substantive provision) are discussed in detail below. But it is plain that a wide variety of vertical restraints and communications—which would provide crucial procompetitive efficiencies to TRU and its suppliers as they cooperate in the development and sale of products—are prohibited by the language of the Order. For example, by prohibiting TRU from asking whether a supplier intends to supply a particular product to Walmart or Target, Paragraph II.C. forces TRU to blindly run the risk that it will invest heavily in a product that will be carried as a loss leader (*i.e.*, at or below cost) by one of these retailers, destroying any opportunity for TRU to make a profit on the item. And by prohibiting TRU from requesting or accepting "partial exclusives" that allow the supplier to retain its existing distribution relationships with local retailers, Paragraph II.B. forecloses a range of business opportunities that would bring innovative products to consumers across the country while protecting the parties' respective interests.

[102] *Compare In the matter of Harold Honickman, et al.*, 115 F.T.C. 964, 967, FTC Docket No. 9233 (1992) ("[C]onsiderations of fairness and the public interest warrant modifying the order to eliminate possibly unintended coverage.").

In addition, Paragraph IV.B. requires TRU to retain records to a degree that is burdensome and costly. TRU's Order document retention system, developed in partnership with Commission staff in an effort to define specific standards for compliance, calls for the indefinite retention of email, non-email electronic documents, and hard copy documents for all employees in specified document retention positions. This results in hundreds of employees being subject to this policy, with hundreds of man-hours spent learning the retention parameters, training employees, and retaining non-email electronic and hard copy documents at the time of an employee's departure. This burden is no longer reasonable.

2. Competitive benefits and weighing

In order to justify the harm to competition created by these restrictions, the Order must produce tangible competitive benefits. We do not contest that the Order may have done so when originally entered, but because TRU now lacks market power, the Order's fencing-in provisions—Paragraphs II.A., II.B., and II.C.—provide no competitive or public benefits in exchange for the significant costs that they impose. In other words, if TRU "were to engage in the activities currently prohibited by the order, it appears that there is little prospect that such activities could diminish competition. There is, therefore, no need to maintain the order."[103]

In such cases, the appropriate relief is to set aside or modify the order. The Commission set aside an order, for example, in *Goodyear Tire & Rubber Co.*, when the relevant "gas station franchises do not appear at this time to have the potential to create market power in the [relevant market,]" in light of the fact that their "once substantial share has been lost to mass marketers [and others.]"[104] Similarly, in *TEAC Corp. of America* the Commission set aside an order provision on the basis that the respondent did not hold market power and therefore the provision's prohibition on vertical conduct (in that case, non-price vertical restraints on transshipment) served no procompetitive purpose that would justify its restraint on competition.[105] This is exactly such a case.

More generally, *Goodyear* and *TEAC* are consistent with a broader line of Commission decisions in which the Commission has granted petitions to set aside or modify orders and order provisions when the petitioner has demonstrated that the order imposes a competitive disadvantage on a firm that impairs its ability to offer full, vigorous competition, while providing no substantial countervailing benefits. We do not here attempt a comprehensive survey, but representative examples include the following:

[103] *In the matter of Goodyear Tire & Rubber Co., et al.*, No. 6426, 113 F.T.C. 763, 1990 WL 596947, at *7 (Aug. 21, 1990).

[104] *Id.*

[105] *In the matter of TEAC Corp. of Am.*, No. C-2752, 104 F.T.C. 634, 1984 WL 565360, at *2 (Nov. 16, 1984) ("When market power either does not exist or cannot be sustained, anticipated efficiency gains are the only rational basis for a manufacturer to impose a vertical restraint. Only procompetitive practices will survive the market test when the creation or enhancement of market power is unlikely; the market does not reward inefficient distribution practices. Thus, when the exercise of market power in a properly defined relevant market is unlikely, we consider non-price vertical restraints to be efficiency enhancing in purpose and effect, and therefore lawful, without further inquiry.") (footnote omitted).

- In *Pendleton Woolen Mills, Inc.*, the Commission reopened and modified an order that put the respondent at a "at a substantial disadvantage" with respect to its competitors, who were not subject to the prohibitions on otherwise lawful conduct that was proscribed by the order.[106]

- In *Albertson's, Inc.*, an order was set aside in the public interest where "there [was] no continuing competitive need for the order in the . . . market that was the focus of the Commission's complaint."[107]

- In *Damon Corp.* the Commission modified an order provision in the public interest because it "appear[ed] to impede . . . an activity which seems to be an important competitive tool[,]" as a result of which the provision "hinder[ed] effective competition" by the respondent.[108]

- In *Onkyo U.S.A. Corp.*, the Commission modified an order when, as a result of the objectionable provisions, the respondent was unable to operate its business as effectively as its competitors and was "thus competitively disadvantaged in a manner that was not contemplated when the order was issued by the Commission."[109]

- Finally, in *Red Apple Companies*, the petitioner successfully sought an order modification on the grounds that "modification of the order is necessary for them to remain effective competitors" in light of new entry from stronger competitors, and that enforcement of the order as written would "weaken respondents competitively with no corresponding benefit to competition."[110]

Similarly, the Order in this case should also be modified. In *Onkyo U.S.A. Corp.*, the Commission modified an order to "put Onkyo on an equal basis with its competitors."[111] In this case, TRU seeks the same relief: the freedom to compete with its dominant competitors, within the law and free from unnecessary restraint.

The Order's purpose—which was to abate the original conduct and to deter any repetition[112]—has been fulfilled. The Company is aware of no suggestion that the conduct at issue in the original case has been repeated even once over the last fifteen years. Like the order provisions in *Magnavox Co.*, in which the "provisions in question [had] been in effect for nearly twelve years," the provisions of the *Toys "R" Us* Order "appear to have served their remedial

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[106] *In the matter of Pendleton Woolen Mills, Inc.*, 122 F.T.C. 267, 270, FTC Docket No. C-2985 (1996).

[107] *In the matter of Albertson's, Inc.*, 110 F.T.C. 1, 2, FTC Docket No. C-3064 (1987).

[108] *In the matter of Damon Corp.*, No. C-2916, 1983 WL 486320, at *2 (Mar. 29, 1983).

[109] *In the matter of Onkyo U.S.A. Corp.*, 122 F.T.C. 325, 326, FTC Docket No. C-3092 (1996).

[110] *In the Matter of Red Apple Companies, Inc., et al.*, 122 F.T.C. 146, 150, FTC Docket No. 9266 (1996).

[111] *Onkyo U.S.A. Corp.*, 122 F.T.C. at 326.

[112] *In the matter of Toys "R" Us, Inc.*, 126 F.T.C. at 614, FTC Docket No. 9278 (F.T.C. 1998).

purposes."[113] The relevant provisions in that case were set aside. So too should Paragraphs II.A., II.B., and II.C. here.

For these reasons, the Order should be modified in the public interest.

IV. Specific Modifications Requested by TRU

This section explains why, consistent with the standards described above, Paragraphs II.A., II.B., and II.C. of the Order should be set aside and Paragraph IV.B. should be modified.

A. Paragraphs II.A. and II.B. Should Be Set Aside.

Paragraphs II.A. and II.B. should be set aside for the following reasons.

1. Current text

Paragraphs II.A. and II.B. of the Order currently provide as follows.

> [Paragraph II:]
>
> IT IS ORDERED that respondent, directly or indirectly, through any corporation, subsidiary, division or other device, in connection with the actual or potential purchase or distribution of toys and related products, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, forthwith cease and desist from:
>
> [Paragraph II.A.] Continuing, maintaining, entering into, and attempting to enter into any agreement or understanding with any supplier to limit supply or to refuse to sell toys and related products to any toy discounter.
>
> [Paragraph II.B.] Urging, inducing, coercing, or pressuring, or attempting to urge, induce, coerce, or pressure, any supplier to limit supply or to refuse to sell toys and related products to any toy discounter.

These paragraphs are subject to the proviso that "nothing in [the Order] shall prevent respondent from seeking or entering into exclusive arrangements with suppliers with respect to particular toys." TRU refers to this provision as the "exclusives exception."

Commission staff have suggested to TRU that Paragraph II.A. could prohibit all vertical agreements that limit supply to competitors, while Paragraph II.B. could prohibit all attempts or

[113] *In the matter of the Magnavox Co.*, No. 8822, 102 F.T.C. 807, 1983 WL 486362, at *1 (July 11, 1983). *See also, e.g.*, *In the matter of Conoco Inc. and Phillips Petroleum Co.*, 2011 WL 5881166, at *5 (F.T.C. Nov. 16, 2011) (stating that "[e]ight years [after it was issued], it is clear that the Order has achieved its remedial objectives in this regard" and modifying order); *In the Matter of Hoechst AG*, 139 F.T.C. 544, 548 (2005).

invitations to enter into such agreements. Commission staff have also suggested that these provisions might even be interpreted to prohibit conduct and agreements that *could have the effect* of restricting supply to competitors. According to this view, for example, the provisions prohibit: (a) "partial exclusives" (*i.e.*, exclusive arrangements that are less than fully exclusive, such as an agreement that TRU will be one of two or three companies permitted to carry the supplier's product exclusively), notwithstanding the exclusives exception; and (b) complaints that bring to a supplier's attention the fact that another retailer is violating the supplier's policies.

2. Impact of changed circumstances

Paragraphs II.A. and II.B. should be set aside in light of TRU's loss of market power, because in the absence of market power, the vertical conduct prohibited by these paragraphs cannot harm competition.

As an initial matter, Paragraphs II.A. and II.B. prohibit purely vertical conduct—they are exclusively concerned with TRU's requests to, and agreements with, suppliers. Vertical conduct is rarely anticompetitive, even when the relevant entity has a significant degree of market power, but it is generally incapable of restricting competition when the relevant entity does not have market power. As the Commission explained in *TEAC Corp.*, granting a petition to reopen and modify an order:

> When market power either does not exist or cannot be sustained, anticipated efficiency gains are the only rational basis for a manufacturer to impose a vertical restraint. Only procompetitive practices will survive the market test when the creation or enhancement of market power is unlikely; the market does not reward inefficient distribution practices.[114]

The conduct prohibited by Paragraphs II.A. and II.B. is largely procompetitive, and the remainder is competitively neutral. Specifically, vertical restraints that limit or preclude supply to competing retailers are generally procompetitive when requested or applied by non-dominant retailers like TRU. This is true even when those restraints fall short of "full" exclusivity.[115] For example, suppose that a supplier approaches TRU with a new product which is being supplied to small, independent retailers and is proving successful. The supplier offers TRU the chance to be the "exclusive national retailer" of the product, but would like to continue to supply the local stores, which have been loyal trading partners and carry other items within the supplier's product lines. Such an arrangement would be in the interests of all parties, as well as consumers: the partial exclusivity would reassure TRU that its major national competitors would not "free ride" on its promotional efforts if it was successful, and this in turn would encourage TRU to work with the supplier to support and promote the product aggressively. The supplier would enjoy the

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[114] *See, e.g.*, *In the matter of TEAC Corp. of Am.*, No. C-2752, 104 F.T.C. 634, 1984 WL 565360, at *2 (Nov. 16, 1984); *see also id.* at * 3 ("[E]ven in a somewhat concentrated market, if the firms actually using the vertical restraint at issue do not collectively possess and are not likely to secure market power, then the restraint is unlikely to facilitate the creation or maintenance of market power.").

[115] This suggested interpretation leads to the odd result that a *fully* exclusive arrangement is permitted under the Order, while a *less* exclusive arrangement—which is presumably less harmful to competition—is forbidden.

benefit of TRU's support and the protection of its existing, local distribution network. This arrangement, in short, would improve product variety and increase competition. In such a case, the supplier should not be turned away because of the Order.

At the time of the conduct that led to the imposition of the Order, the Commission determined TRU's market power and conduct was sufficient to warrant the sacrificing of competitive benefits of vertical conduct in exchange for increased protection against exclusionary conduct. But that logic no longer applies in today's world, where TRU is losing market share [redacted]. As in *Penn Traffic*, the competitive change in the industry "is sufficient to remedy the competitive concerns that the order is designed to address."[116] No competitive gain accrues from tying the hands of a competitor that lacks significant market power.

Because TRU lacks market power, a supplier will grant TRU a partial exclusive *only* when it is efficient and profit-maximizing for that supplier to do so unilaterally (*e.g.*, when TRU will devote additional resources to developing and marketing that product). In each case, the supplier will balance the benefits of alternative channels of distribution against the benefits of harnessing TRU's own incentives through increased exclusivity, and choose a distribution strategy accordingly. More specifically, partial exclusive agreements allow suppliers to more precisely and efficiently conform the distribution of their products to the optimum output- and profit-maximizing strategy, because they provide an array of "intermediate" distribution solutions between the all-or-nothing choices of full exclusives, on the one hand, or universal distribution, on the other. And formalizing this distribution decision in a partially exclusive agreement with TRU, rather than simply supplying some retailers and not others, brings significant efficiency benefits because it gives TRU (and the other chosen retailers) the necessary confidence that their investments in the product's development and promotion will not fall victim to "free riding" from later additions to the distribution network. Nor, in the absence of market power, do partial exclusives increase the risk of anticompetitive foreclosure. Absent market power, a supplier cannot plausibly be "coerced" into accepting an inefficient exclusive arrangement: it would simply refuse.

For these reasons, Paragraphs II.A. and II.B. should be set aside, consistent with Commission precedent. *Culligan* is an instructive example.[117] In that case, the Commission had issued a final order that restricted a respondent's use of exclusivity obligations. The respondent subsequently petitioned the Commission to set aside the order on the basis of changed circumstances when, following competitive developments in the relevant market, the company had lost market power. The Commission accepted this argument, explaining:

> Culligan, which from 1957–62 . . . probably enjoyed as high as a 30% share of the water-softener market based on factory exit shipments, now has a share of less than 15.6 percent, and its share has been declining in recent years. In addition, new entry appears to be easy and not dependent on access to Culligan's distributors. The percentage of water-softener dealers controlled by Culligan has dropped from an estimated 22% in 1972 based on a total of 4,500 outlets to less than 10% today based

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[116] *In the matter of the Penn Traffic Co.*, 123 F.T.C. 57, 61, FTC Docket No. C-3577 (1997).

[117] *In the matter of Culligan, Inc.*, No. 6673, 113 F.T.C. 367, 1990 WL 10012596, at *3 (May 14, 1990).

> on a total of over 8,000 outlets. So-called "assemblers" now account for more than 58% of the market. Culligan, therefore, appears to lack market power.
>
> The Commission concludes that the order is no longer necessary to prevent Culligan from using exclusive dealing to foreclose competition.[118]

The same outcome is appropriate in this case, for the same reasons. Other Commission precedent is in accord.[119]

3. Public interest

Paragraphs II.A. and II.B. should be set aside in the public interest because these provisions limit TRU's ability to compete without securing any countervailing benefit to competition or the public interest.

The public interest is best served when competition is greatest.[120] But Paragraphs II.A. and II.B. prohibit procompetitive and competitively neutral conduct. As a result, these provisions actually harm competition and consumers—and help TRU's dominant rivals—by foreclosing TRU from such conduct. Two examples sufficiently demonstrate this foreclosure: (1) "partial exclusives"; and (2) complaints about policy violations.

Example No. 1: Partial exclusives

As described above, it has been suggested to TRU that Commission staff construes these provisions to prohibit "partial exclusives": agreements between TRU and suppliers that have some exclusive effects but which fall short of a full exclusive.

Partial exclusives are a common and procompetitive form of competition in toy retail, and preventing such conduct harms the public interest.[121] As an initial matter, these agreements,

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[118] *Id.* (citations and internal quotation marks omitted).

[119] *See, e.g.*, *In the matter of Nine West Group, Inc.*, No. C-3937, 2008 WL 2061410, at *8 (May 6, 2008) (noting that "two ways that Nine West can demonstrate that its use of RPM will not harm competition is to show that it lacks market power, and that the impetus for the resale price maintenance is from Nine West itself and not retailers (i.e., the result of a retailer cartel or pressure from a dominant, inefficient retailer). If market power does not exist, the forces of interbrand competition will discipline any supra-competitive pricing."); *In the matter of Levi Strauss & Co.*, 118 F.T.C. 1218, 1223, FTC Docket No. 9081 (1994) (granting petition to modify and noting that "[t]he record evidence suggests that LS&CO lacks market power in the manufacturing of jeans and other casual wear and that the proposed joint venture will not have market power in apparel retailing. Without market power at either level of distribution, LS&CO's retailing venture would be unlikely to give rise to anticompetitive effects.").

[120] *See, e.g.*, *In the matter of Nestlé Holdings, Inc., et al.*, No. C-4082, 2005 WL 1786402, at *3 (July 15, 2005) ("[H]olding [the petitioner] to the [strict terms of the order, as issued], with the resulting disruption to its operations and ability to compete, would likely diminish [its] competitive effectiveness. It is therefore in the public interest to make the change to enable [the petitioner] to continue to compete in the market without disruption of its operations.").

[121] *See* Barry Decl., ¶¶ 12–17.

which are lawful under the antitrust laws, are available to TRU's rivals of all sizes.[122] This includes competitors like Target and Walmart, that have larger shares in toy retail and market strength that [redacted] exceeds that of TRU. Commission precedent favors order modification when relevant provisions "were justified at the time the [o]rder was issued, [but] their continued existence puts respondent at a disadvantage with respect to its competitors by increasing its compliance costs unnecessarily."[123]

Moreover, partial exclusives provide concrete efficiency benefits to manufacturers, retailers, and consumers. Consider, for example, two hypothetical situations that demonstrate the ways in which partial exclusives can arise in practice, and the efficiency benefits that arise as a result.

- **Allowing small manufacturers to "go national" without cutting off independent retailers.** Small toy manufacturers with an innovative product commonly sell to local independent retailers before deciding to "go national" with a major retailer. But, as a precondition of supporting a new product and taking the obvious risks involved, such major national retailers sometimes request exclusivity from their suppliers. A partial exclusive—pursuant to which the manufacturer would continue to supply the independent retailers as well as the national retailer, but would not add new retail channels—would be an ideal solution from the perspective of consumers, competition, and the parties alike. Specifically, it would lead to more output and greater competition than the counterfactual scenario in which the national retailer would require the toy manufacturer to cut off its independent distributors as a prerequisite to carrying the product.

  If the manufacturer were required to cut off the smaller retailers, competition in a number of local retail markets would be lost. Moreover, the loss of revenue and relationship damage occasioned by such a cut-off could discourage the manufacturer from "going national" at all, depriving thousands of consumers of the benefit of the new product and the competition that it brings. (This risk will be particularly acute when the move to national distribution might not succeed: in such a case the manufacturer must reckon with the risk that it will again become dependent on the very same independent retailers that it was forced to terminate.) The partial exclusive solves this problem. It ensures that competition is augmented, not diminished, and that a small manufacturer is able to work with a larger retailer to bring its products to a wider market.

- **Allowing manufacturers to add distribution within an exclusive arrangement.** As noted above, a manufacturer that is a party to such an agreement will sometimes desire to supply a particular product to a second retailer, contrary to the original exclusive arrangement. In such a case, the manufacturer will—rather than risk being sued for breach—approach the retailer to request either a partial waiver of the exclusivity obligation or a modification of the original agreement to expressly permit the additional supply: converting what was a full exclusive agreement into a partially exclusive

[122] Partial exclusives are quite common in the toy industry and recently two of TRU's competitors—Target and Michaels Stores—appear to have obtained partial exclusive agreements from manufacturers [redacted] *See* Barry Decl., ¶¶ 12–17.

[123] *In the Matter of William H. Rorer, Inc.*, No. 8599, 104 F.T.C. 544, 1984 WL 565350, at *3 (Sept. 14, 1984).

> agreement. Plainly, in such a case, the waiver or modification of the agreement to create a partial exclusive is output-maximizing and would benefit consumers: the manufacturer benefits from increased sales; consumers benefit from greater output and lower prices; and the retailer benefits—through additional markdown support from the manufacturer or otherwise—or it would not rationally agree to waive or modify the exclusivity obligation. Moreover, adding a second retailer can allow the manufacturer to reach new consumers and markets: for example, this would occur when the second retailer is active in geographic areas in which the first retailer has only a limited presence (or no presence at all). Such partial exclusive agreements—essentially, limited waivers of the first retailer's full exclusivity rights—threaten no harm, but offer significant benefits, to competition and consumers alike.

Additionally, TRU is already permitted—notwithstanding any prohibition in Paragraph II of the Order—to obtain *fully* exclusive arrangements. If TRU wanted to obtain an exclusive arrangement for a particular product, by market power or otherwise, it could do so without offending the Order by relying on this "exclusives exception." Partial exclusives are, obviously, *less* exclusionary than such lawful "full" exclusives. As a result, prohibiting partial exclusives simply does not guard against any alleged risk of exclusionary agreements. If a partial exclusive agreement were anticompetitive—and therefore inefficient and exclusionary—the supplier would only agree to it if TRU had market power. But if TRU had the ability and incentive to exclude competitors in this way (which it does not), it could do so by obtaining a "full" exclusive, by exercising the very same market power. Thus, the public interest is not served by prohibiting such agreements. And, moreover, as explained above, any risk of anticompetitive exclusion is illusory.

Example No. 2: Complaints

In addition, in the view of Commission staff, Paragraphs II.A. and II.B. preclude complaints (or other similar conduct) to suppliers that *might* result in that supplier terminating another retailer, even if the complaint contains no request to terminate, and even if TRU does not intend or expect that any termination would take place. But such a prohibition is harmful, not helpful, to the public interest.[124]

It is obviously efficient for manufacturers to exercise control over the way in which their products are sold.[125] And, just as obviously, those efficiencies are jeopardized or lost when individual retailers violate the policies that manufacturers use to achieve this outcome. As the Supreme Court has pointed out, retailers and distributors provide a valuable and efficient source of information for manufacturers: complaints make manufacturers aware of relevant conduct in the downstream retail market relating to the supply of their own products, and allow them to respond efficiently.[126] And if competition among retailers is to be free and effective, supplier policies must be applied fairly. TRU should not be prohibited from reporting competitor

[124] *See* Barry Decl., ¶¶ 18–20.

[125] *See, e.g.*, *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 54–55 (1977) ("Economists have identified a number of ways in which manufacturers can use such restrictions to compete more effectively against other manufacturers.").

[126] *See Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 763–64 (1984).

violations when those same competitors remain entirely free to report TRU for any actual or perceived policy violations.[127] Consumers benefit when competition is fair, and this requires that TRU be allowed to stand on a level playing field with its larger retail rivals.

The Commission has specifically recognized in the context of order modification proceedings that protecting the integrity of manufacturer policies through a complaint-and-response system is in the public interest. In *Lenox, Inc.*, for example, the Commission granted a petition to modify an order in the public interest, specifically noting that—as the Supreme Court recognized in *Monsanto*—"dealers are an important source of information for manufacturers [and] dealer complaints about price cutters arise in the normal course of business and do not indicate illegal concerted action."[128] And in *Interco Inc.*, the petitioner (London Fog) sought modification of a Commission final order on the ground that the order prevented it from terminating retailers who did not adhere to its retail price policies.[129] In its petition, London Fog explained that "the discount pricing strategy of some retailers is damaging the quality image of its products and making its product less desirable to stores that compete by offering high levels of customer service with every day pricing rather than 'discount' prices."[130] The company further pointed out that "its competitors are able to do business with both categories of retailers by using marketing programs that are not permitted to London Fog under the order."[131] As a result, the Commission held:

> London Fog has demonstrated that discount advertising is harming London Fog's quality image and affecting its ability to market its product through certain retailers. It also has shown that the order is inhibiting London Fog's efforts to implement certain marketing strategies that could increase its sales. Therefore, London Fog has established that reopening would be in the public interest.[132]

Conclusion

In summary, Paragraphs II.A. and II.B. foreclose and deter a good deal of procompetitive conduct. Generally, such competitive harm should be weighed against the competitive benefits that order provisions provide. But in today's market the provisions bring *no* competitive benefits, because there is no credible risk that anticompetitive effects would arise if TRU engaged in the prohibited conduct.[133] In the absence of market power, the vertical restraints precluded by these provisions simply do not threaten competition.[134]

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[127] *See* Barry Decl., ¶ 18–20.

[128] *In the matter of Lenox, Inc.*, No. 8718, 111 F.T.C. 612, 1989 WL 1126748, at *4 (Apr. 19, 1989) (citations and internal quotation marks omitted).

[129] *In the matter of Interco, Inc.*, 119 F.T.C. 364, 364, FTC Docket No. C-2929 (1995).

[130] *Id.* at 367.

[131] *Id.*

[132] *Id.* at 367–68.

[133] *Compare In the Matter of Goodyear Tire & Rubber Co., et al.*, No. 6486, 113 F.T.C. 763, 1990 WL 596947, at *7 (Aug. 21, 1990) ("[If the petitioner] were to engage in the activities currently prohibited by

The public interest analysis is even clearer in light of the fact that TRU's competitors—including stronger firms like Walmart and Target—use vertical restraints freely. As a result, the provisions inefficiently distort competition among toy retailers by piling unnecessary costs on a single market participant. The Commission has often set aside orders when faced with similar situations. In *Albertson's, Inc.*, for example, the Commission reopened and set aside an order in the public interest on the ground that "the prior approval requirements of the order impose costs on respondent and put it at a disadvantage with respect to its competitors who are not under similar restraints."[135] And TRU's position is very much like that of Onkyo U.S.A., which the Commission analyzed in its 1996 decision granting its petition to reopen and modify an order:

> Onkyo has demonstrated that the order prevents Onkyo, but not its competitors, from freely choosing with whom it will deal. The order, according to Onkyo, also prevents Onkyo from unilaterally imposing price-related restrictions on cooperative advertising, a practice "freely engaged in by [Onkyo's] competitors." In addition, Onkyo, unlike its competitors, is unable to seek and obtain pricing information from its dealers with respect to its own and competing products, nor may it announce in advance suggested resale prices, and unilaterally choose to cease dealing with a dealer because of its pricing practices. As a result, Onkyo is a less effective competitor because it cannot structure its distribution system to meet the demands of the marketplace with respect to its products. Onkyo has thus shown that it is in the public interest to reopen and modify the order.[136]

Other Commission precedent is to the same effect.[137] Like the order imposed by the Commission in *California & Hawaiian Sugar Co.*, the Order in this case was "intended to

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the order, it appears that there is little prospect that such activities could diminish competition. There is, therefore, no need to maintain the order.").

[134] *See, e.g., In the matter of Adolph Coors Co.*, No. 8845, 112 F.T.C. 191, 1989 WL 1126791, at *4 (1989) ("Setting aside the non-price vertical restraints provisions of the order would enable Coors to employ distribution methods that likely would be reasonable under the rule of reason standard, because Coors lacks the necessary market power to raise its prices to supracompetitive levels. It would also allow Coors to take advantage of certain efficiencies in the distribution of its products, which, in turn, would promote interbrand competition.") (citation omitted).

[135] *In the matter of Albertson's, Inc.*, 110 F.T.C. 1, 2 (1987). *See also, e.g., Adolph Coors Co.*, 1989 WL 1126791, at *4 (setting aside order provisions and commenting that "[t]hese arrangements are available to Coors' competitors, and these order provisions therefore injure Coors' ability to compete effectively with other breweries."); *In the matter of the Ford Motor Co.*, No. 9073, 109 F.T.C. 116, 1987 WL 874625, at *2 (1987) (noting evidence of competitive disadvantage and stating: "The Commission therefore will make appropriate modifications to the order to remove the competitive disadvantage Ford dealers suffer under the existing accounting procedure.").

[136] *In the matter of Onkyo U.S.A. Corp.*, 122 F.T.C. 325, 328–29, FTC Docket No. C-3092 (1996).

[137] *See, e.g.*, In *the matter of Damon Corp.*, 1983 WL 486320, at *2 (Mar. 29, 1983) (modifying an order provision because it "appear[ed] to impede . . . an activity which seems to be an important competitive tool[.]"); *In the Matter of Promodes, S.A., et al.*, 117 F.T.C. 37, 41–42, FTC Docket No. 9228 (1994) (setting aside an order provision when the respondent's obligations under that provision "have weakened [its] ability to compete -- a result plainly at odds with the objective of the order."); *In the matter of Clinique Labs., Inc.*, 116 F.T.C. 126, 132–33, FTC Docket No. C-3027 (1993); *In the matter of T&N*

protect consumers . . . not to stifle the respondent's ability to participate in healthy competition[.]"[138] In that case, the Commission modified the order upon the respondent's demonstration that "the order as currently structured inhibits competition" rather than protecting it.[139] And in *William H. Rorer, Inc.*, the Commission set aside provisions of an order when, "[a]lthough these provisions were justified at the time the [o]rder was issued, their continued existence puts respondent at a disadvantage with respect to its competitors by increasing its compliance costs unnecessarily."[140] The same outcome is appropriate in this case.

In conclusion, Paragraphs II.A. and II.B. prohibit conduct that can only have procompetitive or competitively neutral effects—creating an unfair competitive disparity—without generating efficiencies or competitive benefits to justify this harm. As in *National Fire Hose*, a "serious disparity now exists between [the party subject to the order] and its competitors in the latitude which is afforded [to that party] to utilize reasonable vertical marketing restraints to enhance interbrand competition."[141] In that case, the Commission held that: "If National is to compete aggressively with others, it would be fair and equitable for the Commission to permit National the right to do so on equal footing. In light of the Commission's past recognition of fostering fairness principles among competitors, the Order under review should be set aside in the public interest."[142] For the same reasons, TRU requests the same relief.

B. Paragraph II.C. Should Be Set Aside.

Paragraph II.C. should be set aside for the following reasons.

1. Current text

Paragraph II.C. of the Order currently provides as follows.

PLC, 114. F.T.C. 696, 700, FTC Docket No. C-3312 (1991) ("T&N has demonstrated that the Asset Agreement imposes considerable costs on its operations and limits its ability to respond to changes in the market, thereby reducing its ability to compete effectively. The reasons favoring modification outweigh any reasons for retaining the order as written."); *In the matter of Union Carbide Corp.*, 114 F.T.C. 250, FTC Docket No. C-2902 (1991) ("The Commission has concluded that Carbide has met its threshold burden of establishing that it is suffering or may suffer some competitive injury as a result of the order and in a way not contemplated when the order was entered."); *In the matter of Diamond Shamrock Corp.*, 113 F.T.C. 316, 1990 WL 10012598, at *4 (1990); In the matter of *U.S. Pioneer Elec. Corp.*, 115 F.T.C. 446, 455, FTC Docket No. C-2755 (1992) ("In light of Pioneer's competitors' use of programs that Pioneer cannot offer and the resulting injury caused to Pioneer's ability to attract and keep dealers, Pioneer has made a threshold showing of an affirmative need for paragraph I.6. to be deleted.").

[138] *In the matter of California and Hawaiian Sugar Co.*, 119 F.T.C. 39, 46, FTC Docket No. C-2858 (1995).

[139] *Id.*

[140] *In the matter of William H. Rorer, Inc.*, No. 8599, 104 F.T.C. 544, FTC Docket No. 8599, 1984 WL 565350, at *3, (Sept. 14, 1984).

[141] *In the matter of National Fire Hose Corp.*, No. C-2935, 1978 WL 206076, at *10, FTC Docket No. C–2935 (Nov. 1, 1978).

[142] *Id.*

[Paragraph II:]

IT IS ORDERED that respondent, directly or indirectly, through any corporation, subsidiary, division or other device, in connection with the actual or potential purchase or distribution of toys and related products, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, forthwith cease and desist from:

[Paragraph II.C.] Requiring, soliciting, requesting or encouraging any supplier to furnish information to respondent relating to any supplier's sales or actual or intended shipments to any toy discounter.

This paragraph is subject to the proviso that "nothing in [the Order] shall prevent respondent from seeking or entering into exclusive arrangements with suppliers with respect to particular toys."

2. Impact of changed circumstances

Paragraph II.C. should be set aside in light of TRU's loss of market power, because in the absence of market power, the vertical exchange of information with suppliers can only help, not harm, competition.

Paragraph II.C. of the Order was intended to prevent TRU from policing suppliers' compliance with the type of unlawful agreement at issue in the original case.[143] The provision reflects an implicit determination that a recurrence of the original conduct (*i.e.*, the facilitation of an exclusionary agreement among suppliers, or the use of market power to exclude competitors) was likely, and that in addition to the direct prohibition of such conduct it was appropriate to prohibit ancillary conduct, such as communications with suppliers that could be used to monitor the supplier's compliance with an unlawful scheme. But with the loss, over the last fifteen years, of the market power held by TRU at the time of the original proceeding—and without any evidence that TRU has participated or attempted to participate in unlawful collusion—this assumption no longer holds. There is no longer a heightened risk of the conduct against which Paragraph II.C. was designed to serve as a safeguard.

In particular, because TRU lacks market power, a supplier will provide it with distribution information only when it is in the joint interests of both retailer and manufacturer to do so. Even if there were some conceivable anticompetitive effect that could result from TRU coercing a supplier to provide such information—and there is not—TRU is simply unable to exert such pressure. A supplier faced with such a demand from a non-dominant trading partner will simply refuse. Thus, the concerns presented in the original litigation (in which, as explained above, TRU's market power was an important feature of the competitive analysis) are no longer apposite. Suppliers have strong incentives to promote downstream competition among retailers,

[143] *See In the matter of Toys "R" Us, Inc.*, 126 F.T.C. 415, 614, FTC Docket No. 9278 (F.T.C. 1998) (describing Paragraphs II.A. through II.D. as "narrowly tailored to stop, and prevent the repetition of, TRU's illegal conduct").

and no incentives to conspire with a non-dominant retailer to exclude its rivals (indeed, such conduct would positively harm the supplier). Thus, TRU's requests for information will be granted only when it is efficient and procompetitive for TRU to receive that information. There is therefore no longer any need to restrain TRU from such conduct.

Commission precedent favors setting aside a fencing-in provision when the underlying conduct has ceased to be a real threat. In *William H. Rorer, Inc.*, for example, the Commission set aside fencing-in provisions of an order when "the pattern of conduct . . . which led to the entry of these 'fencing-in' provisions has now been interrupted for a sufficient period of time so that they are no longer necessary either to dissipate the effects of respondent's past conduct or to prevent its recurrence."[144] And a particularly instructive precedent is found in *General Motors Corp.*, in which the Commission relied on changed circumstances of fact—in particular, increased entry and competition in the relevant market—to set aside an order provision that was "designed to restrict communications that might facilitate noncompetitive cooperation."[145] The Commission noted that, in light of the increased competition, "restrictions in the order on business communications may increase [costs] and hinder the ability of the [relevant parties] to respond to competitive conditions."[146]

The changes in the toy retail industry over the last fifteen years—which have seen the loss of any market power that TRU once held and the emergence of Walmart and Target as more powerful competitive forces—are "sufficient to remedy the competitive concerns" that this provision is "designed to address."[147] As such, the restriction of Paragraph II.C is no longer necessary.

3. Public interest

Paragraph II.C. prohibits a broad range of communications between TRU and its suppliers, including communications that are necessary if TRU is to make efficient decisions about the products it will carry and the ways in which it will compete with its rivals. This prohibition imposes significant costs on TRU, lessens the Company's competitive effectiveness, and diminishes its ability to fight for consumers' business in the marketplace. But it offers no countervailing public or competitive benefit to justify these sacrifices.

Requests for information about distribution strategy are a normal and procompetitive part of retailers' interaction with suppliers, and it is in the public interest to allow TRU to make such requests.[148] In general, as the Supreme Court has said: "In order to assure an efficient distribution system, manufacturers and distributors constantly must coordinate their activities to assure that their product will reach the consumer persuasively and efficiently."[149] And indeed, information about distribution strategy helps TRU to understand the retail profile of its own

[144] *William H. Rorer, Inc.*, 1984 WL 565350, at *3.

[145] *In the matter of General Motors Corp.*, 116 F.T.C. 1276, 1286, FTC Docket No. C-3132 (1993).

[146] *Id.* at 1287.

[147] *In the matter of the Penn Traffic Co.*, 123 F.T.C. 57, 61, FTC Docket No. C-3577 (1997).

[148] *See* Barry Decl., ¶ 21.

[149] *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 763–64 (1984).

products and potential products, and to allocate its own scarce resources correctly to meet competition from other suppliers. This information is particularly important for companies, like TRU, that are in direct competition with Walmart and Target. [redacted] Obtaining distribution information allows TRU to focus on assortment and diversity of products offered to consumers. If TRU does not know what a manufacturer's distribution strategy is, TRU is flying blind and may make errors that result in higher prices across the board if the Company mistakenly invests heavily in the same product that Walmart or Target has decided will be a loss leader. For example, if a particular toy will be heavily carried by mass-merchandizing retailers (who may be likely to use the product as a loss leader, and set a price that TRU cannot rationally match), it would be inefficient for TRU to invest heavily in carrying and promoting that product. The relevant resources would be better spent developing and carrying new and innovative products on which TRU has a chance of competing more successfully. In this way, product diversity is improved, competition is maximized, and consumers enjoy the rewards.

Receiving such information would also help TRU move faster toward the market's competitive price for a particular product. Information about the product lines on which price competition will be strongest enables TRU to work harder to reduce prices and negotiate lower purchase costs for that product. The resulting price reduction in turn elicits a competitive response from the market, increasing the pace and vigor of the process of price rivalry among toy retailers. The result: lower prices and increased consumer welfare.

Moreover, suppliers commonly provide such information to TRU voluntarily and without prompting.[150] Paragraph II.C. puts TRU in an odd position to the extent that TRU can receive this information but not request it. TRU must constantly walk an unmanageable line between receiving distribution information (which is both lawful and good for consumers) and "encouraging" the provision of such information. Such uncertainty imposes unnecessary transaction costs on TRU's businesspeople, to the ultimate detriment of the consumer. Furthermore, when a supplier decides—for its own reasons (and, therefore, efficiently)—to provide such information to TRU, the Company must choose between two unappealing and anti-consumer alternatives: either (a) telling the supplier to stop providing such information, which is not required by the Order and is clearly inefficient; or (b) accepting the data without comment, which raises the risk that TRU could be accused of tacitly "encouraging" the provision of such information. This dilemma is bad for TRU, bad for suppliers, and bad for consumers, and it demonstrates the wisdom of retiring Paragraph II.C.

In cases such as these, Commission precedent compels modification. For example, the Commission's decision to grant a petition for order modification in *Onkyo U.S.A. Corp.* rested in part on the fact that, as a result of the objectionable provision in an order, "Onkyo, unlike its competitors, is unable to seek and obtain pricing information from its dealers with respect to its own and competing products, nor may it [engage in certain other practices]. As a result, Onkyo is a less effective competitor because it cannot structure its distribution system to meet the demands of the marketplace with respect to its products."[151] The same logic applies in this case.

[150] Barry Decl., ¶ 22.

[151] *In the matter of Onkyo U.S.A. Corp.*, 122 F.T.C. 325, 328–29, FTC Docket No. C-3092 (1996).

Paragraph II.C., in sum, "unnecessarily inhibits respondent from engaging in conduct which, in and of itself, is innocuous and may, in certain circumstances, be procompetitive."[152] It should be set aside.

C. Paragraph IV.B. Should Be Modified.

Paragraph IV.B. should be modified as described below for the following reasons.

1. Current text

Paragraph IV.B. of the Order currently provides as follows:

[Paragraph IV]

[IT] IS FURTHER ORDERED that respondent shall:

[Paragraph IV.B.] Maintain and make available to the staff of the Federal Trade Commission for inspection and copying, upon reasonable notice, all records of communications with suppliers of respondent relating to any aspect of actual or potential purchase or distribution of toys and related products, and records pertaining to any action taken in connection with any activity covered by paragraphs II and III of this order[.]

2. Analysis

Over the past three years, TRU has worked with Commission staff to make changes to the Company's document retention policy in an effort to improve compliance with the Order and ease the burden of document collection. Although the Company is now working under this revised agreement, it has found that even the newly modified policy is unduly burdensome. TRU has discovered that the significant burden of compliance rests on processes that cannot be automated and that impose burdens far in excess of their benefits.

Under the current document retention system, the Company must preserve—indefinitely—all emails sent or received by hundreds of employees, along with an enormous volume of non-email electronic documents and paper files for those same individuals. In addition, the requirement to preserve hard copy documents has required a burdensome investment of time in training hundreds of individuals throughout the Company, along with constant reminders to these employees of their preservation obligations. The additional duty of TRU's Human Resources team to collect and preserve certain hard copy documents any time an employee in a relevant position leaves the Company has, despite TRU's best efforts, become very difficult.

As a general matter, the recordkeeping obligations in Paragraph IV.B are unnecessary because the Commission is always free to ask the Company for documents at any time, as with any other company, and TRU will have all the documents that would generally be available under its

[152] *In the matter of Occidental Petroleum Corp.*, C-2492, 101 F.T.C. 373, 1974 WL 175259, at *1, FTC Docket C-2492 (Mar. 18, 1974).

corporate record retention program. But if some specific recordkeeping obligation is required under the Order, that obligation should at least be tailored in the public interest to ensure that its burden does not outweigh its utility. In particular, the scope of the document retention provision should be limited to the universe of individuals who would necessarily be involved in any conduct or discussions that implicated the core concern of the Order: the Company's officers (i.e., Vice-Presidents and above) within the merchandising organization. In other words, because a group boycott of the sort that occurred in the 1990's could not possibly recur without the involvement of one or more of these officers, limiting TRU's document retention obligations to these individuals would amply serve the Order's remaining purposes.

If the requested modification is granted, the Company would have no objection to the inclusion of a requirement that TRU must, on an annual basis, review the methods of communication used by Company employees and report to the Commission any new methods of communications used with suppliers. The Commission and the Company would then be able to discuss whether a further modification is appropriate in light of this change. Such a modification would be consistent with Commission precedent indicating that recordkeeping obligations should not impose unnecessary or disproportionate burdens on the respondent company.[153]

CONCLUSION

For the foregoing reasons, TRU respectfully requests that the 1998 Final Order be modified. Specifically, TRU requests that Paragraphs II.A., II.B., and II.C be set aside, and that Paragraph IV.B. be amended to limit the scope of the Company's recordkeeping obligations to the Company's officers (i.e., Vice-Presidents and above) within the Merchandising organization.

Respectfully submitted,

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Counsel for Toys "R" Us, Inc.

[153] *In the matter of the Reader's Digest Ass'n, Inc.*, No. C-2075, 102 F.T.C. 1268, 1971 WL 128725, at *3 (Sept. 30, 1983) ("Finally, Reader's Digest seeks to limit its record-keeping obligations in paragraphs I.A.(7)–(9) to three years; its current obligations are indefinite. The Commission agrees that three years is sufficient for its monitoring purposes, and Reader's Digest has agreed to further modify the order to allow the Commission ready access to all required contest records."); *In the matter of the Coca-Cola Co.*, 97 F.T.C. 927, 1981 WL 389481, at *1–2 (June 4, 1981); *In the matter of Glendinning Cos., Inc.*, 97 F.T.C. 163, 1981 WL 389452, at *1–2 (Feb. 24, 1981).

<u>APPENDICES</u>

Appendix 1: Declaration of Mary Coleman, Ph.D.

Appendix 2: Declaration of Gerald Cleary

Appendix 3: Declaration of Richard Barry

Appendix 4: Declaration of Paul Desiderioscioli

PUBLIC VERSION

BEFORE THE
FEDERAL TRADE COMMISSION

In the matter of: Toys "R" Us, Inc. FTC Docket No. 9278	**DECLARATION OF MARY T. COLEMAN, PH.D.**

DECLARATION OF MARY T. COLEMAN, PH.D.

I, Mary T. Coleman, Ph.D., declare and state as follows:

1. I am an Executive Vice President at Compass Lexecon. I have been employed in this role since April 2013. Previously, I was a Senior Vice President at Compass Lexecon from August 2009. I was a Managing Director at LECG LLC from May 2004 to August 2009. I served as the Deputy Director for Antitrust in the Bureau of Economics of the Federal Trade Commission from 2001 to 2004. I hold a Ph.D. in Economics from Stanford University. A copy of my CV is attached as Exhibit 1.
2. I have been asked by Toys "R" Us, Inc. ("TRU"), to prepare a report analyzing competitive changes in toy retail since the mid-1990s, and analyzing whether TRU currently holds a significant degree of market power. That report ("Report") is attached to this Declaration as Exhibit 2.
3. The Report accurately states my conclusions. As explained therein, based on the data reviewed in preparation of the Report, I have concluded that TRU no longer holds significant market power.

I declare under penalty of perjury that the foregoing is true and correct. Executed on October 16, 2013.

Mary T Coleman

Mary T. Coleman

Exhibit 1

CURRICULUM VITAE

Mary Coleman, Ph.D.

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200 State Street
9th Floor
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(617) 520-0200 main
(617) 520-0210 direct
E-mail: mcoleman@compasslexecon.com

PROFESSIONAL EXPERIENCE

Compass Lexecon
Executive Vice President, April 2013 – present
Senior Vice President, August 2009 – April 2013

Federal Trade Commission, Bureau of Economics, November 2001 – March 2004
Deputy Director for Antitrust, June 2002 – March 2004
Associate Director for Competitive Analysis, November 2001 – June 2002

LECG, LLC, Washington, DC, 1993 – 2001; 2004-2009
Director/Managing Director of Mergers and Acquisitions Practices, 2004 – 2009
Principal, 1999 – November 2001
Practice Director, Mergers and Acquisitions Group, 2000 – November 2001

FEDERAL TRADE COMMISSION, Bureau of Economics, *Economist,* October 1990 – 1993

EDUCATION

Ph.D., STANFORD UNIVERSITY, Economics, Stanford, CA, 1990
Dissertation: "Movements in the Earnings-Schooling Relationship: 1940 – 1988"
Advisor: Professor John Pencavel, Department of Economics
B.A., *summa cum laude*, STONEHILL COLLEGE, Economics, North Easton, MA, 1986

TESTIMONY

Deposition testimony: In re Online DVD Rental Antitrust Litigation, U.S. Dist. Court, M:09-cv-2029 PJH.

Submission of expert affidavit in settlement hearing in Shawn Sullivan et al v. DB Investments Inc., De Beers SA et al, Civil Action Index No. 04-02819, United States District Court, District of New Jersey (2008).

"Oil Pipelines' Effects on Refined Products Prices," Federal Trade Commission Conference, *Factors that Affect Prices of Refined Petroleum Products*, August 2, 2001.

MEMBERSHIPS IN PROFESSIONAL SOCIETIES

Associate Member, Antitrust Section, American Bar Association (Co-Chair, Economics Committee)

PUBLICATIONS AND PAPERS

1. Co-editor (with Bruce Hoffman) of ABA's Section of Antitrust Law, *Market Power Handbook*, 2012.

2. "Market Definition in Consumer Products Industries," with David Weiskopf, jointly authored chapter in ABA Section of Antitrust Law, *Market Definition Handbook*, 2012.

3. "Natural Experiments," with James Langenfeld, in 1 Issues in Competition Law and Policy 743 (ABA Section of Antitrust Law 2008)

4. "Key Issues in Proving Unilateral Effects after *Oracle*," *Antitrust*, Spring 2005, 19(2), p. 26-30.

5. "The Use of Economics by the European Commission and the U.S. Antitrust Agencies, with Henry Kahwaty, *International Antitrust Bulletin*, Spring/Summer 2004, p. 35-40.

6. "The Use of Natural Experiments in Antitrust Analysis," presented at ABA Fall Forum, November 2004, available upon request.

7. "Empirical Analyses of Potential Competitive Effects of a Horizontal Merger: the FTC's Cruise Ships Mergers Investigation," with David Meyer and David Scheffman, 2003, *Review of Industrial Organization*, 23, 121-155.

8. "Dialogue and Consultation Facilitates Convergence in Analyses of Mergers in the EU and US,"*ABA M&A Committee Newsletter*, 2003, http://www.ftc.gov/be/convergence.pdf

9. "Quantitative Analyses of Potential Competitive Effects from A Merger," with David Scheffman, 2003, George Mason Law Review, Winter 2003, 12, p. 319-370.

10. "Best Practices for Interacting with the Federal Trade Commission, Re: Data and Empirical Analyses in Antitrust Investigations," *ABA Economics Committee Newsletter*, 2003, http://www.ftc.gov/be/bestpractices.pdf

11. "FTC Perspectives on the Use of Econometric Analyses in Antitrust Cases," with David Scheffman, 2002, http://www.ftc.gov/be/ftcperspectivesoneconometrics.pdf

12. "Current Economic Issues at the FTC" with David Scheffman, *Review of Industrial Organization*, 21: 357-371, 2002.

13. "Oil Pipelines' Effects on Refined Products Prices," with George Schink and James Langenfeld, presented Federal Trade Commission conference, *Factors that Affect Prices of Refined Petroleum Products*, August 2, 2001.

14. "The Meaning of Monopoly: Antitrust Analysis in High Technology Industries," with David Teece, *Antitrust Bulletin*, Fall/Winter 1998, p. 801-857.

15. The Merger Guidelines in the United States, Australia and New Zealand: An Economic Perspective," with Christopher Pleastsikas and David Teece, *Trade Practices Journal*, 6(3), September 1998, pp. 153 - 171

16. "Antitrust Analysis and remedies in high-tech industries," with James Langenfeld, *Global Competition Review*, June/July 1998, pp. 42 - 43

17. "Movements in the Earnings-Schooling Relationship: 1940-1988," *Journal of Human Resources*, July 1993, pp. 660 - 680

18. "Trends in Market Work Behavior of Women Since 1940," with John Pencavel, *Industrial and Labor Relations Review*, July 1993, pp. 653 - 676

19. "Changes in Work Hours of Male Employees Since 1940," with John Pencavel, *Industrial and Labor Relations Review*, January 1993, pp. 262 – 283

20. "Small Children, Small Pay: Why Child Care Pays So Little," with Victor Fuchs, *American Prospect*, Winter 1990

Exhibit 2

Competitive Analysis of Toys "R" Us, Inc.

October 16, 2013

Mary T. Coleman, Ph.D.
Compass Lexecon

I. Introduction

1. This report has been prepared at the request of Toys "R" Us, Inc. ("TRU"). It summarizes competitive changes in toy retailing since the mid-1990s, with particular emphasis on the changes in the competitive position of Toys "R" Us since that time. It also summarizes my conclusions on the issue of whether Toys "R" Us holds a significant degree of market power today.

2. In preparing this report, I have reviewed industry data from the NPD group, reports from financial and other industry analysts, declarations by fact witnesses, public securities filings, and other publicly available information. The conclusions stated herein are based on my review and analysis of that material, and are consistent with the evidence provided by the fact witness declarations.

II. TRU Does Not Possess Significant Market Power as a Toy Retailer

A. Market Definition

3. The key concern in an analysis of whether TRU holds significant market power is the competition TRU faces in the sale and purchase of toys. For this analysis, I do not find it necessary to conduct an in-depth analysis of market definition, and instead use the decisions in the original proceedings for guidance on market definition.

4. The Seventh Circuit in *Toys "R" Us, Inc. v. FTC* did not engage in a detailed discussion of market definition, but spoke broadly of a "market for traditional toys" and "a market [for all toys] that includes video games."[1] The Commission did likewise, and concluded that the appropriate market definition was "all traditional toys."[2] However, the *Seventh Circuit* also commented that "[t]he little girl who wants Malibu Barbie is not likely to be satisfied with My First Barbie, and she certainly does not want Ken or Skipper. The boy who has his heart set on a figure of Anakin Skywalker will be disappointed if he receives Jar-Jar Binks, or a truck, or a

[1] 221 F.3d 928, 931 (7th Cir. 2000). *See also* Toys "R" Us, Inc. v. FTC, 221 F.3d 928 at 937 (7th Cir. 2000) (referring to a market for traditional toys).

[2] *In the matter of Toys "R" Us, Inc.*, 126 F.T.C. 415, 593, FTC Docket No. 9278, (F.T.C. 1998).

baseball bat instead."[3] The Commission also commented that "bicycles and other sports equipment" may not have been part of the relevant product market.[4]

5. These decisions suggest that it is hard to draw bright lines around product markets for toys. On the one hand, an "all toys" market definition arguably fails to capture the lack of substitutability between many products in that category; on the other, markets drawn with reference to individual products would be too narrow to usefully capture the competitive interactions among and between retailers as suppliers of toys to consumers and as purchasers of toys from manufacturers. Thus, it is helpful to consider a variety of possible relevant product markets.

6. For the purposes of this analysis, I have identified two alternative approaches to product market definition. The first approach posits a market for "all traditional toys." This includes games and puzzles, dolls, arts-and-crafts toys, and a range of other products commonly purchased for the entertainment of children. The second approach posits the existence of narrower product categories, which allows for a more granular analysis of competition among toy retailers. Following the approach of the NPD Group—a data-collection organization whose quantitative data was used by both parties in the original case[5]—I have outlined eleven such categories: (1) infant / preschool (including some baby products); (2) outdoor & sports; (3) arts & crafts; (4) dolls; (5) games and puzzles; (6) plush; (7) vehicles; (8) action figures; (9) building sets; (10) youth electronics; and (11) all other toys.

7. I have examined these product markets at the national level. This approach is consistent with TRU's strategy of generally setting prices on a national basis in response to the competition it faces from nationwide retailers, such as Walmart and Target, as well as from online retailers.[6]

B. Walmart and Target Have Grown Substantially at the Expense of TRU

8. Over the past 15 years, TRU has lost its leading position in toy retail. Retail giants Walmart and Target have grown [redacted], and today hold leading positions in toy retailing, with Walmart's share [redacted] than TRU's share. Meanwhile, Target's and TRU's shares are about the same. This shift started before the conclusion of the original *Toys "R" Us* case—TRU lost its number one ranking in U.S. toy sales to Walmart in 1999 [redacted].[7] The data presented below show these developments, and demonstrate that Walmart in particular is ahead of its competitors in terms of

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[3] *Toys "R" Us*, 221 F.3d at 931.

[4] 126 F.T.C. 415, 541 n.17.

[5] *See id.* at 530 n.5 ("The NPD Group, an industry consultant, keeps separate market share statistics for manufacturers of traditional toys, excluding video games, and for all toys, including video games. Both parties' expert economists relied on NPD data.")

[6] *See* Declaration of Paul Desiderioscioli ¶ 3.

[7] IBISWorld Industry Report, Hobby & Toy Stores in the US (45112), March 2012 at p. 24.

scale, share, and competitive significance to consumers and suppliers alike. These conclusions are consistent with the views and findings of a number of industry analysts.[8]

9. The rise of Walmart and Target has increased the competitive pressure on TRU. Among other things, these two competitors have an advantage over specialty toy retailers in their ability to "loss lead" on toys – especially in the crucial holiday season – in order to drive traffic and sales in other areas of their stores. Industry analysts have similarly recognized this effect, commenting that "mass discounters can cut the price on selected toys, making up the difference outside the toy aisle, while Toys "R" Us as a pure retailer has to make it up all on toy volume."[9] The result has been a significant increase in the intensity of price competition on toys. As noted by one industry analyst: "Retail prices for toys declined by a third between 2003 and 2010. Large mass merchandisers expand toy and seasonal merchandise departments during Christmas, and price popular toys at a loss to drive store traffic."[10] As a consequence of these developments, specialty retailers such as TRU find it increasingly difficult to compete, as several analysts have recognized.[11]

10. These developments are exhibited by an array of sales data. Table 1, below, compares Walmart's, Target's, and TRU's shares of traditional toy sales from 1993 to 2012.[12]

[8] *See, e.g.*, IBISWorld Industry Report, Hobby & Toy Stores in the US (45112), November 10, 2008 at p. 12 ("The market for toy and hobby retailers underwent a significant transformation following the decision by discount department stores and mass merchandisers to add/expand their range of hobby and toy merchandise. The entry of these external retailers effectively changed the competitive landscape for operators. . . . In terms of external competitors, Wal-Mart is the largest player in the traditional toy market with a share of the market surpassing that of all independent toy stores combined even though it is not classified as an industry player.").

[9] A.G. Edwards, *Toy Retail Pricing Survey: St. Louis: September 2004*, October 8, 2004 at p. 4.

[10] First Research Industry Profile, Toy & Hobby Stores, July 25, 2011 at p. 4.

[11] Morgan Stanley Equity Research, *Retail, Vendors: Toys*, September 10, 2004 at p. 2 ("We have significant doubts about TOY's ability to compete with discounters like Walmart and TGT in its current form."); Morgan Stanley Equity Research, *Retail, Vendors: Toys*, August 18, 2004 at p. 3 ("The majority of retail store base growth since the early '90s has come from discounters as the specialty channel has stagnated and/or gone away entirely . . . . This shift to big-box discounters from specialty retailers over the past decade has made price a more meaningful element of consumer purchase than overall experience."); A.G. Edwards, *Toy Retail Pricing Survey: St. Louis: September 2004*, October 8, 2004 at p. 2 ("We believe what is occurring is that retail market share is continuing a multi-year shift from Toys "R" Us to more cost effective retailers Wal-Mart, Target, etc. We believe the Toys "R" Us downsizing is merely a reallocation of retail market share within the domestic toy industry. . . . We would remind investors that in the early 1990's Toys "R" Us forced several toy competitors, Child World, Kiddie City, etc. out of business. In our opinion, the same thing is occurring here, only with other players and different roles.").

[12] NPD data on online toy sales does not separately break out sales for these firms prior to 2002. Online sales, if any, may not be reflected in the shares presented in the table for years 1993–2001 (inclusive).

Table 1 - TRU, Walmart and Target: Dollar Shares of Traditional Toy Sales

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
TRU	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Walmart	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Target	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
TRU	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Walmart	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Target	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

	1993-2001 Change in share	2002-2012 Change in share	1993-2012 Change in share	1993-2012 % Change in share
TRU	[redacted]	[redacted]	[redacted]	[redacted]
Walmart	[redacted]	[redacted]	[redacted]	[redacted]
Target	[redacted]	[redacted]	[redacted]	[redacted]

Sources: Toy Manufacturers of America (1993-1997 data); NPD Group. (1998-2012 data)[13]

11. As Table 1 shows, the decline in TRU's market share began in the mid-1990s. [redacted] These changes indicate increased competitive pressure for TRU.[14]

[13] Greg Johnson, *The Game Has Changed: It's Toys R Us, or Them*, Dec. 13, 1998, *available at* http://articles.latimes.com/print/1998/dec/13/business/fi-53526. Associated Press, *Wal-Mart Takes Lead in U.S. Toy Sales*, Mar. 30, 1999, *available at* http://articles.latimes.com/1999/mar/30/business/fi-22372. Press Release, NPD Reports Top Ten Traditional Toy Retailers (Apr. 3, 2001), https://www.npd.com/press/releases/press_010403 htm. NPD data are based on survey responses from nationally representative samples. Beginning in 2008, NPD's data are combined with data from a Nielsen/IRI joint venture household panel. These two data sources are projected and weighted to yield estimates representing 100% of total traditional toy retail sales. Shares include online sales.

[14] IBISWorld Industry Report, Hobby & Toy Stores in the US (45112), March 2012 at p. 7 ("In the past decade, discount department stores have emerged as top hobby and toy retailers. In particular, Walmart has developed into the top retailer of children's toys, accounting for more than a quarter of the entire toy market. The national scale of department stores has enabled their dominance; because they purchase in bulk, they are able to achieve significant cost savings. In addition, department stores can bypass wholesalers and purchase directly from well-known manufacturers like Mattel and Hasbro, eliminating the costs associated with middlemen. As a result, department stores have been able to operate with lower price markups and have passed these savings down to consumers in the form of heavily discounted prices. Over the five years to 2012, this factor has increasingly drawn consumers away from traditional hobby and toy specialty shops to large retailers excluded from the industry.").

C. Analysis of Competition in Narrower Toy Categories

12. The picture remains the same when a more granular analysis is applied that distinguishes among the eleven narrower toy categories described above. In additional to competition from Walmart and Target, TRU also faces competition from large specialty retailers in one or more of these narrower categories, and also online competition, including from Amazon.com, the fourth largest overall toy retailer. For example, TRU faces competition in the arts and crafts category from Michaels Stores, which has more than 1,000 stores in the US and Canada,[15] in the plush category from Build-a-Bear Workshop, which has over 400 stores worldwide,[16] and in the youth electronics category from Radio Shack, which has over 4,700 company operated stores in the US and Mexico,[17] and Best Buy, which has over 1,000 stores in the United States.[18]

13. As the data show, [redacted]

[15] *See* http://www michaels.com/Corporate/Presentations,default,pg.html.

[16] *See* http://www.buildabear.com/shopping/contents/content.jsp?catId=100003&id=100004.

[17] *See* http://www radioshackcorporation.com/.

[18] *See* Best Buy 10-KT report filed March 27, 2013, available at www.sec.gov.

Table 2 - TRU: Shares by Toy Category

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2002-2012 Change in Share
Infant Preschool	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Dolls	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Arts & Crafts	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Outdoor & Sports	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Games and Puzzles	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Building Sets	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Vehicles	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
All Other Toys	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Action Figures	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Plush	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Youth Electronics	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Source: NPD Group. [redacted]

14. Walmart, by contrast, has thrived, and continues to do so. As Table 3, below, shows, [redacted]

Table 3 - Walmart: Shares by Toy Category

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2002-2012 Change in Share
Infant Preschool	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Dolls	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Arts & Crafts	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Outdoor & Sports	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Games and Puzzles	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Building Sets	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Vehicles	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
All Other Toys	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Action Figures	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Plush	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Youth Electronics	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Source: NPD Group [redacted]

15. Over the same 2002-2012 time period, Target increased its share [redacted] Table 4, below, demonstrates the size and breadth of Target's competitive gains.

Table 4 - Target: Shares by Toy Category

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2002-2012 Change in Share
Infant Preschool	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Dolls	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Arts & Crafts	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Outdoor & Sports	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Games and Puzzles	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Building Sets	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Vehicles	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
All Other Toys	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Action Figures	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Plush	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Youth Electronics	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Source: NPD Group. [redacted]

16. Combined, these three tables show a significant change in competitive positions over time. [redacted]

Table 5 - [redacted]

	[redacted]	[redacted]	[redacted]	[redacted]
Infant Preschool	[redacted]	[redacted]		
Dolls	[redacted]	[redacted]		
Arts & Crafts	[redacted]	[redacted]		
Outdoor & Sports	[redacted]	[redacted]		
Games and Puzzles	[redacted]	[redacted]		
Building Sets	[redacted]	[redacted]		
Vehicles	[redacted]	[redacted]		
All Other Toys	[redacted]	[redacted]		
Action Figures	[redacted]	[redacted]		
Plush	[redacted]	[redacted]		
Youth Electronics	[redacted]	[redacted]		

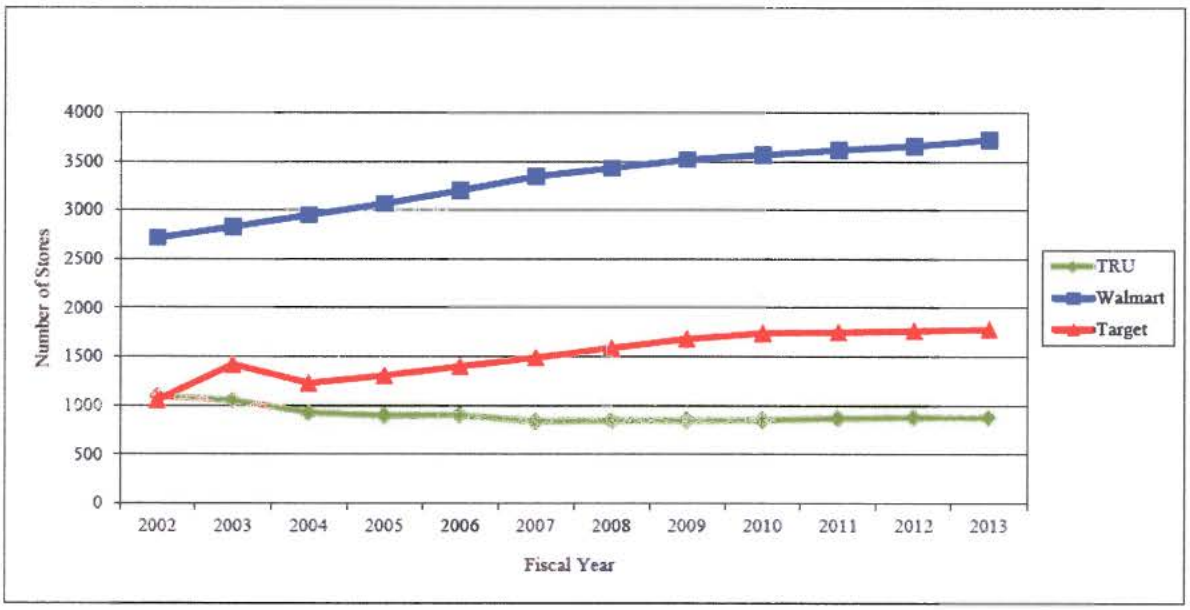
Source: NPD Group. [redacted]

17. The data demonstrate TRU's substantially diminished competitive position, and suggest that it does not hold significant market power as a toy retailer.

D. Store Openings and Closings

18. [redacted] TRU has reduced its number of permanent stores in the United States [redacted] since 2002.[19] The following chart, Table 6, shows TRU's store count as reported in its annual filings from 2002 to 2013. At the time of its most recent annual filing TRU operated 875 stores, [redacted] Target, which has 1,778 stores, [redacted] Walmart's footprint of 3,719 stores. [redacted] The number of permanent Walmart stores has increased [redacted] over the period 2002 to 2013, growing from 2,713 to 3,719 as of January 31, 2013. Meanwhile, the number of Target stores has increased [redacted] over the same time period, growing from 1,053 to 1,778 as of February 2, 2013.[20]

Table 6 - US Store Counts (2002 to 2013)



Source: Walmart, Target, and TRU annual filings.[21]

[19] *See also* A.G. Edwards, *Toy Retail Pricing Survey: St. Louis: September 2004*, October 8, 2004, p. 2. ("We believe what is occurring is that retail market share is continuing a multi-year shift from Toys "R" Us to more cost effective retailers Wal-Mart, Target, etc. We believe the Toys "R" Us downsizing is merely a reallocation of retail market share within the domestic toy industry.")

[20] Source: Walmart and Target 10-K reports filed between 2002 and 2013, *available at* http://www.sec.gov.

[21] Notes: (1) Year is the year the 10-K report was filed and store counts are typically given for January of that year or the end of the prior year; (2) Walmart's store count is for discount stores and supercenters only (neighborhood and small format stores and Sam's Club stores are excluded); (3) TRU's store count is domestic stores and includes

E. Online Competition

19. Additional competitive pressure has been generated by the growth of online retailing. Online sales were practically non-existent at the time of the original case. [redacted]

Babies R Us stores and Kids R Us stores (while the latter existed); (4) the TRU 2010 count does not include 29 pop-up stores that remained open at the end of January 2010; (5) the TRU 2011 count includes 19 Express stores with lease terms of at least two years, but excludes 60 temporary Express stores that remained open at the end of January 2011; (6) the TRU 2012 count includes 31 permanent Express stores, but excludes 16 temporary Express stores which remained open at the end of January 2012; (7) the 2013 count includes 36 Express stores that each have cumulative leases of at least two years, but excludes 48 temporary Express stores which remained open as of February 2, 2013.

Table 7 - Online Sales as a Proportion of Total Sales, by Toy Category

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2002-2012 Change in Share	2002-2012 % Change in Share
Infant Preschool	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Dolls	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Arts & Crafts	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Outdoor & Sports	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Games and Puzzles	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Building Sets	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Vehicles	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
All Other Toys	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Action Figures	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Plush	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Youth Electronics	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Overall	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Source: NPD Group. [redacted]

20. The growth of online sales has enabled Amazon.com to become a significant toy retailer and has increased price competition between online and "bricks-and-mortar" toy retailers at a national level.[22] [redacted]

21. Amazon.com appears to be in a position to grow in competitive significance – [redacted]. As an online retailer, Amazon.com avoids the costs associated maintaining a physical retail presence, and further benefits from the fact that it does not pay sales taxes in a significant majority of states to which it supplies goods.[24] Amazon.com's introduction of a "Price Check" app, which allows customers to use their mobile device to check the online availability of a product they see while they are in a brick-and-mortar store, has further added to its competitive strength.[25] [redacted]

[22] In 2000, TRU entered into a partnership with Amazon.com for the operation of its online store. The partnership was dissolved in 2006 following a legal dispute.

[23] NPD does not have sales data for Amazon.com between 2001 and 2005.

[24] *See* http://www.amazon.com/gp/help/customer/display.html?nodeId=468512.

[25] *See* http://www.amazon.com/gp/feature.html?ie=UTF8&docId=aw_ppricecheck_iphone_mobile.

Table 8 - [redacted]

	[redacted]	[redacted]	[redacted]	[redacted]
Infant Preschool	[redacted]	[redacted]	[redacted]	[redacted]
Dolls	[redacted]	[redacted]	[redacted]	[redacted]
Outdoor & Sports	[redacted]	[redacted]	[redacted]	[redacted]
Games and Puzzles	[redacted]	[redacted]	[redacted]	[redacted]
Building Sets	[redacted]	[redacted]	[redacted]	[redacted]
Arts & Crafts	[redacted]	[redacted]	[redacted]	[redacted]
All Other Toys	[redacted]	[redacted]	[redacted]	[redacted]
Vehicles	[redacted]	[redacted]	[redacted]	[redacted]
Plush	[redacted]	[redacted]	[redacted]	[redacted]
Youth Electronics	[redacted]	[redacted]	[redacted]	[redacted]
Action Figures	[redacted]	[redacted]	[redacted]	[redacted]

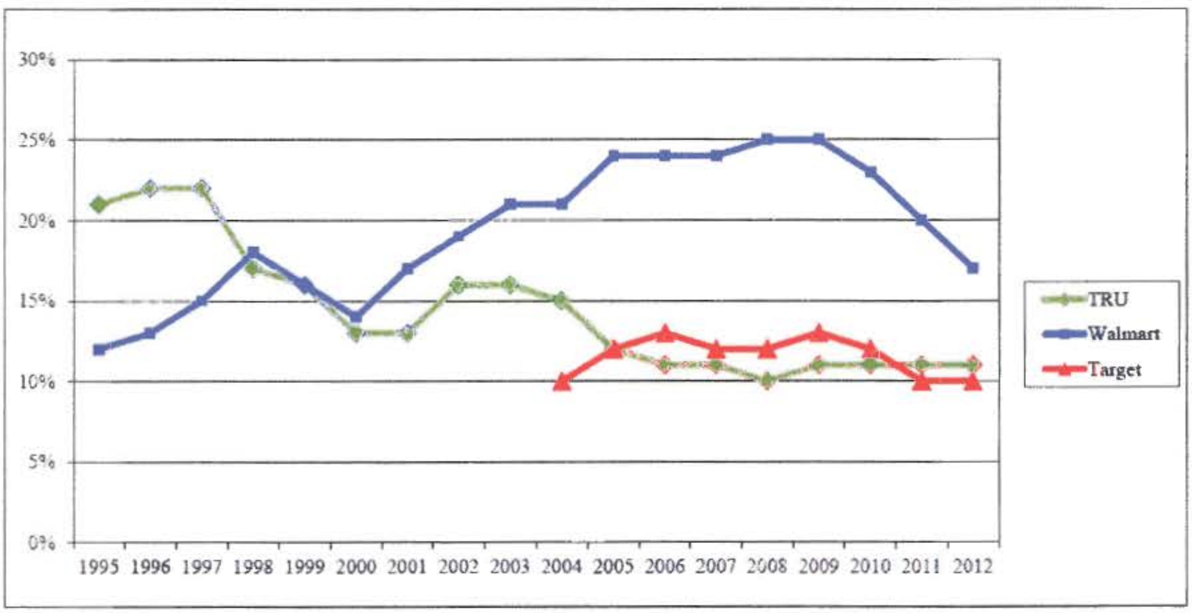
Source: NPD Group. [redacted]

III. TRU Does Not Possess Significant Market Power as a Purchaser of Toys

22. Information from 1998 to date indicates that TRU's competitive position as a purchaser of toys in the wholesale market has also diminished, [redacted]. The largest toy manufacturers in the United States are Hasbro and Mattel, and TRU's share of their total distribution has declined [redacted] in the years since the FTC's original investigation. Over the same period, Walmart's and Target's shares have increased [redacted]. Tables 9 and 10, below, and the accompanying charts, show TRU's, Walmart's, and Target's shares of Hasbro's and Mattel's overall sales from 1995 to 2012.

Table 9 - TRU, Walmart, and Target: Share of Hasbro's Sales (1995–2012)

	TRU	Walmart	Target
1995	21%	12%	n/a
1996	22%	13%	n/a
1997	22%	15%	n/a
1998	17%	18%	n/a
1999	16%	16%	n/a
2000	13%	14%	n/a
2001	13%	17%	n/a
2002	16%	19%	n/a
2003	16%	21%	n/a
2004	15%	21%	10%
2005	12%	24%	12%
2006	11%	24%	13%
2007	11%	24%	12%
2008	10%	25%	12%
2009	11%	25%	13%
2010	11%	23%	12%
2011	11%	20%	10%
2012	11%	17%	10%



Source: Hasbro Annual Reports.[26]

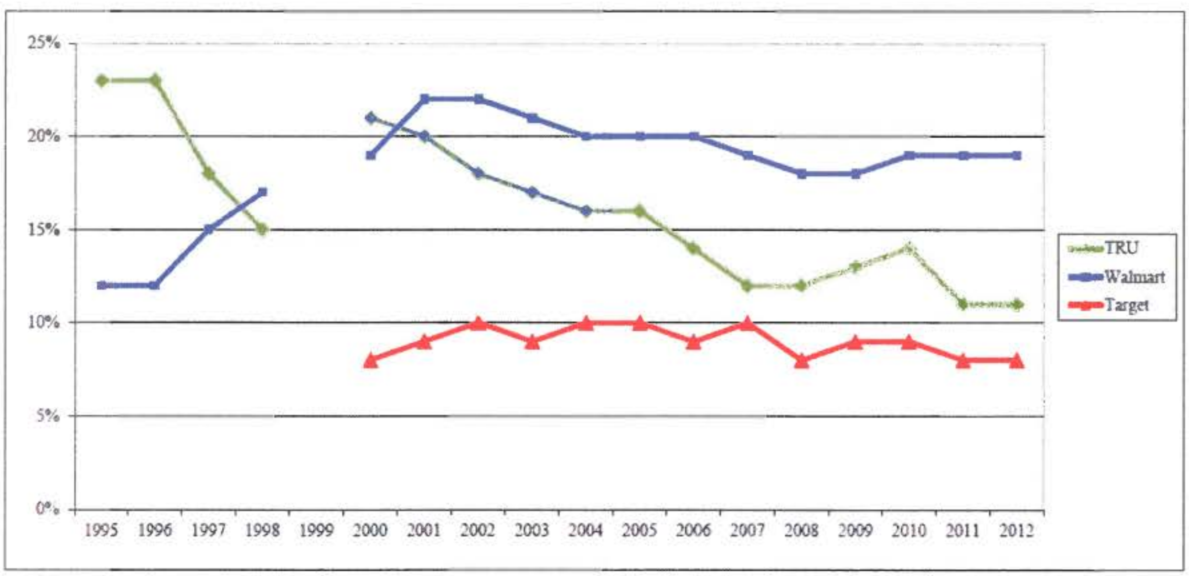
23. As these data show, TRU's significance as a distributor of Hasbro products has declined [redacted]

[26] Hasbro shares are based on consolidated net revenue; n/a = data not reported.

[redacted] Hasbro did not report Target's share of its sales until 2004. [redacted]

Table 10 - TRU, Walmart, and Target: Share of Mattel's Sales (1995–2012)

	TRU	Walmart	Target
1995	23%	12%	n/a
1996	23%	12%	n/a
1997	18%	15%	n/a
1998	15%	17%	n/a
1999	n/a	n/a	n/a
2000	21%	19%	8%
2001	20%	22%	9%
2002	18%	22%	10%
2003	17%	21%	9%
2004	16%	20%	10%
2005	16%	20%	10%
2006	14%	20%	9%
2007	12%	19%	10%
2008	12%	18%	8%
2009	13%	18%	9%
2010	14%	19%	9%
2011	11%	19%	8%
2012	11%	19%	8%



Source: Mattel Annual Reports.[27]

[27] Mattel shares are based on consolidated net sales; n/a = data not reported.

24. As these data show, Walmart has been a more significant distributor of Mattel products than TRU for the past twelve years. [redacted]

25. These changes are consistent with the competitive developments in toy retail described above. [redacted] While it may still be a valuable distribution partner for toy retailers, it no longer holds significant buyer-side market power.[28]

IV. Conclusion

26. The evidence regarding TRU's competitive position suggests that it does not possess significant market power as a toy retailer, either as a supplier to consumers in downstream retail markets or as a purchaser in upstream wholesale markets. As toy retailers, Walmart [redacted] exceeds TRU's share and has for several years in overall toy sales and in most categories. Target has also grown [redacted] and has had a greater share than TRU for the past few years in overall toy sales as well as in several categories. Both Walmart and Target continue to grow in competitive strength and significance and competition from them has substantially increased price competition in toy retailing. TRU's reduction in its number of permanent stores, while Walmart and Target continue to expand aggressively, further demonstrates the competitive challenges faced by the company. In addition, the growth of online retailers, particularly Amazon.com, has further added to the competitive pressure TRU faces, [redacted] As a toy purchaser, data indicate that while TRU remains an important distribution partner, it is no longer an indispensable distribution partner. Publicly available data for Mattel and Hasbro demonstrate the [redacted] drop in TRU's distribution share. Manufacturers both large and small have a range of choices, and [redacted]

[redacted] *See also* Declaration of Richard Barry ¶¶ 4-6, 8–11, 14-16, Declaration of Paul Desiderioscioli ¶ 6-8, and Declaration of Gerald Cleary ¶¶ 7–13, 17–19.

BEFORE THE
FEDERAL TRADE COMMISSION

In the matter of: Toys "R" Us, Inc. FTC Docket No. 9278	**DECLARATION OF GERALD CLEARY**

DECLARATION OF GERALD CLEARY

I, Gerald Cleary, declare and state as follows:

I. BACKGROUND

1. I am currently self-employed as a consultant to suppliers of children's products. I have been in this role since 2006, before which I was Executive Vice President of Sales and Merchandising at Mattel.

2. I have extensive experience in the children's products industry, and attach a copy of my resume as Exhibit 1. Between 2004 and 2006, I was Mattel's Executive Vice President, Sales and Merchandising, and I held the title of Executive Vice President of Mattel or one of its divisions continuously from 1997 to 2006. I served as Executive Vice President of Tyco Preschool before it was acquired by Mattel (1993–1997); and was CEO of Insync Marketing, Inc., a marketing consulting firm focusing on toys and children's products, between 1991 and 1993. I have also worked for Tonka Corporation (as Divisional President, 1988–1991, and Vice President, Sales, 1983–1988), Bandai America, Inc. (as Vice President, Sales, 1982–1983), and Marx Toys (as a manager, 1970–1979).

3. I have been asked by Toys "R" Us, Inc. ("TRU"; "Company"), to provide my opinion on the competitive significance of TRU, changes in the toy industry since the early and mid-1990s, and related matters.

4. In my current role as a consultant, I am currently working on only one project that involves TRU. That project involves the launch of an arts and crafts project in North America.

II. COMPETITIVE CHANGES SINCE THE EARLY / MID 1990s

5. In the early and mid 1990s, TRU was the leading retailer of toys in the United States. It carried a large share of the products that Mattel (and other major toy suppliers) sold. It was the largest or one of the largest accounts in the market.

6. I personally participated in negotiations with TRU many times during the 1990s. I remember that TRU enjoyed a very strong bargaining position in those negotiations. I also remember that I needed TRU in order to reach my sales targets. Without TRU's support, there would have been no way to do this. I believe that other suppliers would have been in a similar position.

7. Since the early and mid-1990s, competition in toy retail has changed dramatically. In my view, the most significant development in toy retail competition is the emergence of Walmart and Target [redacted]. They outrank their competitors (including TRU) in terms of consumer traffic, number of stores, purchasing volume, and bargaining power with suppliers. TRU's competitive strength has declined [redacted] since the 1990s, largely because of the [redacted] gains made by Walmart and Target. [redacted]

[redacted] Major suppliers—like Hasbro, Mattel, LEGO, etc.—are generally more important to retailers, because they usually supply the majority of the most desirable toys.

8. I personally participated in senior-level sales negotiations with TRU until I left Mattel in 2006. [redacted]

9. [redacted]

10. I also personally participated in senior-level sales negotiations with Walmart and Target until I left Mattel in 2006. I believe that Walmart and Target are [redacted] important toy retailers in the United States, and have been for several years. These companies enjoy a [redacted] strong bargaining position in their dealings with suppliers, because they can purchase and sell so many toys.

11. In my opinion, Walmart and Target enjoy a [redacted] competitive advantage because of their general-retailer format. I know that they are able to "loss lead" on toys (*i.e.*, sell toys at or below cost) to drive traffic, making up the necessary margin on other products. I know that they are also able to make a significant volume of toy sales to shoppers with children who visit the store to purchase other products.

12. I am aware that, in recent years, Amazon.com's toy retail business [redacted] have a significant position as a retailer of toys. Amazon.com has

some distinctive competitive advantages over its brick-and-mortar competitors, including price, convenience, not charging sales tax on sales to consumers in most states, and low-price or free shipping. E-commerce in toys is likely to become more significant in the coming years.

13. In my opinion, competition among toy retailers is currently very fierce.

III. EXCLUSIVE ARRANGEMENTS

14. Retailers of all kinds and sizes often ask for help in differentiating their products from those of their competitors. This is commonly done by requesting exclusive products or variations of products.

15. In my experience, if a retailer is protected by some kind of exclusivity on a particular product, the retailer will work harder to promote and support the product. [redacted]

IV. DISTRIBUTION OPTIONS FOR SUPPLIERS

16. In today's market, suppliers of toys and children's products have alternatives [redacted]

17. Large suppliers are able to deal directly with Walmart, Target, Amazon.com, and other major retailers, [redacted]

18. Smaller manufacturers, who may find it harder to deal directly with the major national retailers, are able to reach independent retailers through a network of sales representatives. A supplier's product may be particularly attractive to independent

retailers if the supplier is not simultaneously selling the product to a major national retailer.

19. Smaller manufacturers are also able to enter into licensing deals with larger suppliers, pursuant to which the larger firm will manufacture the product under the terms of a licensing agreement. This arrangement provides an opportunity to bring the product to major retail chains like Walmart, Target, or Amazon.com.

I declare under penalty of perjury that the foregoing is true and correct. Executed on December 30th 2013.

Gerald Cleary

Gerald Cleary

BEFORE THE
FEDERAL TRADE COMMISSION

In the matter of: Toys "R" Us, Inc. FTC Docket No. 9278	**DECLARATION OF RICHARD BARRY**

DECLARATION OF RICHARD BARRY

I, Richard Barry, declare and state as follows:

I. BACKGROUND

1. I am employed by Toys "R" Us-Delaware Inc., a wholly owned subsidiary of Toys "R" Us, Inc. (together "TRU" or "the Company"), as Executive Vice President and Chief Merchandising Officer. I am responsible for the Company's purchase of products for sale through our retail stores.

2. I have worked for the Company for approximately 28 years. I started at TRU in 1985 as a part-time employee working in a store in Cardiff, United Kingdom, and have worked in all of TRU's store-based positions. I ran a group of stores as an Area Manager and then a Regional Director of Operations, and then I ran TRU's UK operations as a Sales Director. In 2000, I became a Divisional Merchandising Director, responsible for electronics, then in April 2004 I moved to the United States to become Divisional Director of Merchandising, supporting international markets (including Europe, Japan, Australia, and the Company's franchise business). In 2005, I became a Vice President-Divisional Merchandising Manager. In 2009, I was promoted to General Merchandising Manager

for the electronics and learning divisions. Finally, in 2012 I was promoted to Chief Merchandising Officer, the position I hold today.

3. TRU is an international retailer of toys and other products for babies and children. TRU's products include toys, games, puzzles, arts-and-crafts kits, electronic goods, collectibles, books, music, DVDs, outdoor toys, party supplies, sporting goods, clothing, bicycles and powered riding toys, baby products, and many others. They are sold through TRU's network of stores in the United States and around the world, and through the Company's websites, including at www.toysrus.com, www.babiesrus.com, and www.fao.com.

II. COMPETITION AMONG TOY RETAILERS

4. Today, TRU competes with a vast number of other retailers of various kinds. The Company's most significant competitors are Walmart, Target, and Amazon.com. Other general retailers with which TRU competes include Kmart, Kohl's, JC Penney, and other mass merchandisers.

5. In addition, TRU faces strong competition from specialty retailers in particular product categories. For example, when selling sporting goods, TRU competes directly with Dick's Sporting Goods and Sports Authority; when selling electronics and video games, TRU competes directly with Best Buy and GameStop; and when selling children's books, TRU competes directly with Amazon.com, Barnes & Noble, and other bookstores. More generally, TRU competes with strong specialty retailers in most, if not all, of its product categories.

6. I recall that, in the 1990s, TRU was the leading retailer of toys in the United States. [redacted]

[redacted] In particular, the emergence of Walmart and Target, and the development of online competition (particularly Amazon.com) has caused TRU to lose its position as the leading U.S. toy retailer. Today, I believe TRU is placed third, behind Walmart and Target, in volume of purchases and sales of toys.

7. During my time at TRU, I have routinely dealt with a number of major suppliers, including Mattel, Hasbro, LEGO, and others.

8. [redacted]

9. On a number of occasions TRU has been unable to convince a supplier to allow us to carry their products. [redacted]

10. [redacted]

[redacted]

11. In addition, Amazon.com and other online retailers have further intensified price competition among toy retailers in recent years. Amazon.com, in particular, carries a wide range of products at aggressive prices, has a broad consumer base, and has made it easy for consumers to check online prices at home or on a smartphone. For example, beginning with the 2011 holiday season, Amazon.com began providing a smartphone app, "Price Check," which allows a consumer to go into a TRU store, scan a barcode on a product displayed or carried in-store, and purchase it from Amazon.com on the spot. Amazon.com's competitive advantages are intensified by the fact that it does not collect sales tax when it sells items to consumers in most states. [redacted]

III. PARTIAL EXCLUSIVES

12. Partial exclusive agreements are commonly used in toy retail, and suppliers often approach TRU with proposals to enter into these agreements. Sometimes a retailer, including TRU, will choose not to carry or promote a product unless its investment will be protected by some form of exclusivity.

13. I am aware that TRU's competitors sometimes enter into partial exclusive agreements with manufacturers preventing TRU from selling certain products. [redacted]

14. [redacted]

15. [redacted]

16. As a consequence of these partial exclusive agreements, TRU has been unable to obtain and sell products that it would like to carry in its stores.

17. Partial exclusive agreements are in TRU's interest, and in the interests of consumers, because they allow a supplier and TRU to work together to promote a product vigorously and to build a brand (by providing shelf-space allocation in stores, marketing and promotion support, etc.). Often TRU will support the entire assortment in a supplier's product line and not simply cherry-pick items like a mass merchandiser often does. And, in my experience, TRU generally devotes more resources to supporting and promoting a product when that product is protected by some form of exclusivity. This is because TRU can be more confident that, if its promotional efforts are successful, its competitors will not simply pick up the product and sell it at (or below) cost in order to drive traffic to their stores.

IV. COMPLAINTS REGARDING POLICY VIOLATIONS

18. TRU's suppliers often adopt policies relating to the sale of their products, including both price and non-price policies. TRU generally tries to comply with these policies, and TRU's competitors have complained when TRU has failed to do so.

19. Sometimes TRU's competitors violate supplier policies (for example, selling below the manufacturer's required minimum price). TRU is placed at a competitive disadvantage when it is prevented from notifying suppliers when its competitors violate the rules.

20. In my experience, complaints about policy violations do not lead to termination of the violating retailer. I believe that manufacturers generally contact the violator and demand that it comply with the policy. I am not aware of any situation in which a retailer has been terminated as a result of a complaint from TRU about compliance with a manufacturer's policies.

V. COMMUNICATION WITH SUPPLIERS

21. Communication with its suppliers is very important to TRU. The more information that TRU has about the product and the supplier's intentions for production and distribution, the better TRU can make decisions relating to that product. TRU has a team of veteran toy buyers who are skilled at determining the right quantity to buy based on their experience of how these toys have performed in the past at TRU, and in the total toy marketplace generally. Understanding the number of units of a product that will be sold by a vendor and looking at the history of how these toys have sold in the past is a very important consideration. [redacted]

[redacted] This process is utilized for many of the major purchases that we make, ensuring we maximize our business while minimizing our risk. This information is then used by TRU—in conjunction with NPD reports—to measure its performance and also to identify positive and negative sales trends for brands in the market.

22. On some occasions, TRU's suppliers have decided—unilaterally, and without being asked—to provide TRU with information regarding their supply of products to other retailers. Often the supplier will give TRU such information as part of their sales pitch, explaining, for example, that TRU is missing an opportunity to maximize its business and that our share will be much lower than would normally be expected. [redacted]

VI. CONCLUSION

23. In my opinion, based on over two decades of experience working in toy retail, it would help TRU to compete more effectively against Walmart, Target, and its other competitors if it were permitted to enter into partial exclusive agreements, complain about competitor violations, and communicate fully with its suppliers about the production and distribution of the suppliers' products.

I declare under penalty of perjury that the foregoing is true and correct. Executed on October __, 2013

____

Richard Barry

BEFORE THE
FEDERAL TRADE COMMISSION

In the matter of: Toys "R" Us, Inc. FTC Docket No. 9278	**DECLARATION OF PAUL DESIDERIOSCIOLI**

DECLARATION OF PAUL DESIDERIOSCIOLI

I, Paul Desiderioscioli, declare and state as follows:

1. I am employed by Toys "R" Us-Delaware Inc., a wholly-owned subsidiary of Toys "R" Us Inc. (together "TRU" or "Company"), as a Vice President and Divisional Merchandising Manager ("VP-DMM"). I oversee and manage the Company's purchases of consumables, including baby food, formula, wipes, diapers, and personal care products.

2. I have been employed by the Company for approximately 17 years. Throughout this time I have been involved with the purchase and sale of juvenile consumables at all levels: I began as a buyer's assistant, worked in planning & allocation, became an associate buyer, and then a buyer. I have been in my present role as a VP-DMM for approximately three years.

3. TRU's main suppliers of consumable products include Procter & Gamble, Kimberly-Clark, Nestlé, Abbott Nutrition, Mead Johnson, and Johnson & Johnson. The Company's principal competitors in this space include Walmart, Target, Amazon.com (which became a significant competitive force in this area around three or four years ago), and warehouse

club stores (since the 2000s). We also face competition from grocery stores, drugstores, and many other stores that sell juvenile consumables.

4. [redacted]

5. [redacted]

6. [redacted] Consumers like these packs because they provide an opportunity to buy a large amount of product at a low unit price.

7. [redacted] But throughout the years, these companies have always refused my requests.

8. This was not the only time I have been told by a supplier that a particular product is only for the club stores. [redacted]

I declare under penalty of perjury that the foregoing is true and correct. Executed on October __, 2013.

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Paul Desiderioscioli