

It strains credulity that RCA records sold in the *Life* package, RCA records sold in the *Reader's Digest* package, RCA records sold by the RCA Record Club and RCA records sold by dealers, department stores and racks, are all in different markets.

Another mail-order seller of some stature is Book-of-the-Month Club, which offered a package of folk records produced by Vanguard (RX 499); Pickwick (RX 538); and Concert Hall Society (RX 541).

In a footnote to CPF 425, the Government states that RX 345 shows that in 1962 the Columbia Club had 44% of all sales by direct mail. Later in the footnote, that sweeping statement is qualified by the statement that

RX 345 tends to be ambiguous on its face. The designation "Columbia Club" was intended to include some indeterminate non-Club mail order sales of Columbia and Epic records (Wright 8039).

Actually, that figure includes:

(1) Sales of Columbia, its subsidiary labels and of outside labels through the Columbia Record Club.

(2) Non-Club mail-order sales of Columbia and its own subsidiary labels by record dealers, mail-order specialty houses, etc.

(3) Packages sold by Columbia on a test basis.

(4) Packages pressed by Columbia for, and sold by, third parties.

The 44% figure represented sales for the first three quarters of 1962 and not the entire year, as indicated in the Government's proposed finding. Moreover, the figure represented a decline from the third and fourth quarters of 1961 (RX 450).

Otherwise, the record indicates that Columbia's share of all mail-order sales continued to slide during the rest of 1962. *Life*, for example, achieved its major sales volume on record packages at the end of 1962 (see RPF 273); BOMC increased its mail-order activity in and toward the end of 1962 (see RPF 274; RX 496, RX 502 *in camera*); and the RCA Clubs grew rapidly during the entire year (see RPF 437).

The Government notes "a high degree of concentration in direct mail sales" on the basis of RXs 345 and 450:

	<i>Percent</i>
Columbia .....	44
RCA Victor .....	20.8
Reader's Digest .....	18.2
Capitol .....	8.1
Total .....	91.1
All others .....	8.9

According to respondents, this conclusion of concentration is contrary to the facts. It refers to RX 451, which purports to show a decline in Columbia's share of the so-called club market. RX 451 shows Columbia's percentage share of total record club dollar purchases as declining from 66% in 1957 to 41.5% in 1961 (or possibly 50.5% as of May 1961).

Respondents also complain that the Government ignores the trend toward a dispersion of sales with the entry of new firms into this new field of mail order (see RPFs 273-78, 436-40).

Respondents also challenge the Government's statement that "there is no question that the Reader's Digest is the largest direct mail seller by far, apart from the record clubs" (citing Adler 4915).

Adler did testify that Reader's Digest was the largest direct-mail seller (Tr. 4915)—a fact acknowledged by Hitesman (Tr. 10143-45)—but without comparing its sales to those of record clubs.

*In camera* evidence shows that Reader's Digest sales are substantially higher than those of the Capitol Record Club (compare RX 700 *in camera* and CX 465 *in camera*; see also RPF 299).

The demonstrated fact that records sold by the Reader's Digest and the RCA Record Club sound similar is dismissed by Government counsel as "nothing more than a revelation that some classical and popular music is recorded from a standard written score. \* \* \* " It is difficult to reconcile this argument with the Government's repeated insistence that performances by individual artists are "unique." The fact of the matter is that records may be artistically distinctive and yet compete with each other in the market place. "A man by the name of Rene Leibowitz" will hardly be credited with contributing to the Government's effort to draw a hard-and-fast line between club records and package records (compare CPF 443 with Exceptions, pages 388-89).

The opinion testimony of Marek and RCA as to claimed differences between record club members and buyers of record packages is contradicted by the business operations of his own organization (see respondents' Exceptions to CPFs 425 and 439).

The price structure used in the mail-order sale of packages is not "entirely different" from club prices. The per unit price, or the total dollar commitment, is similar.

The best selling Reader's Digest packages (in mono) have prices ranging from \$12.98 to \$22.89 (RXs 386c, 703a,b). New mono members of the RCA Record Club have obligated themselves to spend from \$16 to \$22 during the first year of membership

for enrollment and commitment records. (Both the Reader's Digest packages and the RCA Club payments are exclusive of mailing and handling charges, the amounts of which are not shown in this record.)

On a per-LP basis, prices of the Reader's Digest packages and the RCA Record Club are also similar. The average prices per LP for the Reader's Digest packages (mono) range from \$1.33 to \$2.33.

Prices charged by the RCA Record Club during the first year of membership have averaged from \$1.77 to \$2.18 per record.

Interestingly enough, the *Reader's Digest* offers a preferential price to members of the "*Reader's Digest Family*." The Government, in a footnote, identifies the Family as comprising *Reader's Digest* subscribers. Actually, the Family includes also active and cancelled members of the RCA Record Club (RX 386; Hitesman 10079; Adler 5008). This broadening of the Family to embrace both package buyers and club members ill comports with the Government's theory of separate markets.

#### OPINION OF THE COMMISSION

JULY 25, 1967

BY DIXON, *Commissioner*:

The complaint in this case, issued on June 25, 1962, charged that the Columbia Broadcasting System, Inc., and its wholly owned subsidiary, Columbia Record Club, Inc., had engaged in certain unfair business practices in violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. 45,<sup>1</sup> including attempted monopolization, the "squeezing" of retail dealers with whom it competes, and the making of agreements with competing record manufacturers to fix noncompetitive record prices, fix and depress the prices paid to artists for their recording services (royalties), and cut off the supply of certain records to actual and potential competitors in the "club" sector of the phonograph record industry.<sup>2</sup> Hearings were held before a hearing examiner of the Commission, and approximately 11,000 pages of testimony and 1,400 exhibits in support of and in opposition to the allegations

<sup>1</sup> That section provides in part: "Unfair methods of competition in [interstate] commerce, and unfair or deceptive acts or practices in commerce, are hereby declared unlawful."

<sup>2</sup> The complaint also charged (Count II) that respondents had unfairly misrepresented, in certain of their advertising, the "savings" to be realized by the consumer in purchasing records from the Club. That charge was subsequently abandoned by counsel supporting the complaint.

of the complaint were received into the record. In an initial decision of 304 pages filed September 30, 1964, the examiner found that the allegations of the complaint had not been sustained by the evidence and ordered the dismissal of the proceeding.

We believe that decision was erroneous and hence must be reversed and set aside.

The charges in the complaint center around Columbia's formation and operation of its Columbia Record Club, an organization that distributes phonograph records direct to the consuming public through what is called the "club" or "subscription" form of mail order selling.<sup>3</sup>

Columbia entered the club market in August of 1955. One of its purposes in so doing was to prevent the entry of certain non-record firms, particularly the entry of mail order book-distributing organizations.<sup>4</sup>

Commencing in May 1958, Columbia decided that the Club could be more profitably operated if it sold not just its own (Columbia) records, but those of some of its competitors as well. However, instead of going to those manufacturers' wholesale distributors (the "open market") and buying the records at the same price paid by other record retailers (the Columbia Record Club is admittedly a "retailer," in that it sells directly to the ultimate consumer), the Club entered into a series of "licensing" agreements with nine (9) of its medium-sized and smaller competitors under which it gets their records for a total of some 87.5¢, versus a price of \$1.60 or more all competing retailers are required to pay for those same records. It also included in those "licensing" agreements provisions (a) fixing (depressing) the price (royalty) to be paid by those manufacturers to their artists on records sold through the Columbia Record Club,<sup>5</sup> and (b) giving the Columbia Record Club the sole and "exclusive" right or "license" to make records from those nine competitors' "master"<sup>6</sup> recordings (for a "royalty" of some 17.8¢ per record made from them), those competitors expressly promising not to engage in a club operation themselves, not to sell directly to anyone else who operates a club,

<sup>3</sup> Finding 3.

<sup>4</sup> Finding 5.

<sup>5</sup> Two of the earlier contracts also contained provisions fixing the price at which the Columbia Record Club was to sell the competitors' records through the Club and fixing the price at which the competitors themselves were to sell the same records to their own distributors (nonclub channel). There is insufficient evidence to establish that those agreements are currently in effect, however, or that similar agreements were ever entered into with the other seven licensor-competitors. The evidence on the fixing of artists' royalties, on the other hand, is clearly set out in several of the contracts, including the later ones. Findings 10 and 11.

<sup>6</sup> A master is an original recording or duplicate thereof, from which other phonograph records can be manufactured.

and not to allow anyone else to use their "masters" for the purpose of producing records to be sold through a club. In short, Columbia sought to assure itself that no one else would be able to sell the records of those nine producers through the mail in competition with the Columbia Record Club.

## I

The Columbia Broadcasting System, Inc. (hereinafter CBS or Columbia) is a New York corporation with seven (7) operating divisions, one of which is Columbia Records,<sup>7</sup> a manufacturer and seller of phonograph records. In 1961, CBS as a whole had sales of \$473.8 million and net assets of \$142.4 million. In 1961 and 1962, the Columbia Record Club had phonograph record sales of \$41.5 million and \$53 million, respectively; the company's nonclub sales of records (to wholesalers and retailers) was roughly the same in volume, making phonograph records somewhat less than 20% of CBS' total sales.

Columbia is the leading producer and seller of phonograph records in the United States. In 1960, total consumer expenditures for all kinds of records (including "LP's" and "singles" <sup>s</sup>), through all channels of distribution (including clubs, racks,<sup>9</sup> juke boxes, and dealer stores), was an estimated \$521 million.

One of the principal issues to be determined in this proceeding is the "relevant market" in which the competitive effects of these challenged agreements with Columbia's nine competitors are to be evaluated. Respondent argues in favor of a broad "all-record" market. Counsel supporting the complaint, on the other hand, argues that the appropriate "relevant market" involved here is not the sale of all records through all channels of distribution but the sale of "LP" records only, through only one of the mail order channels, a method of selling by mail called the subscription of "club" technique.

The outer boundary of the relevant market is the broad, all-record market. This market, however, consists of four channels by which records are distributed to consumers: retail stores, racks,

<sup>7</sup> The other six are: (1) CBS Television Network, (2) CBS Television Stations, (3) CBS Radio, (4) CBS Laboratories, (5) CBS International, and (6) CBS News.

<sup>8</sup> "LP's" are the "long-playing," larger discs that have six performances on each side and retail for \$2 and up; "singles" are the smaller discs with one performance on each side, retailing for less than \$1. The LP's account for about 75% of all record sales, "singles" for the remaining 25%.

<sup>9</sup> "Racks" are the familiar structures displaying the 50 or so current "hits" in supermarkets, drug stores, and other high traffic areas.

nonclub mail, and club mail.<sup>10</sup> We find the club market to be a relevant submarket.

The very fact of these agreements excluding competitors from an equal opportunity to sell these records "through any mail order record club"<sup>11</sup> evidences Columbia's *own* conviction that the clubs are a sufficiently distinct market to make this restrictive arrangement economically worthwhile. As one text writer has put it, "the courts will take as the market, for the purposes of deciding cases, just that market which the concern itself takes for its field of activity; if a firm shows an intent to exclude competition from that field, it will be assumed that the field sufficiently describes a market, for otherwise what would be the point of the effort to exclude?"<sup>12</sup>

Furthermore, as discussed in some detail in the accompanying Findings As To The Facts, a number of economic factors operate to produce entirely different conditions of supply and demand in the sale of phonograph records through the various submarkets. Each of the relevant submarkets possesses different cost components and structures.<sup>13</sup> On the demand side they offer consumers different sets of advantages and disadvantages. The clubs especially appeal to a group of customers that have certain distinctive characteristics.<sup>14</sup> These supply and demand conditions are sufficiently different between the retail and club markets, for example, that each is capable of generating particular competitive forces which, in turn, can discipline one another.

The present arrangement is found to be a restriction upon competition in the club market as a relevant submarket. In addition, this practice lessens the competitive contribution of the club submarket to the broader, all-record market. In certain structural situations a given practice which occurs and is measured in a relevant submarket can have an adverse effect not only in that submarket but also upon the broader market itself. This is especially true—as in the instant case—where the submarket under question enjoys a cost advantage.<sup>15</sup> The capacity of the other channels of distribution to discipline the club sector is limited by their cost disadvantages. In such an instance it is especially

<sup>10</sup> Finding 13.

<sup>11</sup> CX 20.

<sup>12</sup> Neale, *The Antitrust Laws of the USA*, p. 125 (1960).

<sup>13</sup> Finding 22.

<sup>14</sup> Findings 19 and 20.

<sup>15</sup> Findings 22 through 24. For a brief discussion of the significance of different cost structures upon competition among relevant submarkets (or "interindustry competition") see: (1) Kaysen and Turner, *Antitrust Policy*, p. 102, fn. 2 (1959) and (2) *United States v. Corn Products Refining Co.*, 234 Fed. 964, 975-977 (S.D.N.Y. 1916).

important to maintain the level of competition in the advantaged outlet.

## II

Columbia maintains that the "licensing" agreements challenged in this proceeding were entered into with its nine competitors for the purpose of meeting the demands of its Club members for a greater "variety" of records to choose from. The evidence is very clear, however, that the relatively small number of records offered by the Columbia Record Club is not a matter of record shortage but a deliberate policy on the part of the Club's officials, in accordance with what they conceive to be the particular tastes of their Club members. The Columbia Record Club could offer an unlimited variety of phonograph records to its members if it thought such a policy would be more profitable than the narrower selection it now offers.<sup>16</sup>

## III

The purposes and the effects of the "licensing" agreements at issue here are twofold, namely, (a) to give the Columbia Record Club a discriminatorily low price on the "hit" records of those nine competitors, and (b) to bar the entry of competing clubs into the market by denying them access to suitable records ("hits") on equally favorable terms, *i.e.*, at costs that would permit them to profitably compete with the Columbia Record Club.

It should be emphasized that, while these agreements are couched in terms of "exclusive" contracts, their immediate effect is not to deny other club operators access to those records altogether, but simply to make the newcomer pay a higher price for them. Thus, it was agreed between Mercury Records, one of the nine "licensors," and the Columbia Record Club, that "during the term of this agreement you [Mercury Records] will not, in the territory of the United States and Canada, (1) sell by direct mail, (2) offer for sale by direct mail, or (3) authorize or consent to the sale or offering for sale by direct mail by any third party of phonograph records manufactured from master recordings which you now own or control or which you may hereafter own or control."<sup>17</sup> The effect of this provision is not, however, to physically prevent other clubs from acquiring these records at all; rather, since anyone can buy any manufacturer's records on an "open market" at a going market price from the country's

<sup>16</sup> See Findings 21, 25 and 28.

<sup>17</sup> CX 34, p. 3, par. 7.

hundreds of independent wholesalers,<sup>18</sup> the effect is simply to force any other club desiring to sell those records to go to the wholesalers and pay that "open market" (distributor-to-dealer) price of \$1.60 to \$2.47.<sup>19</sup> Under these licensing agreements, however, the Columbia Record Club's total costs of acquiring a finished Mercury, Kapp, or other licensor record, ready for sale through the club, is 87.5¢.<sup>20</sup> This gives it, then, a cost advantage on these records of from 72.5¢ to \$1.59½, depending on whether the new club operator is able to acquire those same records from the wholesalers at the "best" price (\$1.60) or the "list" price (\$2.47). The magnitude of this barrier<sup>21</sup> thus thrown up in the path of potential club operators is suggested by the fact that the Columbia Record Club's own profit, according to its own figures, was no more than 24¢ per record on sales to first-year members and 75¢ per record on sales to second-year members.<sup>22</sup>

This cost "handicap" imposed on potential club entrants by these licensing agreements has obviously affected the structure of the club market and seriously lessened the vigor of competition in it. There can be little question but that entry into that market would be substantially more attractive if the potential entrant could secure the records of these nine manufacturers for the 87.5¢ paid by the Columbia Record Club, rather than for the \$1.60 to \$2.47 charged by the wholesalers. The records of these nine firms constitute a quite substantial share of the total supply of records available to club operators on at least potentially realistic terms. As discussed in the accompanying Findings, the "big three"—Columbia, RCA, and Capitol—can foreclose from potential entrants into the club field some 48% of all records simply by unilaterally refusing to sell their own respective labels (Columbia, RCA, and Capitol) directly to such potential entrants

<sup>18</sup> These nine competitors of Columbia promised only that *they* would not sell to any other club operator and wouldn't "authorize or consent" to the sale of their records through a club by any third party. There is of course no authority under the law for these manufacturers to control the further disposition of their records, once those records have been sold to their wholesalers, *i.e.*, the producers cannot lawfully prevent their wholesalers from reselling the records to other clubs, regardless of what the "exclusive" contracts with Columbia might say about it.

<sup>19</sup> Finding 23.

<sup>20</sup> Finding 22.

<sup>21</sup> Barriers to entry are "evaluated roughly by the advantages of established sellers in an industry over potential entrant sellers. . . ." Bain, *Barriers to New Competition* 3 (1956) (emphasis in original). One such barrier is the ability of established firms to secure needed input factors, *e.g.*, phonograph records for resale, "at lower prices than potential entrants can. . . ." *Id.*, at 14.

<sup>22</sup> The Columbia Record Club reported total costs of not less than \$2.13 per record. Subtracting this from its first- and second-year prices of \$2.37 and \$2.88 gives a profit of 24¢ and 75¢, respectively.

(or by refusing to sell to him except on prohibitive terms<sup>23</sup>). For all practical purposes, then, the new club that expects to seriously compete with the clubs of the "big three" would be limited to the records of the nonbig three manufacturers, those represented by the remaining 52%.

Since RCA and Capitol both testified in this proceeding that their clubs had been profitably operated with the use of only their own records—*i.e.*, RCA has operated a successful club using only RCA records (16% of all records sold in the country in 1960), and Capitol has operated a successful club offering only Capitol records (11.1% of all records)—this remaining 52% would undoubtedly be sufficient to permit the profitable operation of a number of additional record clubs besides those of the "big three." The "licensing" contracts involved here, however, not only expressly bar these nine most likely entrants from starting their own clubs,<sup>24</sup> but dries up their share of that remaining 52% of the total supply of records to all other potential entrants. They sold, in the 12 months prior to the signing of their respective licensing contracts with Columbia, an aggregate of some 11.2% of the LP's<sup>25</sup> sold through retail dealer stores.<sup>26</sup> This transfer of another 11.2 percentage points out of the nonintegrated sector and over to one of the "big three" integrated firms further reduces by that amount the supply of records available to potential new club operators on economical terms.

The foreclosure involved here, however, is considerably greater than that indicated by any of these figures. As noted above, not all of the approximately 25,000 separate records offered for sale by the country's approximately 50 record manufacturers are equally attractive to the particular segment of the record-buying public that joins clubs. Their preferences run primarily to the most popular of the "hit" records, particularly to the 150 or so records that are, at any given moment, on the popularity "charts" published by the trade magazines (*Billboard*, etc.). It is from these much smaller groups of records that the bulk of the records *suitable for club use* are apparently drawn in actual practice.

<sup>23</sup> Columbia did in fact refuse to sell to one ultimately unsuccessful club except at the full wholesaler-to-dealer "list" price of \$2.47, less periodic discounts, or at an average price of \$2.12. Tr. 9014-9015; finding 27. A club paying that price for its records, and incurring the same additional costs that the Columbia Record Club incurs, would have total costs of \$3.37½, and hence would lose just over \$1 on each record sold in competition with the Columbia Record Club at the latter's price of \$2.37.

<sup>24</sup> Findings 6-9.

<sup>25</sup> "Singles" cannot be sold economically through clubs.

<sup>26</sup> This is presumably a fair approximation also of their share of all LP sales through all nonclub channels of distribution, *i.e.*, racks and juke boxes as well as dealer stores.

And of course it was precisely on the basis of their actual or potential capacity for producing "hits" that the nine "licensors" were selected by Columbia in the first place.<sup>27</sup>

These licensing contracts foreclosed to potential club entrants (except on disadvantageous terms) some 41.2% of what would otherwise have been an "open" market in "hit" records suitable for club use.<sup>28</sup>

But even if the effects of these contracts are evaluated not in terms of the share of club-type records actually tied up by the Columbia Record Club and hence actually foreclosed to potential club operators, but simply in terms of the smaller dollar share represented by the Columbia Record Club's sales of those particular records it ultimately elected to use itself (approximately 30% of the records it tied up), the principal conclusion would still be the same.

The Club's 1961 sales of \$41.5 million were an estimated 53% of all "club" sales in that year, with approximately 36.7 percentage points representing its sale of its own (Columbia) records (\$28.7 million), and the other 16.3 percentage points (\$12.8 million) representing its sale of the nine competitors' records. In these circumstances we think the most clearly appropriate legal standards by which to judge the legality of the conduct involved are those expressed in the Supreme Court's recent merger<sup>29</sup> decisions, particularly those involving the so-called "horizontal" combinations.<sup>30</sup> The factual situation before us—one

<sup>27</sup> Finding 25.

<sup>28</sup> *Ibid.*

<sup>29</sup> While combinations effected by contract are admittedly less "permanent" than mergers of stock and all physical assets, we do not understand the law to be that competition may be lessened and monopoly created merely because it is scheduled to end at some specified future date; if there is injury to competition, there is injury to the public and should be ended without delay. Here, moreover, the time limit itself is more apparent than real; the contracts run for a stated period of years (*e.g.*, three years), but they are frequently renewed for additional periods of similar length.

It might be suggested that, since the actual effect of these agreements is not to "exclude" competitors from access to the records of these nine licensors in the physical sense of that term but only to make them pay a higher price than the Columbia Record Club pays, the applicable legal standard should be that expressed in the price discrimination law. Since the price differential (\$7.5¢ vs. \$1.60) has allowed into the club market no significant competitors other than the integrated "big three" and has thus given the Columbia Record Club a virtual monopoly on the sale of the records of these nine firms through clubs, we think the situation should be evaluated primarily in terms of merger standards. However, considering the magnitude of the discriminatory price involved (a discrimination of some 54.7% in the Columbia Record Club's favor) and of the market share it has been able to get and hold as a result of it (53% in 1962), the conclusion would doubtless be the same under the price discrimination law. *Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685 (April 24, 1967).

<sup>30</sup> *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962); *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963); *United States v. First Nat'l Bank & Trust Co.*, 376 U.S. 665 (1964); *United States v. El Paso Natural Gas Co.*, 376 U.S. 651 (1964); *United States v. Continental Can Co.*, 378 U.S. 441 (1964); *United States v. Aluminum Co. of America (Alcoa-Rome)*, 377

in which a firm with some 36.7% of the relevant market already, has acquired by contract with nine of its competitors another 16.3%, and in which it then shares over 90% of that market with only two other firms<sup>31</sup>—falls squarely within the rule of *Philadelphia Nat'l Bank* against a consolidation that “produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market. \* \* \* ”<sup>32</sup> That merger, had it been allowed, would have produced a firm with 36% of the relevant market, substantially less than the 53% held here by the Columbia Record Club.

#### IV

Columbia offers several “business justifications” as to why it should be allowed to retain its “exclusive” hold on the sale of the records of these nine competitors in the club market. One of them—the argument that the Columbia Record Club is a less efficient retailer of records than the country’s approximately 5,000 record dealers and thus should be allowed to buy at a lower price in order to offset the latter’s alleged cost advantages—would be relevant only if the question was solely one of discrimination against, and competitive injury to, the dealers. Here, however, the competitive injury we find has occurred in the club rather than the nonclub market. A club’s “justification” for inducing a discriminatory price not accorded to the operators of dealer stores obviously is no “justification” for contract provisions imposing a higher price *on clubs*.

Respondent argues further, however, that the Columbia Record Club is entitled to keep its “exclusive” hold on the Club sale of these records, and hence its advantage over other clubs, because of certain “guarantees” it gave the nine competitors in question. In negotiating these contracts, Columbia expanded its obligation beyond the unit “royalty” payment of so much for each licensor record sold (an average of 17.8¢ per record) by adding a promise on its part to pay the licensor-competitors a *minimum* total dollar figure, regardless of how few licensor records the Club might in fact sell. For example, in its contract with Kapp, respondent agreed to pay Kapp royalties on *at least* 150,000 records per year, for four years.<sup>33</sup> From this point, respondent reasons as follows:

U.S. 271 (1964); *United States v. Pabst Brewing Co.*, 384 U.S. 546 (1966); *United States v. Von's Grocery Co.*, 384 U.S. 270 (1966).

<sup>31</sup> See generally *Federal Trade Commission v. Procter & Gamble Co.*, 386 U.S. 568 (1967); Brodley, “Oligopoly Power Under the Sherman and Clayton Acts—From Economic Theory to Legal Policy,” 19 *Stanford L. Rev.* 285, 299 (January 1967).

<sup>32</sup> *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 363 (1963).

<sup>33</sup> See CX 41, 44, 45, 81, 180, 184, 191, 265, 512.

"[T]hese [licensor] companies almost universally demanded guarantees and we felt that we could meet the guarantees more successfully if we had exclusivity on the artists and the product [records] produced by these companies."<sup>34</sup>

There would seem to be no question but that the Columbia Record Club could, in fact, "meet the guarantees *more successfully*" on those records, *i.e.*, that it could take in more revenue if it had a monopoly on the mail order distribution of those records than if it had to compete with others selling those same records through the mail. This follows from the elementary economic principle that the sale of any product is more profitable, *i.e.*, that more money can be gotten for it, if it is sold in a monopolized rather than a competitive market. It does not follow, however, that one can first agree to pay a high price for something, a price that reflects the expectation of being able to resell it in a market free of competition, and then use the high price originally paid for it as "justification" for keeping the monopoly. This is a circular or "boot-strap" argument, to say the least. Assuming that Columbia has in fact "guaranteed" to pay Kapp and the others more than the club can earn from the sale of their records in a genuinely competitive market,<sup>35</sup> this establishes only that the parties knowingly bargained for the purchase and sale of a monopoly, not that the monopoly itself should be sustained. We know of no principle of law under which a private interest in realizing the fruits of a purchased monopoly must be given precedence over the public interest in preventing such monopolies.

Respondent's "advertising" argument is somewhat similar to those already discussed. A Club official explained it to the hearing examiner this way: "The basic reason [for demanding "exclusive" rights to sell these records through the mail] was that we would be advertising the artists and the labels extensively, spending millions of dollars in advertising for new members and in promoting these artists and their records and the labels in our club magazines, and we felt that during the period of the contract our

<sup>34</sup> Tr. 5240.

<sup>35</sup> There is little evidence that the "guarantees" given are actually all that "high." Thanks to the "negative option" system employed by the Club, approximately 35% of the Club's total membership (some 2 million) can be expected to accept the record "selected" for them (the "regular selection") each month (Finding 3). Thus, in 1962, no "regular selection" in the Club's "popular division" (40% of the total membership) sold less than 95,000 records. In effect, this means that the Columbia Record Club can generally meet a 100,000-150,000 "guarantee" by simply picking *one* of the licensor's records for the coveted role of "regular selection" of the month. In fact, there is reason to believe this is the real significance of the guarantee provisions in the contracts—they assure the licensor he'll get at least one of his records featured as a "regular selection" and hence in the hands of 100,000 "automatic" buyers.

[advertising] investment justified this exclusivity.”<sup>36</sup> As we understand it, respondent’s basic argument here is that its advertisements, some of which carry the names of these nine licensor-competitors’ labels, and the names and pictures of some of their more popular artists, have created some sort of residual or continuing “demand” for the records of those manufacturers and their artists and that this continuing “demand” is something respondent alone, as its creator, should be allowed to exploit. To allow a newcomer to sell Mercury, Liberty, Verve, Caedmon, Kapp, Warner Bros., United Artists, Vanguard, and Cameo-Parkway records through the mail would thus permit such a newcomer to take a part of what respondent’s advertising had created—in short, it would, as we understand the reasoning, permit him to reap where he had never sowed. Or, stated another way, respondent is apparently arguing for the establishment of a principle of law that the *first* seller to *advertise* a given product must thenceforth be allowed to enjoy a monopoly on the sale of that product in the area covered by his advertisement, lest some residual “demand” created but not harvested by that first advertiser be garnered by later entrants into that market. We are at a loss to understand how, under such a rule as this, competition could ever arise at all.

There is nothing in respondent’s advertisements to support such a conclusion.<sup>37</sup>

The purpose of these advertisements is as straightforward as their appeal to the customer’s “bargain” instinct:

Q. Mr. Rabar, what is the basic purpose of Columbia Record Club national advertising?

A. There is only one purpose; to get members.<sup>38</sup>

The sole criteria applied in determining whether a club advertisement will be placed in a particular periodical is whether it produces

<sup>36</sup> Tr. 5239 (emphasis added). Although Columbia’s licensing contracts give it an “exclusive” on *all* of the records in each licensor’s catalog (including new ones as they’re released), it doesn’t actually use all of them. Thus, of the 2,509 records offered for sale by these nine producers, the Columbia Record Club has elected to use or offer to Club members only 736 (29.3%) of them. Its “exclusive” contracts, however, barred all other clubs from using not only these 736 records but the other 1,773 records (70.7%) as well, records that it had no desire to use itself but didn’t want anyone else to use, either. The President of RCA testified that, in his view, this was one of the “deleterious” effects of exclusive licensing: “[N]o record club can use up all of the repertoire of a Verve, a United Artists, other labels, and that it may well be, if you have an exclusive contract with another label, that part of the repertoire remains unused; it lies fallow; it stays on the shelf. And if that is true, then the cultural effect, as you call it, would be deleterious.” Tr. 1871. He also thought it had bad “commercial” effect: “I think exclusive [licensing] contracts, in that sense, such as the one that Columbia has had with [these licensor] labels, [is] likely to have certain bad effects. These bad effects \* \* \* always do come about when one agency in distribution or in entertainment, become so all-powerful [a] smaller manufacturer listens all too carefully to what this agency dictates or tells [it].” Tr. 1871.

<sup>37</sup> See, e.g., Finding 3, n. 4.

<sup>38</sup> Tr. 6779.

a "profitable cost per order [member enrollment]" ratio.<sup>39</sup> Every word in the advertisement itself—including the prices quoted, and the artists mentioned by name—is similarly aimed at improving the advertisement's "pull," *i.e.*, the percentage of the advertisement's viewers that respond and join the Club.

In short, this is not "institutional" advertising engaged in to promote these nine competitors' names or their particular "brands";<sup>40</sup> rather, it is straightforward "price" advertising, aimed at selling not so much the idea that these records are "better" than some other sellers' records, but at selling the consumer on the idea that the Columbia Record Club is a better or more economical source from which to buy records the public already knows about. (The Club is normally not interested in offering a record of one of its licensors until that record has already become relatively well known, *e.g.*, until its sales hit the 50,000 mark.)

Respondent's argument here is also inconsistent with the relatively short "life" of the typical popular record. There was testimony that the "normal sales curve" of a hit record generally covers a span of some three months (in order to have at least one popular record selling well at any given time, the better known artists carefully arrange to release a new one at least once every three months). In this situation, it is not clear how much "harvest" is actually left in the fields for any newcomers to get from the "old" records advertised by the Club in times past. The real harvest is more likely to come from the sale of records not yet recorded and hence not yet advertised by the Columbia Record Club. The question, then, is not whether some new entrant should be allowed to reap where he never sowed, but whether he should be permitted to participate in *both* the future sowing and the future reaping. We are clear that he should. The Columbia Record Club has, by the admission of its own officials, earned a satisfactory profit on every dollar it has spent so far, including every dollar "invested" in advertising. Having gotten back all that it spent, plus a return it considers satisfactory, we see no rational justification for not allowing new firms to share in whatever profits there may be in the mail order sale of these licensors' *future* records and for denying the record-buying public the benefits of their competition for those profits.

<sup>39</sup> Tr. 5148.

<sup>40</sup> It should be noted that, by and large, the demand for phonograph records runs primarily toward the particular artist, rather than in terms of the "label" of the manufacturer he may happen to be temporarily recording for.

## V

Our order is a narrow one, designed simply to stop the fixing of artists' royalties by Columbia and its competitors, and to eliminate the "exclusive" feature of these contracts. In the latter regard, respondents will be prohibited from entering into or maintaining any contracts with competing record manufacturers that "prevent other club operators, including potential club operators, from acquiring the phonograph records of any other manufacturer or producer on the same terms and conditions as respondents acquire such records \* \* \*." Elimination of this cost barrier can reasonably be expected to make the club market substantially more attractive to potential entrants and thus to promote the public interest in the development of a more competitive structure and more vigorous competition in this market.

## VI

One further matter requires mention here. Respondents and several nonparty witnesses to this proceeding persuaded the examiner to put a mass of data *in camera*. We have examined that material carefully and have found only one exhibit that, in our opinion, ever had any serious claim to being "confidential," and the basis for that claim has been removed by time. This was a *Billboard* market study for 1962.<sup>41</sup> It would of course be improper to unnecessarily publish data that constitutes a firm's stock-in-trade and thus allow its potential customers to get it free rather than having to pay for it. But its saleability was described as depending upon its timeliness, and hence the 1962 data can now have no more "secrecy" value than the 1961 data that was considered already "stale" at the time of the hearings in 1963.<sup>42</sup> The other documents placed *in camera* by the examiner and considered so "confidential" by respondents and these nonparty witnesses consisted largely of sales data and club membership figures. There is nothing "confidential" about sales data in an antitrust proceeding; unless it can be used freely, meaningful measurement of the various markets involved are virtually impossible.

Nor is there any presumption of confidentiality for any other data the parties might prefer to call "secret" and withhold from public scrutiny. Indeed, the presumption is the other way. Competition depends for its continuing vitality upon free entry and free exit to and from industries, and entry depends in no small measure upon knowledge of opportunities, *i.e.*, knowledge of sales

<sup>41</sup> RX 811, *in camera*.

<sup>42</sup> CX 244a, *in camera*.

volumes, of probable costs, and of estimated profits. The public interest lies in encouraging entry, not in protecting the barriers erected around industries by established firms, whether these be knowledge barriers or other kinds. Only in the most extraordinary circumstances should data of this kind be withheld from the public record. *H. P. Hood & Sons, Inc.*, 58 F.T.C. 1184 (1961).

An appropriate order will be entered.

#### FINDINGS AS TO THE FACTS, CONCLUSIONS AND ORDER

The Federal Trade Commission issued its complaint in this matter on June 25, 1962, charging that the Columbia Broadcasting System, Inc., and its wholly owned subsidiary, Columbia Record Club, Inc., has engaged in certain unfair business practices in violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. 45. Hearings were held before a hearing examiner of the Commission, and testimony and other evidence in support of and in opposition to the allegations of the complaint were received into the record. In an initial decision filed September 30, 1964, the examiner found that said charges of law violation were not sustained by the evidence and ordered the dismissal of the proceeding.

The Commission, having considered the appeal filed by counsel supporting the complaint and the entire record, and having determined that the initial decision should be vacated and set aside, now makes these its findings as to the facts, conclusions drawn therefrom, and order, the same to be in lieu of those contained in said initial decision.

#### FINDINGS AS TO THE FACTS

1. The respondent, Columbia Broadcasting System, Inc. (hereinafter CBS or Columbia), is a corporation organized and existing under the laws of the State of New York, with its principal office and place of business at 485 Madison Avenue, New York, New York. It has seven operating divisions: (a) CBS Television Network, (b) CBS Television Stations, (c) CBS Radio, (d) CBS Laboratories, (e) CBS International, (f) Columbia Records, and (g) CBS News. Its aggregate sales increased from \$316.5 million in 1955 to \$473.8 million in 1961.<sup>1</sup> Its total net assets increased, in that same period, from \$74.0 million to \$142.4 million.

2. An unincorporated division, Columbia Records Division, pro-

<sup>1</sup> CX 264, pp. 34-35.

duces phonograph records in its four (4) manufacturing plants<sup>2</sup> and sells them to a wholly owned subsidiary, Columbia Records Division Corporation, which in turn sells to (a) a division that sells to wholly owned "branch distributors" and to non-CBS independent wholesaler distributors, both of which resell to sub-distributors and retail record stores and (b) a wholly owned subsidiary corporation, Columbia Record Club, which retails the records directly to the consuming public, bypassing the wholesaler-retailer distribution channels. In 1961, and 1962, the Club's sales of records to consumers totaled \$41.5 million and \$53 million, respectively<sup>3</sup>; Columbia's nonclub sales to the trade were approximately the same as its Club sales. In the aggregate, then, phonograph records accounted for somewhat less than 20% of CBS's total sales of \$473.8 million in 1961.

3. This proceeding is concerned primarily with Columbia's formation and operation of its Columbia Record Club, an organization that distributes phonograph records direct to the consuming public through the "club" or "subscription" form of mail order selling. Under the "club" method of selling, the consumer becomes a "member" of the selling organization and "commits" himself to buy a minimum number of phonograph records over a stated period of time.

The principal features that distinguish the "club" from the nonclub (retail dealer or rack) method of selling and buying are as follows. The Club's initial communication with the consumer is accomplished by extensive advertising, principally in such national magazines as *Life*, *Look*, etc. These advertisements describe an "introductory offer"<sup>4</sup> under which the consumer, as an inducement to "join" the Club and agree to buy a certain number of records at a fixed price over a stated period of time, is offered a number of records immediately at a nominal (below-cost) price.<sup>5</sup>

<sup>2</sup> These plants are located at (a) Bridgeport, Connecticut; (b) Pitman, New Jersey; (c) Terre Haute, Indiana; and (d) Los Angeles, California. The one located in Pitman, New Jersey, completed in May 1961, houses "the world's largest Lp [long-playing] manufacturing facilities," with "an annual capacity of 25 million Lp's." CX 264, p. 9. That is 14.4% of all LPs sold in the United States in 1961 (163 million). RX 441.

<sup>3</sup> CX 256, 783-e, and RX 422, *in camera*.

<sup>4</sup> For example: "[T]he Club offers the biggest hits from Columbia—Mercury—Kapp—Liberty—United Artists—Warner Brothers—Epic and many other record companies! More Top Stars \* \* \* More Savings \* \* \* the greatest values ever offered by any record club! \* \* \* fabulous savings \* \* \* world's largest record club. By joining now, you can have your choice of ANY SIX of the 78 outstanding records shown on these two pages—up to a \$36.88 retail value—ALL SIX for only \$1.89. What's more, you'll also receive a handy record brush and cleaning cloth—an additional value of \$1.19—absolutely FREE! \* \* \* only membership obligation is to purchase six selections from the more than 400 to be offered in the coming 12 months. \* \* \*" CX 731-B.

<sup>5</sup> Tr. 5144.

The basic "popular" LP carries a "list" price of \$3.98 in both Club and nonclub channels. Discounting and the like among the retail dealers has reduced their average price, in recent years, by an estimated 25% below list, or to \$2.98. The clubs, on the other hand, "discount" by "giving away" records designated as "free." Thus, at the time of these hearings in 1963, the Columbia Record Club's "introductory offer" to new members was six (6) records for an aggregate price of \$1.89, plus 55¢ postage, or approximately 41¢ per record, provided the new member also agrees to buy *another* six (6) records in the next 12 months at the "list" price of \$3.98 each, plus 35¢ postage on each, or a total of \$4.33 per record. The total bill for the 12 records figures to \$28.42, or \$2.37 each.

In the second year, the Club member buys on a 3-for-the-price-of-2 basis. For each two he "buys" at the list price of \$3.98, he gets a second one "free." Thus, he buys two for \$3.98 each (\$7.96), plus a 35¢ mailing and handling charge for each (70¢), or a total of \$8.66—for an average price of \$2.88 per record.

After receiving the first six records under the "introductory offer," the new member buys his second six in accordance with what is called the "negative option plan." Every 28 days the Columbia Record Club mails to its members a 24-page magazine describing the 100 to 200 records currently being offered by the Club, along with a card of the type used in data processing machines, called a "negative option card."<sup>6</sup> The card describes four (4) "options." First, the member can do nothing about the card (*e.g.*, throw it away), in which case he will automatically be sent, and billed for a phonograph record called that month's "current selection" of the Club "division" to which he belongs.<sup>7</sup> Second, the member can "check" a "box" on the card reading: "INSTEAD OF the current selection, send me the records I have checked on the reverse side." Third, he can check a box reading: "IN ADDITION TO the current selection, send me the records I have checked on the reverse side." Fourth, the member can check one saying: "CHECK here if you DO NOT wish to receive *any* records this month."<sup>8</sup> In practice, the Club's officials anticipate in advance that approximately 35% of the members of its largest ("popular") division will not return

<sup>6</sup> See RX 385, attachment to p. 19.

<sup>7</sup> The Club had four divisions until recently: Listening and Dancing; Classical; Broadway; and Jazz. A fifth division, Country and Western, was later added. Some 40% of the Club's total members are in the largest division, Listening and Dancing ("popular") division. The other three were of approximately equal size, about 20% each. The Club had approximately 2 million members in all divisions in November 1962. Tr. 5128.

<sup>8</sup> RX 385, attachment to p. 19 (boldface type in original; emphasis added). The member that wants no record at all in a particular month will of course still have to buy at least six (6) records over the commitment period of 12 months.

the card and hence will receive and accept the record selected for them by the Club.<sup>9</sup>

4. The Columbia Record Club itself was formed in August 1955. Thereafter, commencing in May 1958, Columbia decided the Club could be more profitably operated if it sold not just its own (Columbia) records, but those of some of its competitors as well. However, instead of going to those manufacturers' wholesale distributors (described here as the "open" market for phonograph records) and paying the same price paid by other record retailers (the Columbia Record Club is admittedly a "retailer," in that it sells directly to the ultimate consumer), the Club entered into a series of "licensing" agreements with nine (9) of its medium-size and smaller competitors under which it uses their "masters" to produce finished records at a total cost of some 87.5¢, versus the \$1.60 or more all competing retailers (whether clubs or stores) are required to pay wholesalers for those same records. It also included in those "licensing" agreements provisions (a) fixing (depressing) the price (royalty) to be paid by those manufacturer-competitors to their own artists on records sold through the Columbia Record Club<sup>10</sup> and (b) giving the Columbia Record Club the sole and "exclusive" right or "license" to fabricate records from those nine competitors' "master" records (for a royalty of some 17.8¢ on each record it fabricates from them), those competitors expressly promising (i) not to engage in a "club" operation themselves, (ii) not to sell their records directly to anyone else who resells them through a mail order "club" operation, and (iii) not to allow anyone else to use their "master" recordings for the purpose of producing finished records for resale through a mail order "club" operation.

5. Columbia established the Record Club for the purpose of preventing the entry of certain nonrecord firms, particularly *book* publishers and distributors. Columbia intended to thwart further competition not only in the sale of records but in the hiring of

<sup>9</sup> Tr. 713-714. In one period, for example, the lowest "pull rate" of any record (percentage of members accepting the record selected for them) in the monophonic section of the Listening and Dancing Division was 25% (95,667 records sold); the highest had a pull rate of 34% (156,948 records sold). Tr. 8411. One of the Club's officials testified that the "current selections" sent automatically to members accounted for 48.4% of the Club's total sales volume in 1962. Tr. 8418, 8531-8532.

<sup>10</sup> Two of the earliest of these contracts also contained provisions (a) fixing the price at which the Columbia Record Club was to resell the competitors' records and (b) fixing the price at which those competitors were themselves to sell their records in nonclub channels, *i.e.*, to their own distributors (who in turn sell to retail stores). The evidence is not sufficient, however, to support a finding that these two price fixing agreements have continued in effect or that they were a part of the later licensing contracts.

The evidence on the fixing of artists' royalties, on the other hand, is clearly set out in several of the contracts, including the later ones. See Findings 10 and 11.

artists. In approximately the middle of 1951, Mr. Goddard Lieber-son, then the executive vice president of Columbia Records, initiated a series of meetings with an official of the Book-of-the-Month Club, Mr. Harry Scherman,<sup>11</sup> to see if there "was an area of possible working together with someone in the *book club* business to go into something of the record club type of operation."<sup>12</sup> Columbia concluded that the book club's approach was "not realistic" and dropped the matter. Then, in 1954, the book club initiated further meetings. Again, Columbia found the proposal unattractive. At the last of that series of meetings, however, in December 1954, the book club's official announced "that he had come to the *final decision that the Book of the Month Club under his management was definitely going into the record club business, that he would repeat to us his interest in doing it in conjunction with Columbia Records, and when we told him that we did not have an interest in joining with him in this venture, he told us that, be that as it may, he should warn us then that he would need important artists, and if they were ours, and some of them would be, he said, he would make an effort to get them under contract, you know when their contracts with us had terminated.*"<sup>13</sup> This was later confirmed by several of Columbia's artists, who reported that they had in fact been approached by Book-of-the-Month Club with very attractive offers.<sup>14</sup>

Columbia's officials were concerned over this new competitive threat: "[I]t was perfectly obvious that the club form of selling was the way of the future and that Book-of-the-Month had already demonstrated through its Music Appreciation Record Club that it could make a successful club. \* \* \* Well, if the mail order people became powerful in the record club field, as they gave every indication of doing in 1955, it was entirely conceivable and in fact probable that *with the immense purchasing power that could be generated through mail order selling, the important recording artists would naturally gravitate to these companies.* \* \* \* [Hence those artists] would be not available for retail, or at least would be available under such terms and conditions as might not be beneficial to the retail business."<sup>15</sup> "[I]t was soon obvious they [the book firms] would be able to go to artists and offer them better deals than we could."<sup>16</sup>

<sup>11</sup> Tr. 6168, *et. seq.*

<sup>12</sup> Tr. 6170 (emphasis added).

<sup>13</sup> Tr. 6173 (emphasis added).

<sup>14</sup> Tr. 6174.

<sup>15</sup> Tr. 5035-5038 (emphasis added).

<sup>16</sup> Tr. 4839.

Columbia moved swiftly and effectively:

Q. Before this was over, Mr. Adler, which Columbia artists did Book-of-the-Month Club actually sign?

A. I don't recall now whether they signed one or none. I think *we effectively thwarted it*.

Q. Is it possible that they didn't sign any Columbia artists?

A. I said I didn't know whether they signed one or none. *We effectively thwarted their plan.*<sup>17</sup>

This threat of new competition was particularly alarming because it came from outside the "industry" (records), posing the danger of entry by a complete stranger: "Well, we felt that several things could happen with a third party being in the business, a third party, I mean, other than the record manufacturer and the dealer and the normal distribution that goes to the dealer. We felt that if the important artists were siphoned away into a club there was a reasonable possibility that they would never find their way to the retail business; therefore, the retailer would suffer. We would also suffer by not having these artists."<sup>18</sup>

6. Columbia's purpose in entering into the licensing contracts with its competitors included, in addition to the obvious one of increasing the Club's sales and market share, the desire to prevent those competitors from entering the club field on their own or from selling their records to anyone else who attempted to sell in that club field. The first contract between Columbia and its competitor-licensors, the one with Caedmon dated May 15, 1958, granted Columbia "the *exclusive* right, privilege and license" to "use the master recordings" of Caedmon in the manufacture and sale "through our mail order record club," Caedmon agreeing that it would "not sell *by mail order methods* of any kind or nature whatsoever, and [would] not authorize or consent to such sale *by any third party*, of phonograph records manufactured from any of the master recordings, or from copies or duplicates thereof."<sup>19</sup> This provision was amended 11 days later, May 26, 1958, to make it somewhat more specific as to the channel of distribution aimed at and the competitors Caedmon was not to sell to: "You [Caedmon] agree that, during the term of this agreement, you will not distribute or sell or authorize or consent to the distribution or sale by any third party of phonograph records manufactured from any of the master recordings, *through any mail order record club* which regularly distributes or offers for sale to its members significant quantities of phonograph records of a musical nature, *including,*

<sup>17</sup> Tr. 5043-5044 (emphasis added).

<sup>18</sup> Tr. 6177-6178.

<sup>19</sup> CX 19, pars. 3(a) and 4(c) (emphasis added).

without limitation, the 'Book-of-the-Month Club,' 'Music Treasures of the World,' any RCA Victor record club, and any Capitol record club."<sup>20</sup>

In other words, the restriction on Caedmon was reduced from the broader channel ("mail order methods of any kind or nature whatsoever") to the narrower one ("any mail order record club"), and four competitors of the Columbia Club were specifically named as examples of the competing "clubs" Caedmon was forbidden to sell to. (Caedmon remained free, however, to sell its records through normal retail channels.)<sup>21</sup>

7. The second of these contracts, the one with Verve dated March 31, 1959, similarly granted Columbia the exclusive "right, privilege and license" to manufacture and sell phonograph records made from certain specific Verve "Licensed Masters" through the club channel, *i.e.*, "by direct mail in accordance with the merchandising method known and understood, in the mail order business, as the 'subscription' or 'club' plan as distinguished from individual over-the-counter sales by retail store outlets receiving their phonograph records from phonograph record distributors \* \* \*."<sup>22</sup> "You [Verve] agree that during the Term of this agreement you will not, in the territory of the United States and Canada, (1) sell by direct mail, (2) offer for sale by direct mail, or (3) authorize or consent to the sale or offering for sale by direct mail by any third party of phonograph records manufactured from master recordings which you now own or control or which you may hereafter own or control."<sup>23</sup>

8. The third of these agreements, the one with Mercury dated April 1, 1960, granted the Columbia Club "the sole and exclusive right, privilege and license" to manufacture and sell records made from Mercury "master recordings" by "direct mail in accordance with the merchandising method known and understood, in the mail order business, as the 'subscription' or 'club' plan as distinguished from individual over-the-counter sales by retail store outlets receiving their phonograph records from phonograph record distributors. \* \* \*"<sup>24</sup> It further provides: "You [Mercury] agree that

<sup>20</sup> CX 20 (emphasis added).

<sup>21</sup> "It is understood and agreed, however, that nothing herein contained is intended to or shall in any way restrict the distribution and sale of such phonograph records through normal retail channels." CX 19, 4(c).

<sup>22</sup> CX 23, p. 3.

<sup>23</sup> *Id.*, pp. 7-8. Certain records are excepted from this provision, under certain described circumstances. Thus, it was agreed that "you [Verve] will not authorize any other mail order record club (hereinafter referred to as 'other club'), such as the Capitol or RCA Victor Club, to release phonograph record albums embodying the performances of Ella Fitzgerald or Oscar Peterson except" in certain described circumstances. *Id.*, p. 4.

<sup>24</sup> CX 34, p. 2, par. 2.

during the term of this agreement you will not, in the territory of the United States and Canada, (1) sell by direct mail, (2) offer for sale by direct mail, or (3) authorize or consent to the sale or offering for sale by direct mail by any third party of phonograph records manufactured from master recordings which you now own or control or which you may hereafter own or control."<sup>25</sup>

9. The remainder of the contracts contain similar provisions giving the Columbia Club the "sole and exclusive" right to use the licensor's masters to produce records for sale by the "club" method and expressly prohibiting the licensor from selling in competition with the Columbia Club or allowing anyone else to use its masters to do so.<sup>26</sup>

10. Certain of these contracts between Columbia and its competitors also contain express provisions fixing the prices (royalties) to be paid by these companies to artists who record for them. Thus the contract with Verve (March 31, 1959) provided that Verve would attempt to get its artists to agree to accept (a) a 50% reduction in their royalty rate on their records sold through the Columbia Club, and (b) a complete waiver of any royalty payment at all on those of their records that the Club should give away *free* to its subscribers as "introductory offer" or "bonus" records.<sup>27</sup> The contract recognized, however, that Verve might be "unable \* \* \* to obtain execution [by the artist] of a modification agreement substantially in the form attached hereto as Exhibit I," and provided that, in such event, Verve was to notify Columbia of this recalcitrant artist within 15 days. "We shall then have the right to negotiate directly with any such artist to obtain the execution of any such modification, but in the event we shall be

<sup>25</sup> *Id.*, p. 3, par. 7.

<sup>26</sup> Respondent attaches significance to the fact that the contracts do not run in perpetuity, but are limited in time—*c.g.*, Cameo-Parkway, 1 year; Caedmon, 2 years and 1 month; Kapp, Liberty, and United Artists, 3 years and 4 months; and Mercury, 3 years and 6 months. However, several of them contain express "options to renew" and they are in practice regularly renewed.

Columbia also emphasizes the fact that the more recent of the contracts contain "release" clauses giving the licensor-competitors an option to either take individual records ("partial" release) or entire catalogs ("complete" release) out of the Columbia Record Club and put them in another club if they get a better offer from such other record club. (The Caedmon, United Artists and Liberty contracts contained both types of release clauses, and the Kapp contract had a "partial" release clause only.) There has been no significant use of these clauses, however, and the licensors make it clear that they like their arrangements with the Columbia Record Club and have no intention of allowing their records to be offered through any other club. See, *c.g.*, tr. 1594-1595.

<sup>27</sup> CX 27-a, 28-a. While Verve was to use its "best efforts" to obtain this kind of concession from its artists, Columbia said that "we agree to accept," in lieu of the one described, a modification "similar to Exhibit II. \* \* \*" CX 29-b. That "Exhibit II," prepared for the signature of the artist, provides in part: "I agree to waive [all] my royalties \* \* \* on all records sold via mail order under the 'subscription' or 'club' plan \* \* \*. I have received \$500 as payment in full for this waiver." CX 30.

unsuccessful, we agree that such master recording shall not be deemed to be included in Schedule A or C of this agreement [records to be used by the Club]. With reference to such direct negotiation, if we obtain a modification whereby the artist is to be paid a royalty in excess of fifty per cent (50%) of the royalty payable to you hereunder, with reference to such Licensed Master, the royalty payable to you pursuant to paragraph 12 [five (5) per cent of the royalty price with respect to ninety per cent (90%) of our net sales] shall be increased to a figure no less than two and one-half percent (2½%) greater than that payable to the artist."<sup>28</sup> Thus, taking \$3.46 as the "royalty price" on a \$3.98 list price record, Verve was to get 17.3¢ (5% of the royalty price) on 9 out of every 10 of its records sold by the Club. But if the artist insists upon more than half of that 17.3¢, it would be raised to the point where Verve could pay the artist his full price and still realize 8.6¢ (2½% of the "royalty price," \$3.46).

11. Another of Columbia's contracts with its competitors, the one with Mercury (April 1, 1960), was still more explicit on the subject of suppressing competition in bidding for artists' services: "You [Mercury] recognize that it is our [Columbia] policy to pay no more than half of customary artist royalty with respect to recordings sold by us by our direct mail operation, and agree in general to conform to this policy, except, in cases of artists who are dead or no longer under contract to you."<sup>29</sup> This provision concluded: "Nothing herein shall prevent you [Mercury] from absorbing or paying on your own behalf any additional royalty on records sold by us to any of your artists. You will, however, advise

<sup>28</sup> CX 23, pp. 19-20, par. 25. This provision continued: "Nothing contained in this paragraph shall alter the concept that all royalty payments to artists are to be made directly by you; and in that regard, we [Columbia] will send a copy of any modification obtained by us to you within five (5) days after such modification has been executed by the artist." *Ibid.*

The royalty provisions in at least one of the other contracts expressly designated the artist's share: "We [Columbia] will pay you [Vanguard] a royalty of five (5) per cent of the royalty price plus an additional artist royalty of two and one-half (2½) percent of the royalty price. Said royalty shall be paid on ninety (90) per cent of our net sales of Albums manufactured from the master recordings. Net sales are defined as gross shipment less returns." CX 43, p. 3, par. 7.

<sup>29</sup> CX 34, p. 6, par. 13. It was further provided: You [Mercury] will make your best efforts to make available to us under the terms of this agreement the performances of major artists who are now under contract to you or who have previously been under contract to you, and will supply us by May 31, 1960, with a list of those who are not so available. If this list in our view is so material to the terms of this contract that we deem it impossible to meet the guarantee herein provided, we shall so notify you within ten days thereafter and shall then be obliged to pay only such royalties pursuant to paragraph 11 as are earned on items already used or announced by us and not on the royalty guarantee as provided in section 11 hereof. Except for payment as such this contract shall thereupon be terminated.

"You agree that the performances of any artists signed by you subsequent to the date of this contract and to be performed before the termination thereof shall be available to us pursuant to the terms of this agreement." *Ibid.*

us on request of any such additional payments or agreements to pay, and you agree that we shall not be liable for any royalty beyond that specified in paragraph 11 [7½% and 10%, respectively, on nonclassical and classical records, figured on 95% of net sales]."<sup>30</sup>

Similar provisions were contained in Columbia's contracts with its other competitors.<sup>31</sup>

12. While there are no provisions in the written contracts between Columbia and its competitors that deal with the matter of not attempting to hire away each other's artists, the record is clear that there is, in fact, an understanding or agreement among them to lessen their competition in this respect. Thus, one of Columbia's licensor-competitors was asked about an incident in which Columbia had let him know that one of his artists had offered his services to Columbia:

Q. Is this one of the advantages of being in the club, by the way?

A. I wouldn't say it is one of the advantages of being in the club. I can think of many other significant advantages. I would say that is possibly, one could consider this a *fringe benefit*.<sup>32</sup>

13. Several alternative "markets" have been suggested as the appropriate area in which to evaluate the probable competitive effects of these licensing agreements, including (1) the "all-record," (2) "all-LP," (3) "all-mail-order," and (4) the mail order "club" markets. The one advanced by respondent is the "all-record" market, *i.e.*, all phonograph record sales in the United States, including both "LP's"<sup>33</sup> and "singles," and including sales made through all channels of distribution—retail stores, "rack,"<sup>34</sup>

<sup>30</sup> *Ibid.* As a Columbia official explained the situation in a letter to Mercury: "It has been my experience—and of course I will be glad to defer to your judgment in this matter—that once you *truckle* to an artist, it is very difficult to get the artist in line again." CX 358(c)-(d) (emphasis added).

<sup>31</sup> Warner Brothers, CX 39, p. 5, par. 11; Kapp, CX 41, p. 7, par. 13; Vanguard, CX 43, p. 4, par. 9; United Artists, CX 44, p. 6, par. 13; Liberty, CX 45, p. 6, par. 13; Cameo-Parkway, CX 453, p. 6, par. 13.

<sup>32</sup> Tr. 3676 (emphasis added).

<sup>33</sup> "LP" is an abbreviation of "long-playing," a record that generally contains six (6) songs or performances on each side (usually 3 minutes of playing time per song), for a total of 12 songs or performances per record (36 minutes), as contrasted with the "single," which has only one (1) song or performance on each side (6 minutes playing time on both sides). The two records also differ in diameter and in turntable speed: the LP is 12 inches in diameter and revolves at a speed of 33⅓ revolutions per minute, while the "single" is 7 inches in diameter and turns at 45 revolutions per minute. The two also sell at different prices—the LP "list price" is \$3.98 and up, the "single" 98¢-99¢. The LP accounted for about 75% of total phonograph record sales in 1961.

<sup>34</sup> "Racks" are the familiar structures displaying phonograph records in supermarkets, drug stores, and other high-traffic retail areas. Their distinguishing characteristic is that, unlike the retail record dealer's store, which may carry virtually all of approximately 25,000 separate records offered for sale by all record manufacturers, frequently carry only the 50-150 most popular records (the current "hits").

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## Findings

juke boxes, and "clubs."<sup>35</sup> In 1960, total consumer expenditures for all kinds of records, through all channels, were an estimated \$521 million.<sup>36</sup> Columbia's share of this total was an estimated 21.2%.<sup>37</sup> The other two members of the phonograph record industry's "big three," RCA and Capitol, had an estimated 16% and 11.1%, respectively, of the all-record market. Decca, Mercury, and MGM followed with 3.4%, 2.7%, and 2.4%, respectively. Some 20 other firms shared the bulk of the remaining 43.2%.

Firm	Share of 1960 all-record sales (percent)
Columbia .....	21.2
RCA .....	16.0
Capitol .....	11.1
"Big Three" total .....	48.3
Decca .....	3.4
Mercury .....	2.7
MGM .....	2.4
All others .....	43.2
	100.0

CBS produces a somewhat larger share of all "LP" (long-playing) records,<sup>38</sup> that is, exclusive of "singles".<sup>39</sup>

Firm	1960 share of "LP" sales (percent)
Columbia .....	25.4
RCA .....	17.5
Capitol .....	13.6
"Big Three" total .....	56.5
Decca .....	3.3
Mercury .....	2.1
MGM .....	1.8
All others .....	36.3
	100.0

<sup>35</sup> The relative share of each of these four (4) channels of distribution in the consumer's total expenditures on phonograph records in 1961 was estimated as follows (CX 199a):

Channel of distribution	1961 sales	
	Dollars (millions)	Percentage
Retail stores .....	\$305	52
Racks .....	147	25
Clubs .....	100	17
Juke boxes .....	35	6
Totals .....	587	100

As noted below, the "club" figure for 1961—\$100 million—was later scaled downward, that figure being estimated as closer to actual Club sales in the following year, 1962, when the "universe" had grown to an estimated \$620 million. This would give the clubs 16.1% of all record sales in the latter year.

<sup>36</sup> CX 199b.

<sup>37</sup> RX 350.

<sup>38</sup> As noted, LP's account for approximately 75% of all phonograph record sales.

<sup>39</sup> RX 354.

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In what is referred to in this record as the "mail order" channel of distribution—the sale of phonograph records through the mail by all types of organizations, including sales by mail order houses, "clubs," etc.—respondent offers the following share data:<sup>40</sup>

Firm	Share of all phonograph record sales by "mail order" in percent	
	3d & 4th quarters 1961	1st 3 quarters 1962
Columbia .....	47.1	44.0
RCA .....	18.3	20.8
Reader's Digest .....	17.6	18.2
Capitol .....	9.6	8.1
All others .....	7.4	8.9

In the still narrower "club" channel of distribution—that is, the sale of phonograph records through the "membership" or "subscription" method of mail order selling as described below—CBS accounts for more than 50% of total sales:<sup>41</sup>

Firm	1960 share of all phonograph record sales through "clubs"	
	percent	
Columbia .....	56.1	
RCA .....	26.8	
Capitol .....	7.7	
"Big Three" total .....		90.6
All others .....	9.4	

14. The significance of the specific sales volume acquired by Columbia under the challenged "licensing" agreements (some

<sup>40</sup> RX 450.

<sup>41</sup> CX 357. Some market share data is available for two later years, 1961 and 1962, but it is not as complete for all channels of distribution as the 1960 figures set out above. One index for the all-record market is available, an index based on a comparison of individual record manufacturers' payments of excise taxes with total excise tax collections. This shows Columbia with 16.52% in 1960, 18.47% in 1961, and 20.72% of the all-record market in 1962. RX 418, *in camera*. Columbia contends that its share of all "club" sales fell from 56.1% in 1960 (as shown above) to 41.5% in 1961. RX 451, *in camera*. No such decline occurred. In fact, sales of the Columbia Record Club increased from \$30.4 million in 1959, to \$37.5 million in 1960, to \$41.5 million in 1961, and to \$53.2 million in 1962. CX 783-e and RX 422, *in camera*. Certainly no greater increases occurred in the sales of the club sector as a whole. The alleged decline in its share in 1961 is based on the fact that the "universe" figure—sales of all clubs—is not an exactly known figure but one estimated by *Billboard*, the industry's statistician, which admittedly "overestimated" the 1961 universe figure (putting all club sales at \$100 million) and thereby giving Columbia a fictitiously lower "share" of that inflated total. *Billboard* later put the 1962 figure at \$100 million, scaling the 1961 figure downward accordingly.

\$12.8 million in 1961) is similarly affected by the choice of the "relevant market." First, if there is only a single "all-record" market for phonograph records in the United States, then the total sales of the Columbia Record Club—including both its own Columbia records and those licensed from its competitors—do not constitute a dominant market share. Measured against the 1961 "universe" figure of \$587 million, the Columbia Record Club's sales of \$41.5 million in 1961 constituted some 7.07% of all phonograph records sold to consumers in that year. Of that \$41.5 million total, \$12.8 million of it (30.9%) represented the Club's sales of the nine (9) competitors' records under the challenged licensing agreements. Measured against the over-all, all-record universe figure of \$587 million, that \$12.8 million sales volume acquired by Columbia from its competitors amounts, therefore, to only 2.19% of all phonograph record sales through all channels of distribution. Stated another way, acceptance of an "all-record" market as the relevant market would mean the situation is one in which Columbia, with slightly less than 20% of that over-all market on its own labels, has "acquired" by contract another 2.19% from its competitors.

A much more concentrated structure is presented, however, if the sale of phonograph records through the "club" channel of distribution is itself considered a separate market, set apart from the over-all record market by meaningful economic factors. The Columbia Record Club had, as noted, 56.1% of the sales of all record "clubs" in 1960 and at least 53% in 1962. The latter figure is, we believe, a conservative estimate of its share in the intervening year, 1961. As noted above, its 1961 sales, in dollars, were \$41.5 million, with \$12.8 million (30.9%) being accounted for by its sales of competitors' records. This means that, *without* the sales volume acquired pursuant to these challenged licensing agreements, the Columbia Record Club's 1961 sales would have been \$28.7 million, or \$12.8 million less. In terms of percentages, it would have had not 53% of all sales through the "club" channel of distribution but some 37%, about 16 percentage points less. Stated another way, the existence of an economically meaningful "club" market would mean the situation is roughly one in which (1) a firm with some 37% of the relevant market already (\$28.7 million) has acquired another 16 percentage points by contract with nine of its competitors (\$12.8 million), for a total of approximately

53%, and (2) in which that firm and two others have more than 90% of the relevant market.<sup>42</sup>

15. There is no persuasive evidence here that the sale of phonograph records through clubs and through nonclub mail order methods combine to make up an economically meaningful "mail order" market. The principal category of sales proposed for this "market," other than Club sales, is the sale of what are called record "packages," *i.e.*, groups of records sold as a unit in a single mail order transaction. *Reader's Digest* magazine is the largest seller<sup>43</sup> of such packages, with sales of some \$12.1 million in 1962,<sup>44</sup> a figure that would be equivalent to approximately 12.1% of all "club" sales in 1962 (\$100 million) or approximately 2% of all record sales, through all channels of distribution (\$620 million in 1962).

The "package" records sold by *Reader's Digest*, however, are *not the same records* that are sold in the "clubs." Some of the records sold in these packages bear the same titles, and were performed from the same published music scores, but the *artists* are not the same. The official in charge of *Reader's Digest's* package operation testified that these package records consist primarily of "war horses" or "standard repertoire" (*e.g.*, Beethoven's symphonies) performed by orchestras and performers that are generally unknown to the American public; no "name" artists are used as performers, and hence the records "cost less"<sup>45</sup> and sell

<sup>42</sup> Using the Columbia Record Club's actual sales figure for 1962, \$53 million, and assuming that the licensors' contribution to that total remained at no more than the 30.9% they accounted for in the prior year, 1961, then the two components of the Club's 1962 sales of \$53 million would have consisted of (1) \$36.6 million on Columbia's own labels, plus (2) \$16.4 million on the licensors' labels. (In units, the nine licensors' records constituted 36.3% of all records shipped by the Columbia Record Club in 1962—8.1 million out of the total of 22.3 million LP's it shipped. CX 823, *in camera*.) Dividing each of these figures by the 1962 "club" universe of \$100 million gives 36.6% as the approximate share of the club market of Columbia's own labels, 16.4% as that of the nine licensors, for a combined total of 53%.

<sup>43</sup> The principal sellers of "packages" are *Reader's Digest* magazine, *Life* magazine, Book-of-the-Month Club, Columbia, and Sears Roebuck. Tr. 10, 157. *Reader's Digest* gave its phonograph record sales in terms of an "average" figure for the years 1960, 1961, and 1962 as \$12.1 million. RX 700, *in camera*. (Its sales in 1957 had been \$7.8 million. *Ibid.*) Both *Life* magazine and Book-of-the-Month Club had total phonograph record sales of \$1 million or less in 1962. RX 502 and 507-508, *in camera*. This latter figure is some 1/4th of 1% of the industry's approximately \$620 million total sales and less than 1% of the estimated \$100 million of all "club" sales in that year (RX 311, *in camera*; tr. 6867, 6931).

<sup>44</sup> *Ibid.* These "package" sales of *Reader's Digest* are separate and distinct from its sales through a "club" operation it conducts as a selling agent for RCA. In the package business, *Reader's Digest* sells records manufactured by RCA but bearing its own "Reader's Digest" label. In the other operation, it is under formal contract to "act as [RCA's] agent in developing, advertising, promoting, and servicing [RCA's] Record Clubs." RX 704-a (contract between RCA and *Reader's Digest*); tr. 9459. The RCA Club (administered by *Reader's Digest*) has a much larger sales volume, approximately \$14 million in 1961 and \$22.7 million in 1962. RX 645. The latter figure would be approximately 22.7% of the estimated \$100 million total "club" sales in 1962 (compared to the Columbia Record Club's \$53 million, or 53%).

<sup>45</sup> Tr. 10, 114-10, 115; 10, 146-10, 150.

for less. This is precisely the opposite of the situation in "club" selling. As discussed below, the records sold in clubs feature the artist and his personality, rather than the repertoire itself, and hence sell largely those records that carry the performances of well-known, highly publicized artists. In the one case, the seller is attempting to sell the repertoire alone (*e.g.*, Beethoven's Fifth Symphony); in the other, he is selling the artist (*e.g.*, Columbia's Leonard Bernstein).<sup>46</sup> Supply and demand conditions are obviously not the same in the sale of these two entirely different records. One of respondent's own officials implicitly recognized this. "They [Book-of-the-Month Club] are now *out* of the record club business. They are *in* the business of selling records by mail order."<sup>47</sup> The *Reader's Digest* official in charge of its "package" operation testified that "I don't think the package business is in competition with the record club business."<sup>48</sup> With different performers, different costs, and different prices, the "package" record and the "club" record are clearly in different markets.

16. In view of our findings below that club sales are in a market by themselves and constitute the relevant market involved in this proceeding, it necessarily follows that "singles" are not a part of that market; only "LP's" can be economically marketed through the club channel of distribution.<sup>49</sup>

17. We find that the "relevant market" involved here is the sale of phonograph records through what respondent describes in its own licensing contracts as sale "by direct mail in accordance with the merchandising method known and understood, in the mail order business, as the 'subscription' or 'club' plan as distinguished from individual over-the-counter sales by retail store outlets,"<sup>50</sup> *i.e.*, the relevant market is the sale of records through the "club" channel of distribution.

First, as discussed in some detail above,<sup>51</sup> this record is replete with evidence of respondent's *intent* to exclude competing clubs from that marketing channel. And a purpose to exclude others from an area necessarily implies a conviction that it constitutes an economically meaningful market, because otherwise there would be no potential economic gain from the exclusion. Respondent's own belief that the exclusion was from an economically meaningful market is inherent in the language of the contracts:

<sup>46</sup> See, *e.g.*, tr. 10, 159-10, 164; 10, 623-10, 635; 10, 661-10, 673.

<sup>47</sup> Tr. 5073 (emphasis added).

<sup>48</sup> Tr. 10, 123.

<sup>49</sup> Tr. 4894.

<sup>50</sup> See, *e.g.*, CX 23, p. 3.

<sup>51</sup> Finding 5.

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You [Caedmon] agree that, during the term of this agreement, you will not distribute or sell or authorize or consent to the distribution or sale by any third party of phonograph records manufactured from any of the master recordings, through any mail order record club which regularly distributes or offers for sale to its members significant quantities of phonograph records of a musical nature, including without limitation, the "Book-of-the-Month Club," "Music Treasures of the World," any RCA Victor record club, and any Capitol record club.<sup>52</sup>

You [Mercury] agree that during the term of this agreement you will not, in the territory of the United States and Canada, (1) sell by direct mail, (2) offer for sale by direct mail, or (3) authorize or consent to the sale of phonograph records manufactured from master recordings which you now own or control or which you may hereafter own or control.<sup>53</sup>

18. A finding that the relevant market here is the sale of records generally would require a finding that phonograph records sold through local retail stores, "racks," and juke boxes are adequate "substitutes," as far as the consumer is concerned, for records sold through "clubs," *i.e.*, that, as to a given record<sup>54</sup> being offered at the same price, the consumer is indifferent as to which channel of distribution he patronizes. This is clearly not the case. First of all, the prices are not the same. There is an entirely different price structure on records sold through clubs and those sold through nonclub channels. In the nonclub sector, the "suggested retail prices" (prices the manufacturers suggest their dealers charge consumers) are as follows: (a) "popular" records, \$3.98; (b) "classical" records, \$4.98; (c) "broadway show tunes," \$5.98.<sup>55</sup> While respondents have adequately demonstrated that dealers in some of the smaller towns do in fact charge these full list prices, there was evidence that the "average" dealer price has been reduced ("discounting," etc.) by some 25%, to approximately \$2.98

<sup>52</sup> CX 20.

<sup>53</sup> CX 34, p. 3, par. 7. See also Findings 6, 7, 8 and 9.

<sup>54</sup> The records sold through the Columbia Record Club are admittedly physically identical to records sold through dealer stores, racks, and juke boxes, *e.g.*, Andy Williams' "Moon River" (recorded by Kapp Records, one of the nine competing manufacturers that signed a "licensing" agreement with the Columbia Record Club) is simultaneously sold through the Columbia Record Club and through these other retail outlets. In other words, there is no "product differentiation" involved in the definition of the relevant market here. As noted below, however, this does not mean that club and nonclub outlets have exactly the same repertoire in all respects: the Columbia Record Club limits itself primarily to "hit" records, offering some 100-200 records per month (about 1,500 per year) to its Club members, whereas retail dealers often carry the entire 25,000 separate records currently offered by all of the country's record manufacturers. The point is simply that, on each of the small number of "hits" that the Club does elect to handle, physically identical copies of that precise record—the same song, same performer, etc.—are in fact being offered for sale to the consuming public at the same time by other retail outlets.

<sup>55</sup> These are the prices for monaural records; stereo records are \$1.00 more. "Singles," which constitute some 25% of all record sales, have a suggested list price of 98¢-99¢.

on a "popular" (\$3.98) record. The "club" price to the consumer, on the other hand, is approximately \$2.37 for exactly the same record, a difference of more than 20% between the club and nonclub prices to the consumer. If consumers were in fact indifferent as to which channel of distribution they bought their records through, making their choice solely on the basis of price, then the club channel would necessarily have all of the business on those particular records it elected to sell, and the nonclub sector would have none.<sup>56</sup> It is clear, then, that consumers do in fact distinguish between the various channels of distribution.

19. The so-called "disadvantages" of buying through club versus nonclub outlets—limited selection to choose from, having to wait from a month to six (6) weeks before the records arrive, not being able to play them before buying, and the necessity of making a "commitment" to buy six (6) records at \$3.98 each (plus mailing costs) over a period of a year—are obviously evaluated differently by different people. The clubs have their primary appeal to persons having certain characteristics, most particularly those having (1) a propensity to shop by mail,<sup>57</sup> (2) a desire to develop a phonograph record "collection,"<sup>58</sup> (3) a desire for "guidance" or expert assistance in developing that record collection<sup>59</sup> and (4) an active interest in buying at economical prices.<sup>60</sup>

More specifically, the individuals that join phonograph record clubs tend to be (1) young adults, who have (2) just purchased a phonograph record *player*,<sup>61</sup> who are (3) relatively uncertain in their own musical preferences, and who, having purchased other (nonrecord) items by mail in the past, (4) have no particular reluctance to buy records in that manner. These characteristics make up a record buyer that is, in the phraseology of Columbia's market researchers, "susceptible to club values,"<sup>62</sup> *i.e.*, a buyer that believes the clubs' "advantages" (20% lower price, the convenience of arm-chair buying,<sup>63</sup> expert "guidance" in developing a well-

<sup>56</sup> One of the Columbia Record Club officials testified that the larger part of the record-buying public obviously thinks there are some "disadvantages" in buying through the "club" channel because "otherwise, we would have *all* of the sales of records through clubs rather than at retail \* \* \*." Tr. 4929 (emphasis added). As noted, the clubs accounted for something less than 20% of all record sales in 1962 (less than \$100 million out of a total of an estimated \$620 million).

<sup>57</sup> RX 320. Tr. 8338-8342.

<sup>58</sup> RX 340. Tr. 7959, 8315, 8320-8321.

<sup>59</sup> Tr. 8305.

<sup>60</sup> Tr. 8315, 8323.

<sup>61</sup> RX 337. Tr. 7944-7945, 8308-8309.

<sup>62</sup> See RX 340.

<sup>63</sup> Tr. 8319, 8323.

rounded collection of "hits," etc.) far outweigh its "disadvantages."

20. Columbia's officials recognize the distinctive characteristics of the people who make up the "club" market for phonograph records, particularly the fact that they are "new collectors" who are only temporarily "susceptible" to club values and who will soon "outgrow" the Club or cease to be one of its potential customers. For the Columbia Record Club as a whole, the long-run "shrinkage rate," *i.e.*, percentage of members resigning during the year, is 54.13%. This means that, of any hypothetical group of 100 new members enrolled at the beginning of any particular year, 54 of them would have dropped out by the end of the year.<sup>64</sup> The "club market," in short, is composed of those members of the record-buying public whose characteristics, at a particular period of time, make them regard the club's features as "advantages," not disadvantages, and who are thus responsive to the club's substantial price advantage over nonclub channels.

21. To the new collector who considers the "club" method of buying generally equal to or at least not decisively inferior to shopping for records in retail stores, price tends to become a highly significant factor. That is to say, in the area of "overlap" in product between the "clubs" and nonclub retail outlets,<sup>65</sup> a consumer "susceptible" to club values can be induced by the clubs' approximately 20% lower price to purchase his entire requirements of those particular records from them, buying none of those specific records in the retail dealer market. A club member who has just committed himself to buy 12 records from a club for \$2.37 each (including postage) may well buy *other* records at his local retail dealer's store for \$2.98, but not one of the 12 "hits" selected from the club's offerings at the lower price (and, to him, greater convenience). In the sale of those 12 records, to this particular consumer (and, therefore to the other three to four million club members like him), the clubs of the "big three" have no economically meaningful competition. This particular portion of the record-buying public—the young adults just beginning their record collections, those who have a relatively high propensity to shop by mail, etc.—is highly "susceptible" to the clubs' offer of this distinctive group of records ("hits") at a sharply differentiated price (20% lower), and hence constitutes a separate "market" in which

<sup>64</sup> RX 365. Tr. 8406.

<sup>65</sup> The three clubs offer, as noted, 200-400 records to their members in any given month, or less than 2% of the 25,000 records offered for sale in the retail stores. It is only in the sale of those relatively few records that there is any "overlap" between the offerings of the two channels of distribution.

different conditions of supply and demand operate than those present in the other channels of distribution.

22. The Columbia Record Club is able to profitably sell records at a lower price than those same records can be sold through nonclub retail outlets because it enjoys a substantial cost advantage over those other channels of distribution. That is to say, the "club" market is characterized not only by different "demand" conditions, but by different circumstances on the "supply" (cost) side as well. The cost structure in the club retailing of phonograph records is entirely different from the cost structure in nonclub record retailing. The Columbia Record Club presented data showing total costs per licensor record shipped by the Club in 1962 as \$2.13, broken down as follows:<sup>66</sup>

	cents
Acquisition cost (mfg., royalties to licensors, etc.) .....	87.5
Free merchandise .....	12.3
Advertising costs .....	35.3
Sales promotion costs .....	17.2
Other operating and distribution costs .....	28.9
Bad debts .....	31.8
<b>Total:</b> .....	<b>\$2.13</b>

23. In the nonclub sector (*e.g.*, the manufacturer-wholesaler-dealer chain), the outlet at the end of the chain that is said to compete with the clubs, the dealer, necessarily incurs total costs that substantially exceed those of the club, no matter how efficient he might be. Instead of the 87.5¢ the Columbia Record Club pays for the records of Liberty, Kapp, Warner Brothers, and the other licensors, the dealer structure (there are some 5,000 or more phonograph record dealers in the country) pays a price that ranges from a low of about \$1.60 to a high of \$2.47.<sup>67</sup> Columbia's own

<sup>66</sup> Tr. 10,469-10,470; 10,937. The 87.5¢ "acquisition" cost is itself broken down as follows (CX 821, *in camera*):

Manufacturing cost .....	42.8¢
Royalties to licensors .....	17.8¢
Copyright royalties .....	13.7¢
AFM fees .....	2.4¢
Excise tax .....	10.8¢
<b>Total:</b> .....	<b>87.5¢</b>

<sup>67</sup> The "list" price structure of the industry calls for (on the "popular" record) a manufacturer-to-wholesaler price of \$1.89 to \$1.92; a wholesaler-to-dealer price of \$2.47; and, finally, a dealer-to-consumer price of \$3.98. There is, however, considerable "discounting" at two of these levels and, by some of the smaller firms at least, at all three of them. Thus, one distributor testified that, while "to many customers [retail dealers] we got as high as \$2.47" per record, "[t]o the customer which had the most preference by size and things of that sort, the lowest we would get down is between \$1.80 and \$1.85." Tr. 1427. Many dealers, however, apparently pay the full "list" price of \$2.47 for the majority of their records. See, *e.g.*, tr. 832-833; 1267-

dealers paid in 1961, after all "discounts" had been taken into account, an "average" price of \$2.12 per record. While the price paid for records is presumably the largest single item of cost to the dealers, it is not the only one. The addition of all operating and overhead costs would undoubtedly bring the costs of even the largest and most efficient phonograph record dealer substantially above the \$2.13 costs incurred by the Columbia Record Club in its operation. To the extent that the nonclub sector has higher costs than the clubs, its capacity to compete with them is proportionately reduced and the products it offers, at the higher prices its greater costs force it to charge, become progressively less acceptable as "substitutes" to the consumer. Here, the thin profit-margins of the many dealers that testified in this proceeding,<sup>68</sup> on the one hand, and the evident satisfaction of the Columbia Record Club with its profit-margin,<sup>69</sup> on the other, raises a fair inference that the difference in the prices charged (\$2.37 by the clubs versus an average of \$2.98 by the dealers) is more than accounted for by the difference in their cost structures. Different prices and different costs are two of the principal hallmarks of economically separate markets.

24. The source of the Columbia Record Club's advantage over the nonclub sector, the ability to acquire records for 87.5¢ that cost nonclub retailers \$1.60 or more, is also one of the primary factors responsible for the highly concentrated structure of the "club" submarket. On its own (Columbia label) records, this cost advantage stems simply from the fact of integration, *i.e.*, from the fact that Columbia, in its role as a manufacturer, can "sell" records to its retailing arm (the Columbia Record Club) at a lower price than it charges outside distributors (wholesalers and retailers). RCA and Capitol, being similarly integrated from manu-

1273; 2219-2221; 2893-2897; 3261; 3301-3302; 3392-3393; 5705-5706. Even Goody's, a large dealer in New York City, testified that "\$2.47 is the norm" and that \$2.00 "[is] the best deal" it can get. Tr. 1284-1285.

The wholesaler cannot sell for much less than that \$1.80 figure since he pays his own manufacturer-supplier a minimum of at least \$1.60. Thus, one wholesaler testified that "the best deal that I as a distributor can get \* \* \* can bring my price [from the manufacturer] down to about \$1.61, \* \* \*" Tr. 1418. Operating expenses would add "at least five or more percent to that figure," tr. 1419, bringing the total to \$1.69. This range is corroborated by the testimony of one of the smaller manufacturers, Audio-Fidelity (developer of the stereo record), that it sometimes sells to wholesalers "for \$1.60 or \$1.70." Tr. 2025-2026. (Columbia, however, apparently gets the full "list" price from its wholesalers. In 1961, its LP sales to its wholesalers on its own "Columbia" label totaled \$30,332,000 in dollar volume and 16,600,000 in units sold, for an average price of \$1.93 on each "Columbia" LP sold to its wholesalers that year CX 253, *in camera*.)

<sup>68</sup> See, *e.g.*, tr. 2149; 2185-2186; 2273-2274; 2345; 2397-2400; 2467-2471; 2554-2555; 2660; 2692; 2797-2798; 2811; 2957.

<sup>69</sup> Tr. 8532.

facturing to club retailing, presumably enjoy a similar position. The principal issue in this proceeding, however, is not integration, as such,<sup>70</sup> but the use of the restrictive "licensing" agreements described below to foreclose potential competitors from, and hence artificially maintain a noncompetitive structure in, the "club" market. In substance, those agreements enable the Columbia Record Club to enjoy the same cost advantage over potential entrants into the *club* market that it enjoys over retail dealers in the nonclub market. As noted, they enable the Club to acquire the records of these nine (9) medium-sized and smaller competitors at a total cost of 87.5¢ per record,<sup>71</sup> while expressly prohibiting those competitors from selling directly to any other club, on any terms whatsoever, a restriction that would compel another club desiring to handle the records of those nine producers to go to the latter's wholesalers and buy them at the "open market" price (wholesaler-to-dealer) of at least \$1.60. This imposes on potential entrants into the club market an immediate cost disadvantage, vis-a-vis the Columbia Record Club, of at least 72.5¢ ( $\$1.60 - 87.5¢ = 72.5¢$ ). The magnitude of that disadvantage is illustrated by the fact that, according to the Columbia Record Club's own figures, its profit on each record sold through the Club is not over 24¢ on those sold to first-year members, and not over 75¢ on sales to second-year members.<sup>72</sup>

The significance of the market share foreclosed by this cost disadvantage can be summarized as follows. Columbia produces in its own plants, as noted above, some 21.2% of all phonograph records bought by American consumers through all channels of distribution. And RCA and Capitol have an estimated 16% and 11.1%, respectively. Therefore, these three companies—Columbia, RCA, and Capitol—can foreclose from potential entrants into the club field some 48% of all records<sup>73</sup> simply by unilaterally refusing to sell their own respective labels (Columbia, RCA, and

<sup>70</sup> While the complaint in this matter charged a form of "dual distribution" (selling direct to consumers, in competition with Columbia dealers, at a price (\$2.37) that is lower than the price charged by the Columbia factory to Columbia dealers (\$2.47) for the same Columbia records), the evidence of injury to competition at the dealer level is not, in our opinion, sufficient to support economically meaningful findings on this point.

<sup>71</sup> Finding 22.

<sup>72</sup> The price to first-year members, as noted, is an average of \$2.37 per record. Subtracting the Club's average cost figure of \$2.13 gives a per-record profit of 24¢. The second-year price averages \$2.88; cost remains the same, \$2.13, for a per-record profit of 75¢.

<sup>73</sup> Columbia did in fact refuse to sell to a club that attempted to enter except at the full wholesale-to-dealer price of \$2.47, less periodic discounts, or an average price of \$2.12. Tr. 9014-9015. A club paying that price for its records, and incurring the same additional costs that the Columbia Record Club incurs, would have total costs \$3.37½, and hence would lose just over \$1.00 on each record sold in competition with the Columbia Record Club at the latter's price of \$2.37.

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Capitol) directly to such potential entrants (or by refusing to sell except at prohibitively high prices). This still leaves, however, some 52% of the market "open" to nonintegrated clubs. Since both RCA and Capitol testified here that their clubs had been profitably operated with the use of only their own records—*i.e.*, RCA has operated a successful club using only RCA records (16% of all records sold in the country in 1960) and Capitol has operated a successful club offering only Capitol records (11.1% of all records)—this remaining 52% would obviously be sufficient to permit the profitable operation of a number of additional record clubs besides those of the "big three." It is the foreclosure of the most significant portion of that nonintegrated 52% of the supply of records to potential club entrants, through the device of excluding them from direct access to these manufacturers, that is involved in the "licensing" contracts involved here. While data is not available on the share of all phonograph record sales through all channels of distribution by these nine manufacturers, a rough approximation is provided by Columbia's estimate of their share of all record sales through the largest of the distribution channels, sales through retail record dealers:<sup>74</sup>

Licensor Record Manufacturer	Date of Contract	Licensor's Share of Retail Dealer "LP" Sales in Year Prior to Contract	
		As percent of all Dealer Record Sales	As percent of all Dealer Record Sales
1. Caedmon .....	May 15, 1958	—	—
2. Verve .....	March 31, 1959	0.6	1.1
3. Mercury .....	April 1, 1960	3.5	2.7
4. Warner Bros. ....	September 15, 1960	1.5	1.4
5. Kapp .....	October 7, 1960	1.7	1.8
6. Vanguard .....	June 1, 1961	*	1.5
7. United Artists .....	July 1, 1961	1.6	1.1
8. Liberty .....	October 25, 1961	1.7	1.0
9. Cameo-Parkway ....	December 15, 1961	1.2	0.7
Total:		11.8%	11.3%

\* Indicates less than 0.5%.

No matter which of these figures is taken—11.8% or 11.3% of all record sales—the share of the nonintegrated supply effectively foreclosed by these contracts is substantial. Thus, 11.3% of *all* phonograph record sales constitutes some 22% of the 52% manu-

<sup>74</sup> RX 452 and 453, *in camera*.

factured by all firms *other than* the integrated "big three,"<sup>75</sup> and hence not subject to price control at the manufacturing level by those integrated competitors. In other words, the situation is one in which some 48% of the total supply of records is *already* controlled by the "big three" and hence subject to being withheld entirely from the new entrant into the "club" market (or sold to him only on terms so disadvantageous to him as to destroy his capacity to offer really effective competition), and in which one of those three integrated firms then proceeds to foreclose, by means of restrictive licensing agreements, economical access to *another* 11.3 percentage points, bringing the total record supply under the control of the big three to over 59% and leaving potential "club" entrants less than 42% from which to draw the records needed for club use.

25. The significance of the foreclosure is even greater to the would-be operator than any of these figures indicate, however. As noted above, not all of the approximately 25,000 separate records carried in the stores of the retail dealers are equally attractive to the particular segment of the record-buying public that joins phonograph record clubs. They tend to be relatively young, relatively unsophisticated in their record choices, and hence most prone to accept the most "popular" ("hit") records, those that are being played most frequently by the media and listened to most frequently by their friends.<sup>76</sup> The total quantity of records *suitable for club use* is therefore largely limited, as a practical matter, to the 100-400 records on the popularity "charts" at any given time. And the licensing agreements giving the Columbia Record Club exclusive club rights to the records of these nine competitors cover a disproportionately large share of these "hits," *i.e.*, those licensor-competitors are particularly strong with the kind of artists (and hence of records) that appeal to the purchasers in the club market.<sup>77</sup> Thus, the March 24, 1962, popularity "chart" published by *Billboard* magazine (a trade magazine) listing the 150 largest-selling monaural LP's as of that date indicated that 33 of the 150,

<sup>75</sup> 11.3% divided by 52% equals 21.7%.

<sup>76</sup> See Findings 19 and 20.

<sup>77</sup> "[W]e have the artists whom the public wants to hear. If I may say so, I think that's an important point. A person who buys a record, popular or classical, is largely buying the record because of the particular artist's performance. In the pop field, if it's an Andy Williams or Johnny Mathis, they want what Johnny Mathis or Andy Williams will do. So it is in the classical field. They want Bernstein's performance of this work or Ormandy's of that, or Bruno Walter's, or whomever it happens to be. *The public is concerned with the artist* and that is, by the way, our complete philosophy of recording." Tr. 7324 (emphasis added). Thus, one of Columbia Record Club's advertisements declared that "every record checked on this page has hit the best-seller lists." CX 114.

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or 22% of them, were records produced by the licensor-manufacturers that have given the Columbia Record Club exclusive rights to their "club" sales.<sup>78</sup> Columbia itself had another 32 on that chart (21.3%), for a total of 65 (43.3%) of the "hits" on either Columbia or licensor labels. Columbia, RCA, and Capitol together accounted for 103 of those 140 best-sellers (69.3%).<sup>79</sup> The remaining 47 records (30.7%) constituted, for all practical purposes, the principal records available to potential club entrants for club distribution. A more realistic assessment of the share of the market covered by the contracts in issue here is thus made by comparing the 33 licensor-hits foreclosed to the potential club operator with the number that would have been available to him had there been no such contracts on that date, namely, 80, or 53.3% of the entire 150.<sup>80</sup> Those contracts thus foreclosed potential entrants into the club market from 33 out of a total of 80 (41.2%) best-selling records that would have otherwise been available (those not on the "big three's" own labels).

26. The significance of the "exclusive licensing" contracts described above lies, as noted, in the fact that they give Columbia a *price advantage* over any actual or potential competitor in the "club" market (and, indirectly, in the nonclub market as well). It is this cost differential that makes it virtually impossible for competing clubs to enter the club market and successfully match the prices at which Columbia, RCA and Capitol<sup>81</sup> resell to the

<sup>78</sup> United Artists (7 best-sellers on the chart); Kapp (7); Cameo-Parkway (5); Mercury (4); Warner Brothers (3); Vanguard (2); Verve (1). CX 200.

<sup>79</sup> Ibid. It was of course precisely on the basis of its estimate of their capacity to produce future "hits" for its Club that Columbia signed up the nine licensor-competitors in the first place:

"The basic reason [for signing up Cameo-Parkway] was that \* \* \* Columbia and the companies we were then affiliated with had not [had] a great deal of success with the teen-oriented type of material. We found the type of members we were getting in were asking for this material. The profile of our club was getting younger, and we felt that we had to meet their legitimate requests for this type of material. Bernie Lowe, who was then head of Cameo-Parkway, had had a *long history of success in creating teen-oriented material* and one of his artists, Chubby Checkers, created the dance craze, the twist. He had, in addition, other popular teen artists such as Bobby Rydell. We felt, after he approached us, that it would be mutually beneficial for us to distribute his catalog through the club. Tr. 5199-5200 (emphasis added)."

Similar testimony was given in explanation of the other contracts. See tr. 5165 (Caedmon); 5166 (Verve); 5185 (Mercury); 5189-5190 (Kapp); 5195-5196 (United Artists); 5197-5198 (Warner Brothers); 5201 (Liberty); 5201-5202 (Vanguard).

<sup>80</sup> It has subsequently been reported in the trade press that another one of the big three, Capitol, has similarly been given "exclusive" rights to the club distribution of a number of other record manufacturers, thus presumably reducing still further the supply of records suitable for club distribution available to the potential entrant into the club market.

<sup>81</sup> As noted below, RCA and Capitol were negotiating with certain other independent manufacturer-competitors for similar "licensing" arrangements at the close of the record in this proceeding and one of them, Capitol, has subsequently been reported by the trade press as having actually entered into such arrangements.

consuming public. This differential is accomplished by (1) allowing Columbia to borrow the "master" for a "royalty" payment (17.8¢) on each individual record it manufactures from that "master." The sum of that royalty payment (17.8¢ per record), and the additional costs Columbia actually incurs in manufacturing the physical records from that "master" (42.8¢), plus advertising and other costs, is a total of 87.5¢, the aggregate cost respondent actually incurs in acquiring the finished licensor records, whereas (2) Columbia's competitors are compelled to acquire those same records, if at all, through the more expensive route of buying them, *as retailers, from wholesale distributors* (all clubs are admittedly "retailers," in that they sell directly to the consumer and do so in direct competition with the traditional retail record store), at the usual distributor-to-dealer price of \$1.60 to \$2.47. In other words, Columbia has gotten a lower price for itself and has gotten, along with it, an agreement from its suppliers that they won't give that lower price to any of Columbia's club competitors. The result is a cost barrier<sup>82</sup> to any would-be new entrants in the club market and the insulation of the Columbia Record Club from the added competition they necessarily would bring.

27. The effects of these arrangements on potential entrants to the club market are illustrated by the experience of a firm that attempted to enter in 1958, the Diners' Record Club.<sup>83</sup> Founded by Mr. Bernard Solomon (who also has an ownership interest in several small record manufacturing companies, one of which is also in the music publishing business), the firm was initially able to buy records *directly* from apparently all of the various manufacturers, including both the big three (Columbia, RCA, and Capitol) and the major independents. According to the testimony of Mr. Solomon, some of the *manufacturers* had sold him records for as little as 50¢ per record, the more general price,

<sup>82</sup> As emphasized above, these "exclusive" contracts do not physically prevent competing clubs from acquiring or reselling the records of these nine manufacturers; they simply make it much more *expensive* for them to do so. Thus, the records of any manufacturer in the country can be readily obtained in the "open market," *i.e.*, from that manufacturer's own *distributors* or from "transshipping" wholesalers who, in turn, acquire them from his distributors. Hence the only effect of these "licensing" provisions is to limit the *source* from which competing clubs can buy the records of these nine manufacturers, denying them the opportunity to buy *directly* from those manufacturers and therefore forcing all would-be competitors out into the "open market" where the price is necessarily higher. (As noted above, wholesale distributors *pay at least* \$1.60 per record and hence must necessarily charge *at least* that amount to any club they might sell these records to.)

<sup>83</sup> This firm was not owned by the well-known Diners' Club but had a contract to use its name, mailing lists, etc.

however, being some \$1.50.<sup>84</sup> Then, the manufacturers stopped selling to him *directly*:

Q. Did there come a time during the operation of the Diners' Record Club when you were unable to buy certain products?

A. Yes \* \* \* Columbia, RCA and Capitol.

Q. Did there come a time when you were unable to buy [records] from Kapp Records [a Columbia licensor]?

A. Well, Kapp, I solicited and they said they couldn't sell me records.

Q. And did there come a time when you were unable to buy [records] directly from United Artists [another Columbia licensor]?

A. Well, I bought records from United Artists, but they discontinued selling the records to me.

Q. What is your understanding of the reason that Kapp Records discontinued selling to you? \* \* \*

THE WITNESS: Well, Kapp Records never sold to me. We just had meetings, conversations, and correspondence, but they never sold me records. \* \* \* Well, they stated to me that they had an exclusive agreement with Columbia and couldn't sell me any records.<sup>85</sup>

Q. What is your understanding of the reason United Artists discontinued selling to you? \* \* \*

THE WITNESS: Mr. Si Mael and Harry Goldstein of United Artists both informed me that they had to stop selling me because of the arrangements with Columbia Record Club.<sup>86</sup>

Solomon had been selling, in his Diners' Record Club, a small label called "Challenge Records." Early in 1961, Warner Brothers, one of Columbia's "licensors," contracted with Challenge to take over its distribution. The Diners' Record Club promptly lost Challenge as a source of supply: " \* \* \* Warners had an exclusive arrangement with the Columbia Record Club and they were taking over the distribution of Challenge; that could not be interfered with as part of the deal and Challenge would have to follow the same [exclusive] route for clubs as Warner Brothers did."<sup>87</sup>

In reply to a direct request from the Diners' Record Club, David Kapp, president of Kapp Records, wrote Solomon as follows: "Our agreement with the Columbia Record Club is an exclusive one, and consequently we cannot enter into any agreement to sell you records for your club."<sup>88</sup> As to why the "big three" cut him off:

<sup>84</sup> "Generally, it was \$1.50 for monaural records and \$1.75 for stereo records, but there were variations both ways where we paid a lot more in some cases." Tr. 3787. See also tr. 3817, 3844, 3907-3911, 3943, 6531.

<sup>85</sup> Tr. 3787-3788, 3790-3791 (emphasis added).

<sup>86</sup> Tr. 3790-3791.

<sup>87</sup> Tr. 3796. While the Columbia-Warner contract covers only the distribution of certain specific Warner records, Solomon was still certain that he lost Challenge as a supplier because Columbia wanted it that way.

<sup>88</sup> CX 562. Similarly, Mercury wrote him, on January 27, 1961: "In view of our relationship with Columbia it is impossible for us to participate in your record club arrangement." CX 563.

Q. What is your understanding as to the reason the three majors [Columbia, RCA, and Capitol] refused to sell to Diners' Record Club?

THE WITNESS: In the cases of these approaches to these three companies, it was my understanding that the reason I couldn't buy product directly from the company was because of the existence of their own record clubs and therefore they didn't want to avail me of their products.<sup>89</sup>

Solomon explained the failure of his Diners' Record Club in these terms:

Q. Mr. Solomon, why did your company go out of business?

A. Well, as I said before; No. 1, a lack of adequate source of material of records to feature in the club. We had a basic repertoire from a number of companies, but needed three major companies, certainly; Columbia, RCA, Capitol, as well as the affiliated [licensor] companies to Columbia Record Club in order to successfully operate the business.<sup>90</sup>

Columbia maintains that the Diner's Record Club went out of business because of the business inadequacies and personal shortcomings of its controlling stockholder and chief executive officer, Mr. Solomon. It is alleged that those manufacturers who have refused to sell to him have done so for reasons unrelated to the issues involved in this case, including such things as slowness in paying for records previously sold to him, allegedly unreasonable demands on his part for price and promotional concessions from his suppliers, and, apparently, for alleged discrepancies in his income tax reports. While the first two items are obviously relevant, the record suggests that the financial difficulties of Mr. Solomon's Club, and hence his problems with creditors and his efforts to get more favorable terms, were at least in a substantial measure related to the price disadvantage he worked under.

Respondent also suggests that, notwithstanding the licensing provisions prohibiting its nine licensor-competitors from selling to any other club, Solomon's Club was still able to get records from those manufacturers. There is some evidence that at least some of those companies did make a few sales to Diner's Record Club after having promised Columbia they wouldn't do so. For example, Solomon conceded that Mercury sold him some 100,000 records for about 50¢ per record not only after the date of Mercury's "exclusive" contract with Columbia but even after the January 27, 1961, letter explaining that its contract with Columbia made it

<sup>89</sup> Tr. 3801-3802.

<sup>90</sup> Tr. 3928. He testified further: "Let me say that a lot of the names and material that we did offer in the club, as Mr. Rabinowitz [Columbia's attorney] pointed out before, were good names; however, they must be recognized that these were old masters that were recorded many years ago, and the quality was inferior. These same artists had all since gone and been attracted to Columbia, RCA, Capitol and other larger record companies, and we were dealing with old-type product, even though they had a name stature they still didn't stand up to the performance—their current performance. In addition, a lot of this older catalogue was not in stereo and stereo was a very big factor in our operation." Tr. 3928-3929.

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impossible for Mercury to do business with him.<sup>91</sup> (These and later sales were apparently accomplished through the device of letting Solomon set up his own ostensibly "independent" distributorship.<sup>92</sup>) However, some 90 % of the records bought at that price were what the industry calls "cutouts," records with so small a demand that the manufacturer is no longer currently producing them—in short, records that are on "sale."<sup>93</sup> The few current records they let him have "were put in in order to, like they call it, sweeten the pie."<sup>94</sup> Secondly, although Solomon was able to buy some records from Mercury still later through his own "distributor," he testified that "the prices were anywhere from 55 to 60 percent higher than I had paid previously."<sup>95</sup>

28. A significant feature of these contracts giving the Columbia Record Club the sole and "exclusive" right to make copies of and sell these competitors' records in the club market is that, with two exceptions,<sup>96</sup> they gave Columbia the right to *prevent other clubs* from using *even the records Columbia did not want to use itself*. The total number of records thus removed from club distribution by these licensing agreements was 1,773, or 70.7 % of the 2,509 records owned by these 7 licensor-manufacturers in the 1962-63 period. Or, to put it another way, the Columbia Record Club elected to use 736, or 29.3 % of those 2,509 records, and effectively precluded anyone else from using any of them, including not only the 29.3 % it picked out for its own use, but the remaining 70.7 % as well. This is shown for each of the licensor labels in the table below:<sup>97</sup>

Licensor-Mfr.	Number of Records in Catalog	Licensor Records Used by Columbia Club	
		Number	Percent of Total Number in Catalog
Caedmon .....	194	76	39.18%
Verve .....	695	86	12.37
Mercury .....	754	279	37.00
Kapp .....	275	124	45.09
United Artists .....	283	68	24.00
Liberty .....	248	77	31.05
Cameo-Parkway .....	60	26	43.33

<sup>91</sup> CX 563.

<sup>92</sup> Tr. 3944-3945.

<sup>93</sup> Tr. 3950-3951. Solomon defines them as records that "can be purchased on the open market at a price of less than a dollar and are not sold through the regular distributors, but through various \* \* \* distress sale operations." *Ibid*.

<sup>94</sup> Tr. 3952.

<sup>95</sup> Tr. 3945.

<sup>96</sup> The Warner Brothers and Vanguard contracts covered certain named records of those two labels, rather than their entire catalogs. CX 39, 43.

<sup>97</sup> The catalogs of these companies are included in the record as CX 265, 285, 289, 398, 445.

29. Entry into the business of manufacturing or producing phonograph records for sale through the conventional distributor-retailer channels is relatively inexpensive. Representatives of several producers testified that all the new entrant needs is an artist under contract and enough money to (a) rent a recording studio for the required number of hours and (b) hire a "custom presser"<sup>98</sup> to run off a few thousand copies of the record for distribution to the "disc jockeys" and wholesale distributors around the country. The "custom presser's" charge for producing a "normal run" of 10,000 finished records from a tape is, as noted, 38¢ per record,<sup>99</sup> or only \$3,800. And while the cost of a contract with a well-known artist can run into many thousands of dollars,

Record Manufacturer	Year of Entry Into Record Industry
RCA .....	1928
Decca .....	1934
Columbia .....	1938
Capitol .....	1942
Mercury .....	1945
London .....	1946
Imperial .....	1946
Miller International (Stereo Fidelity) .....	1947
Jay-Gee (Jubilee) .....	1947
Atlantic .....	1948
MGM .....	1949
Dot .....	1950
Vanguard .....	1950
Kapp .....	1953
Audio Fidelity .....	1954
ABC-Paramount .....	1955
Liberty .....	1955
Verve .....	1955
Cameo-Parkway .....	1956
Chess Record .....	1956
United Artists .....	1957
Roulette Records .....	1957
Warner Brothers .....	1958
Reprise Records .....	1961

470 and RX 298. Respondent's officials initially testified that the Club had actually used 51 of Caedmon's records, 47 of Verve's, 177 of Mercury's, 86 of Kapp's, 54 of United Artists', 63 of Liberty's, 20 of Cameo-Parkway's. Tr. 5251-5252. Columbia's counsel, in oral argument before the examiner, said: "The Club has used almost 24% of United Artists catalog and not 17% as claimed at page 33 of Complaint Counsel's reply; and has used almost 37% and not 28% of the Mercury catalog." Tr. 11,074. And, by July 1963, the Club had used 26 Cameo-Parkway records, 43% of that label's catalog. Ibid.

<sup>98</sup> Tr. 2827.

<sup>99</sup> Tr. 2832-2834.

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there is testimony here that there is no shortage of *new* artistic talent<sup>100</sup> and hence that the new entrant has no difficulty in "discovering" new artists at relatively modest costs. This is corroborated by the fact that some 20 firms have entered since 1945 [page 363]:<sup>101</sup>

30. Entry into the "club" or "subscription selling" mail order market, however, is more expensive. Columbia suggests that the capital requirements for entering the "club" market are very high, relying principally on the fact that its own Columbia Record Club was launched in 1955 with an advertising campaign that cost \$500,000; that its own Club spent some \$8 million on advertising in 1962 (15% of sales); that servicing the Club operation is very expensive; and that Diner's Record Club, attempting to enter on an initial capital of \$5,000 and another \$30,000 in initial advertising funds secured from suppliers, ultimately went out of business.<sup>102</sup> Respondent's economist, Mr. Peter Max, using the "net assets" held by Columbia, RCA, and Capitol when they formed their respective clubs in 1955 and 1958 (\$48.9 million, \$26.8 million, and \$305.6 million, respectively) as a test of adequate financial resources for entry,<sup>103</sup> concluded that there were at least six (6) "potential entrants" capable of making a "serious entry into this area":<sup>104</sup>

Record Company	1961 Current Net Assets
Decca (MCA, Inc.) .....	\$63,954,886
London .....	18,055,842
Dot (Paramount Pictures) .....	75,118,096
MGM .....	90,943,354
ABC-Paramount .....	65,941,312
Colpix (Columbia Pictures) .....	44,178,523

Applying this test, however, at least three (3) others of the

<sup>100</sup> Tr. 5740-5746.

<sup>101</sup> RX 437. Interestingly enough, entry into record *retailing* appears to require considerably more capital than entry into record "manufacturing." Thus, whereas several producing firms were founded on initial investments of \$5,000 or less (*e.g.*, Starday, tr. 5740-5746), one retailer testified that he had paid \$80,000 for his business—\$40,000 for his record inventory, \$15,000 for fixtures, and \$25,000 for the store's goodwill. Tr. 3157, 3161.

<sup>102</sup> Finding 27.

<sup>103</sup> "Now, I should explain very briefly the measure that I selected here, namely, current net assets. This, of course, is defined as—in terms of balance sheet accounting—as the company's current assets less its current liabilities. It therefore yields, as a residual amount, a measure of the company's *highly liquid* assets or liquid assets which are unencumbered by short-term liabilities and represents in physical terms, of course, such things as cash and readily marketable securities which funds, if the company so chose, might be used to finance significant or serious entry into this area." Tr. 9789-9790 (emphasis added).

<sup>104</sup> Tr. 9789-9790; RX 487.

nine (9) "licensors" (besides MGM) are also potential entrants into the club business.<sup>105</sup>

Record Company	1961 Current Net Assets
United Artists .....	\$65,364,751
Warner Brothers .....	47,513,439
Mercury (Consolidated Electronics) .....	40,554,784

31. As to the number of firms that have actually entered the "club" market, respondent's economist testified as follows: "As we know, it was only in 1955 when Columbia, as the first full catalog club, entered or launched into the mail [order] method of distribution in a serious way. Since that time, of course, there have been some highly significant entrants. Obviously the entry of Capitol and the entry of RCA Victor into this channel of distribution constitute highly significant entries. In addition, in defining this channel of distribution as the purveying of records through the mail, we have entry of such entities as *Life* [magazine] in, I believe, 1962. Dot [Records], very recently, as I understand it, at least in a preliminary way; I believe the record indicates a similar sort of entry, at least in a preliminary way, by Starday [Records]. Apart from RCA Victor, we have the entry into the distribution of records by mail by *Reader's Digest* [magazine] in fairly recent years."<sup>106</sup>

In fact, only three (3) of these—Columbia, RCA, and Capitol—are "serious" or "significant" factors in the club market. Starday, a small manufacturer of records located in Madison, Tennessee, a suburb of Nashville, started producing records in 1952 on a beginning capital of less than \$1,000 and had total sales of only \$600,000 in 1962,<sup>107</sup> a very small fraction of 1% of the industry's 1962 sales. As to its own club: "I hope to start my own record club because I recognize the need. Whether I would want Columbia or one of the other clubs to handle my records would depend on unforeseen things in the future pertaining to my own club, if I get it started."<sup>108</sup>

We know of no record evidence of any club having been in fact started by Dot.<sup>109</sup>

<sup>105</sup> Moody's Industrial Manual, 1963.

<sup>106</sup> Tr. 9788.

<sup>107</sup> Tr. 5755.

<sup>108</sup> Tr. 5764.

<sup>109</sup> Mr. Randolph C. Wood, president of Dot Recording Corporation and vice president of his parent company, Paramount Pictures, testified that, from the selling of appliances in Gallatin, Tennessee, he had "entered the mail order business [of] selling records by mail,

32. There has been no successful entry into the "club" market,<sup>110</sup> then—at least as far as this trial record indicates<sup>111</sup> since RCA and Capitol entered in 1958. One serious attempt at entry was made, and it failed largely because of the cost disadvantage it suffered under in acquiring records for resale through its club. The club market thus remains, after nearly 10 years since the last of the "big three" entered, a tight knit oligopoly, with a single firm, Columbia, holding more than 50% of the market and two others, RCA and Capitol, sharing the bulk of the other 50%. This is in marked contrast to the relatively high rate of entry into the producing of phonograph records and clearly suggests the presence of substantial barriers to entry. The most formidable is plainly the "exclusive" licensing contracts between the Columbia Record Club and its nine licensor-manufacturers, and the 71.5¢ or more per record cost disadvantage<sup>112</sup> they impose on potential entrants into the club business on the records of this group of major independent producers, producers whose records a potential entrant would want to sell in a new club operation. This cost barrier constitutes a serious impediment to entry into the club

COD by radio" in 1947, and had founded Dot Recording Corporation in April of 1950. Tr. 4103. He testified further:

Q. Are you presently interested in having your products sold through a record club?

A. Mr. Lavine, I have been interested for several years, to the point of constantly thinking about this facet of the business, because in order to be competitive and do the best job for our artists, which, after all, are the most important part of our operation if you had to narrow it down, for competitive reasons I am almost *forced* to be interested in club operation, either through affiliation or through our own club. That doesn't mean that I really want to do it. It is the fact that I feel that I will have to do it or should do it.

Q. Are you taking steps at the present time to implement this point of view?

A. We are contemplating [it] but [have made] no definite decision. We are running mail order tests and we have negotiated and discussed the possibility with all of the companies who have clubs in the past; so far, we have not made a definite decision.

Q. When you say you are running mail order tests, is that with a view to the possibility of starting a Dot Record Club?

A. Yes, it would be a Dot Record Club.

(Tr. 4119-4120; emphasis added.)

Organized on an original investment of about \$1,000, Dot records had sales of some \$15 million in 1962 (tr. 4127-4135), mail order sales of less than \$100,000. It had, over-all, some 3.6% of the dealer LP market in 1961. CX 241.

<sup>110</sup> There is, as discussed in Finding 15, no serious competition between "club" and "package" records.

<sup>111</sup> The trade press has subsequently reported, and advertisements confirm, the entry of a firm called "Record Club of America." Neither complaint counsel nor respondent have offered to inform us as to the competitive significance of this new entrant. It recently filed a motion to intervene in this proceeding, but only for the purpose of advising us that Capitol, like Columbia, had entered into a series of "licensing" agreements with other manufacturers, thus acquiring exclusive club rights over those manufacturers' records and denying the movant access to them. That information was largely cumulative of what was already in this record, and the motion to intervene was accordingly denied. Since both complaint counsel and respondent requested that the Commission deny that motion to intervene, we assume they are agreed that this new entrant, Record Club of America, has no competitive significance in the club market.

<sup>112</sup> Findings 6 and 22.

market,<sup>113</sup> and the cause of a substantial lessening and prevention of competition within that market.

## CONCLUSIONS

1. The Columbia Broadcasting System, Inc., and the Columbia Record Club, Inc., are corporations engaged in commerce, as "commerce" is defined in the Federal Trade Commission Act.

2. Respondent has entered into a series of "exclusive licensing" contracts with nine (9) of its competing phonograph record manufacturers or producers whereby, in return for "royalty" payments that average approximately 17.8¢ per record, those producers loan or "license" their record "masters" (from which finished records are made) to the Columbia Record Club on an "exclusive" basis, agreeing, in substance, that for a period of years they will not (a) sell their records through a mail order "club" operation of their own; (b) sell their records directly to anyone else who resells through a mail order "club" operation; or (c) allow anyone else to use their "master" recordings for the purpose of producing finished records for resale through a mail order "club" operation.

3. The relevant market in which to evaluate the competitive effects of these licensing agreements is the sale of phonograph records through mail order record "clubs." Members of such clubs constitute a separate and distinct sector of the record-buying public, their distinguishing characteristics being (a) a relatively high propensity to shop by mail, (b) a relatively high or beginner's interest in securing "guidance" or expert assistance in selecting records for that collection, and (c) a relatively active interest in buying at economical prices. The individuals that make up this market tend to be relatively young adults that have just purchased a phonograph record player, and that are interested in having someone else select for them the most "popular" or "hit" records at lower prices than can be secured in the conventional record dealers' stores. The clubs of the "big three" record producers (Columbia, RCA, and Capitol) cater to this distinct

<sup>113</sup> We reject as frivolous the contention of respondent's economist, Mr. Peter Max, that these nine (9) "exclusive" licensing contracts, wherein those firms expressly promise not to start their own club and not to sell to anyone else who starts a club, constitute a "form of entry." Tr. 9791-9793. The essence of the concept of entry is the addition of a new decision-maker to challenge the price and product policies of the established firms and put competitive restraints on their discretionary power. See, e.g., Joe S. Bain, *Barriers to New Competition* 5 (1956). Here, these nine (9) firms, all potential entrants themselves and producers of products needed by other entrants, expressly abdicated that vital decision-making function, appointing the Columbia Record Club, in effect, their exclusive sales agent, to make all "club" decisions for them.

group of customers by selling them a limited variety of "hits" (some 200-400 per month, versus the 25,000 available in dealer stores) at a price that is approximately 20% lower than the dealers charge for the same records (\$2.37 versus approximately \$2.98). The clubs are able to sell to this market at these prices because they enjoy substantially lower costs than the nonclub retail dealers. Different prices and different costs in the two channels of distribution clearly indicate that different conditions of supply and demand prevail in each and that they therefore belong to separate and distinct "markets."

4. The purpose and the effect of these exclusive licensing contracts is to prevent other actual or potential club operators from acquiring the records of those nine producers on equally favorable terms. Because of those agreements, other clubs cannot buy at all from these manufacturers themselves, nor can they "rent" the latters' "masters" and fabricate their own copies as the Columbia Record Club is allowed to do. Rather, the existence of these exclusive grants to Columbia forces other clubs desiring to sell the records of those nine producers to go to the latters' wholesalers and pay \$1.60 or more per record—as contrasted with the 87.5¢ the same records (Mercury, Kapp, Warner Bros., etc.) cost the Columbia Record Club. This cost disadvantage has the effect of barring potential newcomers that would otherwise have found the operation of a club profitable and hence of preventing competition with the clubs of the "big three" that could have otherwise been reasonably expected to flourish. The result is that a competitive industry structure has never been allowed to develop in that market. The Columbia Record Club had 56.1% of that market in 1960; RCA had 26.8%; and Capitol had 7.7%. Together, the clubs of the "big three" controlled 90.6% of all phonograph record sales through clubs. As a result, potential competitors (clubs) have been denied access to that market and the returns they could have otherwise have earned in it and the public has been denied the lower prices and other benefits that could reasonably have been expected to flow from the heightened competition their entry would have created. This prevention of competition constitutes an unfair practice and an unfair method of competition within the meaning of Section 5 of the Federal Trade Commission Act.

5. Respondent has further fixed and continues to fix and maintain, by agreement with several competing manufacturers or producers of phonograph records, the prices (royalties) paid by those producers, to the artists who record for them on records

sold through the Columbia Record Club, in violation of Section 5 of the Federal Trade Commission Act.

## ORDER

*It is ordered,* That respondents Columbia Broadcasting System, Inc., and Columbia Record Club, Inc., and their officers, representatives, agents and employees, successors, or assigns, directly or indirectly, or through any corporate or other device, in connection with the manufacture, promotion, offering for sale, sale and distribution of phonograph records in commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from:

Entering into, maintaining, or continuing any contract, licensing agreement, or understanding with any other manufacturer or producer of phonograph records to:

(a) Establish, fix, or maintain the price or royalty paid by any other manufacturer or producer of phonograph records to any artist for such artist's recording services;

(b) Prevent other club operators, including potential club operators, from acquiring the phonograph records of any other manufacturer or producer on the same terms and conditions as respondents acquire such records, including but not limited to agreements which have the effect of:

i. Giving respondents the sole or exclusive right, privilege, or license to manufacture, distribute or sell through clubs phonograph records manufactured from master recordings owned or controlled by any other manufacturer or producer of phonograph records;

ii. Restricting or preventing any manufacturer or producer of phonograph records from licensing, authorizing, or consenting to the making of phonograph records from its master records by any other person for the purpose of resale by the subscription or club method of direct mail selling;

iii. Restricting or preventing any manufacturer or producer of phonograph records from selling its own records by the subscription or club method of direct mail selling;

iv. Restricting or preventing any manufacturer or producer of phonograph records from selling its records directly to any person for resale by the subscription or club method of direct mail selling.

Complaint

72 F.T.C.

*It is further ordered,* That the initial decision be, and it hereby is, set aside, and the Findings As To The Facts, Conclusions and Order of the Commission be, and they hereby are, substituted therefor.

*It is further ordered,* That respondents shall, within sixty (60) days after service upon them of this order, file with the Commission a report, in writing, setting forth in detail the manner and form in which they have complied with the order set forth herein.

Commissioner Elman not concurring.

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IN THE MATTER OF  
INTER-STATE BUILDERS, INC., ET AL.

ORDER, OPINIONS, ETC., IN REGARD TO THE ALLEGED VIOLATION OF THE  
FEDERAL TRADE COMMISSION ACT

*Docket 8624. Complaint, May 14, 1964—Decision, July 28, 1967*

Order requiring a Cincinnati, Ohio, distributor of aluminum and insulated siding products to cease misrepresenting that a customer's house will be used as a model, that its salesmen are factory representatives, that its prices are reduced, and that its products are guaranteed.

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act, and by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that Inter-State Builders, Inc., a corporation, and Milton S. Gottesman, individually and as a director of said corporation, hereinafter referred to as respondents, have violated the provisions of said Act, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint stating its charges in that respect as follows:

PARAGRAPH 1. Respondent Inter-State Builders, Inc., is a corporation organized, existing and doing business under and by virtue of the laws of the State of Ohio, with its principal office and place of business located at 1902 Dana Avenue, Cincinnati, Ohio.

Respondent Milton S. Gottesman is a director of the corporate respondent. He formulates, directs and controls the acts and practices of the corporate respondent, including the acts and practices hereinafter set forth. His address is the same as that of the corporate respondent.

PAR. 2. Respondents are now, and for some time last past have been, engaged in the advertising, offering for sale, sale and distribution of aluminum and insulated siding products to the public.

PAR. 3. In the course and conduct of their business, respondents now cause, and for some time last past have caused, their said products, when sold, to be shipped from their place of business in the State of Ohio to purchasers thereof located in various other States of the United States, and maintain, and at all times mentioned herein have maintained, and substantial course of trade in said products in commerce, as "commerce" is defined in the Federal Trade Commission Act.

PAR. 4. In the course and conduct of their business, and for the purpose of inducing the purchase of respondents' products, respondents' salesmen or representatives have represented, directly or indirectly, in oral solicitations to prospective purchasers:

1. That the homes of prospective purchasers have been specially selected as model homes for the installation of respondents' siding, that after installation such homes would be used as points of reference for advertising purposes by respondents and that as a result of allowing their homes to serve as models, purchasers would receive special or reduced prices for respondents' products and/or commissions from sales made to other buyers who purchased respondents' products after observing the model home in respondents' advertising.

2. That respondents' salesmen or representatives were special representatives from the factory, thereby implying that purchasers would be dealing directly with the manufacturer.

3. That respondents' salesmen or representatives were representatives of United States Gypsum Company.

4. That respondents' products are "guaranteed" or "unconditionally guaranteed," thereby representing that said products are guaranteed in every respect for an unlimited period of time.

PAR. 5. In truth and in fact:

1. The homes of prospective purchasers were not specially selected as model homes, and respondents never intended to use, nor did they use, purchasers' homes as points of reference for advertising purposes. In addition, respondents did not give special prices or discounts to purchasers who agreed to have their homes used as models, and purchasers did not receive commissions on sales due to the fact that respondents never advertised the "model homes."

2. Respondents' salesmen or representatives are not factory representatives, and purchasers do not deal directly with the manufacturer of such products, but with respondents.

3. Respondents' salesmen or representatives are not representatives of United States Gypsum Co.

4. Respondents' products are not guaranteed in every respect nor are they guaranteed for an unlimited period of time.

Therefore, the statements and representations set forth in Paragraph Four hereof are false, misleading and deceptive.

PAR. 6. Further, in the course and conduct of their business, respondents have made certain statements and representations with respect to their products in direct mail circulars. Among and typical of such statements and representations are the following:

Special Money-Saving Offer  
Tremendous Savings  
Save up to 50% on materials.

PAR. 7. Through the use of the aforementioned statements, and others similar thereto, not specifically set out herein, respondents have represented, directly or by implication, that they were conducting a special sale and that the prices of the advertised products constituted a reduction from the actual bona fide prices at which such products had been offered to the public on a regular basis for a reasonably substantial period of time in the recent, regular course of respondents' business, and that savings were thereby afforded to purchasers.

PAR. 8. In truth and in fact, respondents were not conducting a special sale and the prices of the advertised products did not constitute a reduction from the actual bona fide prices at which such products had been offered to the public on a regular basis for a reasonably substantial period of time in the recent, regular course of respondents' business, and savings were not thereby afforded to purchasers.

Therefore, the statements and representations set forth in Paragraphs Six and Seven hereof are false, misleading and deceptive.

PAR. 9. In the conduct of their business, at all times mentioned herein, respondents have been in substantial competition, in commerce, with corporations, firms and individuals engaged in the sale of aluminum and insulated siding products of the same general kind and nature as those sold by respondents.

PAR. 10. The use by the respondents of the aforesaid false, misleading and deceptive statements, representations and practices has

had, and now has, the capacity and tendency to mislead members of the purchasing public into the erroneous and mistaken belief that said statements and representations were and are true and into the purchase of substantial quantities of respondents' products by reason of said erroneous and mistaken belief.

PAR. 11. The aforesaid acts and practices of respondents, as herein alleged, were and are all to the prejudice and injury of the public and of respondents' competitors and constituted, and now constitute, unfair methods of competition in commerce and unfair and deceptive acts and practices in commerce, in violation of Section 5 of the Federal Trade Commission Act.

*Mr. Thomas J. Whitehead, and Mr. John T. Walker* supporting the complaint.

*Mr. James L. Ostrander, Cincinnati, Ohio, and Mr. G. Duane Vieth, Mr. James F. Fitzpatrick, and Mr. Richard B. Sobol of Arnold, Fortas & Porter, Washington, D.C.,* for respondents.

INITIAL DECISION BY JOHN B. POINDEXTER, HEARING EXAMINER

SEPTEMBER 9, 1966

The complaint in this proceeding, issued by the Federal Trade Commission on May 14, 1964, and amended at the hearing on the record, alleges that Inter-State Builders, Inc., a corporation, and Milton S. Gottesman, individually and as a director of said corporation, hereinafter called respondents, violated the provisions of the Federal Trade Commission Act by making false and deceptive statements and representations both orally and in newspaper advertisements and other printed advertising material in connection with the sale of aluminum siding and other home improvement materials to the public.

Respondents answered and denied the substantial allegations of the complaint. Thereafter, a hearing was held in Cincinnati, Ohio, at which time oral testimony and documentary evidence were offered in support of and in opposition to the allegations of the complaint. Proposed findings of fact and conclusions of law were filed by respective counsel.

Thereafter, on January 21, 1965, the hearing examiner issued an initial decision finding that the allegations of the complaint had been sustained and that respondents had violated Section 5 of the Federal Trade Commission Act. Respondents were ordered to discontinue their false pricing, savings, guarantee, and affiliation claims to sell aluminum siding or other products.

Respondents appealed to the Commission from this decision, urging, among other grounds, that the hearing examiner erred in refusing to make available to respondents' counsel for cross-examination and impeachment purposes interview reports prepared by Commission investigators which recounted their prior interviews with consumer witnesses who testified at the hearing in support of the allegations of the complaint.

Upon consideration of the appeal, the Commission vacated said initial decision and remanded the matter to the hearing examiner to:

(1) examine the interview reports made with respect to each of the witnesses (other than Milton S. Gottesman) called by counsel supporting the complaint to determine whether such reports contain pre-hearing statements which should be made available to respondents' counsel under the "Jencks rule" as described in the Commission's opinion dated April 22, 1966 [69 F.T.C. 1152];

(2) deliver to respondents' counsel any of such reports or portions thereof found by him to be statements within the meaning of the "Jencks rule" and to be relevant for the purposes of cross-examination;

(3) if requested by respondents' counsel, reconvene the hearing-in-chief to permit respondents' counsel to utilize such reports or portions thereof for the purpose of cross-examining any of such witnesses whom respondents' counsel requests be recalled for such purpose; and

(4) issue a new initial decision which should include specific findings with respect to the issues presented on this remand.

Thereafter, pursuant to said order of remand, the hearing examiner scheduled a hearing for August 15, 1966, at which hearing counsel supporting the complaint was requested to produce the original or an exact copy of the investigation report made by the Commission investigator of his interview with each of the eighteen consumer witnesses who testified at the original hearing in support of the allegations of the complaint.

Accordingly, a hearing was held on August 15, 1966, in Washington, D.C. At said hearing counsel supporting the complaint produced what he represented as being authentic copies of each of the eighteen investigation field reports made by the Commission investigator. The hearing examiner examined each of said reports "in camera" to determine whether any or all of said reports contained "Jencks statements" as enunciated in the majority opinion of the Commission issued on April 22, 1966 [69 F.T.C. 1152].

After examining each of said reports, the hearing examiner announced on the record that he was able to determine from the face of each report that it did not contain a "Jencks statement," but was a mere summary of the investigator's interview with the witness. The hearing examiner then stated that he would prepare and issue a new initial decision which would embody findings of fact and conclusions of law based upon the record made at the original hearing as well as his examination of the eighteen investigation field reports. Respective counsel have informally advised the hearing examiner that they each waive the refile of proposed findings of fact, conclusions of law, and proposed order based upon the hearing held in Washington, D.C., on August 15, 1966.

Upon the basis of the entire record, the undersigned hearing examiner makes the following findings of fact and conclusions of law, and issues the following order:

#### FINDINGS OF FACT

1. The respondent Inter-State Builders, Inc., is a corporation organized and doing business under the laws of the State of Ohio, with its office and principal place of business located at 1902 Dana Avenue, Cincinnati, Ohio (45207). The individual respondent Milton S. Gottesman is a director and manager of the corporate respondent. He formulates, directs and controls the acts and practices of that corporate respondent (Tr. 48), including the acts and practices hereinafter found. His address is the same as that of the corporate respondent.

2. Respondents are now, and for some time past have been engaged in the offering for sale, sale and distribution of aluminum and insulated siding products to the public. In the course and conduct of their business, respondents now cause, and for some time past have caused their said products, when sold, to be shipped from their place of business in the State of Ohio to purchasers thereof located in various other States of the United States, including Kentucky, Indiana, and West Virginia (Tr. 53), and maintain and have maintained a substantial course of trade in said products in commerce, as "commerce" is defined in the Federal Trade Commission Act. The gross dollar sales of corporate respondent Inter-State Builders, Inc., for the fiscal year 1962 (October 1, 1961, to September 30, 1962) were \$853,478.26, and for 1963 (October 1, 1962, to September 30, 1963) were \$875,495.71. (Tr. 326.)

3. Inter-State Builders, Inc., obtains most of its business from

newspaper advertisements or direct mail advertising. Mr. Gottesman, Inter-State's director and manager, places advertisements in newspapers on behalf of Inter-State, similar to CX 1, 2, 3, and 4, soliciting the business of homeowners who may be interested in having new aluminum or other types of siding, roofing material, doors, windows, etc., installed on their homes. An example of respondents' newspaper advertising is CX 2, an advertisement which appeared on behalf of Inter-State Builders, Inc., in the April 17, 1962, issue of the Dayton, Ohio, Journal Herald. This advertisement contained, among other statements, the following:

Inter-State Builders, Inc. will select 25 homes in the area to cooperate in their advertising program \* \* \* for those cooperating, the homeowners will save hundreds of dollars on the installation of aluminum siding \* \* \* For the 25 homes selected not only is the price sharply discounted, but special terms will be arranged with no money down \* \* \*. If you think your home will qualify and if you would like aluminum siding at a sharply reduced rate call Cincinnati—Collect ME 1-5300 \* \* \*. Leave your name, address and phone number and a local representative will call on you for an appointment. If a phone is not handy drop a card or letter to Inter-State Builders, Inc., 1902 Dana Avenue, Cincinnati 7, Ohio.

These newspaper advertisements sometimes contain a coupon on which the interested homeowner may write his name, address, and phone number, then detach and mail to Inter-State Builders, Inc., at the address given in the advertisement, its office located at 1902 Dana Avenue, Cincinnati, Ohio (45207).

4. Inter-State also obtains business from direct mail circulars similar to CX 17 and CX 18. These circulars state, among other things, the following:

Special Money-Saving Offer  
Tremendous Savings  
Save up to 50% on materials

At the bottom of the circular is a printed, postage-guaranteed postcard addressed to Inter-State Builders, Inc., 1902 Dana Avenue, Cincinnati, Ohio (45207). On the reverse side of the card are spaces for the name, address, and phone number of the interested homeowner to be filled in. A perforation allows the card to be detached from the circular for mailing to Inter-State at its address printed on the card.

5. After the coupon or postcard has been returned to and received by Inter-State, Inter-State then turns the name, address and phone number of the answering prospect over to a salesman, or as Mr. Gottesman, in his testimony characterized, a "broker." The "broker" then calls the prospect by telephone and makes an appointment for the "broker" to call in person at the residence

of the homeowner.<sup>1</sup> At this meeting, the "broker" attempts to "sell" the prospect by obtaining from the homeowner a signed contract for the installation of the home improvements at a specified price. Inter-State Builders, Inc., receives a commission of 12 percent from the "broker" on all sales where the lead for the sale was furnished by Inter-State. The "broker" estimates the actual cost of the completed job, adds an amount for his profit, and inserts this total amount in the sales contract and signs the contract along with the homeowner purchaser. (Tr. 73.) Inter-State supplies its "brokers" with contract forms, credit applications, promissory notes, "pitch" books, etc. (Tr. 70-72.) It also supplies them with a time payment schedule for computation of financing charges for their use in case the contract is to be signed on an installment basis. (Tr. 90.)

6. At the time of the hearing, one "broker," Mr. Jack Maschmeier, of Cincinnati, Ohio, was employing three girl telephone solicitors who were using three telephones located in one of the rooms of corporate respondent's offices at 1902 Dana Avenue, Cincinnati, Ohio (45207). This office and the three telephones were provided by corporate respondent without any charge to the "broker," Mr. Maschmeier. (Tr. 424-425.) At the direction of Mr. Maschmeier, the girl telephone solicitors used the sales "pitch" described in CX 51, to the general effect that the girl calling was not a sales person but was an employee of the U.S. Outdoor Advertising Company, which was making a survey of the homeowner's area for one of the country's leading manufacturers of building materials, for the purpose of selecting one home which was to be used to advertise a brandnew permanent covering for the outer walls of the house, etc., etc. The girl would attempt to make an appointment for the "special representative" of U.S. Outdoor Advertising who was "in town for a few days" to call on the homeowner. If she was successful in making the appointment, the "special representative of U.S. Outdoor Advertising Company," in reality Mr. Maschmeier, would then make a personal call on the homeowner and attempt to obtain a signed contract for the installation of the siding or other improvements at a specified price set out therein, and generally providing for monthly payments over a

<sup>1</sup> Some "brokers" employ so-called "telephone solicitors," who call the prospects by telephone and make appointments for the "broker" to visit the home of the prospect. In some instances, the telephone solicitors obtain prospects for the "broker" by dialing the numbers of persons listed in the telephone directory of a particular city or town and inquiring if such person is interested in having new siding or other materials installed on his or her home. Also, some "brokers" employ men called "canvassers," who go from house-to-house and solicit home improvements. If the homeowner is interested, the "canvasser" makes an appointment for the "broker" to call at the home of the prospect.

one-, two-, or three-year period. Copies of approximately thirteen signed contracts from thirteen different homeowners were received in evidence at the hearing, CX 20, 22, 24, 27, 30, 34A-B, 35, 37, 40, 43, 46, and 48. (Mr. Maschmeier testified as a witness for respondents.)

7. Each contract is on a printed form called a "Sales Contract," provided by Inter-State Builders, Inc., with its name and address listed at the top of the form, and reciting that the homeowner who signed the contract would be called the "Purchaser" and that "Inter-State Builders, Inc., and/or Inter-State Construction Co."<sup>2</sup> would thereafter be called the "Contractor," etc. Each of the thirteen homeowners who signed a contract was called as a witness by counsel supporting the complaint.<sup>3</sup> Their testimony, as well as the testimony of five other homeowners who had been solicited by Inter-State's salesmen but did not sign contracts for the installation of siding or other home improvements, with slight variations, took one or all of the following forms: that the prospect's home had been selected as a model for the installation of Inter-State's siding; that, if the prospect purchased and had corporate respondent's materials installed and permitted the "improved" home to be shown as a model to other prospects, the purchaser would receive a special or reduced price, and/or would receive a commission<sup>4</sup> on sales made by the salesman to other homeowners as a result of having viewed the purchaser's improved model home. As a matter of fact, the corporate respondent did not select houses to be used as models and did not give special or reduced prices to purchasers of its installed home improvements for advertising purposes. (Tr. 93-94.)

8. Some of corporate respondent's salesmen or "brokers" represented to prospects that they were "from the factory," thereby implying that they were employed by the factory which manufactured the siding products and that the purchasers would be purchasing directly from the manufacturer and, for this reason, might receive a lower price. (See the testimony of Mrs. Albert Johnson, Tr. 105-130; Miss Wilma Rayles, Tr. 147-153; Mr. James Kelley, Tr. 177-187; Mrs. Dorothy Chapman, Tr. 188-199; Mrs. Mildred Heffelmire, Tr. 219-242; and Mrs. Marlene Kelley, Tr. 298-311.) Some salesmen also represented themselves to be

<sup>2</sup> Inter-State Construction Co., was formerly operated by Mr. Gottesman in Louisville, Kentucky. (Tr. 49.)

<sup>3</sup> Counsel also called five additional witnesses who did not sign sales contracts but who testified concerning the representations made to them by corporate respondent's salesmen in their attempt to sell corporate respondent's home improvements.

<sup>4</sup> The amount of the commission varied in amounts, \$25, \$50, or \$100.

representatives of the United States Gypsum Company. (See testimony of Messrs. Vincent Ehemann, Tr. 204-210; Carl Moritz, Tr. 212-218; Dale Trester, Tr. 263-276; Scott Jewell, Tr. 277-288; and Mrs. Clair Cornett, Tr. 289-297.) As a matter of fact, said salesmen were not representatives of any factory or of the United States Gypsum Company, but were salesmen for corporate respondent. Corporate respondent's salesmen also represented to their prospects that its products and installations were "guaranteed" or "unconditionally guaranteed," thereby representing that said products and completed jobs were guaranteed in every respect for an unlimited period of time. As a matter of fact, there are limitations on Inter-State's guarantees and corporate respondent's guarantees are limited to "the labor and materials" (testimony of the individual respondent, Mr. Gottesman, Inter-State's manager and operating head, Tr. 91-96).

9. By respondents' use of the statements referred to in Paragraph 4 herein, such as "Special Money-Saving Offer," "Tremendous Savings," "Save up to 50% on materials," in their direct advertising circulars (CX 17 and CX 18), respondents represented that they were conducting a special sale and that the prices of the advertised products constituted a reduction from the actual bona fide prices at which such products had been offered to the public on a regular basis for a reasonably substantial period of time in the recent, regular course of respondents' business and that savings were thereby afforded to the purchasers. The testimony of the individual respondent Gottesman refutes the claim that corporate respondent ever conducted a special sale or that its prices were reduced. Corporate respondent could not have a special sale because, by Mr. Gottesman's own testimony, Inter-State did not have a regular price for materials alone or for a completed job, and the completed price of a siding job varies from home-to-home and the completed price estimate varies from "broker" to "broker." (Tr. 80, 83-84.)

10. Respondents seek to avoid any legal liability or responsibility for the false representations of such salesmen or "brokers" on the ground that such salesmen or "brokers" were not in the employ of respondents, but were independent contractors working only for themselves. It may be true that the salesmen or "brokers" were not paid a salary by corporate respondent but only received their remuneration from sales of home improvements made for and on behalf of the corporate respondent. Nevertheless, the respondents clothed said salesmen or "brokers" with apparent authority to bind respondents for representations made by said salesmen.

Respondents furnished said salesmen or "brokers" with printed contract forms bearing the name of corporate respondent Inter-State Builders, Inc., for the use of such salesmen in selling and obtaining signed contracts for the installation of home improvements on behalf of said corporate respondent. The respondents also furnished said salesmen or "brokers" with credit applications, time schedule payment forms, "leads" to prospective purchasers, manufacturer's "pitch" books (Tr. 70-72, 90), and the use of an office and three telephones, all without charge to said salesmen (Tr. 424-425). The Federal Trade Commission Act was passed by the Congress as an aid to protect the public against unscrupulous business practices such as those found to have been practiced here, and respondents cannot escape responsibility for such unlawful acts and practices committed by their agents by claiming that said salesmen are independent contractors.

11. As argument in support of their contention that said salesmen or "brokers" are not employees of respondents, respondents say that said salesmen or "brokers," after obtaining signed contracts from homeowners for the purchase and installation of respondents' aluminum siding or other home improvement materials, is not obligated to "sell" the contract to Inter-State Builders, Inc., but is free to "sell" the contract to some other home improvement company. This type of argument begs the question. Even should it be assumed that the salesman or "broker" is free to "sell" the contract to some other home improvement company, this does not relieve respondents of their responsibility for any false representations made by said salesmen or "brokers" while purporting to act for respondents. The complaint herein involves only alleged false representations made by salesmen who were soliciting home improvements on behalf of the corporate respondent Inter-State Builders, Inc., not some other company. The contracts were on forms provided by the respondents and with the name "Inter-State Builders, Inc." printed thereon. The salesmen or "brokers" represented and led the homeowner to believe that the salesman or "broker" was obtaining the contract for and on behalf of Inter-State Builders, Inc., and that Inter-State Builders, Inc., would install the home improvements called for in the contract. The evidence and testimony is conclusive that the salesmen or "brokers" were acting for an on behalf of Inter-State Builders, Inc., at the time they made the false representations complained about in this proceeding. After clothing such salesmen or "brokers" with ostensible authority to act on their behalf and accepting the benefits accruing from such signed contracts which had been obtained

by said salesmen or "brokers" at least partly as a result of such false representations, respondents cannot now escape responsibility by disowning such salesmen or "brokers" as their agents.

12. At the hearing held in this proceeding on August 15, 1966, pursuant to the Commission's order of remand issued April 22, 1966 [69 F.T.C. 1152], the hearing examiner examined the field report prepared by the Commission investigator reporting his interview with each of the eighteen consumer witnesses who testified at the hearing in this proceeding and finds that neither of said investigation field reports contains a so-called "Jencks statement" as defined in the Commission's opinion issued April 22, 1966, but contain mere summaries of the investigator's interview with the witness. It is plain from the face of each field report that the report does not contain a "Jencks statement," that is, a substantial verbatim recital of an oral statement made by the witness to the Commission investigator and recorded contemporaneously with the making of such statement, but is a mere summary.

13. It is further found that the representations made by respondents in their newspaper and direct mail advertising and by their salesmen or "brokers," as found herein, are false and deceptive. The use by respondents of the aforesaid false and deceptive statements and representations has had and now has the capacity and tendency to mislead members of the purchasing public into the erroneous and mistaken belief that said statements and representations were and are true, and into the purchase of substantial quantities of respondents' products by reason of said erroneous and mistaken belief.

14. In the conduct of their business and at all times mentioned herein, respondents have been in substantial competition, in commerce, with corporations, firms, and individuals engaged in the sale of aluminum and insulated siding products of the same general kind and nature as those sold by respondents.

#### CONCLUSIONS

The aforesaid acts and practices of respondents, as found herein, were and are to the injury and prejudice of the public and of respondents' competitors, and constituted, and now constitute, unfair methods of competition in commerce and unfair and deceptive acts and practices in commerce, in violation of Section 5 of the Federal Trade Commission Act.

It is further concluded that neither of the investigator's reports of interviews with the eighteen consumer witnesses contain a "Jencks statement" but were mere summaries of the investigator's

interviews with each witness. There is nothing in any of the interview reports which would indicate that the report or any part thereof or any statement made therein by the Commission investigator had been approved by the witness or purported to be "a substantially verbatim recital of an oral statement made by said witness to an agent of the Government and recorded contemporaneously with the making of such statement." On the contrary, each report shows on its face that it is a mere summary of the investigator's interview with the witness.

ORDER

*It is ordered,* That respondents Inter-State Builders, Inc., a corporation, and its officers, and Milton S. Gottesman, individually and as a director of said corporation, and respondents' agents, representatives and employees, directly or through any corporate or other device, in connection with the offering for sale, sale and distribution of aluminum siding or other products, in commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from:

1. Representing, directly or by implication, that the home of any of respondents' customers or prospective customers had been selected as a model home to be used as a point of reference for advertising purposes, unless in every instance the home has in fact been selected as a model, and unless in every instance the home is used for such purposes;
2. Representing, directly or by implication, that any special price, allowance, discount or commission is granted by respondents to purchasers in return for permitting the premises on which respondents' products are installed to be used for model home demonstration purposes, unless respondents grant such special price, allowance, discount or commission in every instance;
3. Representing that respondents' salesmen or representatives are factory representatives, or otherwise misrepresenting the status of such salesmen or representatives;
4. Representing that respondents' salesmen or representatives are representatives of the United States Gypsum Company, or representing that respondents or their representatives are affiliated with any company or organization with which they are not in fact affiliated;
5. Representing, directly or by implication, that any of respondents' products are guaranteed, unless the nature and extent of the guarantee, the identity of the guarantor and the

manner in which the guarantor will perform thereunder are clearly and conspicuously disclosed;

6. Representing that respondents' customers are granted any reduction in price for their products, unless the price offered constitutes a substantial reduction from the actual bona fide price at which such products had been offered for sale on a regular basis for a reasonably substantial period of time in the recent, regular course of respondents' business;

7. Misrepresenting in any manner the savings available to purchasers of respondents' merchandise.

#### OPINION OF THE COMMISSION

JULY 28, 1967

BY JONES, *Commissioner*:

This matter is before the Commission for the second time on appeal by respondents. After appeal from the first initial decision by the hearing examiner issued on January 21, 1965, the Commission, without considering the merits, remanded the case to the examiner to reconsider certain interview reports of witnesses called by complaint counsel [69 F.T.C. 1152]. The examiner issued his second initial decision on September 9, 1966, confirming his earlier exclusion of the interview reports as attorney's work product and reaffirming his findings and conclusions on the merits of the case. The case is again before us on respondents' appeal from these decisions of the examiner.<sup>1</sup>

The complaint, issued on May 14, 1964, charged that respondents violated Section 5 of the Federal Trade Commission Act and alleged that respondents' "salesmen or representatives" had falsely represented in oral solicitations that prospective purchasers of respondents' aluminum and insulated siding products would receive discounts on purchases in return for allowing their homes to serve as models of respondents' products or would receive commissions on sales made to other buyers who purchased respondents' products after observing the purchasers' remodeled homes; that respondents' prices were advertised as special sales prices and as

<sup>1</sup> Counsel for both sides advised the examiner during the hearing on remand that they would waive the refiling of proposed findings of fact, conclusions of law and proposed orders which had been originally submitted prior to the initial decision of the examiner on January 21, 1965 (Suppl. I.D. p. 375). On September 9, 1966, the examiner's supplemental initial decision issued incorporating the findings and conclusions of his first decision except for some deletions in par. 8 of his first initial decision and except for the findings and conclusions relating to the production of the interview reports as to which new findings and conclusions were entered by the examiner. Since the examiner's second initial decision encompassed the findings and conclusions of his first decision as to the merits of the case as well as his findings and conclusions on remand, we will refer in this opinion only to his second initial decision.

reductions from respondents' regular price of such merchandise and that respondents falsely represented that their guarantees were unconditional. Respondents denied that the alleged representations with respect to model homes, guarantees and special sales prices were false, alleged that, if made, they were not material in inducing the purchases of respondents' products and finally, claimed that the persons through whom their products were sold were not their "salesmen or representatives" and that they did not direct or control the representations made by these persons.

The hearing examiner concluded that respondents were responsible for the representations of the persons through whom they sold their products (I.D. pars. 10-11) and that respondents had made the representations with respect to the discounts or commissions which purchasers would receive if their homes were used for display purposes, as well as those respecting special prices and unconditional guarantees and that those representations were false (I.D. pars. 3-7, 13). Finally, the examiner concluded that the contested interview reports were not producible within the meaning of the Jencks rule as discussed in the Commission's opinion on remand (I.D. par. 12).

In their appeal, respondents do not challenge the examiner's findings that respondents' prices were falsely represented and that additionally respondents' customers had been falsely advised that their homes would be used as demonstration models for respondents' other potential customers and that they would receive commissions on sales to such potential customers (Resp. Suppl. Br. p. 2).

Respondents, however, do challenge the examiner's findings and conclusions that they are responsible for the representations of their salesmen and that they had misrepresented their guarantees. Respondents also contend that the prohibition in the proposed order with respect to respondents' representations that commissions will be paid prospective purchasers permitting their homes to be used for demonstration purposes was not supported by the examiner's findings. Finally, respondents argue as a threshold issue the correctness of the examiner's conclusions with respect to the non-producibility of the interview reports and contend alternatively that the reports are producible as Jencks rule statements or that at least the examiner should have ordered a *voir dire* to determine this point. Thus respondents urge that the case be reversed and remanded (Resp. Suppl. Br. p. 2).

We will consider each of these issues seriatim.

## I

*The Producibility of the Interview Reports**A. The Hearing Examiner's Decision*

On remand of this matter to the examiner a hearing was held on August 15, 1966, at which complaint counsel produced copies of the interview reports with respect to each of the 18 consumer witnesses who testified in support of the complaint.<sup>2</sup> The examiner called a recess for an unspecified period of time during which he apparently examined the interview reports.<sup>3</sup> After reconvening the hearing he announced that he had concluded that the reports did not contain any statements within the meaning of the Jencks rule. However, he requested complaint counsel to deliver copies of the reports to respondents' counsel; complaint counsel did so without objection. After examining the reports respondents' counsel returned them to the hearing examiner and stated that in his judgment the reports were producible either as substantially verbatim statements "or conceivably the reports were drawn from notes which might have been read back in part or in whole to witnesses and approved by them" (Tr. 478). Respondent argued that there was enough on the face of the reports which "should have triggered a *voir dire* examination to determine whether or not the statement was substantially verbatim" (Tr. 478-79, 481, 482, 485-86). The examiner declined to do so. In his decision on remand he stated that after an examination of the documents, he was able to determine from the face of each report that it did not contain a Jencks statement. In his initial decision he concluded:

\* \* \* that neither of the investigator's reports of interviews with the eighteen consumer witnesses contain a "Jencks statement" but were mere summaries of the investigator's interviews with each witness. There is nothing in any of the interview reports which would indicate that the report or any part thereof or any statement made therein by the Commission investigator had been approved by the witness or purported to be "a substantially verbatim recital of an oral statement made by said witness to an agent of the Government and recorded contemporaneously with the making of such statement." On the contrary, each report shows on its face that it is a mere summary of the investigator's interview with the witness (I.D. pp. 381-382).

<sup>2</sup> The hearing examiner's order dated July 26, 1966, scheduled the remand hearing for August 15, 1966, and stated that at that time he "will examine and inspect the so-called field reports made by the Commission's investigators \* \* \* in order that the hearing examiner may determine whether said reports made by the investigators were 'Jencks statements.'"

<sup>3</sup> On oral argument, respondents' counsel contended that this interval did not exceed 10 minutes (Tr. Oral Argument p. 3). Complaint counsel vigorously disagreed with this estimate and contended the interval was at least 45 minutes (Tr. Oral Argument pp. 33-34). Neither counsel noted for the record at the time the exact length of time taken by the examiner (Tr. Oral Argument p. 34). We do not believe the time of the interval is of any legal significance.

The interview reports have been placed under seal and delivered to the Commission on this appeal. Both counsel agree, and indeed respondents' counsel strongly argued in his brief, that it is proper for the Commission to examine these reports and to draw its own conclusions as to their producibility (Resp. Br. p. 2; Compl. Counsel's Br. pp. 1-2).

The issues raised by respondents with respect to the producibility of the 18 interview reports in issue are three: (1) do these interview reports constitute substantially verbatim statements of the witnesses interviewed, (2) were these interview reports shown to and adopted or approved by the witnesses, and (3) can the producibility of these reports be determined on their face without recourse to a *voir dire*. Before considering the particular interview reports involved in this case, it will be useful to summarize the applicable case law respecting the criteria which have been used by the Courts in determining what constitutes a producible statement within the meaning of the Jencks rule.

B. *The Applicable Law Relative to Producibility of Witnesses' Interview Reports*

The Courts are clear that any substantially verbatim statement of a witness or any report of a witness' statement which has been adopted or approved by a witness should be produced.

The question of whether a report has been signed, adopted or approved by the witness is of course a question of fact which must be determined either from the face of the report or on the basis of extrinsic evidence. In *United States v. Lamma*, 349 F. 2d 338, 341 (2nd Cir. 1965), the Second Circuit held that in the ordinary case, it is the Court's obligation to examine the report to determine whether it raises on its face any suggestion that adoption or approval might have occurred. If such an inference is raised from the face of the document the Court is then under a duty to conduct a *voir dire* to determine the issue. If no such inference appears from an examination of the document, it is respondents' duty to adduce some facts which would create such an inference. Absent such facts suggesting the possibility of an adoption or approval, the Court is not required to conduct a *voir dire* and is free to decide the question on the basis of an examination of the document itself.

In determining what constitutes a record of a substantially verbatim statement, the general rule applied by the Courts is that any report which can fairly be said to reflect a witness' own words should be produced. Reports which constitute merely an attorney's

summary of a witness' remarks just as importantly need not be produced. *Palermo v. United States*, 360 U.S. 343, 350 (1959). As the Supreme Court stated in *Palermo*, the utmost caution must be exercised in ordering production of reports which do not fairly represent the witness' statement since it would be "grossly unfair to allow the defense to use statements to impeach a witness which could not fairly be said to be the witness' own rather than the product of the investigator's selection, interpretations and interpolations" (360 U.S. at 350). The Court went on to point out that:

It was important that the statements could fairly be deemed to reflect fully and without distortion what had been said to the government agent. Distortion can be a product of selectivity as well as the conscious or inadvertent infusion of the recorder's opinions or impressions. It is clear from the continuous congressional emphasis on "substantially verbatim recital," and "continuous, narrative statements made by the witness recorded verbatim, or nearly so \* \* \*," see Appendix B, post 79 S. Ct. page 1228, that the legislation was designed to eliminate the danger of distortion and misrepresentation inherent in a report which merely selects portions, albeit accurately, from a lengthy oral recital. Quoting out of context is one of the most frequent and powerful modes of misquotation. We think it consistent with this legislative history, and with the generally restrictive terms of the statutory provision, to require that summaries of an oral statement which evidence substantial selection of material, or which were prepared after the interview without the aid of complete notes, and hence rest on the memory of the agent, are not to be produced. Neither, of course, are statements which contain the agent's interpretations or impressions (pp. 352-53).

Thus the Courts have demonstrated that if the Jencks Act should be applied as the Commission is here applying it, not only is the concept of that legislation fair, but so is its application.

This same rationale was emphasized by the Second Circuit in *United States v. Lamma*, 349 F. 2d 338, 340 (2nd Cir. 1965) in which the Court observed that where an alleged recorded statement of a witness is to be used for impeachment purposes, "it should be his own statement and not someone else's interpretation of what the witness said or what he thought the witness said."

In determining whether a report reflects a witness' statement or merely the attorney's summary of what the witness told him, the Courts have indicated that some or all of the following factors should be looked to:<sup>4</sup>

1) The extent to which the report conforms to the language of the witness;

<sup>4</sup> *United States v. Lamma*, 349 F. 2d 338, 340 (2nd Cir. 1965); *Williams v. United States*, 338 F. 2d 286, 288 (D.C. Cir. 1964); *Saunders v. United States*, 316 F. 2d 346, 349-50 (D.C. Cir. 1963); *United States v. Aviles*, 315 F. 2d 186, 191 (2nd Cir. 1963); *United States v. McKeever*, 271 F. 2d 669, 674-75 (2nd Cir. 1959); *United States v. Waldman*, 159 F. Supp. 747, 749 (D. N.J. 1958).

- 2) The length of the report in comparison with the length of the interview;
- 3) The lapse of time between the interview and the preparation of the report;
- 4) The appearance in the report of the substance of the witness' remarks;
- 5) The use of quotation marks;
- 6) The presence in the report of the comments or ideas of the interviewer.

The Court is not under any absolute obligation to conduct a *voir dire* in order to determine the issue of whether a report is or is not a statement of the witness within the meaning of the Jencks rule. This is a matter for the discretion of the Courts. *Campbell v. United States*, 365 U.S. 85, 93 (1961); *Palermo v. United States*, 360 U.S. *supra* at 354-55; *United States v. Lamma*, 349 F. 2d 338, 341 (2nd Cir. 1965); *United States v. Hilbrich*, 232 F. Supp. 111, 121 (N.D. Ill. 1964). As the Supreme Court stated in *Palermo*:

It is also the function of the trial judge to decide, in the light of the circumstances of each case, what, if any, evidence extrinsic to the statement itself may or must be offered to prove the nature of the statement. *In most cases the answer will be plain from the statement itself.* In others further information might be deemed relevant to assist the court's determination. This is a problem of the sound and fair administration of a criminal prosecution and its solution must be guided by the need, reflected in so much of our law of evidence, to avoid needless trial of collateral and confusing issues while assuring the utmost fairness to a criminal defendant (360 U.S. 354-55), (emphasis added).

It is against the background of these general principles that we must make our decision as to the correctness of the hearing examiner's conclusion that the 18 interview reports were not producible within the criteria laid down by our earlier opinion on remand.

### C. Description of the Interview Reports

The 18 field reports under consideration were prepared by two attorneys on the staff of the Commission each of whom drew up nine reports. For convenience of reference each of the series of nine reports will be referred to respectively as the Burger reports and the Rynerson reports.

The nine Burger reports were prepared on the basis of three days of interviews, two interviews on November 8, 1962, in two different cities in Ohio, three interviews on November 9, 1962, again in two different cities, and four interviews on November 10,

1962, all in the same city. All of the Burger interview reports were dated either January 3 or 4, 1963, almost two months after the dates of the interviews reported. Five of these reports record joint interviews of husband and wife attributing the facts or information recited in the report to "informants" under such variations as "informants first learned of \* \* \*" or "informants did not know \* \* \*" and the like. The other four reports concern interviews of either husband or wife.

None of the nine Burger reports contain any indications or notations that either the reports or the notes, if any, on the basis of which they were prepared had been shown to or approved or adopted by the witnesses.

Each of the Burger reports, whether reporting interviews of husband and wife teams or of individuals, commences with the opening paragraph "Upon being informed as to the purpose of the interview, the informant(s) advised the writer substantially as follows:"

Six of the Burger reports, of which three were interviews of husband and wife jointly, are organized in a substantially similar manner and contain identically titled sections, frequently listed in the same order, bearing the headings "1. Relationship of Informant to Investigation," "2. Method of Solicitation," "3. Salesman," "4. Product," "5. Solicitation Representation" and "6. Basic Sales Pitch," (further broken down into subtopics entitled "model home representations," "referrals" and "debt consolidation") and "7. Sales Contract." It is clear from a mere examination of these reports that they are not verbatim recitals of witnesses' statements. We can take official notice of the fact that, however, much as we might wish, witnesses do not respond in interviews in such neat, precise and organized fashion. It is certainly clear that six witnesses will not narrate their experiences in virtually the same order, picking out virtually the identical items to discuss. The language of these reports is clearly the language of the attorney summarizing and capsulating those facts stated by the witnesses which in the attorney's mind was relevant to her inquiry.

The other three Burger reports, while not organized under precise headings, in general followed the same pattern of organization and in many instances employ identical language in detailing the facts. Thus, for example, two of the reports, not organized into sections, start the paragraph with the identical sentence to the effect that "The [name of interviewee's family] first contact with Interstate was \* \* \*" etc. Moreover, the vocabulary and style of these latter three reports is substantially similar to the

other six more tightly organized Burger reports and again clearly appear to be the work of the attorney and not the words of the interviewees. It is also noteworthy that this vocabulary and style of all of these reports is the same whether the interviewees were individuals or a husband and wife team. Again it is obvious that nine witnesses will not detail their experiences in the same sequential order of events nor will they use identical language.

In some of the Burger reports, some material is set off by parentheses and in one case by the notation "Writer's Note." It is clear from reading these reports that the purpose of this differentiation was to distinguish those facts recited in the report which emanated from the witnesses and those which were known to Miss Burger. Thus in these reports, this differentiation does not create the inference, as respondents' counsel's cursory perusal of these reports thought it did, that the material not so set off therefore represented the witness' statements.

The Burger reports also occasionally contain words or phrases set off in quotation marks. In some instances these quotation marks are used to set off proper nouns such as "plasticrylic." More frequently they appear around isolated words or phrases in the middle of a sentence. Typical of this usage of quotation marks in the Burger reports (represented by the inner quotations) is the following excerpt from a joint composite husband and wife interview:

For allowing their home to be the "first in the neighborhood", "a model" "to advertise" the products, the K \* \* \* s would receive the opportunity of a lifetime: a "reduced price" on the expensive material; "factory prices", "wholesale," "factory to your." \* \* \* Mr. W[ \* \* \* ] stated that the K \* \* \* s could get the siding "cheap" now.

These same words appear also in quotation marks in other Burger reports. It is clear from the way in which these words are used that they are intended to remind the investigating attorney of individual words used by the witness and to highlight them as such in her mind. However, in no sense could excerpts of them if given to respondents' counsel be of any value as reflecting the witness' narrative of events discussed.

The nine Rynerson reports were prepared virtually contemporaneously with the conducting of the interview with a two or three day interval elapsing between interview and report. Eight of these interviews took place on October 26 and one on October 25, 1963. Eight of the reports of these interviews were apparently dictated on October 28 and one on October 29, 1963. Two of the Rynerson reports record interviews of husband and wife jointly

without differentiating in most cases the facts recited in the report between those contributed by the husband and those by the wife.<sup>5</sup> None of these reports indicate that they had been approved or adopted by the parties or that the notes, if any, which formed the basis for their preparation had been shown to or approved or adopted by the interviewees.

Six of the nine Rynerson reports, start with an opening paragraph identifying the interviewees followed by the words "informant(s) stated in substance as follows." This pattern is followed irrespective of whether the interviewees were a husband-wife team or simply one person. In five of the reports this same format is also used to introduce facts attributed by the interviewees to respondents' salesmen. Thus these Rynerson reports describe these facts with the sentence: "the salesmen stated in substance as follows:"

The format, style and language of the nine Rynerson reports are almost identical. Eight of these reports in fact use the identical words in describing respondents' salesman. Thus these eight reports whether respondents' salesmen were or were not "pushy," or whether they tried to "rush" the interviewees into signing contracts. In two of these cases the report was a composite husband and wife interview. It is obvious that these words are either the words of the attorney capsulating his impression of the sense of what the witnesses reported to him or reflected the witnesses' responses to precise questions of the attorney rather than their own volunteered narrative of their experiences with respondents' representatives.

There are other examples of facts attributed to the interviewees appearing in these reports in identical language, such as the representations attributed by the interviewees to respondents' salesmen as to whether the siding "would need to be painted, would not need maintenance for a lifetime, would not burn, would resist all kinds of weather, would insulate, would save on heating bills, would not dent or peel or was indestructible." Again, it is highly unlikely that nine interviewees narrating what nine different representatives of respondents told them would use virtually identical language in describing the various representations of painting, maintenance, peeling, burning, etc. or would recite these representations in the same sequence. It is also inconceivable that witnesses will volunteer to an interviewer facts with respect both to representations which *were* made as well as to representations

<sup>5</sup> In one instance facts were attributed to one or the other of the spouses such as "Mrs. B recalled in response to questions, that \* \* \*."

which *were not* made. Unless prompted by specific questions, witnesses do not narrate negative representations as to what salesmen had *not* represented.

Some of the Rynerson reports contain words and phrases in quotation marks. In four of these reports these quotation marks are used to refer to the contents of a mailer received from respondents by the interviewee. The quoted words were those which the witness recalled had been contained in the mailer which the interviewee had not retained and the report expressly stated that they had been elicited from the witness by express questions. It is significant that the paragraph in each of these four reports describing the interviewees' receipt of the mailer and its recollected contents is almost in *haec verba*, thus again negating any inference that these reports reflect the witnesses' own words or narrative of their experience with respondents. In a few instances quotation marks are put around a word or a phrase within a sentence such as "one of the men said he was a representative of Interstate, that is 'a fieldman,'" or in another instance "The C \* \* \* s said 'no' to this price." Similarly statements attributed by the interviewee to what respondents' salesmen said to them are on occasion set off in quotation marks. In no instance in any of these reports was a full sentence ever quoted. It is apparent from reading these reports that the attorney's use of quotation marks was intended to indicate that the quoted word or phrase was that used by the witness.

As with the Burger reports, some of the Rynerson reports record information identified as emanating from Commission files and also contain comments about the witness' demeanor, personality and estimated capability as a witness as well as their stated willingness to appear if called. In some instances this material is set off by parenthesis but in most instances it simply appears as part of the running text of the report in no way differentiated from the facts elicited from the witnesses. The interweaving of material obviously culled from the witness with that which just as obviously emanated from the attorney or from some other source underscores again the inescapable conclusion that these reports are in no sense a recital of a statement by a witness but on the contrary are clearly summaries of facts culled by the attorney from statements made by the interviewees to the attorney and probably in response to precise questions of the attorney.

On the basis of our examination of these 18 reports, we hold that the hearing examiner was correct in his conclusion that none of these reports constitute statements of witnesses which are

producible under the principles laid down in the Jencks Act cases.

The two Rynerson reports and the five Burger reports, recording joint interviews of husbands and wives, clearly constitute a composite record of facts detailed by two persons and we conclude that in no sense could they be regarded as a substantially verbatim statement of a single witness.

The remainder of the Burger and Rynerson interview reports do not record "continuous narrative statements" given by any of these witnesses.<sup>6</sup> As noted above, the material in seven of the reports was itemized under separate headings. There can be little doubt that this well-organized format is not an accurate reflection of any of the witness' statements but represents an attempt by the attorney to categorize the various remarks which were made for the purpose of facilitating their use in the proceedings. *United States v. Aviles*, 337 F. 2d 552, 559 (2nd Cir. 1964). The other reports, while less rigidly subdivided, also indicate that they are the product of the efforts of the investigators to organize by subject matter the various statements made by the witnesses. This is underscored by the fact that the Burger and Rynerson reports respectively follow a substantially similar organization pattern which clearly negates any possible inference that they record a narrative detailed by a witness. Clearly even the wildest coincidence would not explain the fact that nine witnesses interviewed by one attorney would all detail their story in one organizational pattern and nine other witnesses interviewed by another attorney would all detail their stories in another but also similar organizational pattern. The fact that these reports were organized in such substantially similar patterns and that the language also appears to be substantially similar indicates clearly that the facts reported in each of the reports are the result of the attorney's selection and that only the highlights of the interview which were relevant and useful for the attorney's preparation of the case were recorded.

Moreover, the language of these eighteen reports is clearly that of the attorneys rather than that of the witnesses. The reports consistently detailed the facts in the same words and expressions.

<sup>6</sup> Ten of these reports are introduced with the statement that the "informant[s] advised the writer substantially as follows." This fact does not in our opinion require the conclusion that the reports are substantially verbatim transcriptions of the witnesses' remarks. Prefatory statements of this nature, which are standard in interview reports, appear to be mere formalities and thus do not indicate the intention of the interviewer or affect the substance of the reports. See *United States v. Williams*, 328 F. 2d 386 (D.C. Cir. 1964) where the court ignored a statement at the opening of a report that "the following is a summary of the witness conversation not read to or by the witness; it is not intended to be a substantially verbatim account," in reaching the conclusion that it was a substantially verbatim recording.

It is inconceivable that 18 witnesses recounting their experiences with different representatives of respondents on 18 different occasions would use such identity of sequence and expression.

Because of the similarity of style and format and even of the words used in all of these reports and because of the intermixture of facts contributed by the witness with facts known to the interviewer, we conclude on the basis of our examination of these reports that they are obviously summaries of relevant facts culled by the interviewing attorneys from what the witnesses told them and in no sense could be regarded as a recital of a continuing narrative told by a witness in his or her own words and style. These field reports clearly indicate on their face that they are not substantially verbatim recordings of the witness' statements and therefore we conclude that the examiner did not err in reaching this conclusion without the benefit of a *voir dire* examination.

The hearing examiner also concluded that these reports had not been signed, approved or adopted by any of the witnesses (I.D. par. 12 and "Conclusions").

We are convinced from our examination of these reports that, under the circumstances of this case, respondents' counsel not having even on this appeal adduced a single fact or circumstance even remotely suggesting that any of these reports were adopted or approved by the witnesses, the examiner was entitled to rely on his examination of the face of these documents and that it was entirely reasonable for him to conclude that there was no adoption or approval. Our own examination of these documents convinces us that he was correct, that the possibility of the adoption or approval of these reports by the witnesses was so remote as to be nonexistent and that under the circumstances of this record there was nothing to warrant the examiner to take extrinsic evidence on the issue of the possible adoption or approval of these reports by the witnesses.

None of the reports was signed by any of the witnesses and none contain any indication on their face that they were shown to or read back to the witnesses or in any other way approved or adopted by the witnesses. Indeed there are other indications on these documents which suggest conclusively that these reports were not shown to the witnesses.

Several of these reports contain references to facts contained in the Commission's files and other facts obviously not known to or contributed by the witness. They also contain in some instances the interviewing attorney's appraisal of the witness' personality and demeanor. These facts strongly negate any possibility that

the reports were or indeed could, under the Commission's Rules of Practice, have been shown to the witness.<sup>7</sup> Several of the reports affirmatively state that the witness was willing to testify at the proceedings. Surely if the investigating attorneys were careful to note this fact, they certainly would have noted the even more critical fact that the contents of the report had been shown to and approved by the witness.

Moreover, the extrinsic circumstances surrounding the preparation of these reports also tend to negative any inference that either the reports or any notes on which they were based were read back to or approved by the witness. The interviews all took place in cities in which there are no Commission field offices. Since the intervals between the interview and the report ranged from two days to two months, it seems probable that these reports were transcribed by the interviewing attorneys in their own offices in Washington, D.C. To obtain approval by the witness of the report the examining attorney would have been required to return to the witness' home, telephone the witness or deliver a copy to him by mail. Had the investigator taken any of these steps we believe that he would have in some way indicated on the reports that he had done so.

We reach the same conclusion with respect to the question of whether the witnesses may have adopted or approved any notes taken by the attorneys during the course of the interview. Again we are of the view that if such notes had been read back to and approved by the witness, some affirmative indication of such an important factor would have been made on the face of the report. However, in the light of the ultimate format of these reports, whether or not the notes from which they were prepared were checked with the witness, appears to us to be wholly irrelevant. If notes were taken and approved by the witness, there must be some correlation between the notes and the interview report in order for any such adoption of notes to constitute an adoption by the witness of the report. We have concluded that the reports are not substantially verbatim records of statements made by witnesses but represent the summaries of the attorneys encompassing highly selective facts in a sequence organized by the attorneys for their own purposes and convenience. Under the circumstances, it is impossible for us to infer that any notes which

<sup>7</sup> The fact that these reports refer to Commission files and other data not elicited from the witness would probably make it improper for the attorney to have shown the reports to the witness since disclosure of information from the Commission's files is prohibited by both the Commission's Rules of Practice and Section 10 of the Federal Trade Commission Act which generally prohibits disclosure of documents in the Commission's files.

could have been presented to the witness could have taken the well-organized form of the reports or could have been cast in essentially the same language which appeared in the reports. Accordingly, the factors which led us to conclude that the reports were not substantially verbatim recordings of the witnesses' remarks also compel the conclusion that they were not substantially identical to any interview notes which might have been taken and which might have been read back to the witness.

Respondents argue that in the absence of any express negative statement to this effect appearing on the face of the report, the hearing examiner must order a *voir dire*,<sup>8</sup> We do not read the cases as laying down such an inflexible rule. Indeed the courts have gone to great pains, even in criminal cases involving even more important rights of individual liberties, to underscore the discretion which the triers of fact have in these matters and the weight which will be accorded their decision. *Campbell v. United States*, 373 U.S. 487, 493-94 (1963); *Palermo v. United States*, 360 U.S. 343, 353, 360 (1959); *United States v. Lamma*, 349 F. 2d 338, 341-42.

In the instant case we hold that under the circumstances of this remand, respondents' counsel failed to bring out or even suggest the existence of facts which might create the barest inference of approval or cast the slightest doubt on what we have concluded are very clear indications of nonapproval appearing on the face of these reports. As the Second Circuit in *Lamma* pointed out, the question of a witness' knowledge of any facts bearing on adoption or approval is a matter for respondents' counsel to elicit.

The Commission's opinion on remand was issued on April 22, 1966 [69 F.T.C. 1152]. In that opinion we laid out the procedure which should be followed by the examiner and stated:

The initial step is for him to inspect the document *in camera*. He may be able to determine from its face whether it is a mere summary or has been approved by the witness. If it is unclear whether the document qualifies as a Jencks statement the examiner should on his own motion conduct a *voir dire* examination into the circumstances surrounding its making (Comm. Op. p. 36 [69 F.T.C. at 1175]).

The examiner scheduled the hearing on remand to be held on

<sup>8</sup> Respondents also argued that the hearing examiner in failing to conduct a *voir dire* violated the Commission's instructions to him on remand (Resp. Br. p. 2). Respondents are in error in contending that the Commission directed the examiner to hold a hearing "unless there was some indication on the face of the document that the witness had approved it" (Resp. Br. p. 7). The Commission's opinion and order made it quite explicit that the examiner was to examine the documents and "if it was unclear whether the document qualifies as a Jencks statement," a *voir dire* might be conducted (Commission's opinion p. 36 [69 F.T.C. at 1152]; Commission's order par. 1 directing examiner "to determine [this issue] by appropriate procedures, including a hearing if necessary \* \* \*") [69 F.T.C. at 1176].

August 15, 1966. In his order he stated that at the hearing he intended to examine the documents in order to determine the issue of their producibility. Respondents' counsel did not indicate that the hearing should encompass anything else. He had ample time and opportunity to ascertain from the witnesses prior to the hearing whether the reports or the notes, if any, on which they were based, had ever been read back to them or whether they had in any other manner approved or adopted these reports. Apparently this was not done, or no such facts were elicited from those witnesses. Despite the Second Circuit's opinion in *Lamma* and our own direction to the examiner, respondents' counsel did nothing. He never raised to complaint counsel or to the examiner the position which he is contending for here, that under no circumstances could this issue of adoption or approval be determined without a *voir dire*. Instead, he came to the hearing called by the examiner and acquiesced in the announced procedure under which complaint counsel produced the eighteen reports in question for examination by the examiner without indicating to the examiner his position that unless the examiner found the reports to be producible the hearing on remand would have to encompass examination of the attorneys or of the 18 witnesses to resolve the issue of approval or adoption. After the hearing examiner announced his conclusion and provided respondents' counsel with an opportunity to examine the reports himself, counsel then inquired from complaint counsel as to whether the Commission files indicated that any notes had been taken and was informed that they did not. Respondents' counsel then requested the examiner to conduct a *voir dire* to resolve the question of whether the reports were *substantially verbatim records* of the witness' statements. Counsel argued in support of this request that *his* examination of the face of these documents indicated to him clearly that the reports were substantially verbatim and therefore as a minimum the examiner should conduct a *voir dire* before ruling. No brief was tendered to the examiner on the point nor any cases cited to him. Respondents' counsel, either by way of affidavit or even oral statement, never once indicated that he had knowledge of any facts, no matter how inferential, that even one of these witnesses might have adopted or approved the report. Thus, respondents' counsel confined his opposition to the examiner's conclusion as to producibility of these reports on the identical source relied upon by the examiner, namely, the face of the documents. We believe that in the face of this argument and in the absence of any suggestion by respondents' counsel of the existence of facts which

might at least raise an inference of approval, the examiner was entitled to resolve the issue as he did on the basis of his examination of the reports.

We also have examined these documents and we conclude that these 18 reports show clearly on their face that they were not signed, approved or adopted by the witnesses, and that therefore the examiner was correct in determining that a *voir dire* was unnecessary since no doubt had been raised by respondents' counsel with respect to the correctness of this conclusion.

## II

### *The Allegations of the Complaint and the Order*

#### *A. Alleged Misrepresentations*

Respondents concede that the representations made by their field men with respect to the special reduced prices at which their aluminum siding products were being sold, the use of the purchasers' houses as demonstration models and the possibility of additional discounts and commissions which could be earned in other sales made by respondents on the basis of such use, were false and misleading and have not appealed from the examiner's findings and conclusions sustaining these complaint allegations.

The only allegations in the complaint remaining in issue on the merits of the alleged representations therefore are those charging that respondents' salesmen falsely represented that respondents' products were "guaranteed in every respect for an unlimited period of time" (Complaint, Pars. Four (4) and Five (5)).

The examiner found, and respondents concede, that respondents' salesmen in many instances represented that the products and completed jobs were "guaranteed" and "unconditionally guaranteed" (I.D. par. 8; Resp. Br., p. 27; see also Tr. 105, 108, 133, 136, 150, 167, 284, 301, 317). The examiner also found that there were limitations on respondents' guarantees and that many of them were limited to "labor and materials" (I.D. par. 8; Tr. 91-96). He concluded that these guarantees of labor and materials were conditional guarantees and hence that respondents' oral representations were false and misleading (I.D. par. 8).

The evidence is undisputed that respondents' representatives orally represented that respondents' products were unconditionally guaranteed (Tr. 105, 108, 167, 222, 258, 283-84, 301). It is also undisputed that in some instances, the contracts ultimately entered into contained guarantees of labor and materials (CX 22,

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24, 35) and in other instances contained no written guarantees of any kind (CX 20, 30, 40, 46).

Respondents do not dispute these facts. Rather, respondents contend that their guarantees of labor and materials are unlimited guarantees as orally represented and that in any event, "in every case where a representation as to a guarantee has been made, respondents have honored the guarantee" and hence no deception occurred in practice (Resp. Br. p. 28). The hearing examiner made no findings on the facts underlying respondents' defense of performance.

Thus two separate issues are presented: First, were customers deceived when they were orally told that respondents' products were guaranteed and subsequently found out that the unconditional guarantee as written in the contract was expressed in terms of labor and materials? Second, under the circumstances of this case, were customers deceived when after receiving similar oral representations, their contracts contained no written guarantees of any kind?

On the first issue as to whether an oral representation that a product is unconditionally guaranteed is false where the written guarantee is described in terms of labor and materials, we believe that the examiner was wrong on this record in concluding that such oral representations were false (I.D. par. 8). We recognize that unlimited guarantees can, if so expressed, encompass matters other than labor and materials such as time of completion and indeed completion itself. However, the record does not indicate that anything beyond labor and materials was referred to. Respondent Gottesman testified that the guarantee covered "the performance that we have committed as far as the labor and materials are concerned" (Tr. 91). He also testified that only obvious limitations were involved such as an automobile running into the home (Tr. 96). If any time limitations were intended, these would be written into the contract (Tr. 90). Our attention has not been drawn to any such contract provisions. The contracts in evidence, embodying guarantee representations, contained the phrase "labor and materials guaranteed unconditionally" (*e.g.*, CX 24 and CX 35). The examiner failed to indicate in what respect he believed that these contractual guarantees were more limited than those orally represented (I.D. par. 8). We conclude, therefore, that in those instances in which unconditional guarantees of labor and materials were written into the contracts, the salesmen's representations with respect to unconditional guarantees were not false or deceptive.

The examiner did not consider the question of whether customers were deceived in those instances in which oral claims of guarantees were made but no written guarantees were given to the customers or included in the contracts.

In his testimony respondent Gottesman stated that Inter-State "take[s] care" of all complaints in those cases in which the contracts contained specific provisions for unconditional guarantees (Tr. 392). However, Gottesman did not intimate, as respondents' counsel claims, that respondents honor all representations, oral or written (Resp. Br. p. 28). He was able to cite only one instance where respondents repaired a hole in a defective installation under a contract containing no provision respecting guarantees (Tr. 105, 126, CX 20). Moreover, the record demonstrates that respondents' contracts specifically provided in small print that respondents were "not responsible nor bound by any representation not contained in this agreement" (*e.g.*, CX 22). This provision is not only consistent with Gottesman's testimony on the stand, but is also consistent with respondents' contention vigorously urged here on appeal that it is not responsible for the representations made by its field men. In the face of this contract provision which respondent Gottesman's testimony confirmed, evidence of a single isolated incident where a repair was made without a written guarantee hardly provides support for respondents' contention which they now make in their brief that for the life of their products respondents did in fact repair or replace defective products or reimburse the customers for such products, as their salesmen's representations imply, irrespective of whether or not the contract contained any written provision to this effect. Moreover, the evidence in the record indicates that the failure of the contracts to incorporate the salesmen's oral representations of unlimited guarantees in fact operated to prevent customers from even claiming any rights under such oral guarantees. For example, Mrs. Marlene Kelly, an Inter-State customer, testified on cross-examination that this was precisely her reaction. In response to a question as to why she never called Inter-State and asked them to make repairs when some of the siding went bad, she testified:

A. Well, we signed the release contract. What good would it do? They didn't give us a handwritten guarantee (Tr. 308).

We conclude, therefore, that respondents have failed to adduce sufficient probative facts to support their defense that they honor all oral representations of guarantees regardless of whether these appeared subsequently in the contract or not.

We do not have to reach the question, therefore, of whether such a defense is legally sufficient, although we would and do conclude for the reasons already expressed in the Seventh Circuit opinion in *Montgomery Ward and Co., Inc. v. Federal Trade Commission*, 379 F. 2d 666 (7th Cir. 1967) that such a defense, if made out, would be legally insufficient to the charge that oral representations of the existence of guarantees are deceptive where they are not subsequently incorporated into a contract and where the contract specifically provides that the guarantor is not responsible for any representations not contained in the contract.<sup>9</sup>

*B. Respondents' Responsibility for the Statements of Their Salesmen*

The complaint charged that misrepresentations were made in oral solicitations to prospective purchasers by respondents' "salesmen or representatives." Respondents denied that the persons through whom their products were sold to the public were their salesmen or representatives but claimed that they were "brokers" or "independent contractors" who were not in the employ of respondents and over whose activities respondents exercised no "control or direction" and therefore that "any representations made by such brokers are solely their own" and "may not be attributed to respondents." The examiner, while conceding that it "may be true that the salesmen or 'brokers' were not paid a

<sup>9</sup> We see no significant difference between the practice here of orally representing the existence of a guarantee which was not subsequently provided for in the written contract and the practice of Montgomery Ward in advertising unlimited guarantees and subsequently giving its customers guarantee certificates containing more limited terms. As the court pointed out in its opinion in *Montgomery Ward and Co., Inc.*:

"Assuming Wards has a policy of honoring guarantees as advertised, the issue is yet not one of performance, but one of advertising, of what a prospective purchaser is likely to think on the basis of the advertising alone. The delivery of limiting guarantee certificates with the product purchased might mislead customers notwithstanding Wards' policy. Given such a certificate, customers are not likely to ignore its limitations when seeking satisfaction under its guarantee, particularly in view of the certificate language, 'the obligations assumed under this warranty are in lieu of all warranties express or implied.' If, on the other hand, each purchaser actually was informed that advertised guarantees would be honored, the certificates were meaningless. The Commission determination that this state of affairs disclosed that purchasers from Wards would be likely to believe they would be bound by the certificate is not unreasonable. That Wards generally intended the certificates to be meaningful is indicated by internal advertising policy directives directing copywriters to accompany promotional copy with a disclosure of guarantee terms.

\* \* \* \* \*

"However, having fully credited Wards with having corporate integrity and a company policy of truthful advertising, the fact remains, as the Commission found, this could not cure 'the capacity to deceive inherent in attaching specific and limited guarantees to products which are then advertised without limitation.' We share the Commission's 'doubt that none but the most aggressive and sophisticated customers will either recall or retain the advertisement which originally led them to consider the purchase, nor will the average customer persist in his demands that Wards disregard the specific guarantee certificate and honor claims under the broader guarantee originally advertised.'"

salary by corporate respondent but only received their remuneration from sales of home improvements made for and on behalf of the corporate respondent," found that since respondents "clothed said salesmen or 'brokers' with apparent authority to bind respondents \* \* \* respondents cannot now escape responsibility by disowning such salesmen or 'brokers' as their agents" (I.D., pars. 10, 11). In their appeal respondents contend that due to their "lack of control or direction over the activities of such brokers they have no responsibility for the latter's representations.

In claiming that their inability to direct or control the activities of their representatives insulated them from their salesmen's misrepresentations, respondents have apparently misconstrued the applicable legal test, under which, as the examiner correctly found, a seller is held liable for deceptive acts in violation of Section 5 of the Federal Trade Commission Act made by individuals whom the seller has invested with apparent authority to act on its behalf and that it is immaterial that respondents have not directed or controlled these persons. This principle was clearly articulated by the Court in *Goodman v. Federal Trade Commission*, 244 F. 2d 584, 588, 592 (9th Cir. 1957) which rejected the precise contention made by respondents in this case:

The petitioner's primary contention is that the salesmen who sold the course were *independent contractors*, for whose actions he was not responsible. The brunt of the argument is based on the claim that because the petitioner carried the salesmen on his books as independent contractors, his agreements with them so stated, and he had no control over their work and the manner of performing it, the connection between him and his salesmen conformed to the classical characteristics which courts have attached to that relationship.

The criteria of direction and control, which govern in determining whether or not such relationship exists, are well recognized in law. \* \* \* However, when interpreting a statute the aim of which is evil practices in it, the courts are not concerned with the refinements of common-law definitions, when they endeavor to ascertain the power of any agency to which the Congress has entrusted the regulation of a business activity or the enforcement of standards it has established. \* \* \*

Thus the courts take the view that the principal is bound by the acts of the salesperson he chooses to employ, if within the actual or apparent scope of his authority, even *when unauthorized* (244 F. 2d pp. 588, 592).

A similar immunity from the statements of representatives was claimed by the respondents in *International Art Co. v. Federal Trade Commission*, 109 F. 2d 393, 396 (7th Cir. 1940) where reliance was placed upon testimony of the representatives "to the effect that the business was being conducted by them independently and that they receive no orders or directions from the Art Company." In response to this contention the court noted that:

\* \* \* each salesman was issued a certificate designating him as the representative of the Art Company; the order was taken in its name; the picture was shipped in its name, and the customer was notified in its name of the time of delivery. All blanks used by the salesmen were furnished by the Art Company and bore its name (109 F. 2d p. 396).

On the basis of this evidence the court concluded:

The customer had a right to believe—in fact, could not have believed otherwise, than that the salesmen were the agents of the Art Company, with full authority in the matter. \* \* \*

Here, the agent was clothed with apparent and, we think, real authority to speak and act for and on behalf of the principal, and the latter is bound thereby. We know of no theory of law by which the company could hold out to the public these salesmen as its representatives, reap the fruits from their acts and doings without incurring such liabilities as attach thereto (*Ibid.*).

See also *Standard Distributors, Inc. v. Federal Trade Commission*, 211 F. 2d 7 (2nd Cir. 1954) and *Steelco Stainless Steel, Inc. v. Federal Trade Commission*, 187 F. 2d 693 (7th Cir. 1951).

There can be no doubt that in this case respondents have conferred upon their agents the actual or apparent authority to speak and act for or on behalf of Inter-State and thus are responsible for their representatives' conduct. Respondents furnished their salesmen with printed contract forms bearing the name of Inter-State (and an affiliated corporation, Inter-State Construction Co.) as well as printed credit applications and time-schedule payments. The salesmen were given specific authority to negotiate the terms of and indeed execute the contracts with purchasers on behalf of and in the name of Inter-State. Indeed, one of these "independent contractors" occupied respondents' office and, in making his solicitations, utilized three telephones, provided and paid for by respondents.

Although the form of respondents' contract indicates in small print that it is subject to acceptance by an officer of Inter-State and/or Inter-State Construction Co., the only signatures appearing on the executed contracts contained in the record are those of the purchasers and the salesmen who signed, not as brokers, but for and on behalf of Inter-State or its affiliate. Respondents claim that "Once a contract is signed with an individual homeowner the broker will take the contract from dealer to dealer attempting to sell it for the best price" (Resp. Suppl. Br. p. 4). The contract, however, provides that it is entered into by Inter-State or its affiliate and must be accepted by one of said companies to be binding. The only conclusion which could be reached by a customer is that he is dealing solely with Inter-State and that the salesman who signs the contract on Inter-State's behalf is its authorized

representative. This conclusion is further buttressed by the fact that the customer's first contact with respondents was typically through respondents' advertisements which contained a coupon to be filled in by any interested person. Thereafter, a salesman called on the customer who had filled in the coupon. The inevitable effect of this practice would be to cause the customers to believe that the salesmen who called on them were authorized representatives of Inter-State rather than brokers who represented suppliers in general.<sup>10</sup>

Accordingly, we conclude that respondents, who clothed their salesmen with both actual and apparent authority to represent them are fully responsible for the representations made by these representatives in attempting to sell respondents' products.

### C. *The Order*

The order proposed by the hearing examiner is identical to that proposed by counsel supporting the complaint and attached to the complaint issued against respondents.

Respondents attack one paragraph in this order as without substantial foundation in the evidence introduced in the record. Complaint counsel has not appealed from the examiner's proposed order.

The order paragraph opposed by respondents' counsel prohibits respondents from:

Representing, directly or by implication, that any special price, allowance, discount or commission is granted by respondents to purchasers in return for permitting the premises on which respondents' products are installed to be used for model home demonstration purposes, unless respondents grant such special price, allowance, discount or commission in every instance. (Order, par. 2.)

Respondents contend that this paragraph is too broad insofar as it applies to commissions and bonuses.<sup>11</sup> Respondents argue that "there was no evidence—and the examiner made no such finding—that Respondents ever misrepresented the facts relating to" the bonuses or commissions available to homeowners (Resp. Br. pp. 30-31 and Suppl. Br. p. 10).

Notwithstanding respondents' assertion, the record is clear, and the hearing examiner found, that respondents' representatives

<sup>10</sup> Although respondents have throughout this proceeding referred to their salesmen as "brokers," it is interesting to note that in all of their advertising and sales brochures appearing in the record (CX's 1, 2, 3, 4, 17, 18), the persons now characterized as "brokers" were always referred to as "representatives."

<sup>11</sup> In its original brief prior to remand, respondents' objections to this paragraph were confined to its reference to commissions (Resp. Br. pp. 30-31). In its supplemental brief after remand, respondents broadened their challenge to the application of this paragraph to both "commissions and bonuses" (Resp. Br. pp. 10-11).

falsely assured purchasers that they would receive some type of special pricing concessions on sales made by salesmen to other homeowners. The examiner found that "the corporate respondent did not select homes to be used as models and did not give special or reduced prices to purchasers of its installed home improvements for advertising purposes" (I.D. par. 7). This finding is not challenged by respondents on appeal. Respondents' president, Gottesman, also named as a respondent here, conceded on direct examination that the corporate respondent never used purchasers' homes as models (Tr. 93). While none of the witnesses used the words "bonuses or commissions" in their testimony the clear purport of the evidence in the record is that respondents' sales pitch here was to represent to their prospective customers that they would receive monetary compensation for permitting their homes to be used for demonstration purposes to enable respondents to make sales to other persons. Thus, we are of the opinion that the order need not track the express representations used by respondents' salesmen, but may and indeed must be couched in sufficiently broad terms to ensure that respondents cannot avoid the prohibitions contained in the order by a slight verbal shift in their solicitations.

Accordingly, in our opinion, the examiner did not err in including in the order a prohibition forbidding respondents from misrepresenting that commissions will be paid in return for permitting customers' premises to be used for model home purposes and we reject respondents' appeal on this issue.

Coming to the provisions of the order as proposed by the examiner, we are of the view that they are not sufficiently restrictive to ensure that these respondents will not in the future engage in the same deceptions which they are being directed to terminate in this case.

Paragraphs 1 and 2 of the order, directed at the principal misrepresentations employed by respondents in this case, prohibit respondents from making those representations in the future unless they are in fact true. Paragraph 1 of the order prohibits respondents from representing to their prospective customers that their homes have been selected as model homes to be used in respondents' advertising "unless in every instance the home has in fact been selected as a model, and unless in every instance the home is used for such purposes." Paragraph 2 as noted above qualifies its prohibition on representing that special discounts and the like will be paid for such use "unless respondents grant such special price, allowance, discount or commission in every instance."

The evidence is clear in this record that respondents' method of doing business has never encompassed the use of a customer's home for demonstration purposes.

At the hearing respondent Gottesman conceded on examination by complaint counsel that Inter-State had never used the home of any customer as a model home (Tr. 93). There is no indication in the record that respondents ever intend in the future to use a home as a point of reference for advertising purposes. Since purchasers' premises are not used as models we fail to see how in any case respondents could grant allowances or discounts in return for such use. Moreover, it would make little business sense for respondents in the future to use this type of advertising and thereby discount their own prices when they can simply use photographs of homes, which they are presently doing, in order to illustrate what aluminum siding looks like (*e.g.*, RX 1). Respondents' customers are widely separated. Respondents' primary sales message is their low, low prices and the great benefits which can accrue to the homeowner from the use of aluminum siding. If respondents wish to enhance their sales pitch through the use of testimonials of satisfied customers they can certainly solicit such testimonials if they choose. However, if they in fact paid for such testimonials it would be highly misleading not to disclose this fact. Yet this is in effect what respondents' use of their customers' homes for demonstration purposes would amount to if they truthfully did this and paid the homeowner for such use.

For all of these reasons, we conclude that the "unless" clauses in both prohibitions should be eliminated. If respondents devise a nondeceptive sales message embracing some type of testimonial which might violate these two paragraphs in the order, the Commission's procedures afford such respondents ample opportunity to petition the Commission, either for an interpretation of the order as to whether the new sales program would or would not violate the order, or for a modification of the order if one is clearly necessary in order to permit respondents to engage in what can be demonstrated to be a nondeceptive sales promotional solicitation.

Paragraph 5 of the order prohibits respondents from misrepresenting their guarantees. Since the gravamen of the deception which we have found to exist in this area of respondents' activities was their oral representation of guarantees and their omission of any guarantees in their contracts we are adding to this paragraph a specific prohibition against "making any direct or implied representation that any of respondents' products are guaranteed unless in each instance a written guarantee is given to the purchaser

containing provisions substantially the same as those contained in such oral representation."

Finally, we are also adding a new paragraph to the order respecting respondents' salesmen. As we have noted respondents have attempted to avoid any liability for their salesmen's activities on the ground that they do not "exercise control or direction over the activities of such brokers." While the issue of such actual exercise of control is not relevant to the question of respondents' responsibility for their salesmen's conduct, it is directly pertinent to the issue of relief. Unless respondents are required to take some action to control their salesmen, the order will amount to little more than a vain gesture. Indeed, respondents point out in their brief:

Since Respondents cannot control the brokers' actions, it is futile to issue a cease and desist order directing Respondents to assure that these brokers will not make any further misrepresentations (Resp. Suppl. Br. p. 7).

For this reason, we are revising the order by adding to it a provision which requires respondents to take affirmative steps to (a) prevent their salesmen making any of the representations condemned in the order and (b) to counteract the effect of any such representations which may have been already made.

### III

#### CONCLUSION

In conclusion, the initial decision and order issued by the hearing examiner, as amended to conform to this decision and the order issued hereunder, are adopted as the decision and order of the Commission.

Commissioner Reilly agrees with the opinion and order except with that portion of the opinion dealing with guarantees.

Commissioner Elman dissented and has filed a statement.

#### DISSENTING OPINION

JULY 28, 1967

BY ELMAN, *Commissioner*:

The *Jencks* rule is a rule of fairness in adjudication. It is concerned with substance, not form. The essential question in determining the producibility of an interview report is whether it recorded the witness's statements with sufficient accuracy and reliability to justify allowing the defense to use the report in cross-examination for purposes of impeaching or discrediting the testi-

mony given at the trial by the witness. *Campbell v. United States*, 373 U.S. 487, 495, 497.

The interview reports in this case were prepared by two able and experienced Commission attorneys. They expressly recite that they set forth the substance of the witnesses' statements during the interviews. They do not purport to be, and obviously are not, verbatim transcriptions of every word that was said. Like almost all FTC interview reports, they are not signed by the witness. We do not know, and the Commission does not think it necessary to hold a *voir dire* hearing to ascertain, whether each witness "adopted" or "approved" the interview report or the attorney's notes. On their face, the interview reports appear to be entirely factual, objective, and accurate accounts of the witnesses' statements to the Commission attorneys.

As Commission counsel point out in their brief on appeal (pp. 2-3), there are numerous discrepancies between the testimony of certain witnesses at the hearing and their prior statements as recorded in the interview reports. This would seem to be all the more reason for making the reports available for cross-examination purposes, rather than withholding them. If the Commission is sustained in its holding here that these interview reports on their face are not producible, and do not even require a *voir dire* hearing, no FTC interview reports will ever be made available to any respondents. If the inquiry is, not whether an interview report accurately reflects the substance but whether it mirrors the style, format, sequence, vocabulary, syntax, and punctuation of the witness's statements, the *Jencks* rule has no practical application to Federal Trade Commission proceedings.

My reasons for disagreeing with the majority on this important question of agency practice have already been spelled out in the dissenting opinion previously filed in this case (69 F.T.C. 1128). I add only that the misgivings earlier expressed have now been realized. The net result of the Commission's approach to the *Jencks* rule is to obliterate it. This is more than unfair to respondents in Commission cases. It provides a continuing source of unnecessary friction and delay in the conduct of adjudicative proceedings. It is clearly contrary to the spirit if not the letter of the recently enacted Freedom of Information Act (Public Law 89-487, 90-23).

The Commission's interest is not to win its cases but to win them fairly. It is as much a public purpose to assure respondents a fair opportunity to make their defense as it is to conduct efficient investigations. Both interests are essential aspects of law enforcement; neither requires subordination of the other. The interview

reports in this case, if made available to respondents, would obviously be useful in furthering their defense. Indeed, they have been used in this case, but only to assist Commission counsel in examining the witnesses. When it comes to assisting defense counsel in cross-examination, however, the reports are treated as "secret" and withheld. So far as the majority is concerned, the interview reports have now fully served their purpose, and will be returned to the "confidential" archives. I do not see how this result can be hailed as a vindication of the public interest. What substantial harm to any legitimate interest of the public would arise from letting counsel use these reports on cross-examination, just as Commission counsel used them on direct? In *Jencks* the Court quoted with approval the statements in *United States v. Reynolds*, 345 U.S. 1, 12, and *United States v. Andolschek*, 142 F. 2d 503, 506 (2d Cir. 1944), that "since the Government which prosecutes an accused also has the duty to see that justice is done, it is unconscionable to allow it to undertake prosecution and then invoke its governmental privileges to deprive the accused of anything which might be material to his defense. \* \* \* [T]he prosecution necessarily ends any confidential character the documents may possess; it must be conducted in the open, and will lay bare their subject matter. The government must choose; either it must leave the transactions in the obscurity from which a trial will draw them, or it must expose them fully." (353 U.S. at 671.)

#### FINAL ORDER

This matter having been heard by the Commission upon the appeal of respondents from the hearing examiner's initial decision dated September 9, 1966, and upon briefs and oral argument in support of and in opposition to said appeal; and

The Commission having determined for the reasons stated in the accompanying opinion that the appeal of respondents should be denied and that certain of the findings and conclusions and the order contained in the initial decision should be modified to conform to the views expressed in the accompanying opinion:

*It is ordered*, That the hearing examiner's initial decision, as modified by this order and the accompanying opinion be, and it hereby is, adopted as the decision of the Commission.

*It is further ordered*, That the initial decision be modified by striking the order and substituting therefor the following:

*It is ordered*, That respondents Inter-State Builders, Inc., a corporation, and its officers, and Milton S. Gottesman, individually

and as a director of said corporation, and respondents' agents, representatives and employees, directly or through any corporate or other device, in connection with the offering for sale, sale or distribution of aluminum siding or other products, in commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from:

1. Representing, directly or by implication, that the home of any of respondents' customers or prospective customers has been selected as model home to be used as a point of reference for advertising purposes;

2. Representing, directly or by implication, that any special price, allowance, discount or commission is granted by respondents to purchasers in return for permitting the premises on which respondents' products are installed to be used for model home demonstration purposes;

3. Representing that respondents' salesmen or representatives are factory representatives, or otherwise misrepresenting the status of such salesmen or representatives;

4. Representing that respondents' salesmen or representatives are representatives of the United Gypsum Company, or representing that respondents or their representatives are affiliated with any company or organization with which they are not in fact affiliated;

5. Representing, directly or by implication, that any of respondents' products are guaranteed, unless the nature and extent of the guarantee, the identity of the guarantor and the manner in which the guarantor will perform thereunder are clearly and conspicuously disclosed; or making any direct or implied representation that any of respondents' products are guaranteed unless in each instance a written guarantee is given to the purchaser containing provisions substantially the same as those contained in such representations;

6. Representing that respondents' customers are granted any reduction in price for their products, unless the price offered constitutes a substantial reduction from the actual bona fide price at which such products had been offered for sale on a regular basis for a reasonably substantial period of time in the recent, regular course of respondents' business;

7. Misrepresenting in any manner the savings available to purchasers of respondents' merchandise;

8. Failing —

(a) To send a copy of the order by certified or regis-

## Final Order

tered mail to all present and future "brokers," "salesmen," "contractors," and other representatives;

(b) To advise in writing all such representatives: that respondents will expect such representatives to comply with the provisions contained in the order; that said representatives will be discharged if they disobey this order; and that respondents will accept no contracts or pay any commission or other fee or allowance in connection with the procurement of which representations have been made in violation of this order;

(c) To obtain from all such representatives a signed statement acknowledging the existence of this order and agreeing to abide by it; and

(d) Prior to the acceptance of any contract, to deliver to the customer who has executed the contract a copy of the contract and a separate written statement clearly and conspicuously advising the customer (1) that no oral representation which may have been made by any salesman or representative of respondents and which is not contained in the contract is binding upon respondents; and (2) that such customer may, within a designated period which shall in no case be less than ten days after receipt of such statement from respondents, elect to cancel the contract if in executing it he has relied in whole or in part upon any oral representation not contained in the contract.

*It is furthered ordered,* That the respondent shall within sixty (60) days after service upon it of this order, file with the Commission a report, in writing, setting forth in detail the manner and form in which they have complied with the order to cease and desist set forth herein.

Commissioner Reilly agrees with the opinion and order except with that portion of the opinion dealing with guarantees. Commissioner Elman dissented and has filed a statement.