Senator Herb Kohl's Follow-Up Questions for 5/26/2009 Hearing on the "Discount Pricing Consumer Protection Act: Do We Need to Restore the Ban on Vertical Price-Fixing?" And Answers from Stacy J. Haigney

1. **How important was the rule against vertical price-fixing to the growth of Burlington Coat Factory? Do you believe your stores would have been able to prosper as discount competitors without it?**

Answer to Question No. 1 -

It is Burlington Coat Factory's firm belief that its growth from a single location, discount coat retailer on Route 130 in Burlington, New Jersey to a nation-wide, off-price chain of over 400 stores offering every kind of apparel and accessories, would have been impossible if vertical price-fixing were not subject to the per se rule when Burlington Coat Factory's business began to grow in the 1970's. The best evidence of this is the historical record: Burlington Coat Factory was confined to a single location from 1972, when it was founded, until after 1975 (the year Congress repealed the Fair Trade Laws, restoring the per se rule in all states) when it began to expand exponentially. By 1981, it had 19 stores; by 1983, nearly 40. It is my understanding that there were no large off-price retailers following a business model comparable to Burlington Coat Factory's (i.e., offering full lines of current, in-season merchandise bearing nationally-known brands at prices at least 25% below that charged by department stores) while the Fair Trade Laws were in effect. Monroe G. Milstein, the man who established Burlington Coat Factory, and who oversaw its growth until 2006, made clear to me on several occasions that he would not have even attempted to transform Burlington Coat Factory into a national retailer if vertical price-fixing had been legal. This makes perfect sense: if full-price retailers were legally permitted to force their suppliers to impose vertical price-fixing schemes on key brands, Burlington Coat Factory would not have been able to employ its most potent competitive tool, low prices.

2. **The majority opinion in Leegin decision argued that the rule against vertical price-fixing is bad policy because of what it called the "free rider" problem. This is the situation of a shopper going to a full service store for advice and service, using the services of the store to examine and inspect the product, and then finding a discount retailer or internet website to purchase the product at a discount.**

Supporters of the Leegin majority argue that allowing resale-price maintenance would end this situation. Do they have a point? Do you believe that shoppers who go into Burlington Coat Factory stores have first examined similar merchandise at higher priced, full-service department stores, and thus are "free riding" on these stores?

Answer to Question No. 2 -

I am respectfully of the strong opinion that the supporters of the Leegin majority have no "point" when they urge Congress to accept the so-called "free rider" hypothesis. The "free rider" argument was made to Congress in 1975, in opposition to the legislation which—with massive bi-partisan support and with President Ford's signature—repealed

the Fair Trade Laws. Congress and the Ford Administration found the "free rider" allegation to be far less persuasive than the strong empirical showing on behalf of the measure that "Fair Trade" increased prices and hurt competition. Moreover, when the Sylvania Court over-ruled the per se rule against non-price vertical restraints in 1977, it specifically discussed the "free rider" thesis but, nevertheless, adhered to the view that price restraints must remain subject to the per se rule because of their inherent threat to competition and consumers. The "free rider" specter was also raised repeatedly during the 1980's by the Reagan Justice Department in a vain effort to persuade the Supreme Court to abandon the per se rule. This caused Congress to vote to defund all such efforts by the Department of Justice specifically because Congress wanted the per se rule to remain in effect. Thus, every time Congress has been faced with the question, it has rejected the "free rider" hypothesis as an adequate justification for doing away with the per se rule. The Supreme Court was likewise unimpressed with the "free rider" argument until the very recent past when two additional exponents of this Chicago School of Economics theory were added to the Court, giving its proponents a bare majority. Obviously, that majority thinks that the conjurors of the "free rider" theory have a "point," but Congress has never seen that "point" despite numerous attempts by opponents of price-competition to foist that argument on the Senate and the House.

From the point of view of the retail apparel industry, Congress, and until 2007 the judiciary, have been absolutely correct in rejecting the 'free rider" manifesto. There are full-price retailers who justify their higher prices by pointing to their more expensive store decorations, etc. Their business plan is a perfectly legitimate one: attract customers who are willing to pay more to shop in surroundings that enhance the shoppers' self-image. Burlington Coat Factory's business plan is to attract customers who are more interested in bargains than ambience. Of course, there are consumers who shop both kinds of stores to find, depending upon their individual preferences, the best products, the best prices and/or the finest ambience. But it is a logical non sequitur to suggest that a shopper who ends up making her purchase at Burlington Coat Factory is somehow illegitimately taking advantage of the full-price merchant.

I have heard the argument made that the full-price retailers of high-tech products can be disadvantaged by customers who learn all about a product's function from the well-trained, highly-paid sales personnel of such retailers, only to buy the same product from a discounter with unskilled employees. Whether or not this happens with any frequency in high-tech retailing—and I am highly skeptical that this is the case—it most certainly does not happen in apparel retailing. In the high-tech hypothesis, the full-price retailer allegedly adds value to the product by giving the customer sophisticated know-how. There is no such value added by full-price retailers in the apparel business because everyone knows how to try on clothes without technical assistance! The fact that the full-price retailer makes the marketing decision to present the product in expensive, elegant surroundings teaches the consumer nothing upon which to "free ride." The question also implies that the customer only becomes aware of the existence of the product by seeing it at a full-price store. This supposition is groundless in this day and age when consumers acquaint themselves with available products in myriad ways: via the internet, word of mouth, catalogues, advertising, etc. I also note that, under Sylvania, a manufacturer who sincerely wants its product be sold with certain services, ambience, etc., may lawfully

require retailers to provide such services or ambience without fixing resale prices. In short, there is no "free rider" problem in the industry I have worked in for nearly 30 years, and I respectfully submit that Congress should adhere to the position it has taken vis-à-vis the so-called "free rider" and the per se rule since 1975.

3. **Defenders of the Leegin decision point out that the majority opinion in Leegin still permits antitrust suits against vertical price-fixing if the party bringing the suit can prove that the practice was "unreasonable" and harmed competition. This is what is known in antitrust law as the "rule of reason."**

The rule of reason requires the antitrust plaintiff to assemble evidence of the restraint's history, nature, and likely competitive effects, as well as the market power of those engaged in the practice. How likely would Burlington Coat Factory be to bring an antitrust suit challenging vertical price-fixing if you had to assemble evidence and prove the history, nature and likely competitive effect of the practice? Would you have the resources or factual knowledge to bring such a case?

Answer to Question No. 3 -

Since the Sylvania case in 1977, all vertical restraints subject to the so-called "rule of reason" -- i.e., non-price restraints -- have been de facto legal because of the practical impossibility of a plaintiff's financing and/or winning such a case. There is no reason whatever to suppose that vertical price-fixing cases will be any easier to win or less costly under the Leegin standard. The Supreme Court has recently imposed a heightened pleading requirement on antitrust plaintiffs in the Twombley case which, in a rule-of-reason case, would require detailed pleading (with supporting evidence) by the plaintiff of highly sophisticated issues such as market definition. This means that, without any discovery, a plaintiff must undergo the effort and expense of putting together a complex economic analysis of the market, the history of the restraint, the relative market shares of the product and the parties, etc., simply to survive a motion to dismiss. Assuming that this hurdle can be surmounted, the plaintiff would then have to embark upon years of document-rich discovery and motion practice against a well-heeled adversary with numerous depositions, including of multiple experts on both sides. The cost is more than likely to be well into seven figures. Burlington Coat Factory cannot afford that kind of expenditure and disruption of its business in a litigation which—given the fate of vertical "rule of reason" cases in the past and the present composition of the Supreme Court—is far from certain to succeed. Thus, as a practical matter, the Leegin case deprives Burlington Coat Factory of any remedy if it becomes a victim of vertical price-fixing.

4. **Do you support the Discount Pricing Consumer Protection Act, my legislation, to restore the ban on vertical price-fixing? Why or why not?**

Answer to Question No. 4 -

On behalf of Burlington Coat Factory, I wholeheartedly support the proposed legislation. My company and its customers have thrived in a vibrant retail environment characterized by vigorous price-competition. The Leegin decision threatens to return our economy to

the weak competition and high-consumer prices of the Fair Trade era when companies like Burlington Coat Factory did not exist. And it does so on the basis of the utterly flimsy hypothesis that price-fixing might eliminate some "free riders" which in turn might enhance competition in some instances. In other words, the Supreme Court has irresponsibly decided to conduct a Chicago School experiment to see if our already well-functioning retail economy might marginally improve, despite massive empirical evidence that the experiment is bound to fail. Passage of the Discount Consumer Protection Act will ensure that the marketplace will not suffer the unintended -- but all too foreseeable -- consequences of such reckless experimentation.