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FUNCTIONAL DISCOUNTS UNDER THE ROBINSON-PATMAN ACT

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The Robinson-Patman Act, amending the Clayton Act, was passed by Congress in June, 1936.[1] Its intent was to strengthen federal anti-trust laws forbidding price discriminations injurious to competition or tending to create a monopoly. The statute's language, unfortunately, is vague and ambiguous, and many sellers found it difficult to determine whether their pricing systems met its requirements.[2] Among those finding no easy answer to their questions were sellers classifying their purchasers by function, and charging different prices to the different classes.

Functional Discounts

Producers selling through established trade channels normally classify customers as wholesalers, retailers, and ultimate consumers. In accordance with the place each class occupies in marketing, retailers are given a discount from consumer prices and wholesalers, a discount from retailer prices. These price reductions accorded distributors are known in commercial practice as "functional" or "trade" discounts. They are granted on the basis of the marketing function performed by the buyer in serving particular classes of trade—not on quantity of purchase, time of payment, or any other consideration.[3] In modern marketing, sellers often serve more specialized types of customers than do traditional wholesalers and retailers. They, too, normally receive functional discounts to accord with the distribution function they perform.

Producers in some cases will sell their goods not only to distribu-

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[1]49 Stat. 1528, 15 U. S. C. A. § 13 (1941).

[2]"Sometimes I doubt whether we ever needed the Robinson-Patman law, with all its elusive uncertainty. I have thought that the Sherman Act, properly interpreted and administered, would have remedied all the evils meant to be cured." Judge Lindley, United States v. The New York Great Atlantic and Pacific Tea Company Inc. et al., 67 F. Supp. 626, 677 (E. D. Ill. 1946). See also H. T. Austern, Required Competitive Injury and Permitted Meeting of Competition, Robinson-Patman Act Symposium, CCH 63 (1947).

[3]Alexander, Surface, Elder and Alderson, Marketing 424 (1944).

tors, but to purchasers who fabricate, process, consume in production, or otherwise change the character of goods before further sale or use. Such customers often are classified on the basis of their function—what they do with the goods—and each class may pay different prices. These price differences are not usually referred to in commercial language as "functional" or "trade" discounts. They are similar to such discounts, however, because they are price differences based solely on the functions performed by classes of customers. Since, as will be seen, they are subject to the same general standards under the Robinson-Patman Act, they will be considered functional discounts for purposes of this discussion.

Impact of the Robinson-Patman Statute

It is not comforting to sellers to know that Congress had considered and refused to allow specific exemptions for functional discounts in the Robinson-Patman Act. The original Patman bill in both the Senate and House had authorized differentials in prices "as between purchasers depending solely upon whether they purchase for resale to wholesalers, to retailers, or to consumers, or for use in further manufacture."[4] The House Judiciary Committee, apparently recognizing that modern-day marketing is usually a maze of overlapping functions and integrated operations, added the following provision: "For the purpose of such classification of customers as wholesalers or jobbers, or retailers, the character of selling of the purchaser and not the buying shall determine the classification." Where a buyer does both a wholesale and a retail business, he shall "be classified (1) as a wholesaler on purchases for sale to retail dealers and (2) as a retailer on purchases for sale to consumers."[5]

The Act in its final form contained none of this language. Without official explanation, Congress deleted the sanction for wholesale, retail and manufacturer price differentials,[6] and passed a law the pertinent provisions of which are as follows:

> " It shall be unlawful either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality, where the effect of such discrimina-

[4]Sen. Rep. No. 1502, 74th Cong., 2nd Sess. (1936); H. R. Rep. No. 2287, 74th Cong., 2nd Sess. (1936); Zorn and Feldman, Business Under the New Price Laws 168 (1937).

[5]H. R. Rep. No. 2287, 74th Cong., 2nd Sess. (1936).

[6]Deletion seems to have resulted from the pressure of farm groups who feared the language would deprive farm cooperatives of wholesale discounts. 80 Cong. Rec. 8113, 8117-18, 8122-23.

> tion may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers or either of them: *Provided,* that nothing herein contained shall prevent differentials which make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered "[7]

These words differ from those of the old Clayton Act in that they specifically cover competitive injury to the seller's customers. That Act had referred only to competitive injury "in any line of commerce," and functional discounts had been given specific court sanction on the ground that the statute did not comprehend injury to competition between the seller's customers, but only between the seller and his competitors.[8] Whatever the meaning of the words, "in any line of commerce," subsequently interpreted more broadly in a decision not dealing with functional discounts,[9] there was no doubt that the Robinson-Patman Act was concerned with the effect of price discrimination at customer levels, and that functional discounts were required to accord with its provisions.

There was the possibility, of course, that Congress had intended all discounts granted on the basis of function to be justified by cost savings to the seller. Wholesalers generally buy in larger quantity and less frequently than retailers, and industrial consumers generally buy in larger quantities and less frequently than wholesalers. Cost savings thus arising from the economies of large-scale sale and delivery are undoubtedly a factor in the according of functional discounts. But they are not the sole factor; the discounts customarily are given on orders of any size.[10] As stated in the House Judiciary Committee Report on the proposed Robinson-Patman bill, "wholesalers frequently find it necessary to supplement existing stock by additional purchases in smaller quantities and the above exemption [for wholesale discounts] permits a wholesaler to be accorded wholesale prices on these smaller purchases as incident to his business, without the seller having to accord

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[7]Clayton Act, Sec. 2 (a); 49 Stat. 1526, 15 U. S. C. A. § 13 (1941).

[8]Mennen Co. v. Federal Trade Commission, 288 Fed. 774 (C. C. A. 2d, 1923), cert. den., 262 U. S. 759 (1923); National Biscuit Co. v. Federal Trade Commission, 299 Fed. 733 (C. C. A. 2d, 1924), cert den., 266 U. S. 613 (1924).

[9]George Van Camp & Sons Co. v. American Can Co., 278 U. S. 245 (1929).

[10]Alexander, Surface, Elder and Alderson, Marketing 424 (1944); Werne, Business and the Robinson Patman Law, A Symposium 181 (1938).

them at the same time on the whole body of purchases in similar quantities on sales direct to retailers. This protects the usefulness of the wholesaler in serving retailers dependent upon him for their source of supply."[11]

Early Opinions

Lawyers and businessmen contemplating the statute and its background in 1936, however, could not bring themselves to believe that Congress had meant to outlaw, as such, discounts given customers properly classified according to function. There was nothing in the legislative history of the Act to indicate that such discounts were considered harmful. It was noted that the Robinson-Patman bill had been supported by groups of independent wholesalers and retailers as a protective measure against alleged abuses in the large-scale buying practices of retail chain stores.[12] It seemed unlikely that legislation these groups sponsored would become an instrument to limit the pricing system on which their livelihood depended.

The usual opinion was that Congress had not considered functional discounts injurious to competition *per se,* and that the deletion of the specific exemption for them was a recognition that they needed no exemption under the statute. Before competition can be affected between buyers, they must compete; buyers compete when they offer their products for sale to the same customers; buyers properly classified according to their function do not sell substantially to the same customers. Different prices charged buyers in different functions thus would not be forbidden discrimination. The same reasoning would apply, of course, to those customers buying for industrial consumption, processing, fabrication into other products, or for use in any other non-competitive function. Thus, although functional discounts were price differences, they were not considered, without more, a cause of the evils at which the legislation was aimed.[13]

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[11]H. R. Rep. No. 2287, 74th Cong., 2nd Sess. (1936).

[12]The Robinson-Patman Act, Its History and Probable Meaning, The Washington Post 5 (1936); Werne, Business and the Robinson Patman Law, A Symposium 102-104 (1938); Alexander, Surface, Elder and Alderson, Marketing 452 (1944).

[13]The Robinson-Patman Act, Its History and Probable Meaning, The Washington Post 11 (1936); Werne, Business and the Robinson Patman Law, A Symposium 134 (1938). It has been noted that a functional discount may not be only a price difference, covered by § 2(a) of the Clayton Act, but a payment for a service performed by the buyer, covered by §2(d) of the Act. While it may be true in theory that the seller is "buying" a distribution service for his product, the application of §2(d) would involve functional discounts in standards that would effectively change their character. The Federal Trade Commission has not indicated that it con-

On more specific questions of the statute's application, the opinions were not as definite.

The meaning of the word "either" in "with customers of either of them," seemed of remote effect: a discount given to all wholesalers would have an equal effect on retailers and should not adversely affect competition between them. Some commentators noted, however, that a functional discount might be so large as to permit the buyer receiving it to pass on a part of the saving, and place his customers in a better position than the direct customers of the seller. This problem, however, was looked on as not likely to occur.[14] Also, it seemed, a functional discount ordinarily would not affect competition between sellers granting the discount.[15] In absence of collusion, the giving or increasing of such discounts would be equivalent to price reduction at one competitive level, and promotive of competition.

Since the Act primarily had been aimed at chain retailers, it was suspected that prices charged retail chain stores should correspond to prices charged independent retailers unless a difference could be justified by cost savings. The same was true of mail-order houses, department stores, and consumer cooperatives—despite the fact that all these forms of mass distribution frequently incorporate both wholesale and retail functions. In selling a customer acting both as a wholesaler and a retailer in his reselling activity, the seller was felt to be under some form of obligation to apportion the discounts in a manner corresponding to actual function.[16]

Administrative and Court Interpretation

It has now been eleven years since the Robinson-Patman Act was promulgated and the lawyer is expected to be able to advise his client

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siders §2(d) applicable. Van Cise, Functional Prices, Robinson-Patman Act Symposium, CCH 89-90 (1947).

[14]Zorn and Feldman, Business Under the New Price Laws 176 (1937); Shipman, Two Years' Experience Under the Robinson-Patman Act, reprint from Oil, Paint & Drug Reporter 13 (1938).

[15]Injury to competition with the seller is a basis for finding a price discrimination illegal. E. B. Muller Co. et al v. Federal Trade Commission, 33 F. T. C. 24; 142 F. (2d) 511 (C. C. A. 6th, 1944); Samuel H. Moss, Inc. v. Federal Trade Commission, 148 F. (2d) 378, 90 L. ed. 41 (C. C. A. 2d, 1945).

[16]For publications issued after passage of the Robinson-Patman Act dealing with its probable effects, see Patman, The Robinson-Patman Act (1938); The Robinson-Patman Act, Its History and Probable Meaning, Washington Post (1936); Werne, Business and the Robinson-Patman Law, A Symposium (1938); Zorn and Feldman, Business Under the New Price Laws (1937); McNair, Marketing Functions and the Robinson-Patman Act, 4 Law and Contemporary Problems 334 (1937); Learned and Isaacs, The Robinson-Patman Law, Some Assumptions and Excep-

about the legal status of the functional discount and the permissible limits of its use. The penalty of misunderstanding is severe. Violation involves the seller in stipulations with or orders from the Federal Trade Commission, and in the possibility of criminal fines,[17] treble-damage suits by customers,[18] and the unfavorable publicity attendant upon all of these contingencies.[19]

On investigating the field, however, it will be found that there have been no direct court decisions on the legality of functional pricing since enactment of the Robinson-Patman Act. Further, it will be seen that few unqualified conclusions can be drawn from actions of the Federal Trade Commission in refusing to file complaints under the amended Clayton Act, in dismissing complaints, or in accepting stipulations. There have been a number of such actions but specific reasons were not usually assigned by the Commission.[20] Practically the only available source of precedent is the formal record of cease and desist orders issued by the Commission dealing with practices found illegal under the Act. These records, it will be found, often contain inadequate explanation by the Federal Trade Commission of the theory and reasoning supporting its actions.

Since the lawyer, however, cannot solve problems of pricing policy by not knowing the answers, he must apply himself to the record of administrative enforcement for whatever it may offer. The following orders have dealt with the problem of the functional discount and its application under the Robinson-Patman Act.

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tions, Harvard Business Review, Vol. V, No. 2; W L. Thorpe and E. B. George, Check List of Possible Effects of the Robinson-Patman Act, Dun and Bradstreet, Inc.

[17]49 Stat. 1528, 15 U. S. C. A. §13(a) (1941). To date the criminal sanction has not been invoked. Montague, Sections 2(a) and 2(f) of the Clayton Act as amended by the Robinson-Patman Act and 3 of the Robinson-Patman Act, Robinson-Patman Act Symposium, CCH 14 (1946).

[18]38 Stat. 731, 15 U. S. C. A. §15 (1941). See Elizabeth Arden Sales Corporation v. Gus Blass Company, 150 F. (2d) 988 (C. C. A. 8th, 1945), cert. den. 66 S. Ct. 231 (1945).

[19]By the margin of one Justice, The Supreme Court recently denied the additional sanction of permitting delinquent customers to plead a Robinson-Patman violation as a defense to an action for payment of a business obligation. Bruce's Juices Inc. v. American Can Co., United States Supreme Ct., No. 27, April 7, 1947, CCH Trade Regulation Service, p. 58, 490.

[20]A number of dismissals of complaints against functional discounts appeared in Chairman Ayres' Report to Representative Patman, 81 Congressional Record 12456 (August 25, 1937); Shipman, Two Years' Experience Under the Robinson-Patman Act, reprint from Oil, Paint, & Drug Reporter (1938).

Bird & Son, Inc.

Soon after the effective date of the Act, the Federal Trade Commission justified one of the early prognostications of the writers. It adopted the rule that the character of the selling—not the buying—determines whether customers are competing. In dismissing a complaint issued September 30, 1936 against *Bird & Son, Inc.*,[21] the Commission held that a mail-order house, Montgomery-Ward & Co., was competing with independent retailers in selling floor covering to the public. This being the case, price advantages given Montgomery-Ward were required under the Act to be justified by savings in cost resulting from differing methods or quantities in which the goods were sold or delivered.[22] The Commission by this action reincorporated into the meaning of the Act a part of the deleted sections of the original bill pertaining to functional discounts.

Commercial Inoculants Cases

In the *Commercial Inoculants* cease and desist orders, issued January 12, 1938,[23] the Commission propounded another rule originally incorporated in the deleted sections of the Patman bill—that pertaining to buyers acting in more than one function.

Several companies selling commercial plant inoculants classified their direct customers as jobbers, retailers, and consumers. The amount of discount varied with the product and size of the container, but in all cases the consumer paid the highest price, the retailer a lower price, and the jobber the lowest price. While these discounts were supposedly based on different functions, the Commission found that jobbers frequently sold direct to consumers. It also found that the companies sold to county farm bureaus at prices below the jobbing price, and that these bureaus sold both to retailers and to consumers.

The Commission made the finding that the difference in prices charged to customers competitively engaged in reselling inoculants

[21]Bird & Son, Inc., Bird Floor Covering Sales Corporation, Montgomery-Ward & Company, Inc., 25 F. T. C. 548 (1937).

[22]The complaint was dismissed primarily on the basis of the seller having revised its selling policy to exclude direct sales to independent retailers. To the extent that the new policy was not operating after the effective date of the Robinson-Patman Act, price differences were justified by savings in cost or had no significant effect on competition.

[23]Agricultural Laboratories, Inc., 26 F. T. C. 296 (1938); Hansen Inoculator Company, Inc., 26 F. T. C. 303 (1938); Albert L. Whiting and Lucille D. Whiting, Trading as the Urbana Laboratories, 26 F. T. C. 312 (1938); The Nitragin Company, Inc., 26 F. T. C. 320 (1938).

to consumers were discriminatory *as to that portion so resold,* and that differences in prices charged customers competitively engaged in reselling to dealers were discriminatory *as to that portion so resold.* It ordered the companies to stop the discriminations.

These laconic findings and order reaffirm the rule adopted in the *Bird and Sons* complaint dismissal—that character of the selling determines competition. Additionally, all customers engaged competitively in reselling inoculants to consumers to that extent should be given the same price; all customers reselling competitively to dealers to that extent should receive the same price. Nothing is said of the relationship between the two prices. In its order the Commission thus acknowledged the existence of the functional price differential, and by implication recognized its legality. While customer classification for purposes of giving discounts based on function is apparently permissible, the customer must be correctly classified.

American Oil Company and General Finance, Inc.

The question of how to treat the reseller who operates in two functions was again considered by the Commission in a 1939 complaint against the *American Oil Company and General Finance, Inc.*[24]

Amoco sold gasoline to taxi owners pursuant to a "commercial consumer contract" at prices lower than those to independent retail filling stations. The contract, providing that all products purchased by the commercial consumer were for his own use only and not for resale to employees or any other person, was signed by General Finance, Inc., owner and controller of several taxi companies in Washington, D.C., and operator of a filling station. General Finance disregarded the terms of the contract and sold some of the gasoline to the public. On learning of this, Amoco abrogated the "consumer" contact and entered into a "dealer" contract by which General Finance paid full dealer prices on receipt of the gas. Because some of the gas was to be used in its owned or controlled taxis, the dealer's contract was supplemented by an agreement providing that General Finance would receive a monthly credit on gas actually supplied to taxis owned or controlled by it.

The Commission found, and General Finance admitted, that the gas purchased at the lower price in this manner was actually resold to the public and to its owned or controlled taxis.

General Finance was found to be in violation of section 2 (f) of

[24]American Oil Company and General Finance, Inc., 29 F. T. C. 857 (1939).

the Clayton Act by knowingly obtaining a price discrimination; and Amoco, in violation of section 2 (a) by granting it.

It is difficult to tell from the recorded findings and order whether the Commission concluded that General Finance could not be deemed a consumer because it *resold* gas to its taxis, and that Amoco was aware of this, or that General Finance received a discrimination because it resold part of the gas to the *public*. It may be guessed from the lack of other findings that in the Commission's mind General Finance was entitled to lower prices on gas supplied to its taxis, and that the discrimination resulted from the lower prices on gas resold to the public. It would appear from the findings, however, that Amoco had tried completely adequate methods of handling this problem by contractual arrangement.

If the order was based on Amoco's failure to *enforce* the contract provision that the buyer not resell the gasoline to the public, such contracts would seem to be one way to solve the dilemma of according functional discounts to multiple-function customers. The contract, however, would appear to be in restraint of trade. No assurance is given that such a method would not result in an indictment by the Department of Justice under the Sherman Act, or in another complaint by the Federal Trade Commission for violation of the unfair trade practices section of the Federal Trade Commission Act. Presumably, failure to enforce the contract was not the basis of the Commission's action.

If the Commission felt that Amoco knew of the violation of the contract and consented to it, its order against Amoco might be understandable. This, however, was not stated in the findings.

In the final analysis, the record of this case is an instance of the Commission's failure to clarify the issues on a confusing aspect of Robinson-Patman Act application. By stating the findings in a general way, and the order in terms of the statute, it lost the opportunity to establish a principle or a precedent. A clear decision undoubtedly would have served a useful purpose to others facing similar problems.

Since the Commission seems to have ordered Amoco to discontinue discriminations between *resellers*, and did not refer to the differential between prices to resellers and commercial consumers, it may be hazarded that the case is further precedent for justification of the functional discount. It seems to reaffirm the necessity for a seller in some manner to apportion functional discounts to a multiple-function customer on the basis of actual operations.

Sherwin-Williams Co.

In a cease and desist order issued against the Sherwin-Williams Company, January 8, 1943,[25] the Commission once more specifically considered, among others, the problem of functional discounts and their application to multiple-function customers.

The manufacturers (Sherwin-Williams and its subsidiaries Lowe Bros. and Lucas & Co.) sold paint products directly to wholesalers (called distributors), retailers (called dealers), large consumers, and occasional consumers. The manufacturers regularly allowed "functional discounts to customers who qualified as jobbers, wholesalers, or distributors." The manufacturers had an established policy and practice of granting functional discounts "only to jobbers or distributors [wholesalers] and to such dealers [retailers] that perform the functions of the jobber or distributor, and only in the latter cases, to the extent that such dealers perform such functions."

The Sherwin-Williams Company did not have any customers operating exclusively as distributors, but did grant functional discounts to some of its dealers who perform the functions of a distributor. As a rule, the Company required its dealers acting as distributors to submit statements after the end of each month showing the total sales at dealers list prices (manufacturer's price to retailers) made to other dealers during the preceding month. From such total sales, Sherwin-Williams deducted the discounts that had been received by the reporting dealer with respect to the purchase which had been so resold. The applicable percentage functional discount was then applied to the net amount thus obtained to ascertain the sum due the reporting dealer as a functional discount for that month. Sherwin-Williams issued a credit memorandum to the reporting dealer covering the functional discount allowed for such month.

This method of applying functional discount schedules to multiple-function customers was not considered a discrimination in violation of the Robinson-Patman Act, and no order was issued forbidding the practice.

The Commission found that Lowe Brothers and Lucas allowed a maximum functional discount of 15% to its distributors. In the case of dealers performing all the functions of a distributor, the functional discount, as a rule, bore the same ratio to 15 as the percentage of the dealer's distributor business bore to his entire business. The functional

[25]The Sherwin-Williams Co., The Lowe Brothers Co., and John Lucas & Co., Inc., 36 F. T. C. 25 (1943).

discount usually was allowed on the face of the invoice and was based (after 1938) on the net amount of the dealer's purchases at dealer's list prices, after deducting quantity or volume discounts.

Lowe Brothers as a rule, accepted the statements of its dealers as to the percentage that their distributor business bore to their entire business. Lucas requested its dealer-distributors to submit invoices or certified statements each month showing the sales of trade sale items (standard trade-marked products) to other dealers during the preceding month. Some of the dealers complied; others said they would not do so. As a result, Lucas adopted two forms of distributor agreement, the first being signed by distributors who were willing to submit invoices or certified statements each month; the second being signed by those who would do no more than certify the percentage of their business transacted with retail dealers. Practically all of Lucas' distributors signed only the second contract, and received functional discounts on the basis of the representations contained therein.

The Commission found that as a result of these methods of apportioning discounts a substantial number of Lowe's and Lucas' dealer-distributors received functional discounts with respect to a substantial portion of the trade sale items resold by them to consumers either directly or through retail branches owned by them. Moreover, these dealer-distributors were in competition with other dealer customers and dealer-distributor customers of the manufacturers. Whether or not the Commission, however, held such *method* of apportionment to be in violation of the Robinson-Patman Act is uncertain. The conclusion at the end of the order pointedly did not list it among the specific violations, nor is there a provision in the cease and desist order that the method is bad under the law. The order, on the other hand, forbids in general terms any wholesale discount to customers to the extent they act as retailers. The lawyer is left to his own ingenuity in guessing the full meaning of the Commission's action.

In any case, it is clear that the Lowe and Lucas method of apportioning discounts is not permissible when it is misused and results in substantial error. The following instances of discrimination arising out of such misuse were specifically pointed out in the findings.

Both Lowe Brothers and Lucas allowed wholesale discounts to several firms who resold only to consumers.

Lowe Brothers gave one of its customers a functional discount on the supposition that 33⅓% (later 38%) of his business was as a jobber. The Commission found that actually such customer sold only about 13% of its purchases of such products to other dealers.

Lowe Brothers granted a wholesale discount to a reseller on the supposition that 80% of his business was as a jobber. The reseller operated a retail store located in the same building as his wholesale department, and operated two retail stores in the same city. Approximately one-half of the paint products bought from Lowe were resold to occasional consumers through these retail stores; the other half was sold to dealers located in the same area at Lowe's suggested dealer prices.

Lucas gave a wholesale discount to one customer who was a painting contractor using more than one-half of the material in his own business and reselling the other to consumers.

The practice of allowing functional discounts to customers not performing the related function in these instances was found to injure competition with the manufacturers themselves and between their customers. Such practice was ordered discontinued.

In each of these instances where the manufacturer failed to apportion discounts properly, the specific finding was made that the retailers and consumers receiving the wholesale discount were in competition with *customers of competing manufacturers.* It seems clear that a seller who knows that his customer sells 50% of the product at wholesale and 50% at retail, but authorizes a wholesale discount on 75% of his purchases will win business away from another seller who apportions discounts more accurately. The functional discount used in bad faith or negligently may thus be considered a discrimination resulting in competitive injury at the primary level—between the seller and his competitors.

Despite the uncertainty of much of its language, the Commission's order against Sherwin-Williams and its subsidiaries was an addition to the precedents established for legality of functional discounts. It indicated one acceptable method of apportioning such discounts to multiple-functional customers—that employed by Sherwin-Williams—and at least implied that the seller will not be held accountable if he uses apportionment methods—such as those employed by Lowe and Lucas—if they are applied in good faith and do not result in substantial error.

Subsequently in an order issued May 13, 1944, against the *American Art Clay Company*[26] the Commission gave consideration to "trade discounts" allowed wholesalers, and ordered them discontinued on the basis of actual competition between wholesalers and those resellers not receiving the discount.

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[26]American Art Clay Company, 38 F. T. C. 463 (1944).

Morton Salt Company

In a cease and desist order issued April 14, 1945, against the *Morton Salt Company*[27] the Commission forbade the seller's discriminating in price by (a) selling to some wholesalers at prices different from prices charged other competing wholesalers (b) selling to some retailers at prices different from prices charged other competing retailers and (c) selling to some retailers at prices *lower* than prices charged wholesalers whose customers compete with such retailers.

While the order was based on the misuse of quantity discounts only, the Commission again recognized in effect the right to allow discounts based on function. Wholesalers must be treated alike and retailers must be treated alike, but nothing in the order requires both classes to be treated the same way.

The *Morton Salt* order, however, contained in clear terms what had been intimated by the Federal Trade Commission in previous orders issued against the *C. F. Sauer Co.*[28] and the *Lifesavers Corporation:*[29] a retailer should not receive a *lower* price than a wholesaler if the wholesaler's customer compete with the retailer. This appears to be a valid conclusion; otherwise, direct retailers are placed in a substantially superior competitive position over retailers who buy from wholesalers. The retailer and wholesaler who receive different prices from the seller, however, are not in competition. On what basis, it might be asked, could the Commission find competitive injury between purchasers who do not compete?

Section 2(a) of the Robinson-Patman Act states that a price discrimination *between purchasers* is illegal if it injures competition with "any person who either grants or knowingly receives the benefit of such discrimination, or with customers of *either* of them." By the precise wording of the Statute, the word "either" refers both to the original seller and to his customer. If injury can be shown to competition between customers of either of these individuals, an original price difference, even though charged to noncompeting customers, may be called illegal. Clearly it was this interpretation of the Statute that the Commission adopted in holding that, where the difference was not justified by cost savings, a retailer should not receive a lower price than a wholesaler selling the retailer's competitors.

[27]"Morton Salt Company, Docket 4319. Order set aside and complaint dismissed by Circuit Court of Appeals, 7th Circuit, May 27, 1947, on basis of Commission's failure to show quantity discounts were unjustified or that they had an illegal effect."

[28]The C. F. Sauer Co., 33 F. T. C. 812 (1941).

[29]Life Savers Corporation, 34 F. T. C. 472 (1941).

Standard Oil Company of Indiana

The latest order dealing with functional discounts was entered August 9, 1946, against the *Standard Oil Company of Indiana,*[30] now pending on review in the Seventh Circuit Court of Appeals. Some of the views of the Commission expressed in the findings and order in this case, it is believed, are inconsistent with those previously expressed. If the order does not throw actual doubt on the legality of functional discounts, it at least places practical obstacles in the way of their use.

The Standard Oil Company sold gasoline at a quoted tank-wagon price to over three hundred independent retail filling stations in the Detroit area. At the same time it sold to four so-called "jobbers" in the same area at tank-car price, 1½ cents per gallon lower than the tank-wagon price. These "jobbers" were in the business of reselling gasoline to filling stations, but according to the Commission's findings, "the Citrin-Kolb Oil Company, Stikeman Oil Company, Inc., and Wayne Oil Company sold a substantial portion of the gasoline purchased by them from the respondent direct to the public through retail service stations owned and operated by them. Ned's Auto Supply was engaged entirely in the retail sale of gasoline to the public through its own stations." The Commission also found that "there was no requirement that said jobbers should sell only at wholesale."

The Commission held that each of the "jobbers" by selling to the public through owned or operated filling stations was to that extent a retailer, and in competition with other retail filling stations in the area. Note, for example, the following language in paragraph 8 of the findings of fact:

> "The Commission finds that the price discriminations granted by the respondent to Ned's Auto Supply Company, both prior to March 7, 1938, and subsequent thereto, and the price discriminations granted to Citrin-Kolb Oil Company, Wayne Oil Company, and Stikeman Oil Company, Inc., on gasoline sold by them *at retail* have given a substantial competitive advantage to these favored dealers *in their retail* operations over *other retailers* of gasoline, including retailer-customers of the respondent." [Italics added].

The position taken by the Commission in this finding would support the conclusion that it was following the policies apparently laid

[30]Standard Oil Company, Docket 4389, modified cease and desist order issued August 9, 1946.

down in the orders against *Bird & Son*, the *Commercial Inoculant Companies*, the *American Oil Company*, *Sherwin-Williams*, and the *Morton Salt Company*: character of the selling determines the function of a reseller, and functional discounts should be apportioned among multiple-function sellers. The question of whether the "jobbers" actually stored for, sold to, and invoiced their own filling stations is not discussed in the findings, although it appears that all deliveries were made direct to the four "jobbers." It cannot be said, therefore, that the Commission by this order has "found" all such integrated resellers to be retailers regardless of their operations. The fact is—and it is important to an understanding of the order—that the four so-called "jobbers" in this instance were deemed retailers to the extent they sold through their own filling stations.

Having found the "jobbers" in reality competing with retailers, the Commission proceeds, as would be expected, into questions of differences in cost of sale or delivery, effect on competitive conditions, and the meeting of competition.

Had the Commission stopped here, there would be no reason to feel it had changed its previous views about the legality of functional discounts or its theories of the economics of distribution.

In its study of the results of the lower price given the four "jobbers," the Commission discovered one of them, Citrin-Kolb, resold to independent retailers at less than the Oil Company charged retailers who bought the same gas direct. In the words of the Commission, "During the period from January 1, 1938, to December 31, 1940, Citrin-Kolb Oil Company sold a million gallons of gasoline annually to Langer and Cohn, retail service station operators, at 1 cent per gallon off tank-wagon price and in addition sold another retail service station operator at ½ cent per gallon off tank-wagon price." The Commission found no evidence that the two other jobbers receiving the tank-car price sold gasoline to resellers at a price lower than the posted tank-wagon price charged by respondent to its dealers.

The Citrin-Kolb Oil Company, by passing on part of the price advantage, enabled Langer and Cohn to sell gasoline to the consuming public at discounts of as much as two cents per gallon, giving them a competitive advantage over retailers sold by the Oil Company, and diverted business from such retailers to Langer and Cohn.

As to this activity, the Commission issued the following order (paragraph 6):

"IT IS ORDERED that the respondent, Standard Oil Com-

pany (Indiana), a corporation, and its officers, representatives, agents, and employees, directly or through any corporate or other device in connection with the sale of gasoline in commerce, as 'commerce' is defined in the aforesaid Clayton Act, do forthwith cease and desist from discriminating, directly or indirectly, in the price of such gasoline of like grade and quality as among purchasers 6. By selling such gasoline to any jobber or wholesaler at a price lower than the price which respondent charges its retailer customers who in fact *compete in the sale and distribution of such gasoline with the retailer-customers of such jobbers or wholesalers, where such jobber or wholesaler resells such gasoline to any of its said retailer customers at less than respondent's posted tank-wagon price or directly or indirectly grants to any such retailer-customer any discounts, rebates, allowances, services or facilities having the net effect of a reduction in price to the retailer"* [Italics added]

When the Commission speaks in this paragraph 6 of a "jobber or wholesaler," it means a true wholesaler only—one who resells to retailers. It has said, in effect, to the Standard Oil Company of Indiana: you may not sell to wholesalers at a wholesale discount if any wholesaler charges a less price to retailers than you yourself charge to retailers. And, furthermore, you will violate the Robinson-Patman Act in allowing a wholesale discount to a wholesaler if he "directly or indirectly grants to any such retailer-customer any discounts, rebates, allowances, services, or facilities having the net effect of a reduction in price to the retailer" below that which you charge competing retailers.

Not before this order had the Federal Trade Commission issued a similar ruling about functional discounts. In the *Morton Salt* case it had upheld the position of the wholesaler in the distribution system by deciding that a direct customer-*retailer* should not get a lower price than a wholesaler where competitive injury results. Here the Commission found just the opposite—that a direct customer-*wholesaler* should not get a lower price than a direct customer-retailer where competitive injury results.

The competitive injury, according to the Commission, was between a direct retailer and an indirect retailer. It did not attempt to show the indirect retailer was a "purchaser" from the Oil Company under the Act.[31] Therefore, the *price difference* in question must have been

[31]In a cease and desist order issued in 1937 against the Kraft-Phenix Cheese Corporation, 25 F. T. C. 537 (1938), the Commission found that a retailer who purchased respondent's goods from wholesalers was a "purchaser" from respondent. The finding, however, was predicated on the respondent's promoting directly to the retailer and controlling by resale price maintenance the terms upon which the

the functional discount charged the direct non-competing customers. To arrive at a conclusion of illegality under the Robinson-Patman Act in this situation, the Commission found competitive injury between customers of the Oil Company's wholesaler. Where competitive injury is shown, such a result would seem to be justified by the precise wording of section 2(a) of the Statute referring to "customers of *either* of them." This had been the position of early commentators on the Act who felt that a functional discount might be so large that it would result in competitive injury between direct and indirect buyers.

There is nothing, however, in the official report of the *Indiana Standard Oil* case to show that paragraph 6 of the order was based on the Oil Company's "jobber" price being too large in relation to its retailer price. As a matter of fact, out of three wholesalers who received the jobber price, only one resold to retailers at less than the Oil Company's own retailer price. Furthermore paragraph 6 did not stipulate that the Oil Company should not grant a *large* discount to wholesalers. Nor did it state that the Company should not give a discount of such size as to *permit* the wholesaler to cut resale prices. Instead the order forbade the functional discount to a jobber *where* the jobber cuts prices to retailers below those charged by the Oil Company.

If this is to be the criterion of a legal functional discount, it follows that every such discount may become illegal the moment the buyer cuts prices to his customers.

Did the Commission intend that the seller should control the wholesaler's price? Maintenance of resale prices, absent fair-trade contracts, is by the clear weight of the decisions a violation not only of the Sherman Act but of the Federal Trade Commission Act.[32] It is true that the seller still may exert some measure of control over resale prices by the threat of refusing further sale,[33] but the chance of successfully

retailer bought. Without exploring further the effect or present status of this doctrine, those conditions were not present in the Indiana Standard order.

[32]Dr. Miles Medical Company v. John D. Park & Sons Company, 220 U. S. 373, 31 S. Ct. 376 (1911); Federal Trade Commission v. Beech-Nut Packing Company 257 U. S. 441, 42 S. Ct. 150 (1922). See Federal Trade Commission Report, Resale Price Maintenance, Summary and Conclusion, issued December 13, 1945, in which is stated the following: "Prior to the signing by the President on August 17, 1937, of the District appropriation bill, to which the Tydings-Miller amendment to the Federal anti-trust laws had been attached as a rider, decisions in a number of cases under the Sherman Law and the Federal Trade Commission Act made it clear that where a manufacturer maintained the resale prices of his identified goods by a system of contracts or equivalent cooperative methods, those contracts were void, and such methods illegal under the Sherman Law and the Federal Trade Commission Act."

[33]United States v. Colgate & Company 250 U. S. 300, 39 S. Ct. 465 (1919).

doing so without overstepping the vague bounds of permissible conduct is so remote that it is hardly conceivable the Commission would impose it as an alternative to violating the Robinson-Patman Act.[34] The seller also may, in all but several States and the District of Columbia, enter into fair trade contracts to maintain his resale price. It is hardly to be supposed, however, that the Commission has reversed the position, stated in its recently submitted report to Congress, that the Miller-Tydings Amendment to the Sherman Act, permitting fair-trade contracts, is against the policy of the antitrust laws, and that the essence of resale price maintenance is control of price competition.[35] In view of the Commission's order prohibiting functional discounts "where" the wholesaler cuts prices, the following language from that report is of interest:

> " In the absence of effective Government supervision in the public interest, resale price maintenance, legalized to correct abuses of extreme price competition, is subject to use as a means of effecting enhancement of prices by secret agreements and restraint of competition by coercive action on the part of interested cooperating trade groups of manufacturers, wholesalers, and retailers in such ways and to such an extent as to make it economically unsound and undesirable in a competitive economy.
>
> The Tydings-Miller amendment legalizes contracts whose object is to require all dealers to sell at not less than the resale price stipulated by contract without reference to their individual selling costs or selling policies. *The Commission believes that the consumer is not only entitled to competition between rival products but to competition between dealers of a single product.*"[36] [Italics added].

Perhaps the Commission meant that the supplier should urge his accountants to estimate a functional discount spread that would allow the wholesaler a discount representing his costs, overhead, and a fair profit—a discount that would finance his operations, but would not allow him to undercut the supplier's retailer price. Each wholesaler's costs, however, will differ; the supplier could hardly expect to be the arbiter of a fair profit for wholesalers. Moreover, as stated, the order

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[34]Cf. Article by John D. Haslett, Pricing Policies Lawful under Section 2(a) of the Robinson-Patman Act, and Competitive Justifications for Price Discriminations as Permitted by Section 2(b) of the Act 33 (1947).

[35]Federal Trade Commission Report, Resale Price Maintenance, Summary and Conclusion LX, LXI, LXIV (1945).

[36]Federal Trade Commission Report, Resale Price Maintenance, Summary and Conclusion, December 13, 1945. Above sections also quoted in Senate Committee Print. No. 16, Future of Independent Business 43 (January 2, 1947).

does not prohibit a differential that "permits" price-cutting, but a differential *where* the wholesaler cuts prices.

Must the seller cut off all direct retail customers, and sell only to wholesalers? It hardly seems possible that the Commission desired Standard Oil to discontinue direct selling to the more-than-three-hundred independent filling stations it had been supplying in the Detroit area. Even were all retailers cut off, however, the seller might not be fully protected. What would be the effect, for example, if a wholesaler, unbeknownst to the seller, sells some of the product at retail? If he does so, the price at which he buys would be lower that that of competing retailers buying from other wholesale customers; under the rule of this order the original seller might be held to have discriminated in price in violation of the Robinson-Patman Act.

It is not likely either that the Commission meant that Standard Oil should discontinue sales to all wholesalers. While this is the one sure way to obey the cease and desist order, it should not lightly be assumed that there was a desire to abolish wholesalers, or to encourage direct selling to retailers.

The Commission, in issuing its order in this case had still more to say to the respondent—

> "The above specified requirements of this order are subject, however, to the following provisos .. (c) that none of the prohibitions of this order shall be taken as inhibiting a lower price to *jobbers than to retailers* where respondent thereby makes only due allowance for its differences in cost of manufacture, sale or delivery resulting from the different methods or quantities in which such gasoline is to such purchasers sold or delivered." [Italics added].

Had the Commission not written paragraph 6 into its cease and desist order in this case, the above proviso would have had an understandable meaning, despite an ambiguity in the meaning of the word "jobber." The Commission had found the "jobbers" sold by Standard Oil to be in part retailers. This being so, the Commission would be saying in the proviso that differentials between retailers and those who act partly as retailers are permissible where there is a proper cost difference in selling or delivering to them.

This would not be a singular position. Unfortunately, the proviso must be read in the light of paragraph 6 as well as other sections of the order. From the standpoint of paragraph 6, it means that functional discounts are permissible (even though they allow wholesalers to cut prices) if they can be justified by a difference in cost resulting from selling or delivering to wholesalers and retailers. If this were the only mea-

sure of a legal functional discount, it safely may be said that there could be no functional discount in a practical sense. The seller would probably find it difficult to determine cost differences in selling to wholesalers and retailers. In many instances, he may find that it will cost less to supply individual retailers than individual wholesalers, depending on turnover, size of orders, type of goods distributed, emergency needs and similar factors. True, he might be able to average the cost of supplying all his wholesale customers and all his retail customers, and allow a functional discount reflecting the difference. Whether such a difference would be permissible, however, probably depends on the size of the individual cost variations; it might be difficult to justify when such variations are large. In any event the difference in cost of supplying wholesalers and retailers could not be expected to correspond at all times and in all cases to the size of a functional differential needed to finance the wholesaler's operation.

What, it may be asked, will be the effect of the *Indiana Standard* order on the single-price system—the charging of one price to all customers regardless of their function?

According to the findings of the Commission upon which paragraph 6 of the *Indiana Standard* order was based, the Oil Company was guilty of discrimination only because direct retailers and indirect retailers paid different prices. If the proscribed effect exists because direct retailers pay more than indirect retailers, it would seem to exist if the opposite is true. Yet, since a wholesaler must charge his customers a higher price than he pays his supplier, this is the inevitable result of the single-price system. Had the Commission held in this order (as in the *Kraft-Phenix* order) that the discrimination between "purchasers" was the price difference paid by the direct and indirect retailers, the legality of the single-price system would have been placed in serious doubt. The Commission's findings and order, however, indicate that the discrimination between "purchasers" was the *functional discount allowed direct buyers.* It would follow that a seller charging one price to all direct customers has not discriminated in price, regardless of the fact that indirect customers subsequently pay a higher price than customers who buy direct. This safe method of pricing, thus seems to remain an available refuge to those selling multiple-function customers.

One of the minor tragedies of the *Indiana Standard* order is that Commissioner Mason failed to apply his dissenting talents on all its confusing aspects. Mr. Mason was incensed at (among other things)

the evil effects of pricing according to use, and indeed this is troublesome. The businessman—even by the possibly more realistic rules of the *Sherwin-Williams* order—is placed under a heavy burden to ascertain from each of his customers the proportion of their divided functions, and to assume some responsibility for keeping the information up-to-date. Not to mention the premium this rule puts on the dishonesty of buyers who see in it an opportunity to lower their costs, it places the original seller in danger of being a law violater by the act of his customer in operating outside his normal function. Nor does a seller know how much exemption from other anti-trust laws he may depend on in trying to make his customers operate only in their established function. His lawyer will probably advise him that he can depend on no exemption.[37] These problems under the theory of the Robinson-Patman statute cannot be merely ignored. But in view of paragraph 6 of the Commission's order throwing doubt on the legality of the functional discount itself, they fade into relative insignificance.

In what specific manner, Commissioner Mason might have liked to know, could the respondent obey the cease and desist order without eliminating a number of small-business customers, or adopting resale price maintenance contracts?

He might have questioned the Commission about the difference between this order and those previously issued, affecting functional discounts, in which no concern was shown for the wholesaler's resale price. What is the status of these previous orders, and of what value will they be as guides to lawyers and businessmen?

Obviously no definite conclusion should be drawn from the *Indiana Standard* order until it has gone through the process of complete judicial review. It is to be hoped that the courts will not fail to realize its implications before decision is rendered. If the paragraph 6 order is allowed to stand, unmodified or without further explanation, doubt will be thrown on the practical usability of functional discounts.

The Judiciary Committee of the House in 1936, when the proposed Robinson-Patman Act was being considered, reported—

> "... A separate clause safeguarding differentials between different classes of purchasers becomes necessary. Such differentials, *so long as equal treatment is required within the class, do not*

[37] A related problem arises where the seller wishes to sell a customer in one of his functions at the proper price for that function, but it not interested in the customer's other functions. Does the right of customer selection permit selecting a multiple-function customer in one of his functions; or will the doctrine of the case of Luxor, Ltd., 31 F. T. C. 658 (1940), apply so that section 2(e) of the Robinson-Patman Act

> *give rise to the competitive evils at which the bill is aimed,* while to suppress such differentials would produce an unwarranted disturbance of existing habits of trade."[38] [Italics added].

That such specific exemption was necessary now appears to be true. Unless the courts can read the Robinson-Patman Act otherwise, a large segment of our marketing system may be in for a surprise.†

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forces a seller to select a customer for any function the customer wishes to perform with respect to the sellers product? This problem deserves separate treatment.

[38]H. R. Rep. No. 2287, 74th Cong., 2nd Sess. (1936).

†This article was derived in large part from a paper prepared for the Spring Seminar in "Problems of Trade Regulation" at the New York University School of Law, conducted by H. Thomas Austern of the Washington, D. C., Bar.