PREFACE

The successful completion of this thesis is due in large measure to the guidance, interest, and patience of many persons. A particular debt of gratitude is due Professor Robert B. Miner of The Ohio State University for his valuable guidance and understanding throughout the writing of this thesis. Appreciation is expressed to Professors Theodore N. Beckman and W. E. Dickerson for valuable criticisms and to Professor Harold H. Maynard for inspiration. Last, to my wife, Florence, is extended deep appreciation for her unlimited forbearance and the time and effort given to the typing of the manuscript of this thesis.

December, 1956

Jay D. Cook, Jr.
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CHAPTER I

INTRODUCTION

The state laws known as Unfair Sales Acts and Unfair Practices Acts prohibit vendors from selling products below cost for the purpose of injuring competitors and destroying competition, or deceiving customers. "Cost" is, however, susceptible to a variety of interpretations. Therefore, it is necessary that cost be defined properly if the acts are to function effectively. This study is a critical analysis of the cost definitions prescribed in the acts.

NATURE OF THE STUDY

Cost concepts and the cost provisions of the Unfair Sales and Unfair Practices Acts are presented in Chapter II. The problems involved in defining cost for the purpose of these laws are dealt with in the following six chapters. The definition of the cost base is examined in Chapters III and IV, whereas Chapters V through VII deal with the cost of doing business. Two problems closely related to the cost provisions of the acts are examined in Chapter VIII. These are the cost survey provision and the provision that permits sellers to meet the prices of competitors.
Throughout the thesis court interpretations and the rulings of administrative agencies are presented so that an understanding may be had of the way the laws are actually enforced. The various definitions of cost are evaluated, and where warranted recommendations for their improvement are made. These are synthesized in the concluding chapter.

Only the Unfair Practices Acts prohibit manufacturers, as well as wholesalers and retailers, from selling below cost. A definition of cost for manufacturers involves problems that are quite different from those of marketing institutions. Because of this, only the problems of defining cost for wholesalers and retailers are considered. The problems confronting manufacturers are presented adequately, although dated, in two published volumes.

**JUSTIFICATION FOR THE STUDY**

Many changes in the Unfair Sales Acts and Unfair Practices Acts, often referred to as "state sales-below-cost acts," have been effected since two studies that deal with these acts were published in the latter part of the 1930's.


New statutes have been enacted. Courts have ruled some laws unconstitutional or have given new interpretations to their provisions. Also, shortly after the publication of these studies, World War II changed the prevailing buyer's market into a seller's market. During the war, selling below cost was not a problem. However, in recent years a more competitive market has developed and price cutting has become an important competitive tool.\(^3\) In addition, there is some evidence of a weakening of the effectiveness of the Fair Trade laws.\(^4\) Thus, there is a current need for a more up-to-date and intensive analysis of the cost provisions of the Unfair Sales and Unfair Practices Acts.

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3. There is a plethora of recent articles about the price cutting practices of discount houses and the means by which other marketing institutions are meeting this competition. See, for example, Cameron Day. "Proposal to Repeal Fair Trade Stirs Up Hornets' Nest." Printers' Ink, 251 (April 8, 1955), p. 29; "Justice Department Takes Anti-Fair Trade Stand." Business Week, No. 1316 (November 20, 1954), p. 126; and "War on the Discount House." Business Week, No. 1306 (September 11, 1954), pp. 170-171.

4. Prior to the Schwegmann decision by the United States Supreme Court in 1951, the constitutionality of the acts was well settled except in Florida. Although many state courts have declared their acts constitutional since the Schwegmann case and the United States Supreme Court has refused to review decisions, the courts in five states have ruled the state acts either unconstitutional or inoperative and the courts in seven other states have rendered the non-signer clause invalid. This is a definite change from the period prior to 1951. In 1955 Westinghouse Electric Corp. and W. A. Sheaffer Pen Co. abandoned Fair Trade. The effectiveness of these laws and their constitutionality is questionable.
METHOD OF STUDY AND SOURCES OF DATA

All state statutes that may be classified as sales-below-cost acts, as well as other state statutes with sales-below-cost provisions, were analyzed and classified. The state codes and the Trade Regulation Reporter of the Commerce Clearing House, Inc., are the sources used for this analysis. Appendix D is a bibliography of the various state acts. Judicial interpretations were gathered primarily from the reporter series of the West Publishing Co. Also, Trade Cases, volumes published by the Commerce Clearing House, Inc., were used. These general sources and the important cases, classified by states, are listed in Appendix E. Information about problems of the cost provisions was gathered from secondary sources. These sources are presented in Appendix F.

COMPETITIVE BACKGROUND

It is the purpose of this section to discuss in very general terms the types of competitive markets that exist in the wholesale and retail fields. The effect that these market conditions have upon the determination of prices is briefly described. Then, two major price practices of retailers are presented, namely, average cost pricing and leader selling. This background helps to explain the conditions that have led to laws that attempt to influence prices.
The retail and wholesale fields are difficult to characterize in terms of one definite market model because the degree of competition in a given market tends to vary according to the degree of differentiation of the products sold and the number of competing sellers. In spite of this variation, monopolistic competition is the type of market often attributed as typical of the competitive conditions of these fields. Ease of entry and many sellers selling differentiated products exist in this type of market. Under these conditions a seller may reduce prices without appreciably affecting the volume of sales or the price policies of his rivals. Such conditions often prevail in city shopping districts. Although this type of market may typify the retail and wholesale fields in general, conditions of oligopoly exist in certain markets. The term oligopoly signifies that the number of sellers in a given market is so small that the price policy of one seller appreciably affects the volume of sales and policies of his rivals. The extent to which competitors react to a seller's price policy under these conditions depends on the degree of differentiation of the product or conditions of sale. The less the differentiation of products or conditions of sale, the sooner competitors tend to react to a

seller's price reduction. Conversely, the greater the differen-
tiation, the less competitors feel compelled to react to a seller's reduced price. Perfect oligopoly is the term that describes the former market condition and imperfect oligopoly describes the latter. Both types of markets operate in the wholesale and retail fields. For example, perfect oligopoly tends to exist in small communities where two small retailers sell the same brands of products and offer similar services. Imperfect oligopoly can be found in both large and small wholesale and retail markets.

Certain characteristics that pervade the wholesale and retail fields tend to exert a downward pressure on prices. The first characteristic is the relative ease with which firms may enter the field. This characteristic tends to result in normal or below-normal profits and over-capacity. This situation stems from the spreading of demand over too many firms and the reluctance of firms to leave the industry when profits fall below normal. It tends to intensify either price or non-price competition. The second characteristic is that most sellers handle many products. Sellers, then, are in the position of selling products under varying competitive conditions. For example, a condition of perfect oligopoly may exist for some products and imperfect oligopoly for others. The elasticity of the sales curve of each product that faces the in-

dividual seller tends to vary among these conditions. This places sellers in the difficult position of attempting to measure the demand for each of their products. It makes a difficult task almost impossible. The third characteristic is the existence of a high proportion of common costs. This condition enables the seller to assign costs to products in varying proportions. It also makes the measurement of marginal cost difficult because the marginal cost of each product can be determined only by varying the proportions of each product sold. This procedure may be too costly, and there is no assurance that the change in total cost is due only to the change in the sales of the product for which the cost is to be measured.

9. Elasticity of the sales curve of each product refers to the proportionate change in the quantity of the product demanded from an individual seller as the result of a given change in the product's price. For example, with a given decrease in price, an elastic sales curve means that the increase in the quantity of the product sold as a result of the price reduction is relatively greater percentage-wise than the price change, whereas an inelastic sales curve means that the increase in the quantity sold is relatively less percentage-wise than the price change. The former results in a greater total revenue from the sale of the product whereas the latter produces a smaller total revenue. The degree of elasticity is determined by the elasticity of the total demand for the product and the nature of competition in the market. For example, when there are close competitors, the greater the differentiation of the product or conditions of sale, the more elastic the sales curve tends to be, and, conversely, the less that products are differentiated, the less elastic is the sales curve because competitors tend to follow price changes. See John F. Due. Intermediate Economic Analysis. Chicago: Richard D. Irwin, Inc., 1950, pp. 125-129.

monopolistic competition or imperfect oligopoly, the sales
curve of many products tends to be elastic. Some mer­
chants, therefore, feel that they can attempt to increase
their total profit by lowering the prices of the products
that they believe have an elastic sales curve. Because
of the great number of products handled and the high pro­
portion of common costs, merchants are not sure of the
most profitable price and hence, a price that is too low
may be set. Competitors often react to price reductions
by lowering the prices of similar products. Such action
tends to make the sales curve less elastic. The antici­
pated increase in the product's sales may not materialize
which may result in losses to the competing sellers.

In order to reduce the rigors of this price competi­
tion and because of the difficulty of determining marginal
cost and marginal revenue, merchants tend to resort to
average cost pricing.11 Average cost pricing refers to the
attempt of sellers to cover costs by adding a percentage
markup to the product's cost that is sufficient to cover,
at the estimated volume of business, the direct operating
expenses, a portion of the indirect expense, and a rate

New York: National Bureau of Economic Research, 1943,
pp. 177-179.

No. 3 (Jan. 1941), pp. 387-388.
of profit that is deemed reasonable or "normal". The markup applied to each product tends to vary directly with the direct cost of handling the product. In addition, such factors as markdowns, rate of turnover, and floor space required are considered in determining the price of a product. This price may be modified further by other conditions. The elasticity of demand, style, seasonal factors, quality of the product, services offered, such as liberal return privileges and credit, may be factors inducing an increase or decrease in the price. In addition, prices may be lowered to meet those of competitors. Average cost pricing tends to reduce the downward pressure on prices, and tends to assure a greater safety for the retailer over a period of time. There is greater assurance that the seller's overhead will be covered and a reasonable profit received, although total dollar profit may not be maximized. This practice is aided by cost studies of trade associations and by regulatory measures.

Although average cost pricing tends to prevail in the

12. Strictly interpreted this is not an average cost. The actual average cost applicable to a particular product when a firm sells many products is not determinable. See, for example, George J. Stigler. The Theory of Price. New York: The Macmillan Company, 1947, p. 209.
wholesale and retail fields, some merchants follow the practice of leader selling. The practice of leader selling means the establishment of a price that is lower than the one that would be set according to average cost, which includes normal profit, for the purpose of attracting customers into the store in order to sell other merchandise. 

"Loss-leader selling" is a term that may be applied to the special case of leader selling in which the product is sold at a price lower than the merchandise cost plus the product's share of the seller's overhead expense. In this dissertation, then, leader selling refers only to a price that is set between the normal market price, which covers all costs and a reasonable profit, and the total cost of the product, whereas a price set below the product's total cost is referred to as a loss-leader. A loss-leader, in turn, is differentiated from a predatory loss-leader. The latter is a sale at a price that is less than the "net purchase cost of the goods." The loss realized on the sale of loss-leaders and predatory loss-leaders is expected to be recovered by the merchant from the sale of his other merchandise. Because of this, some customers may be misled.

16. Ewald T. Grether. *Price Control Under Fair Trade Legislation*. New York: Oxford University Press, 1939, p. 200. This definition does not include the reduction of prices for the purpose of selling only the price-reduced product, of passing on to the consumer reduced costs, or of meeting prices of competitors.
17. Ibid., p. 201.
into believing that the prices of the merchant's other merchandise are low. The practices of leader, loss-leader, and predatory loss-leader selling have been followed primarily by the large retailers who desire to take advantage of their great buying power, large number of lines handled, and advertising effectiveness in order to gain a greater share of the market. By lowering the prices of similar products carried by competitors, the large retailers may force their small independent competitors to sell products at prices that result in a net loss. The specialty store is particularly susceptible to such losses because the retailer has a limited number of different products that he can use as leaders in retaliation.19 The depressed prices often can not be restored to their former level without outright agreement by the sellers.20 The small merchants, then, may not be able to cover their costs in the long run. In order to prevent loss-leader selling, wholesalers and retailers have turned to federal and state governments for legislation that prohibits such practices or which attempts to enforce average cost pricing.21

REGULATION OF PRICES

In order to understand the regulatory setting of the

   op. cit., pp. 391-392.
Unfair Practices Acts and Unfair Sales Acts, a brief outline of the different types of statutes that regulate business and the philosophy of each is presented. The background and provisions of the sales-below-cost acts, that apply primarily to the practice of loss-leader selling by merchants, are then presented. This is followed by a brief outline of the economic arguments for and against the state sales-below-cost acts.

Freedom from governmental regulation of business enterprise prevailed in the United States until the late 1800's. Until this time it was the general belief that the well-being of society is best protected by a free and vigorous competitive economy. However, after the Civil War great industrial empires appeared that seriously weakened the competitive system. Therefore, in 1890, in order to protect and strengthen competition, by prohibiting efforts to restrain trade or create monopolies, the Sherman Anti-trust Act was passed by the federal government. Similar statutes were enacted by many states. Later, due to the generality of the Sherman Act and to enforcement difficulties, the Clayton Act of 1914 was enacted in order to prohibit certain forms of conduct that restrain trade or tend to create monopolies. In 1936 the Robinson-Patman Act was passed to amend the price discrimination provision of the Clayton Act and to prohibit other forms of trade practices that lead to monopolies. Some states followed suit and
enacted similar laws.

In addition to the anti-monopoly laws, certain acts prohibit unfair methods of competition and deceptive acts or practices in commerce that injure competitors or the public. This philosophy of business regulation is set forth in the Federal Trade Commission Act of 1914 and later amendments. The act does not prescribe the particular methods of competition that are unfair, but through the years the Federal Trade Commission and the courts have established certain competitive practices as unfair to competitors and the public. These include, as well as trade restraining acts, practices that are considered "unfair as against good morals" and those that are destructive of competition. Thus, not only is competition strengthened by anti-monopoly laws, but the methods of competition must not be unfair or destructive. Although methods of competition may be restricted, the purpose of such laws is to protect the competitive system in the long run.

In the 1870's and 1880's some states and the federal government passed laws that attempted to regulate natural monopolies. It was recognized that the public may be served best by permitting monopolies to operate in certain

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areas and to regulate them. Until the 1930's, the types of businesses that were regulated were those generally considered to be public utilities or natural monopolies. Courts limited governmental regulation accordingly. However, in the 1930's it was recognized by legislatures and courts that producers, merchants, and their employees, as well as consumers, might need protection in order that essential products or services may be produced as required by the public health, welfare, and safety, or that a better distribution of income among the various interests of society would promote the public welfare. All states regulate utilities and the insurance industry, and many regulate, among others, the milk and liquor industries. The purpose of such legislation is to protect producers and merchants from destructive competition, particularly when demand falls, and to assure the public an adequate and safe supply of the product at reasonable prices.

Some federal and state laws are directed specifically at certain unfair pricing practices. The federal Robinson-Patman Act prohibits price discrimination where such practice tends to restrain trade, create a monopoly, or injure competition. For example, one prohibition included in the act is that the difference in prices to different purchasers of like commodities must not exceed the differences in the

cost of manufacture, sale, or delivery due to different methods of sale or quantities of the product when sold to the different purchasers.\textsuperscript{25}

During the 1930's many states passed legislation that was designed specifically to prevent the practice of leader or loss-leader selling. These laws are the Fair Trade Acts and the sales-below-cost acts. They were supported by many trade groups; particularly certain manufacturers of branded products and small independent retailers. In order to extend resale price maintenance to interstate commerce, the federal government passed the Miller-Tydings Act which was strengthened in 1952 by the McGuire Act.\textsuperscript{26} The federal government has not yet enacted a sales-below-cost law.

SALES-BELOW-COST ACTS

In order that the purposes of the state sales-below-cost acts may be clearly understood, the major provisions of the statutes are presented in this section. The different classes of acts, based on their cost definition, are then explained. Last, a brief comparison of these laws with the Fair Trade Acts is presented.

The major provisions of the sales-below-cost acts are those that are concerned with the definitions of terms, the statement setting forth the practice that is prohibited, civil and criminal sanctions, injunctive relief, and exemp-

\textsuperscript{25} Maynard and Beckman, \textit{op. cit.}, pp. 750-751.

\textsuperscript{26} Brown and Davidson, \textit{op. cit.}, pp. 328-330.
tions. These acts prohibit prices that are below a defined cost if the purpose or, as in some acts, effect of the low prices is to injure competitors and destroy competition or deceive customers. These acts, then, are intended to protect individual sellers from the practice of price cutting by competitors, the general public from the reduction or destruction of competition that may result from such a practice, and customers of sellers who may be deceived thereby. Some acts require the injured party to prove that the seller intended to injure competitors or deceive customers. Others specify that proof of a sale below cost is presumptive evidence of intent to violate the act. This provision places upon the accused seller the burden of proving his intentions.27 A violation of the statute may be a civil or criminal act, or both. If a criminal prosecution, a violator may be fined, and in a few acts, imprisoned, and if a civil action, injured competitors may sue for actual or treble damages. In addition, injunctive relief may be granted to prevent such sales if a state administrative body, trade association, or injured competitor can prove that the seller's below cost price will be injurious to competitors. Last, certain sales at prices that are below cost are exempt from the provisions of the acts. Sales of

perishable or damaged merchandise, clearance and liquidation sales, those to charities and governmental units, and sales made below the defined cost if to meet the prices of competitors are the exemptions included in most acts.  

Therefore, in most states an accused violator can justify his low price by proving any one of the following three conditions: (1) that the price was not below cost as defined by the act, (2) even if the price is below cost, that he did not intend to injure competitors or deceive customers, or (3) that the particular below cost sale is exempt from the provisions of the act.

Early in 1956 there were forty-seven sales-below-cost laws that had been enacted by thirty-five states. Some apply to all products and are known as general acts while other laws, referred to as special acts, apply to one industry or to a few industries. The general acts are classified in this study according to their cost definition. The acts in one class, referred to as Unfair Practices Acts, specify a full cost definition whereas those in another class, the Unfair Sales Acts, permit sales at less than full cost. The third class of general acts,

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28. See Chapter VIII for an analysis of the exception that permits a merchant to meet the prices of competitors.
29. These states and their acts are listed in Appendix D by states and in Table 1, p. 32. The Territory of Hawaii also has an act that is similar to the Unfair Practices Acts.
30. The meaning of the term "full cost" is explained in Chapter II, pp. 35-36
referred to in this dissertation as miscellaneous acts, includes laws that prescribe definitions that vary from those specified in the first two classes. The special acts are classified into the Unfair Cigarette Sales Acts and other special acts. The acts in the former class deal only with cigarette products whereas those in the latter class apply to other trades or industries.

Of the state laws that regulate the prices of certain industries, some are sales-below-cost acts and others are price fixing statutes. The former are included in this dissertation as special acts whereas the latter are excluded. Although some of the latter statutes, for example, milk and liquor control laws, contain sales-below-cost provisions, and many of them prescribe certain markups for pricing purposes, they are not included in this dissertation for the following reasons. First, these laws were not passed primarily to prohibit loss-leader selling; their purpose is to regulate production, the number of sellers, and the quality of the product as well as prices, in order to protect the public. Any sales-below-cost provisions

31. The classifications of the acts and the states that enacted the laws are indicated in Table 1, p. 32.
included in these acts are merely incidental. Second, in all cases prices are either fixed or the minimum price is set by the regulatory authorities. In some states, fair trade provisions apply. This is particularly true in the liquor industry. Therefore, these laws fix prices in contrast to the sales-below-cost acts which allow merchants some pricing freedom. Third, even though some of these laws contain provisions that are similar to those in the sales-below-cost acts, the percentage markups prescribed are required, and they are large enough to assure a profit to all regulated merchants. On the other hand, the percentage markups specified in the special sales-below-cost acts included in the dissertation are merely used as presumptive evidence of the individual seller's cost. A seller may apply a lower percentage markup to the product if his cost is lower. The liquor laws of Arkansas, Kentucky, and New Mexico contain sales-below-cost provisions, but the required markups for wholesalers vary from fifteen per cent to seventeen and one-half per cent and the markups for retailers vary from twenty-five to fifty per cent.33

According to the 1948 Census of Business, the operating

expenses of wholesalers in the beer, wine, and liquor trade varied from eight per cent to slightly over fourteen per cent, which are well below the required markups.\textsuperscript{34} Similarly, the operating expenses of retail liquor stores in 1950 amounted to approximately seventeen per cent, which is well below the retail markups that are required.\textsuperscript{35} The Arkansas milk law has cost provisions that are very similar to those in the Unfair Practices Acts, but in addition to the prescription of a full cost definition, a four per cent markup based on this cost is required.\textsuperscript{36} These markups, therefore, assure a profit to the seller. The special acts that are included in this dissertation are those that were enacted primarily to prohibit loss-leader selling and not to regulate prices and assure profits to merchants.

The Fair Trade Acts, enacted by forty-five state legislatures, have attracted considerably more public attention than the sales-below-cost acts. The purpose of these acts also is to prevent price cutting by retailers and wholesalers. In highly simplified terms, they permit manufacturers or other brand owners to set the minimum resale prices of their branded products. Once a resale price

\textsuperscript{34} United States Census of Business, 1948, Vol. IV. Wholesale Trade. U. S. Department of Commerce, Bureau of

\textsuperscript{35} Operating Ratios for Thirty-three Lines of Retail

\textsuperscript{36} Acts of the Sixtieth General Assembly of the State
of Arkansas. Act 380. Camden, Arkansas: The Hurley Com-
maintenance contract is signed, all merchants that sell the manufacturer's product in the state and that are notified of the resale price must sell at or above the set price. These acts, then, prohibit leader selling while the sales-below-cost acts prevent loss-leader selling. The latter acts, therefore, "strike more directly at predatory price cutting" than the former, because they permit differences in prices among competing retailers and aim to prevent only those prices that are set with injurious intent. Sellers have much greater pricing freedom under the sales-below-cost acts, and prices may be reduced if costs permit a reduction. In addition, the Fair Trade Acts apply to a restricted number of products; those that are in free and open competition with other products, and of these, only those that the manufacturer or other brand owner chooses to "fair trade." On the other hand, the general sales-below-cost acts apply to all products. It seems then, that the competitive system can be maintained better in the long run by the prohibition of harmful price cutting under the sales-below-cost acts than under the Fair Trade Acts.

**IMPLICATIONS OF THE SALES-BELOW-COST ACTS**

It is not the purpose of this thesis to evaluate the sales-below-cost laws nor to justify them. Nevertheless,

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37. Maynard and Beckman, op. cit., p. 693.
a brief review of the arguments for and against these acts is presented. It is claimed by those opposing the laws that free competition is the best regulator of prices, and that society is served best under such a system. Low prices to consumers and enhanced efficiency of producers is assured. The use of loss-leaders by merchants may be profitable to sellers because an increase in the sales of the loss-leader and of other products may increase total profits. At the same time, consumers gain from these low prices. The prohibition of loss-leaders, therefore, may prevent merchants from maximizing profits and may raise prices to consumers. Studies about the effect of sales-below-cost laws on prices are not in agreement and indicate that the laws have little effect on average prices. One study indicated that prices to the consumer were raised and another study indicated the opposite effect. Both studies concluded that the deeply cut prices were raised, but that the prices of some other products were lowered to the legal minimum. The acts, then, may operate to increase prices to the lower income consumer.

Proponents of sales-below-cost laws argue that some regulation is necessary in order to insure reasonable

41. Ibid., p. 314.
prices to consumers, fair wages to laborers, and fair profits to producers. It is claimed that these acts permit prices to be set according to the forces of a free competitive market. Only prices set below cost that may reduce competition are prohibited. Because these markets are not perfectly competitive, merchants possess some power in establishing prices. Therefore, some sellers can set prices below cost for the purpose of driving competitors from the field. If successful, the degree of competition is reduced, which harms consumers in the long run through higher prices. Prices will tend to be higher under conditions of oligopoly than under monopolistic competition because the sales curves facing producers under the former conditions tend to be less elastic. In addition, such a pricing practice may be followed by the firm with the greatest financial backing and, therefore, the efficient firms may be eliminated rather than the inefficient. 42

The philosophy that a "fair" price is one based on the seller's cost, and the consequent regulation of prices on this basis, has been roundly condemned. 43 Price is not


determined by cost alone, but by the conditions of supply and demand. The unit cost of a product, in turn, is determined by the nature of the seller's costs, demand, and the price of the product. For example, in the short run when common and fixed costs are proportionately great, a reduction in the price of one product may increase the volume of sales of several products which, in turn, decreases the unit cost of these products because the common and fixed costs are spread over a greater number of units. Sellers are not certain of this price-volume-cost relationship at the time they originally set prices. A certain volume of sales is assumed when price is determined by cost alone. This places the merchant in a perilous position relative to the sales-below-cost acts, for if the sales volume of the product that was originally assumed is not attained, the price may not cover the product's cost and the seller is then subject to civil and criminal prosecution. This demand, cost, and price relationship is admitted by proponents of the acts. However, the laws utilize cost as a standard only in order to make easier the discovery of those merchants that are attempting to reduce competition, injure competitors, or deceive customers. If a merchant does establish a price that later is discovered to be less than the defined cost, he has not violated the act unless the price was originally established with injurious intent.

feldt, op. cit., pp. 164 to 170; and Wilcox, op. cit., pp. 393-394.
The defined cost is not the single criterion of a violation; intent, and the effect of below-cost prices are also standards.

In the last analysis, the regulation or non-regulation of prices and the nature of such regulation depends upon the desired goals established by legislatures. The protection of the small merchant against the competition of the mass distributor, and the enhancement of competition by restricting practices that reduce competition, is considered desirable by the legislatures of the states that have passed sales-below-cost acts.

CONSTITUTIONALITY OF STATE SALES-BELOW-COST ACTS

Approximately fifty cases involving the constitutionality of the state sales-below-cost acts have been decided by state courts. In spite of the great number of cases, twenty-nine laws now in effect have not been tested in the courts. Of those tested, seventeen have been declared constitutional and fifteen have been found unconstitutional. However, eight of the unconstitutional acts either have been amended satisfactorily, have been repealed and replaced by another law, or have been declared constitutional in a later decision. An investigation of the constitutionality of the acts follows. The constitutionality of the cost

44. Appendix E is a bibliography of the important cases listed by states.
45. Refer to Table 1, page 32 for a summary of the current status of the sales-below-cost acts.
provisions is examined in detail throughout the study where each of the cost definitions is discussed.

The California Unfair Practices Act of 1913, as amended in 1935, was declared unconstitutional by a district court of appeals in the case of Balzer v. Caler in 1937 for being a price-fixing and discriminatory statute.46 Since the larger retail stores have lower operating costs, per unit of product, they can set a price on goods that is lower than that permitted the smaller merchant. Because of this, the act was held to discriminate against small vendors. This court's decision later was reversed by the state supreme court in the case of Wholesale Tobacco Dealers Bureau v. National Candy & Tobacco Co.47 The court held that the statute is not discriminatory, since what is required is uniformity of operation, not of result. Also, the court ruled that it is not a price-fixing act as it merely fixes the price below which goods may not be sold. Since this decision, two other Unfair Practices Acts have been held unconstitutional. The Nebraska statute was ruled uncertain and indefinite and, therefore, unconstitutional.

47. Wholesale Tobacco Dealers Bureau of Southern California v. National Candy & Tobacco Co. (California supreme court, 1938), 82 Pac (2d) 3.
by the state supreme court.\textsuperscript{48} The Nebraska legislature, then, in 1941, passed an Unfair Sales Act which is constitutional.\textsuperscript{49} In October, 1955, a Colorado District Court held the state's Unfair Practices Act unconstitutional on the ground that the definition of cost is vague, indefinite, and impossible to comply with, and, therefore, violates the due process clause of the United States Constitution.\textsuperscript{50} The case was not appealed to a higher court.\textsuperscript{51}

Four Unfair Sales Acts have been declared unconstitutional. Two of these were enacted by Maryland. Uncertainty, arbitrariness, and lack of criminal intent are the grounds on which three laws were voided. These three acts are the statutes of Arizona, Oklahoma, and the Maryland act of 1939. They provided that any sale below cost is a criminal act regardless of the intent of the seller. The courts ruled that intent to injure a competitor must be a requirement.\textsuperscript{52} The Oklahoma legislature amended its


\textsuperscript{51} "Marketing Briefs." Business Week, January 21, 1956, p. 156.

crippled act, and in 1951 it was held constitutional by a six to three decision of the state's supreme court.\textsuperscript{53} The Maryland Act of 1939 was repealed and another Unfair Sales Act was enacted in 1941 which later was declared unconstitutional because of the cost provisions.\textsuperscript{54} Nothing has been done to correct the defects of this act and the Arizona law.

Three miscellaneous general acts have been declared unconstitutional. The Minnesota Unfair Trade Practices Act was voided by a United States District Court in 1938 for improper and uncertain cost provisions.\textsuperscript{55} However, the defective act was amended in 1939 after which the Minnesota supreme court ruled it constitutional.\textsuperscript{56} The Pennsylvania and New Jersey Fair Sales Acts of 1937 and 1938, respectively, were found contrary to the Federal Con-


\textsuperscript{54} Isaac Cohen v. Frey & Son, Inc. (Maryland court of appeals, 1951), 80 Atl (2d) 267.


\textsuperscript{56} McElhone v. Geror. (Minnesota supreme court, 1940), 292 N. W. 414.
stitution by the state supreme courts.57 Both acts were judged to be outside the police power of the state legislature because they were arbitrary, vague, and required no criminal intent in a criminal statute. In addition, the New Jersey statute was held to be a price-fixing law. Since these decisions, only the Pennsylvania legislature has enacted another law, an Unfair Sales Act.

Five special acts have been invalidated of which four are Unfair Cigarette Sales Acts. The Iowa cigarette act was declared void by an Iowa district court on the grounds of uncertainty, lack of criminal intent, and lack of legislative power. However, in the same year, the Iowa supreme court reversed the lower court's decision and found the act to be constitutional.58 The Ohio cigarette act of 1941 was held to be discriminatory in the case of Serrer v. Cigarette Service Co.59 The law was amended in 1949. The New Jersey supreme court ruled the New Jersey Unfair Cigarette Sales Act unconstitutional because of an arbitrary definition of wholesaler,60 and the Georgia

60. Lane Distributors, Inc. v. Tilton. (New Jersey supreme court, 1951), 81 Atl (2d) 786.
cigarette act was held null and void because it was ruled that the wholesale cigarette business is not affected with the public interest. The New Jersey Motor Fuels Act was ruled unconstitutional on the grounds of vagueness and price fixing.

Of the fifteen statutes that have been declared unconstitutional, higher courts have reversed the decision of the lower courts for two laws, three states have enacted new Unfair Sales Acts, and the statutes of three states have been satisfactorily amended. No further action has been taken by the legislatures to amend the remaining seven acts.

The cost provisions of six acts have been ruled unconstitutional because they were held to be uncertain and, therefore, impossible to comply with and the provisions in three acts were ruled arbitrary and discriminatory. However, the same provisions in eight other laws have been held to be certain and reasonable. In these latter cases, the courts followed the reasoning of the Wyoming supreme court which was set forth in State v. Langley. In the absence of factual information to the contrary, it is presumed that the legislature had in mind a definite meaning.

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62. Neeld, Deputy Director Division of Taxation, Department of the Treasury v. Automotive Products Credit Association. (New Jersey district court, 1952), 90 Atl (2d) 558.
which is presumed to be the cost generally meant by businessmen; "...the approximate cost arrived at by a reasonable rule." The courts that ruled the provisions uncertain, however, held that the defined cost is impossible to ascertain. This ruling tended to result in those cases where the courts had to face the problem of ascertaining a merchant's cost as defined by the acts. Where the provisions were held to be arbitrary and discriminatory, some part rather than the whole definition was ruled arbitrary. These rulings are discussed in greater detail throughout the dissertation in connection with the analysis of the cost provisions.

63. State v. Langley. (Wyoming supreme court, 1933), 84 Pac (2d) 767.
64. See, for example, Balzer v. Caler. (California district court of appeals, 1937), 74 Pac (2d) 839 and Standard Store v. Safeway Stores, Inc. and King Soopers, Inc. (District Court, Colorado, 1955), Current Court Decisions, op. cit., par. 68,153.
65. See, for example, Serrer v. Cigarette Service Co. (Ohio supreme court, 1947), 76 NE (2d) 91.
<table>
<thead>
<tr>
<th>No Court Decision</th>
<th>Constitutional</th>
<th>Unconstitutional</th>
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<tbody>
<tr>
<td><strong>Unfair Practices Acts</strong></td>
<td></td>
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<tr>
<td>Arkansas</td>
<td>California</td>
<td>Colorado</td>
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<tr>
<td>Kentucky</td>
<td></td>
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<td>Montana</td>
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<td>Washington</td>
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<td></td>
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<tr>
<td>Wyoming</td>
<td></td>
<td></td>
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<tr>
<td><strong>Unfair Sales Acts</strong></td>
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<td></td>
</tr>
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<td>Idaho</td>
<td>Connecticut</td>
<td>Arizona</td>
</tr>
<tr>
<td>Kansas</td>
<td>Louisiana</td>
<td>Maryland (two acts)</td>
</tr>
<tr>
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<td>Massachusetts</td>
<td></td>
</tr>
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<td>Oklahoma</td>
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<td>Virginia</td>
<td>Tennessee</td>
<td></td>
</tr>
<tr>
<td>West Virginia</td>
<td>Wisconsin</td>
<td></td>
</tr>
<tr>
<td><strong>Miscellaneous Acts</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>North Dakota</td>
<td>Minnesota</td>
<td>New Jersey</td>
</tr>
<tr>
<td>Oregon</td>
<td>South Carolina</td>
<td></td>
</tr>
<tr>
<td><strong>Unfair Cigarette Sales Acts</strong></td>
<td></td>
<td></td>
</tr>
<tr>
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<td>Mississippi</td>
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</tr>
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<td>Arkansas</td>
<td>New Mexico</td>
<td>Georgia</td>
</tr>
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</tr>
<tr>
<td>Connecticut</td>
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</tr>
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<td>Pennsylvania</td>
<td></td>
</tr>
<tr>
<td>Massachusetts</td>
<td>Tennessee</td>
<td></td>
</tr>
<tr>
<td><strong>Other Special Acts</strong></td>
<td></td>
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<tr>
<td>California (dairy products)</td>
<td>Michigan (bakery and petroleum)</td>
<td>New Jersey (motor fuels)</td>
</tr>
<tr>
<td>Connecticut (retail drug)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Idaho (dairy products)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Louisiana (retail drug)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Texas (grocery stores)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Utah (agricultural code)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a/ The Ohio Unfair Cigarette Sales Act, amended to meet the objections of the state supreme court, has not been tested since the amendments were made.
CHAPTER II

THE COST PROVISIONS

The cost concepts that may be used by sales-below-cost acts are presented in this chapter. A discussion of these concepts prepares the way for a better understanding of the cost provisions which follow. The cost base, the amount added to this base, and the miscellaneous provisions that are related to the cost provisions are presented in this order for each of the classes of acts.

COST CONCEPTS

The prohibition of sales-below-cost requires a definition of cost. However, the word "cost" has many meanings. Therefore, it is necessary to specify the particular concept of cost that is to apply. The concept employed depends on the purpose of its use and the point of view of the user. Since the purpose of its use in these acts is limited to that of pricing, the point of view of the user determines the concept. For example, economists and accountants are expected to utilize different ideas of cost although pricing is the only purpose of its use.1

These concepts are classified according to the point of view of (1) the economist, (2) the accountant, and (3) the businessman. A fourth classification, minimum cost concepts, includes those that pertain specifically to the sales-below-cost acts. Legislatures, when enacting such laws, may prescribe any one of the first three concepts, a combination of any of them, or they may establish a concept of their own.

ECONOMIC COST

When analyzing price the cost concept utilized by the economist is the cost incurred by the marginal firm. This cost, opportunity cost, is the amount the firm must pay to the owners of the factors of production in order to continue operating. It is measured by the alternative earnings of the productive services. Total cost, then, is the sum of the current expenses necessary to hold the services. The average unit product cost is determined by dividing this sum by the number of units of product produced. Most of these payments result from a contractual relationship between the firm and the owners of the services. Some examples of these contractual or explicit costs are wages,

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salaries, rent, and interest on borrowed capital. However, certain other payments of the firm do not arise from contractual relationships. These are payments to the owner of the firm for the use of his savings as capital funds, rent for the use of his land, and a wage for his personal services. They are considered to be costs by the economist because the owner would not offer these services if there were better opportunities for their use elsewhere. Cost, then, to the economist means the sum of the explicit and implicit opportunity costs of the marginal firm.

ACCOUNTING COST

The primary purpose of the financial accountant is to measure the results of the operations of the business enterprise in terms of profit or loss. In order to accomplish this, the expenditures made to produce revenue must be recorded. The accountant records only explicit expenses; those expenditures actually made or contracted for. Therefore, these explicit expenses, at the time of the computation of profit, are historical costs; definite measurements of past activities.

Most trading firms sell more than one product. This circumstance gives rise to a class of expenses known as

common costs. According to one authority,

They refer to costs that cannot be traced home and attributed to particular units of business in the same direct and obvious way in which, for example, leather can be traced to the shoes that are made from it.5 These expenses are incurred for more than one product, and therefore, they are not directly or wholly responsible for any particular product. Typical of such expenses are rent, heat, and depreciation. Since price policies require a knowledge of the cost of particular or specific products, a branch of financial accounting, cost accounting, developed to cope with the problems incident to the securing of this knowledge. The cost accountant determines the cost of a product by measuring the direct material and labor costs embodied in the product and then adds an overhead cost which is determined by reclassifying and distributing these common expenses to the unit of product.6 Thus, the unit cost of a product is composed of the historical expenses directly attributable to the product and that part of the common costs assigned to it.

BUSINESS COST

Under competitive conditions the price of a product is set in the market. This price tends to equal the economist's concept of cost. However, the less competitive the

market, the more will the price of a product depend on a particular businessman's concept of its cost. This concept tends to be a mixture of the concepts of the economist and the accountant. The latter's historical unit product cost is used, to which is added the former's implicit cost. The implicit cost is the amount above the accountant's cost that the businessman feels is necessary that he receive in order to pay him for the use of his capital, effort, and for the risk incurred. However, the businessman's concept of implicit cost differs from that of the economist in that the latter tends to view this cost as that incurred by the marginal concern, while the businessman views it as that of a particular firm regardless of whether the enterprise is marginal.

MINIMUM COST CONCEPTS

There are other cost concepts used by different individuals or groups for different purposes. Legislatures may utilize one or a combination of the above three concepts or devise their own concept for a particular purpose. The

sales-below-cost acts were passed to prevent the practice of loss-leader selling or to limit the extent of losses realized from such a practice. If loss-leader selling is to be prohibited, the concept specified should be that of the accountant. Profit is not considered to be an element of cost in this concept, and, thus, the minimum price would be set at the level of the historical explicit unit product cost of the firm. Prices set at this level prevent losses from the sale of products, but no profit is realized. Thus, leader-selling is permitted, but not loss-leader selling.

Legislatures may establish their own cost concept in order to carry out a particular purpose. If it is intended to prevent predatory loss-leader selling, the minimum price should be set at the cost base. This tends to prevent the setting of prices below the acquisition cost of products. Prices set at this level result in a loss equal to all the overhead expenses applicable to the product. On the other hand, if a legislature intends to permit loss-leader pricing but desires to limit the amount of this loss, the law should specify that a markup, that is less than the product's share of overhead expenses, be added to the cost base. The amount of the markup will determine the extent of the loss. Therefore, it is necessary that the legisla-

ture clearly specify the particular cost concept intended to be used and clearly define the cost that sets the minimum price.

SUMMARY

The unit product cost as viewed by the economist is defined as an average of the total explicit and implicit opportunity costs of the marginal firm. Accounting cost constitutes the sum of the explicit historical expenses of the particular firm that are directly connected with and are assigned to a unit of product. The businessman's concept of cost is the historical explicit unit product cost of the accountant plus the average unit implicit opportunity cost of the particular firm. The definition of cost set forth by legislatures depends on the purpose of their legislation. It may be any of the above three concepts or a special definition of the legislature. If predatory loss-leader selling is to be prevented, cost should be defined as the net purchase cost, or if it is intended to limit the amount of loss, cost should be the net purchase cost plus a minimum percentage markup. If loss-leader selling is to be prohibited, the accountant's cost concept should be utilized.

COST PROVISIONS OF THE SALES-BELOW-COST ACTS

The Unfair Practices Acts attempt to prevent loss-leader selling by prescribing a full cost definition. The
acts that permit loss-leader selling but attempt to limit losses by prescribing minimum markups are referred to as Unfair Sales Acts.\textsuperscript{11} Although the titles of these acts do not follow these two classes in every instance, the exceptions are too few to prevent the employment of "Unfair Practices Acts" and "Unfair Sales Acts" as an adequate description of each class. As indicated on page 17-18 a third class is necessary because the cost definitions in the laws of four states differ sufficiently from the general pattern of the Unfair Practices Acts and Unfair Sales Acts to warrant a miscellaneous classification. The cost provisions of the special acts are similar to one or the other or both of these two classes.

**UNFAIR PRACTICES ACTS**

There are six states that have an Unfair Practices Act in force at this time. They are: Arkansas, California, Kentucky, Montana, Washington, and Wyoming. The first state to enact a sales-below-cost provision of this class is California, which in 1935 inserted a sales-below-cost provision in its anti-price-discrimination act. After many amendments, the California legislature repealed the old act and enacted a new law substantially similar to the one re-\textsuperscript{11}. Four of these laws bear the title Unfair Practices Act and one is entitled Unfair Sales Practices Act.
All other Unfair Practices Acts were placed on the statute books from 1936 through 1939.

**Cost Base.** The cost incurred to purchase a product, the cost base, is very simply defined in most of the Unfair Practices Acts. It is specified as "... the invoice or replacement cost, whichever is lower, of the article or product to the distributor or vendor, ..." 13 In addition, all of these laws prohibit rebates. 14 The definition of the cost base specified in these acts is one that is devoid of detail, and is simply the lower of invoice cost or replacement cost.

**Amount Added to the Cost Base.** The amount added to the cost base in the Unfair Practices Acts is designated as the "cost of doing business" or "overhead expenses." 15 The overhead provision specifically provides that all costs are to be included and these are enumerated in all acts except the Washington Act. The cost concept intended is, by inference, the accountant's cost concept because interest on borrowed capital is specified rather than interest on

14. See Appendix A., Sec. 17049 for a typical wording of this provision.
15. See Appendix A., Sec. 17029 for the definition of the amount added to the cost base.
total capital. However, two of these laws specifically require labor cost to be economic cost\textsuperscript{16} and delivery cost is to be proved by reference to the rates set by state public utility commissions.\textsuperscript{17} The laws do not prescribe any method of allocating these expenses to the unit of product. The only specification is that the average overall cost of doing business is to be allocated.

Miscellaneous Provisions. Two provisions included in most of the sales-below-cost acts that are closely related to the cost provisions are the cost survey provisions and the exception that permits sellers to meet the prices of competitors. The cost survey provision is included in the Unfair Practices Acts as an administrative expedient.\textsuperscript{18} It is difficult for an administrative agency to know the actual overhead cost of each individual firm. This provision permits trade associations to establish the cost below which sales are not allowed under the law.

The unit cost of a product varies considerably among enterprises. Because of this, the higher cost firms must be permitted to sell below their individual cost in order to meet the prices of their lower cost competitors. Therefore, among the several exceptions to the sales-below-cost provisions of the Unfair Practices Acts is one which permits

\begin{footnotesize}
\begin{itemize}
  \item \textsuperscript{16} See Appendix A, Secs. 17075 and 17076.
  \item \textsuperscript{17} See Appendix A, Sec. 17074.
  \item \textsuperscript{18} See Appendix A, Sec. 17072.
\end{itemize}
\end{footnotesize}
a firm to meet the legal prices of a competitor. A more intensive analysis of these provisions is developed in Chapter VIII.

UNFAIR SALES ACTS

Sixteen states have an Unfair Sales Act that is now operative. These states are:

- Connecticut
- Idaho
- Kansas
- Louisiana
- Maine
- Massachusetts
- Nebraska
- New Hampshire
- Oklahoma
- Pennsylvania
- Rhode Island
- Tennessee
- Utah
- Virginia
- West Virginia
- Wisconsin

They are patterned after the Model Law prepared by the National Food and Grocery Conference Committee. The Tennessee law was the first Unfair Sales Act passed by state legislatures. In the same year, 1937, Utah passed its act which in some respects resembles the Unfair Practices Acts. It includes provisions that apply to producers and a cost survey provision which are not found in other Unfair Sales Acts. However, the cost provisions relating to marketing agencies follow the Model Law. All of these statutes were enacted from 1937 through 1941.

19. See Appendix A, Sec. 17050.
In most cases the cost provisions of these acts specify the lower of invoice or replacement cost, plus freight charges and cartage to the retail outlet, and a specified markup to cover a part of the overhead. There are two separate definitions; one for the retailer and one for the wholesaler. These provisions attempt to limit losses rather than prevent them. The markups are not large enough to insure recovery of the full unit product cost.

Cost Base. The Unfair Sales Acts have a more complete description of the cost base than do the Unfair Practices Acts. 23 Trade or functional discounts are to be deducted from the invoice cost but not customary cash discounts. Eight laws specifically require the deduction of quantity discounts. The invoice or replacement cost that was incurred or existed during prescribed periods of time may be used as the cost base. A definition of replacement cost is included. In addition, these acts specify that freight charges and cartage to the retail outlet are to be added to the invoice or replacement cost.

Amount Added to the Cost Base. A markup is specified for the retailer and one for the wholesaler. 24 It is to cover only a part of the firm's total overhead and a lower markup is permitted if a lesser cost can be proved. There

23. For the definition of the cost base in the Unfair Sales Act, see Appendix B, Sec. 2.
24. See Appendix B, Sec. 2 for an example of the provisions that relate to the amount added to the cost base.
is nothing in the acts to indicate the method of allocating overhead costs in proving a lower markup. These specified markups create a problem when an enterprise is integrated vertically. However, this is solved in most of the acts by the requirement that such firms add either progressively or the sum of the wholesaler's and retailer's markup to the cost base.

**Miscellaneous Provisions.** As in the Unfair Practices Acts, the Unfair Sales Acts permit sellers to meet the prices of competitors. However, the provisions are more varied. Seven states include a clause similar to those in the Unfair Practices Acts while six follow the clause in the Model Law which permits a merchant to meet any competitor's price. A cost survey provision is not included in these laws.

**MISCELLANEOUS ACTS**

Four states (Minnesota, North Dakota, Oregon, and South Carolina) have sales-below-cost acts that are classified in this study as miscellaneous acts. The reasons for this classification should become apparent as each of the laws are discussed. The Minnesota law, entitled Unfair Trade Practices Act, contains cost provisions that are similar to both the Unfair Practices Acts and the Unfair

25. See Appendix B, Sec. 6 for an example of this provision.
Sales Acts. In addition to the full cost provisions of the former acts, prima facie evidence of cost is specified to be the "manufacturer's published list price and discounts... plus the cost of doing business." Then, any sale made by a retailer below this cost plus eight per cent is prima facie evidence of a violation of the act. However, no prosecution is permitted if the markup is fifteen per cent or more above this base. Another minimum markup is specified for wholesalers.

The cost base of the North Dakota Unfair Trade Practices Act is similar to that of the Unfair Practices Acts. On the other hand, like the clauses of the Unfair Sales Acts, freight and cartage are to be added to this cost base. However, there is to be no further addition to this base. Prima facie evidence of cost is the manufacturer's published list price less his published discounts.

The cost definition applicable to marketing firms in Oregon's Anti-Price Discrimination Act is the replacement cost of the goods plus the cost of doing business. The

overhead provisions follow closely those of the Unfair Practices Acts. However, the statute contains additional provisions that apply to retailers and wholesalers in food commerce that differ considerably from the other laws.

The South Carolina act has one section that prohibits sales-below-cost in its law entitled Trusts, Monopolies and Unfair Competition. It provides for an invoice cost base. However, what should be added to this base is not clear. It is assumed that an addition to the base is not required.

SPECIAL ACTS

There are twenty states with one or more special sales-below-cost acts. These statutes apply to a specific commodity only or to specified industries. Of these statutes, fourteen apply to the sale of cigarettes. The states having special cigarette acts are:

Alabama  Indiana  New Mexico  Pennsylvania
Arkansas  Iowa  Ohio  Tennessee
Colorado  Massachusetts  Oklahoma
Connecticut  Mississippi  Oregon

Seven other acts apply to other industries. The states with these acts and the industry to which each act is applicable are:

California - dairy products
Connecticut - retail drug
Idaho - dairy products
Louisiana - retail drug
Michigan - bakery and petroleum products

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Texas - grocery stores
Utah - agricultural products

These acts were enacted more recently than the general laws.

Cost Base. The definition of the cost base in the Unfair Cigarette Sales Acts is essentially the same as the definition in the Unfair Sales Acts. However, excise taxes are included in the cost base in all the acts but those of Connecticut and Massachusetts. Cartage cost to the retail outlet must be added by the wholesaler to his "basic cost" before the markup is added, but the only law that applies this provision also to the retailer's cost base is the Oklahoma cigarette act.

Amount Added to the Cost Base. The overhead provision in the Unfair Cigarette Sales Acts is a mixture of those of the Unfair Sales Acts and the Unfair Practices Acts. The full "cost of doing business" for both the wholesaler and retailer is required and the cost elements are itemized. One provision specifies that, when allocating overhead to the product, the methods of accounting used by the person proving his cost must be accepted by the court. All of the Unfair Cigarette Sales Acts, except the Connec-

32. See Appendix C, Secs. IV(k)1 and IV(l)1 for an example of these overhead provisions.
ticut law, contain provisions that specify wholesale and retail markups that are presumed to be the "cost of doing business." All acts but one have provisions that deal with the problem of integration.

Miscellaneous Provisions. The miscellaneous provisions of the general acts are also in the Unfair Cigarette Sales Acts. All acts but the Connecticut law have a cost survey provision. The exception that allows the meeting of competitors' legal prices in good faith is also included in all acts but those of Connecticut and Tennessee.

Other Special Acts. Among the other Special acts two states, California and Idaho, have cost provisions similar to those of the Unfair Practices Acts. The retail drug control acts of Connecticut and Louisiana have an identical definition of the cost base, i.e., the manufacturer's wholesale list price per dozen or per unit whichever is applicable. Only the Louisiana act adds a
markup of six per cent to this cost base. Michigan's bakery and petroleum industries statute prescribes an invoice cost base to which is to be added the cost of doing business.\(^{37}\) In addition, it includes a cost survey provision and the "meeting competition" exception. The Utah Agricultural Fair Trade Act defines cost as the merchandise cost to the seller or the replacement cost, whichever is lower, plus a specified markup of six per cent.\(^{38}\) The Texas Sales Limitation Act, applicable to all grocery stores, does not provide for any addition to the cost base. An unusual provision prohibits merchants from limiting the sales of any product at this low price.\(^{39}\)

SUMMARY

Four classifications of the state sales-below-cost acts are used in this study: the Unfair Practices Acts, the Unfair Sales Acts, miscellaneous general acts, and special acts. As Table 2 indicates, except for a few of the miscellaneous acts and special acts, the cost base is defined as the invoice cost or the replacement cost whichever is the lower. The greatest variance among these classifications


\(^{39}\) General and Special Laws of the State of Texas, 1955. Chapter 524, House Bill No. 714. (Published under the authority of the State of Texas, undated).
is in the cost provisions that pertain to the amount added to the cost base. The Unfair Practices Acts require the inclusion of all costs of doing business and thus attempt to prevent loss-leader selling. The Unfair Sales Acts, on the other hand, permit loss-leader selling but attempt to limit the amount of loss by providing for a minimum markup to cover a part of the cost of doing business. The cost provisions of the Unfair Cigarette Sales Acts include aspects of both the Unfair Sales and the Unfair Practices Acts.
Table 2

The Number of Acts for Each Type of Cost Provision of State Sales-Below-Cost Acts Constitutional in 1955 by Classification of Acts

<table>
<thead>
<tr>
<th>Acts</th>
<th>Cost Base</th>
<th>Addition to the Cost Base C/</th>
<th>Permissive to meet competition</th>
</tr>
</thead>
<tbody>
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<td>Total</td>
<td>Lower Mfr's Price</td>
<td>Replacement or Replacement</td>
</tr>
<tr>
<td></td>
<td>Number Acts</td>
<td>Invoice or Reprice</td>
<td>No Total</td>
</tr>
<tr>
<td>Unfair Practices Acts</td>
<td>6</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>Unfair Sales Acts</td>
<td>16</td>
<td>14</td>
<td>2</td>
</tr>
<tr>
<td>Miscellaneous acts</td>
<td>4</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Special acts</td>
<td>21</td>
<td>17</td>
<td>3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>47</strong></td>
<td><strong>41</strong></td>
<td><strong>41</strong></td>
</tr>
</tbody>
</table>

a/ Totals may not equal the sum of parts because of additional provisions.
b/ Presumptive evidence of cost in all but the three Special acts.
c/ Based on the cost base.
CHAPTER III

THE COST BASE -- PURCHASE COST

The cost base is the cost of acquiring products and it is used in the sales-below-cost acts as the base to which markups, if specified, are added. There are four major definitions of this base in the acts. They are purchase cost, replacement cost, the lower of purchase cost or replacement cost, and the manufacturer's published list price, less his published discounts. The purchase cost definitions prescribed in the acts are analyzed and the problems of their determination are presented in this chapter. In addition, administrative problems are considered. The other three definitions of the cost base, their problems, and interpretations are discussed in Chapter IV.

COST BASE AS THE MINIMUM PRICE

The cost base may be prescribed as the minimum price in a sales-below-cost act. Therefore, before considering its determination, the theory of such a minimum price is discussed.

The prescription of a minimum price at the level of the cost base tends to prevent predatory loss-leader selling. The sale of a product at a price lower than the cost base results in a direct loss to the seller which tends to
induce him to raise the prices of other merchandise. If the prices of other products are not raised, the loss may be handled as an advertising expense with a consequent increase in overhead costs. Such a pricing practice is often considered to be unfair. For example, a retailer may offer a predatory loss-leader in order to entice purchasers into his store for the purpose of increasing total sales or selling other items at higher prices. The unwary purchaser may be deceived by the "bait" prices. On the other hand, a seller may intend to drive out competitors by this practice. Sales at prices below the cost base force the prices of the same products of other merchants to the same low level which results in all competitors suffering a loss on that product. More important, sellers who specialize in this one product may be severely damaged and forced out of business. Therefore, it seems necessary that the lowest minimum price should be established at a point no lower than the seller's cost base.

Only a few sales-below-cost acts provide that the minimum price be the product's cost base. This is prescribed for both wholesalers and retailers in the North Dakota and South Carolina statutes. Two acts set the minimum price at the cost base for retailers only, while three

Unfair Sales Acts, following the lead of the Model Law, do not prescribe a markup for wholesalers. In addition, the minimum price for wholesalers in food commerce in Oregon is the price paid.

PURCHASE COST

Purchase cost, termed "invoice cost" in many acts, is the sum of the actual expenditures made by a seller when securing his goods. Although invoices are the best evidence of actual cost, they are not infallible, for discounts or transportation charges may not be indicated thereon. Expenses incurred in bringing the goods to a seller's place of business are included in purchase cost while applicable discounts are deducted. Thus, purchase cost is a more inclusive term.

ACTS PRESCRIBING PURCHASE COST AS THE COST BASE

A definition of the cost base in terms of purchase cost only is contained in only three statutes. The South Carolina and Michigan laws specify the price paid as the cost base. The Oregon Anti-Price Discrimination act has a separate provision that prescribes this cost to wholesalers.

2. The two acts applicable to retailers only are the Connecticut Drug Control Act and the Texas Sales Limitation Act. The three states with Unfair Sales Acts are Oklahoma, Utah, and Tennessee.

in food commerce only.\textsuperscript{4}

**DETERMINATION OF PURCHASE COST - BONA FIDE COST**

Many of the sales-below-cost acts specify that bona fide evidence must be presented when proving purchase cost. This means that purchase cost must be the actual expenditures made by the individual as verified by invoices and other bona fide records. Since the invoice often is excellent evidence of purchase cost, some legislatures have provided that untampered invoices must be presented in order to prove purchase cost.

Most of the Unfair Sales Acts and Unfair Cigarette Sales Acts prescribe that the normal, customary, and prevailing conditions in the market must be the standard by which the authenticity of cost evidence is measured.\textsuperscript{5} The courts are instructed to compare the evidence of cost with these market conditions. This provision of the Unfair Sales Acts has been declared unconstitutional in five states for being indefinite.\textsuperscript{6} In one case, a Maryland court of appeals said of this provision:

Upon the dealer who would avoid transgressing the law there is thus placed the burden of first ascertaining what are the "existing market conditions."

\textsuperscript{4} Ibid., 6 Laws of South Carolina, sec. 66-65; and Michigan Statutes Annotated, Vol. 24. (Cumulative Supplement). Secs. 28.78(1) to 28.78(14). Chicago: Callaghan and Company, 1938, Sec. 28.78(5).
\textsuperscript{5} For the wording of these provisions, see Appendix B, Sec. 2 (e) and Appendix C, Sec. IX.
\textsuperscript{6} Arizona, Maryland (act of 1939), New Hampshire, Oklahoma, and New Jersey are the five states.
then determining whether those conditions justify a certain price, and finally, upon the assumption that his analysis is correct and his judgement sound, utilizing that figure as a basis for his cost computation.

But his conclusion is not controlling, for if his estimate of the situation be erroneous, and if in a judicial proceeding it be subsequently determined, as a fact, that the "existing market conditions" did not justify a certain price, then his calculation, being based thereon, is vitiated; the result being that he stands as a violator of the law.7

This provision in the Tennessee Unfair Sales Act was challenged on the grounds that it burdens interstate commerce and denies a seller the right to use as evidence an invoice of goods purchased in another state at a lower price than that which exists within the state.8 However, the state supreme court stated that the provision applies only to an extraordinary purchase, the cost of which could not be used, regardless of the state from which the purchase was made. A strict interpretation of these provisions by the courts may result in the use of an average rather than the individual's cost when proving purchase cost. The merchants who wrangle a low price from a seller may be penalized if the courts rule that the price is not justified by the normal market conditions.

The Unfair Practices Acts contain provisions that

deny a seller the use of invoices to prove the purchase cost of goods purchased in transactions that are not within the ordinary channels of trade. These provisions occasion various interpretations of the phrase "ordinary channels of trade." In the case of State of Washington v. Great Atlantic & Pacific Tea Co. the attorneys for the state claimed that the ordinary channel of trade is wholesaler to retailer because small merchants buy from wholesalers. They further asserted that since the Great Atlantic & Pacific Tea Co. purchases directly from manufacturers, it does not buy through the ordinary channels of trade. The application by courts of such an interpretation could raise the level of purchase cost of some merchants, and by so doing, penalize them.

**DETERMINATION OF PURCHASE COST - SCOPE**

The selection of the elements to be included in or excluded from purchase cost is a difficult problem. Many elements influence it; some reduce it, others increase it. The Committee on Price Determination for the Conference on Price Research listed twelve items as elements of price. All kinds of discounts; freight, promotional, and advertising allowances; and several guarantees and credit terms are

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9. For the exact wording of these provisions see Appendix A, Secs. 17027 and 17028.
Additional items are transportation and handling costs.

**Discounts.** The term discount generically means a reduction in price and, therefore, a reduction of purchase cost. There are many kinds of discounts; for example, trade or functional discounts, quantity discounts, cash discounts, and special discounts and allowances. In this thesis special discounts and allowances are considered separately under the heading, allowances.

**Trade discounts** are required to be deducted by thirty-four of the forty-seven acts when purchase cost is determined. All Unfair Sales Acts, all Unfair Cigarette Sales Acts, and three other special acts specifically require the deduction of trade discounts. A functional classification of buyers is allowed in the Washington Unfair Practices Act. This implies that trade discounts are to be subtracted. When determining purchase cost, trade discounts should be subtracted even though the law does not speci-

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12. Many authorities regard functional discounts as those granted to wholesalers, but not to retailers.


14. These three acts are the retail drug laws of Connecticut and Louisiana and the Texas law applicable to grocery retailers.

specifically require it. The actual payment for the goods is the list price less all applicable discounts including trade discounts.

**Non-cumulative quantity discounts** do not present a great problem.\(^\text{16}\) A phrase that specifies that the purchase cost to the retailer or wholesaler should be the lower of invoice or replacement cost "in the quantity last purchased"\(^\text{17}\) is included in twelve general laws. All cigarette acts but that of Connecticut have this requirement. Three other special acts, the Connecticut and Louisiana drug acts and the Texas Sales Limitation Act, also prescribe that these discounts be deducted from the invoice price.\(^\text{18}\) It is probable that the legislatures of the states that do not mention these discounts presume that they will be deducted, for that is the usual practice of business enterprises.

**Cumulative quantity discounts** are a difficult problem to solve. They ordinarily do not appear in the business

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\(^{16}\) Non-cumulative quantity discounts are differentiated from cumulative quantity discounts. The former are those quantity discounts granted to a buyer that are based on the quantity of goods purchased in one individual order while the latter are based on the volume purchased over a period of time.


\(^{18}\) 2 General Statutes of Connecticut, 1949, Sec. 3959; West's Louisiana Statutes Annotated, Revised Statutes, Vol. 27. Title 51, Chapter 2, Secs. 521 to 525. St. Paul, Minnesota: West Publishing Co., 1952, Sec. 521; and General and Special Laws of the State of Texas, 1955. Chapter 524, House Bill No. 714. (Published under the authority of the State of Texas, undated), Sec. 2.
records at the time of the purchase because the amount of the discount is not known until after a period of time. None of the laws refer specifically to these discounts. However, the Washington act permits prices to be set after allowances are made "...for differences in goods, quality, or quantity,..." This implies any kind of quantity discount. The Attorney General of Wisconsin ruled that a cumulative quantity discount may be deducted only after the volume of purchases necessary for the discount has been made. It is best not to require the deduction of an estimated discount for, although earned by the buyer in the past, it may not be earned in the future. Any actually received, however, should be subtracted from invoice cost.

The majority of the sales-below-cost statutes do not permit the deduction of cash discounts when purchase cost is determined. Of the twenty-six general acts, only the North Dakota law specifically requires that invoice cost be reduced by the amount of the cash discount. Its deduction is specifically denied in seventeen acts. The Minnesota and Montana laws do not allow customary discounts to be subtracted. They define customary discounts as follows:

Customary cash discounts. The term "customary cash discounts" means any allowance, not exceeding two per cent, whether a part of a larger discount or not,
made to the wholesale or retail vendor, where the wholesale or retail vendor pays for merchandise within a limited or specified time.\textsuperscript{22}

According to this provision the part of any cash discount that is greater than two per cent may be subtracted from the invoice cost. However, cash discount terms that are customary vary from one trade to another and are not always two per cent as indicated by these acts.\textsuperscript{23} Six of the cigarette acts require that invoice cost be reduced by cash discounts when they are taken by the buyer. The other cigarette acts do not permit its deduction.

These conflicting requirements reflect business practice. Some merchants consider cash discounts as interest income whereas others subtract them from invoice cost. Usually the small inadequately financed merchants follow the former practice because often they are not financially able to take advantage of the discount.\textsuperscript{24} They consider cash discounts taken as interest income and, therefore, as an addition to operating profit. The larger and more progressive merchants, however, consider these discounts as a


deduction from merchandise cost because they are financially able to take advantage of discounts and because cash discounts, when not taken, are a significant element of merchandise cost.\textsuperscript{25} The National Retail Dry Goods Association recommends that these discounts be deducted before determining gross margin.\textsuperscript{26} In addition, cash discounts are considered as a deduction from purchases in the operating expense bulletins prepared by the Harvard University Graduate School of Business Administration.\textsuperscript{27} Although practice varies, the more progressive merchants and trade associations favor the practice of subtracting cash discounts from invoice cost.

The subtraction of cash discounts is substantiated by court decisions. Two statutes, the Maryland Unfair Sales Act of 1941 and the Ohio Unfair Cigarette Sales Act, were declared unconstitutional because cash discounts were not allowed to be subtracted from invoice cost.\textsuperscript{28} A Maryland court of appeals held that,

If the evidence can be so regarded, then defendant

\textsuperscript{25} Ibid.


\textsuperscript{27} See the various annual bulletins on the expenses and profits of various classes of retail stores prepared by the Bureau of Business Research, Harvard University Graduate School of Business Administration, Boston, Massachusetts.

is selling "below cost," not below his actual cost, but below "cost" determined by an arbitrary formula, which swells his actual cost by ignoring actual cash discounts received ... 29

Two other courts ruled that cash discounts are deductible from invoice cost. 30 However, the Massachusetts supreme court upheld the state's Unfair Sales Act which does not permit the reduction of invoice cost by a cash discount. 31 In addition to court decisions, some state attorney generals have ruled that cash discounts may be subtracted from invoice cost. Such a ruling was made by the Attorney General of Louisiana in spite of the fact that the act specifically prohibits the deduction of cash discounts. 32 The majority of the state courts and some attorney generals have ruled that cash discounts taken may be subtracted from invoice cost when purchase cost is determined.

In addition to authoritative practice and court decisions the practice of subtracting cash discounts may be

supported in theory. There are three reasons why they should be subtracted. First, most cash discounts represent ridiculously high rates of interest. For example, a discount of 2/10, net 30 is approximately equivalent to an interest rate of thirty-six per cent per year. \(^{33}\) It would be to the merchant's best interest to borrow the funds necessary to take advantage of the discount. Second, by considering these discounts as interest income, a firm could record income before a sale is made. Retailers are in business to sell goods; not to lend money. Last, in any well managed business concern, cash discounts are taken for granted. This action is not followed only by those firms in a specially favorable financial position. \(^{34}\) Therefore, the cost of merchandise to a buyer is the net cash price.

**Allowances.** Another problem of the determination of the scope of purchase cost is whether or not allowances should be subtracted from invoice cost. Different kinds of price adjustments are included under the term "allowances." Special discounts, free deals, and advertising allowances are examples of such price reductions.

**Special discounts** are those reductions of the purchase price of an article granted through price bargaining,

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trade-in allowances, and rebates. Often the amount of the special discount is not found in the business records. Nevertheless, all these discounts should be deducted from the invoice price when determining purchase cost for the purpose of the sales-below-cost acts.

A free deal may be defined "as an offer, or a giving, of something for nothing contingent upon the purchase of goods or services at a price." It takes many different forms. Since it usually is in the form of extra merchandise for no additional price, it is actually a reduction of the unit price of each of the items purchased. This unit cost is determined by spreading the total price over the total number of units received, including the free unit or units.

Advertising allowances are ostensibly payments for services performed by the buyer for the seller. Often they are granted whether or not the service is performed. When no service is rendered, they are in effect price reductions. When advertising or promotional services are executed by the buyer, however, the allowances are not a reduction in price, but a payment made by the seller for these services. In this case, they should be deducted from the advertising expense of the buyer.

Only two general acts refer to allowances. The act of North Dakota has a provision that requires the deduction of advertising allowances from the invoice price.\footnote{5 North Dakota Code of 1943, Sec. 51-1001.} On the other hand, the Pennsylvania Unfair Sales Act specifically forbids their subtraction.\footnote{Purdon's Pennsylvania Statutes Annotated, Titles 73-75. Title 73, Chapter 5, Secs. 211 to 217. Philadelphia: George T. Bisel Co., 1953, Sec. 212.} Five of the fourteen cigarette acts have the following provision:

Merchandise given gratis, or payment made, to a retailer or wholesaler for display or advertising, or promotion purposes, or otherwise shall not be considered in determining the cost of cigarettes to the retailer or wholesaler.\footnote{As in the Colorado act, 1935 Colorado Statutes Annotated, Vol. II. (Cumulative Supplement). Chapter 48, Secs. 302(14) to 302(27). Denver, Colorado: The Bradford-Robinson Printing Company, 1936, Sec. 302(21).}

The phrase "shall not be considered" is vague. A literal interpretation indicates that such allowances are not to be deducted from invoice cost. This prohibition inflates the buyer's total cost if the cost of performing the services is included in his cost of doing business. The remaining acts ignore the problem of allowances.

Transportation Cost. All costs incurred in bringing merchandise to the buyer's place of business should be included in purchase cost. In accordance with this, the Model Unfair Sales Act requires freight and cartage expenses to be added to the invoice or replacement cost. To the
invoice or replacement cost of the wholesaler there must be added,

(1) freight charges, not otherwise included in the invoice cost or the replacement cost of the merchandise as herein set forth, and (2) cartage to the retail outlet if done or paid for by the wholesaler, which cartage cost, in the absence of proof of a lesser cost, shall be deemed to be three-fourths (3/4) of one percent of the cost to the wholesaler as herein set forth after adding thereto freight charges but before adding thereto cartage.40

However, according to part (2) if a wholesaler delivers goods to a retailer, an additional three-fourths of one percent of the former's invoice cost must be included in his cost base. Normally this cartage cost is an element of the wholesaler's cost of doing business rather than an element of his cost base. Therefore, if this cartage cost is recorded as an overhead expense it must be subtracted from the wholesaler's cost of doing business so that it will not be included in cost twice. A similar provision applicable to the retailer is included in the Model Law. This is acceptable as this cartage cost is an element of the retailer's cost base.

The general laws of eight states omit any reference to transportation cost. However, all of the Unfair Sales Acts but those of Pennsylvania, Tennessee, and West Virginia include the freight and cartage provision of the

40. National Food and Grocery Conference Committee. Proposed Model State Unfair Sales Act. Reprint of National Grocers Bulletin (September, 1940), p. 9, Sec. 2. Also this is quoted in Appendix B.
Model Law. The Pennsylvania and West Virginia acts omit part (2).\footnote{73-75 Purdon's Pennsylvania Statutes, Sec. 212 and The West Virginia Code of 1949, Article II A, Sec. 4678(8a) to 4678(8n). Charlottesville, Virginia: The Michie Company, 1949, Sec. 4678(8f).} All cigarette acts but that of Pennsylvania require freight charges to be added to the invoice cost but part (2) is omitted in the definition of the retailer's purchase cost in nine laws. The amended Ohio act permits cash-and-carry wholesalers to reduce prices by the amount of the cartage cost if they do not deliver to their customers.\footnote{Throckmorton's Ohio Code Annotated, Baldwin's Permanent Service, 1948-1952. Secs. 6402-10 to 6402-12. Cleveland, Ohio: Banks-Baldwin Company, 1952, Sec. 6402-11.} However, the customer, if a retailer, must add this cartage cost to his invoice cost.

The general acts of four states specify that transportation cost must be the amount set by the state transportation commission unless a lower cost can be proved by the seller. These acts are those of California, Idaho, Virginia, and Washington.\footnote{Deerings California Codes, Business and Professions Code Annotated, Vol. II, Chapter 4, Secs. 17000 to 17101. San Francisco: Bancroft-Whitney Company, 1951, Sec. 17074; Idaho Code, General Laws of Idaho Annotated, Vol. 8, Secs. 48-401 to 48-411. Indianapolis: The Bobbs-Merrill Company, 1948, Sec. 48-403; Code of Virginia, 1950, Annotated, Vol. 9. (Cumulative Supplement). Secs. 59.9 to 59.19. Charlottesville, Virginia: The Michie Company, 1949, Sec. 59.10; and 2 Revised Code of Washington, Sec. 19.88.130.} The Unfair Sales Acts presume this cost to be three-fourths of one per cent of the cost base plus freight, unless a lower cost is proved, while the
cigarette acts presume it to be either one-half or three-fourths of one per cent.

Handling Costs. All costs incurred in getting the goods to the place of business and ready for sale should be included in purchase cost. This embraces the expenses of buying, receiving, and handling. However, none of the sales-below-cost acts require them to be included in the cost base. Since the majority of business concerns consider these expenses as elements of overhead, it is best not to include them as an element of purchase cost for the purpose of these acts.44

Excise Taxes. The addition of excise taxes to the cost base before the markup is added is required in twelve cigarette acts. In addition, six Unfair Sales Acts have this requirement. The inclusion of excise taxes as an element of the cost base increases the amount added to this base because the percentage markups are based on the cost base. The consumer should not be made to bear the tax and also a markup based on it.45 As held in the National Association of Tobacco Distributors v. Simon Bros. case, excise taxes are not an element of the cost base unless the tax is paid by the manufacturer and included in the invoice to the

44. Paton, op. cit., p. 521.
wholesaler or retailer.46 Therefore, excise taxes are best considered as an overhead expense.

Summary. Authorities and the acts are not in agreement about the scope of purchase cost. The laws require the deduction of trade and non-cumulative quantity discounts from the gross invoice price and the addition of transportation expenses for incoming merchandise. However, there is disagreement about cumulative quantity discounts, cash discounts, and allowances. Most authorities and courts have ruled that they should be subtracted, if taken. Since businesses do not include handling costs as an element of purchase cost, they should not be added. Some acts require excise taxes that are passed on to the consumer to be an element, but this unnecessarily raises minimum prices to the consumer. Only those expenses that are directly associated with the acquisition of products are elements of purchase cost.

DETERMINATION OF PURCHASE COST - TIME ELEMENT

Another problem that arises when purchase cost is determined is the selection of a period of time that limits the invoices that may be used in proving purchase cost. If no time limit is prescribed, a seller could use any invoice to prove his purchase cost. On the other hand, the speci-

fication of a period of time may eliminate all invoices of those dealers in slow turnover lines. For example, if a period of thirty days is prescribed and a merchant purchased the product more than thirty days before the sale, he can not use this invoice. His only recourse is replacement cost. A period of time should be prescribed that does not eliminate all invoices, but at the same time places some limit on those allowed.

Few sales-below-cost acts prescribe a time limit. Invoices are limited to those received within the preceding thirty days by four Unfair Sales Acts. The Tennessee act contains a limit of sixty days. The Utah Unfair Practices Act, which is classified as an Unfair Sales Act, prescribes a thirty day period for the invoices of retailers, but none for those of wholesalers. A thirty day limit is prescribed in nine Unfair Cigarette Sales Acts. The grocery trade in California attempted, without success, to have a time period included in the California Unfair Practices Acts.47-50

47. These four acts are those of the states of Maine, Massachusetts, Rhode Island, and Wisconsin.
50. These Unfair Cigarette Sales Acts are those of Alabama, Colorado, Indiana, Massachusetts, Ohio, Oklahoma, Oregon, Pennsylvania, and Tennessee.
Act. 51 As a result, only one of the Unfair Practices Acts, that of Montana, sets such a limit; this is ninety days. 52

The problem of the limitation of invoices may be solved in a way other than the specification of a particular time period. One solution is to consider only the invoices that cover the amount of goods on hand at the time the product is sold. However, few businessmen take the time to count the number of units of product on hand, and then determine the invoices that represent these particular units of product every time a sale is made.

To alleviate this problem a flexible period of time, the inventory period, could be specified by the acts. Most businessmen do have some knowledge of the rate of sale of a product. This rate often is referred to as the rate of turnover. If the annual rate of turnover of a product were six times per annum, the time period would be sixty days; 360 days divided by six. This inventory period permits a flexible adjustment of the period of time best suited for a product or particular trade. It tends to insure that all sellers have at least one invoice that covers the goods on hand at the time of sale. Thus, sellers are not adversely affected as happens when a certain number of days is prescribed.


52. 3 Codes of Montana, 1947, Sec. 51-103.
Once the period of time is resolved, there remains the problem of determining which of the invoices allowed, or all of them, is to be used to determine the cost of the product. There is no problem if only one invoice is allowed or if more than one invoice is received during the inventory period and the price of the product is the same on each invoice. However, if several invoices are allowed and they indicate different prices, there is the problem of selecting which particular invoice to use. This is a problem of valuation. Not one of the acts considers this problem.

Four major methods generally are used to determine invoice cost. The first is specific identification, the second is first-in, first-out which is often called Fifo, the third is a weighted average of the invoice prices, and the fourth method is last-in, first-out or Lifo. Since these acts define cost for a special purpose a fifth method, the lowest cost method, is presented. Each of these five methods of valuing purchase cost is discussed in the order given.

Specific Identification. This method requires each unit of goods to be clearly marked and kept separate from other units. Each is identified by an invoice which permits an accurate cost of a particular item to be determined easily. However, when this method is applied to fungible
and low unit-cost goods, the cost of maintaining the necessary detailed records is a great disadvantage. This method may be employed in any general sales-below-cost act, but only where it can be proved that each item is identified with a particular invoice.

First-in, First-out (Fifo). The second method, often used by firms to value the cost of goods sold, is first-in, first-out, or briefly, Fifo. Under this method the price on the first invoice received during the inventory period is the one that determines the cost of the first product sold. After the number of units purchased on the first invoice is sold, the price indicated on the second invoice applies until the number of units purchased on this invoice is sold, and so on. If no invoices are received during this period, the last invoice received just prior to this period is the one that determines the cost value. The oldest actual cost of the product purchased during the period and not yet sold results from this method.

Average Cost. There are at least two ways of determining an average cost. The manner in which the average cost is determined depends on the bookkeeping system utilized by the business. If a business uses a cost accounting system under which a perpetual inventory is maintained, a moving average of prices determines the cost. A new average is computed every time new units are added to
the inventory. It will at all times indicate the average cost of any unit sold. On the other hand, if the business does not utilize a cost accounting system, the average cost usually is determined by dividing the total number of units purchased during the inventory period into the sum of their prices. If no invoices are received during this period, the price on the last invoice received just prior to the beginning of the period is used.

**Last-in, First-out (Lifo).** This method is relatively new. It assumes that the cost of the most recently purchased item is the cost of the product sold. This concept of purchase cost is the easiest to apply for the purpose of these acts. All a seller need do is prove that a particular invoice is the last one received by him, and this invoice will establish the cost of the product sold.

**Lowest Cost.** Often it is difficult to determine the actual purchase cost of a product. Only the specific identification method gives this actual cost; the use of the other methods gives an assumed purchase cost. The actual cost might be the lowest of all those indicated on the invoices allowed. In order to protect merchants from being convicted for a criminal act, when they actually may not have violated the law, the lowest of all the allowed prices should determine the invoice cost of the product sold. This is the lowest cost method. It assures merchants that
the invoice cost used is no higher than his actual cost.

**ADMINISTRATIVE PROBLEMS**

Any competitor, trade association, or state administrative body designated in the act may bring a suspected violator to court and attempt to prove that he violated the act by selling below the defined cost for the purpose of injuring competitors, lessening competition, or deceiving customers. When the cost base is defined as purchase cost only, the administrative agency, or a damaged competitor, has no means of knowing a violator's cost base. The latter is the only one with access to the cost records. This makes it difficult for the injured party to prove his rival's cost base. However, some acts prescribe a prima facie definition of the cost base. It must be a cost that is known by all concerned. For example, a replacement cost definition tends to be the same for all sellers of the same class and is readily determined. The injured party then can prove that the seller's price is below this prima facie cost. However, the defendant then has the right to prove that his actual cost is less than his price.

Before a seller can be held guilty of violating a sales-below-cost act, it is necessary to prove that he sold below the defined cost with the intent to injure a competitor, lessen or destroy competition, or deceive customers.
It is quite difficult to prove that a seller intended to injure a competitor. One way to ease this difficulty is to declare any sale made below the defined cost a criminal act per se. However, courts have ruled such a declaration unconstitutional.\(^5\) To meet this objection, all Unfair Sales Acts but those of Nebraska and Utah specify that proof of a sale below the defined cost is prima facie evidence of intent to injure competitors, lessen competition, or deceive customers. All that an injured competitor need do, then, is prove that a suspected violator sold a product below the defined cost. The plaintiff need not prove that he was injured by the action. The burden of proving intent, then, rests upon the accused. A Maine court, however, recently ruled this provision in that state's Unfair Sales Act unconstitutional.\(^5\) In the California and Washington Unfair Practices Acts it is specified that proof of both a sale below the defined cost and the injurious effect of the sale is necessary in order to establish a prima facie case of intent. The burden of proving the purpose of his sale rests upon the defendant.

The Montana Trade Commission has had trouble from two


The delivery of larger unit quantities than shown on quoted price lists present a problem that is yet unanswerable. Falsification of invoices has been another such enigma. The original law has been amended to make this practice unlawful, but the mere declaration in the law is not a satisfactory administrative solution.55

These problems always will be present unless only replacement cost is used as the cost base. This is examined in the next chapter.

Although the problems of administering the acts that define the cost base as only purchase cost seem great, they are not insuperable. Although such a definition does not simplify the administration of the acts, it must be used for no one should be found guilty of selling goods at prices that are above his own purchase cost.

CHAPTER IV

THE COST BASE - OTHER DEFINITIONS

Problems that arise from definitions of the cost base other than purchase cost, are considered in this chapter. These definitions are replacement cost; invoice cost or replacement cost, whichever is the lower; and the manufacturer's published list price, less his published discounts. Some of the problems that arise under purchase cost also arise under these definitions. These problems are repeated only for comparative purposes.

REPLACEMENT COST

The cost that would be incurred if a product were purchased on a particular date or during a specified period of time is replacement cost. This definition has been prescribed as the cost base in only two acts, the New Jersey Fair Sales Act, declared unconstitutional in 1939, and the Oregon Anti-Price Discrimination Act.¹ The generally accepted definitions of replacement cost and those prescribed in the acts are presented first. Then the problems of time,

scope, and administration are discussed in that order. The purchase cost problems of fictitious costs and valuation are not incurred when determining replacement cost as no actual purchase is made.

DEFINITIONS

The explicit opportunity cost of the economist is essentially a replacement cost concept. It is what the firm must now pay for the goods and services it needs. A typical definition of replacement cost from the point of view of the business man and accountant is:

... the present net invoice cost of the merchandise sold, plus transportation costs, handling charges, and all other items incurred applicable to the goods, on the basis of what these additional elements would now cost. 2

Discounts offered are to be deducted from the quoted price and other expenditures necessary to bring the goods to the place of business and prepare them for sale are to be added to it. The amount of these expenditures is the cash that would have to be expended at the moment they are being measured. Only explicit costs are used.

Contrary to these generally accepted definitions, the sales-below-cost acts that define replacement cost prescribe varying definitions. Although the definition of the cost base in the Unfair Practices Acts and the Unfair Practices Acts, Studies in Business Administration, 9, No. 2. (Chicago: The University of Chicago Press, 1939), pp. 21-22.
Cigarette Sales Acts is the lower of either purchase cost or replacement cost, a separate definition of the term replacement cost is not included. Therefore, the generally accepted definition of the economist or businessman must be assumed. The definition included in the Model Unfair Sales Act is:

When used in this act the term "replacement costs" shall mean the cost per unit at which the merchandise sold or offered for sale could have been bought by the seller at any time within thirty (30) days prior to the date of sale or the date upon which it is offered for sale by the seller if bought in the same quantity or quantities as the seller's last purchase of the said merchandise.  

This definition allows a time period prior to the date of sale to be used or the cost existing at the date of sale. Quantity discounts are to be deducted. However, there is no mention of other discounts or expenses. Similar provisions are included in thirteen Unfair Sales Acts. The definition in the remaining acts prescribe different time periods.

DETERMINATION OF REPLACEMENT COST - THE TIME ELEMENT

Usually replacement cost means the expenditure that would be incurred if the product were purchased at a particular time such as the date of sale, the date of offer of sale, or the date on which the cost is determined. How-

3. National Food and Grocery Conference Committee. Proposed Model State Unfair Sales Act. Reprint of National Grocers Bulletin (September, 1940), p. 9, Sec. 2(c). Also this is quoted in Appendix B.
ever, only two acts, those of Tennessee and Minnesota, provide that replacement cost must be the cost existing on the date of sale.\(^4\) A period of thirty days prior to the date or offer of sale to be used when determining replacement cost is permitted by twenty-seven laws. The unconstitutional New Jersey Fair Sales Act allowed a sixty day period for wholesalers and the Montana statute permits ninety days for all vendors.\(^5\) No time limit is specified in the North Dakota act except that the cost must be determined as of some date prior to the date of sale.\(^6\)

Although no special definition of replacement cost is specifically set forth in six acts, a provision is included which implies that replacement cost is the cost existing at the date of sale. It specifies that the cost of unusual transactions may not be used to justify a price "...lower than one based upon the replacement cost as of the date of sale..."\(^7\) The Montana and West Virginia acts


\(^7\) Deering's California Codes, Business and Professions Code Annotated, Vol. II. Chapter 4, Secs. 17000 to 17101. San Francisco: Bancroft-Whitney Company, 1951, Sec. 17027. Underlining added. This section is presented in
ever, only two acts, those of Tennessee and Minnesota, provide that replacement cost must be the cost existing on the date of sale. A period of thirty days prior to the date or offer of sale to be used when determining replacement cost is permitted by twenty-seven laws. The unconstitutional New Jersey Fair Sales Act allowed a sixty day period for wholesalers and the Montana statute permits ninety days for all vendors. No time limit is specified in the North Dakota act except that the cost must be determined as of some date prior to the date of sale.

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7. Dearings California Codes, Business and Professions Code Annotated, Vol. II, Chapter 4, Secs. 17000 to 17101. San Francisco: Bancroft-Whitney Company, 1951, Sec. 17027. Underlining added. This section is presented in
include this provision in addition to the provisions that provide that a period of time be used in determining replacement cost.\textsuperscript{8} Probably the legislatures overlooked this inconsistency. The specified time period probably is intended rather than the implied date of sale.

When a seller is permitted to select a purchase cost that existed during a period of time prior to a sale, the lowest price that has been offered to him or that existed in the market during this time may be chosen. This gives the vendor the greatest possible choice of purchase prices. The cost base will always be the lowest possible amount particularly when sellers can choose the lower of either purchase cost or replacement cost.

The replacement cost of some products may not be available on a particular date. This is often true, for some goods are not sold through organized markets and regular channels of distribution, or are infrequently sold, such as heavy machinery. However, such situations are the exception rather than the rule. An organized market or an established channel of distribution tends to exist in those areas where price fluctuations and price competition are most prevalent. The inability to determine a replacement cost in these rare instances does not justify a time

\textsuperscript{8} 3 Codes of Montana, 1947, Secs. 51-103 and 51-104 and The West Virginia Code of 1949. Article 11A, Secs. 4678(8a) to 4678(8n). Charlottesville, Virginia: The Michie Company, 1949, Secs. 4678(8f) and (8g).
period in a definition of replacement cost. Nevertheless, since a violation of the act is a criminal offense, the seller should have the greatest possible choice of available costs. Because of this, a time period should be prescribed. The period should be the same as that for purchase cost, the inventory period.

DETERMINATION OF REPLACEMENT COST - SCOPE

Since most of the sales-below-cost acts prescribe that a comparison be made of replacement cost and purchase cost when determining the cost base, it is necessary that the same elements be included when arriving at the amount of each. The deduction of discounts from the gross invoice price and the addition of acquisition expenses are involved. The problems of selecting which of these elements that should be included in or excluded from the current invoice cost are similar to those concerned with the determination of purchase cost.

The prescription of a period of time from which a replacement cost may be selected permits a merchant to choose (1) the lowest gross invoice price offered to him during the period, (2) the largest of each of the various discounts, and (3) the smallest amount of transportation expenses that could have been incurred during this period. The result could be a replacement cost composed of amounts that existed at different dates during the period. This
is not realistic. It is more realistic to measure the replace-
ment cost by taking the amount of all these elements
that exist on the same date. Thus, if the gross invoice
price of one date is selected, the amount of all other
elements on that same date should be used.

Discounts. The same discounts should be deductible
from the quoted invoice price when determining replace-
ment cost that are permitted when purchase cost is com-
puted. The deduction of trade discounts from the quoted
list or gross invoice price is either specified or implied
in the acts.

It is specified in sixteen general statutes that non-
cumulative quantity discounts are to be deducted. The re-
placement cost definition in the Unfair Sales Acts prescribe
that it be a unit cost in terms of the quantity last pur-
chased by the merchant. Probably the quantity of the last
usual purchase is meant, because fill-in purchases are
abnormally small. Cumulative quantity discounts are not
mentioned in the acts. They should not be deducted from the
quoted invoice price for the same reason that they should
not be deducted when determining purchase cost.

The provisions applicable to cash discounts are the
same as those that pertain to purchase cost. However,
whether or not cash discounts are deductible depends on
the past policy of the buyer. If he has taken advantage
of purchase discounts in the past, it may be assumed he
will do so in the future. In this case the quoted cash discount should be deductible.

Allowances. The special discounts, free deals, and advertising allowances considered deductible when determining purchase cost also should be deductible when resolving replacement cost for comparative purposes. However, if they are the result of bargaining and are not known until after a transaction has been consummated, it is best not to require their deduction when determining replacement cost. On the other hand, if they are offered as a normal procedure, known to be available at the replacement cost date, and have been taken advantage of in the past, it is recommended that they be subtracted. Compared to purchase cost, the scope of replacement cost may be limited by these allowances.

Transportation Cost. Most acts that specify that transportation expenses are to be added to purchase cost also prescribe them to be added to replacement cost. The general acts of California, Idaho, Virginia, and Washington prescribe that freight charges shall be the amount fixed by the state transportation commission. In effect, this is a replacement cost.

Summary. In so far as possible the items to be added to or subtracted from the quoted gross invoice or list price when determining replacement cost should be the same as for purchase cost. The greatest divergence between
these two costs is in the area of allowances. These should be deducted only if they are an accepted practice, known to be available, and have been taken advantage of by the buyer. Handling costs, as for purchase cost, are not added nor should taxes be added.

ADMINISTRATIVE PROBLEMS

Once a proper definition of replacement cost is resolved, a consideration of the effect it may have on the enforcement of the provisions of the acts is in order. It is assumed here that replacement cost only is the cost base.

In order to properly enforce the acts there should be fast detection of violations. To do this there must be current and widespread knowledge of costs. It is claimed that this is accomplished best with a replacement cost definition of the cost base. "Every dealer knows every other dealer's replacement cost, so any evasion of the mark-up provision would be immediately noticed and could be easily checked." However, in a few areas, there is no organized market and in some cases published quotations are not the prices at which transactions are consummated.


Therefore, replacement cost may not be ascertained readily in all cases.

There appears to be little objection to the use of replacement cost as the measure of the cost base if it is used only as prima facie evidence of cost. Used in this manner, all merchants selling at prices below this base can be discovered and prosecuted at once. This tends to assure that sellers are treated equally. Since this definition is only prima facie evidence of cost, each merchant has the opportunity to prove that his actual cost is lower than the selling price, if a purchase cost definition is also included in the act.

Finally it is claimed that a cost base defined as replacement cost only is fair to vertically integrated sellers. The combination of the functions of wholesaling and retailing under one business organization "... makes the proof of actual cost particularly difficult, since the wholesaling... functions are performed by the retailer." On the other hand, if the performance of wholesaling functions by a retailer lowers the total cost of his products, he would not be treated fairly if the replacement cost used is the price quoted to non-integrated retailers. In such a case, his cost base would be inflated. A purchase cost definition prevents this possibility.

12. Tannenbaum, op. cit., p. 28.
LOWER OF INVOICE OR REPLACEMENT COST

All of the state sales-below-cost acts except six define the cost base as the lower of invoice cost or replacement cost. Of the six acts that prescribe another definition, three specify the manufacturer's list price, less discounts,\(^{13}\) two define the cost base as purchase cost only,\(^{14}\) and one act prescribes just replacement cost.\(^{15}\) A discussion of the definition of and reasons for a cost base that involves a choice of two alternatives is presented. This is followed by an investigation of the problems and procedures of determining the lower of the two. Finally, the administrative problems of such a definition and its effects under changing price levels are presented.

CONCEPT OF THE LOWER OF PURCHASE COST OR REPLACEMENT COST

The minimum price prescribed in a sales-below-cost act should be based on the merchant's actual invoice cost. This requires a purchase cost definition. However, if prices should fall, a replacement cost base protects consumers and sellers because the latter are then permitted to reduce prices below actual cost. To be sure of the advan-

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\(^{13}\) Connecticut's and Louisiana's drug acts and Connecticut's cigarette law.

\(^{14}\) South Carolina's act and Michigan's bakery and petroleum law. Oregon's law also specifies purchase cost but just for wholesalers in food commerce.

\(^{15}\) Oregon's general law.
tages of each of these, the selection of the lower is pre-
scribed. This choice enables the vendor to select the low-
est possible cost. It also tends to weaken the charge that
these statutes are price fixing acts. The seller is given
the opportunity to find a cost base low enough which, with
the required markup, will be lower than the price he has
charged.

DETERMINATION OF THE LOWER

The degree of difficulty of determining which is the
lower, purchase cost or replacement cost, depends on the
movement of prices prior to the sale. If there is a severe
drop in prices, the only problem is that of determining
replacement cost. If prices have risen sharply, only
purchase cost need be found. The more stable prices are
before an article is sold, the more difficult is the se-
lection of the lower of the two costs. In this case, both
costs must be determined and carefully compared.

The length of the prescribed time period also affects
the degree of difficulty of determining the lowest of each
of the two costs. The longer the time period, the more
costs there are to compute. As indicated in Chapter III,
this problem may be eased by prescribing an inventory
period. This limits the number of computations that need
be made.
ADMINISTRATIVE PROBLEMS

The administration of the acts is less difficult if a choice of the lower of invoice cost or replacement cost is permitted. The administrative advantages of replacement cost occur during periods of falling prices. Replacement cost, under such circumstances, tends to be lower than purchase cost. When prices do not change materially replacement cost and purchase cost tend to be the same. Here, too, replacement cost can be used as a basis for action against violators. It may also be used when prices rise, as long as any replacement cost that existed during the inventory period is considered. The administrative agency in such cases must use the lowest replacement cost during the period. This tends to be the same as purchase cost.

EFFECTS OF CHANGING PRICES

When prices rise and fall the prescription of just purchase cost or just replacement cost as the cost base may have adverse effects on competitive pricing and be to the disadvantage of the consumer. If purchase cost is used, the seller who bought his goods when prices were at their lowest level during the inventory period has the greatest freedom in setting prices. Conversely, the seller who purchased when prices were highest is restricted in lowering his prices. A greater disadvantage of the use
of purchase cost occurs when prices drop below this cost. In such a situation merchants can not reduce their price to this lower level. This not only restricts their freedom of pricing, but also acts to the disadvantage of the consumer.

A replacement cost base obviates the foregoing problem when prices are falling. However, when the price level rises such a base produces a higher price than purchase cost. Some authorities maintain that this is justifiable.\textsuperscript{16} Since the acts are aimed at the large distributors, replacement cost prevents these distributors from selling at prices that are lower than those of the small merchant. The larger merchants buy in greater quantities and can, thus, purchase goods when prices are low. Also, this tends to prevent the dissipation of enterprise capital.\textsuperscript{17} If prices rise, more capital is needed to replace the products sold. Therefore, prices based on replacement cost tend to assure the replacement of the goods sold. Granted these acts were pushed through legislatures by organized groups of small merchants, it is not fair to legislate against a group of distributors who are efficient in order to protect those who may not be as efficient. Also, consumers are forced to pay higher prices than necessary. If

\textsuperscript{16} See, for example, Tannenbaum, op. cit., p. 27 and Taggart, op. cit., pp. 31-34.
\textsuperscript{17} Tannenbaum, Ibid., p. 28.
a seller wishes, he may set his price at the higher replacement cost level. The acts do not intend to prohibit this, but only to prohibit prices that are too low.

The problem of price level movements are averted if the lower of purchase cost or replacement cost is prescribed. When prices fall, a replacement cost base is the lower. Conversely, when prices rise, purchase cost is the lower. In all cases, the seller may use the lowest possible alternative. His choice of alternatives is greater if replacement cost is allowed to be selected from those available during the inventory period. Sellers have greater pricing freedom and consumers may have lower prices if the lowest possible cost is prescribed. This is particularly important during periods of depressed prices for during these times price tends to be a more important buying motive.

**MANUFACTURER'S PUBLISHED LIST PRICE, LESS PUBLISHED DISCOUNTS**

Many manufacturers publish a list of the prices of products presented in their catalogs. These prices are ordinarily retail prices; the prices at which the manufacturer recommends sale to the consumer. The particular price offered to the merchant depends on the discount from this list price that he is allowed. These discounts may be published or given only to buyers. Changes in the merchant's prices often are accomplished by changing the dis-
counts, not the list prices. Thus, the manufacturer's published list prices tend to remain relatively fixed over a period of time; only the discounts change more frequently.

Three special acts prescribe the manufacturer's published list price, less his published discounts as the definition of the cost base. Connecticut's Retail Drug Control Act prohibits a retail druggist from selling drug products "...at a price below the manufacturer's wholesale list price per dozen...[or] per unit." The Louisiana Drugs and Cosmetics Act has a similar provision. The Connecticut cigarette act defines the cost base as "...the list price of the manufacturer, less the customary trade discount of ten per cent,..." Thus, the cost base for these acts is the apparent cost to the retailer, that is, what he pays for the goods according to the price information of the wholesaler or manufacturer.

This definition of the cost base should not be prescribed in a general act. There are many trades in which

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19. 2 General Statutes of Connecticut, 1949, Sec. 3959.
the manufacturer does not quote list prices or discounts.\textsuperscript{22} This is especially true when retailers handle private brands. Also, the Attorney General of Minnesota ruled that a price list, which includes discounts, circulated among wholesalers but not made available to retailers is not considered as published under the act.\textsuperscript{23} If this definition is prescribed in a general act, a substitute definition is necessary for application to those cases where there is no published manufacturer's list price and discounts. Thus, the use of this definition of the cost base is limited. The three acts that have this definition apply only to a particular trade and also only to retailers.

This definition indicates an apparent cost to the seller. Often the list price, less discounts, is used as a base for further bargaining.\textsuperscript{24} Larger discounts than those actually published, may be granted to a buyer. In such cases, the buyer's actual cost is less than the defined cost. In declaring this provision of the Minnesota law of 1937 unconstitutional, the court held that the prescription of a cost base "...which may or may not be what a merchant has actually paid in the ordinary course of trade for his goods..." is arbitrary and discrimina-

\textsuperscript{22} Tannenbaum, \textit{op. cit.}, p. 19.
\textsuperscript{24} Tannenbaum, \textit{op. cit.}, p. 20.
Such a cost base may establish minimum prices that are higher than prices based on purchase cost or replacement cost.

The manufacturer's published list price, less his published discounts may be used effectively as prima facie evidence of the cost base. Administrative agencies and sellers would have in mind the same minimum cost. A merchant would not price a product below this cost unless he could prove that his purchase cost or replacement cost is lower. The Minnesota legislature amended its 1937 law by prescribing the manufacturer's published list price, less his published discounts, as prima facie evidence of cost. Two other general acts prescribe this definition as presumptive evidence of cost. These are the laws of Idaho and North Dakota. Although it has the advantage of definiteness for administrative purposes, and although it is used best as presumptive evidence of a violation of the act, it is limited to those trades where the manufacturer publishes list prices and discounts.

CHAPTER V

TOTAL OVERHEAD

In order to sell merchandise and carry on operations, business firms incur expenses other than those for the acquisition of products. These expenses are referred to as overhead, operating expenses, or, as in the sales-below-cost acts, cost of doing business. This and the following two chapters deal with the concepts and problems of these expenses and their assignment to products. In this chapter the two overhead concepts utilized by the acts are presented first, and are followed by an examination of the scope of total overhead. The problem of allocating total overhead to products is considered in Chapter VI, whereas the problems of specified markups are presented in Chapter VII.

OVERHEAD CONCEPTS

Two overhead concepts are employed by the sales-below-cost acts; total overhead and specified minimum percentage markups. The total overhead concept requires that a proportion of the total overhead expenses that is large enough to insure that the total cost of doing business will be recovered upon the sale of all products must be added to the cost base of each product. All overhead expenses must be included in the price of each product.
This amount may be assigned to individual products on the basis of an average percentage markup or in varying proportions. The essential point is that the markup added to the cost base of each product must be large enough to insure the recovery of all overhead expenses. However, it should not include any profit.

In the second concept, specified minimum percentage markups, only a part of the total overhead expenses is included in the prices of all products. The specified markup may be an arbitrary percentage or it may be large enough to assure the recovery of only the overhead costs directly associated with the product. In any case, the specified percentage markup added to the cost base is not sufficient to assure any merchant the recovery of his total operating expenses.

Two points should be kept in mind. The markup added to the acquisition cost of a product in order to arrive at a price normally is expressed as a percentage of the sales price. However, in the sales-below-cost acts it is a percentage of the cost base rather than the sales price. Also, the term markup is not synonymous with the share of the total overhead that is assigned to a product. The markup measures the difference between the product's cost base and selling price. This difference may be less than or greater than the product's share of the cost of doing business. Normally business firms include a portion of a
desired profit in a markup as well as a share of the total overhead expenses.

**ACTS THAT PRESCRIBE TOTAL OVERHEAD**

The average overall cost of doing business is required to be added to the cost base in twenty-four laws. Among these are included the Unfair Practices Acts and the miscellaneous acts of Minnesota and Oregon. All of the cigarette acts but the Connecticut law specify markups that are presumed to cover total overhead. However, the cigarette acts of Massachusetts and Ohio specify a markup for the wholesaler that is to cover only a part of the cost of doing business, and in this respect, the acts are similar to loss limitation statutes.¹ Three other special acts that require total operating expenses to be included in the minimum price are,

California's Dairy Products Law
Idaho's dairy products statute
Michigan's bakery and petroleum law.

Thus, approximately half of the sales-below-cost acts contain a cost definition that requires a share of total overhead to be added to the cost base.

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SCOPE OF TOTAL OVERHEAD

Most of the acts that prescribe total overhead enumerate the overhead expenses that are to be included in the cost of doing business. A typical wording of this provision in the Unfair Practices Acts is:

"Cost of doing business" or "overhead expense" means all costs of doing business incurred in the conduct of the business and shall include without limitation the following items of expense: labor (including salaries of executives and officers), rent, interest on borrowed capital, depreciation, selling cost, maintenance of equipment, delivery costs, credit losses, all types of licenses, taxes, insurance and advertising.

The remainder of this chapter is devoted to a critical analysis of each of these overhead expenses in the order listed in the acts. There are differences of opinion about whether some of the enumerated expenses are operating or non-operating. Operating expenses are included in the cost of doing business while non-operating expenses are not. In only a very few cases have courts or administrative agencies ruled on the reasonableness of the individual overhead expenses enumerated.

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2. Deering's California Codes, Business and Professions Code Annotated, Vol. II. Chapter 4, Secs. 17000 to 17101. San Francisco: Bancroft-Whitney Company, 1951, Sec. 17029. Also see Appendix A. For an example of the provision in the Unfair Cigarette Sales Acts see Alabama Laws of the Legislature of Alabama, Vol. II. Special Sessions 1950, Organizational, Special, Regular Sessions 1951, Act No. 805, Secs. I to XI. Montgomery, Alabama: Brown Printing Company, 1951, Sec. IV. Also see Appendix C.
LABOR

The first overhead expense enumerated in the acts is labor. In parentheses most acts extend the meaning of the term, labor, to include salaries of executives and officers. The Minnesota act also adds bonuses. Salaries and bonuses of executives and officers are explicit costs to corporations. Therefore, the cost concept intended is that of the accountant. There is no mention of a partner's or proprietor's implied salary. However, in one state partners' salaries were held to be operating expenses by the state's supreme court. Where courts or administrative agencies have not ruled otherwise, the noninclusion of implied salaries tends to give the unincorporated stores a lower cost of doing business.

The difference between the cost of doing business of the unincorporated store and that of the corporate store is reduced by a provision in the Oklahoma cigarette act which extends the meaning of the term, labor, as follows:

...labor costs (including salaries or drawing ac-

counts of owners, salaries of executives and officers, or general and special allocations and charges made by the parent organizations). ...6

This provision implies the businessman's concept of cost. To the explicit labor cost of the accountant is added an amount owners consider to be their salary, if explicit, or their drawings, if implicit. Thus, that part of the accountant's profit that is represented as a return to the owner for his services is included. This tends to equalize the cost of doing business of the unincorporated enterprises with that of corporations.

The California Unfair Practices Act includes the following provision:

In any action brought under this chapter, where persons are employed or performing services for any person or in the conduct of the business wherein such person is charged with a violation of this chapter, and are so employed or performing such services without compensation or at a wage lower than that prevailing at the time and place of the service for the particular services performed, such services shall be charged as an expense of the business in which rendered and at the rate of the wage for the services rendered prevailing at the time of the service at the place where rendered. 7

Essentially the same provision is included in the Washington law. The scale of wages existing in the locality determines the amount of labor to include in the cost of


7. Deerings California Codes, 2 Business and Professions Codes, Sec. 17076. Also see Appendix A.
doing business regardless of whether the employee is paid this wage or not. \(^8\) This is an economic concept and further equates the cost of doing business among the various enterprises in a locality. However, the Washington supreme court ruled that the prevailing wage scale should not be used in determining the cost of doing business unless it is shown that the seller paid a lower wage for the purpose of injuring competitors or destroying competition. \(^9\) Also, there is nothing in either act that explains how this wage scale is to be determined. \(^10\) It thus seems that this provision is unenforceable because it is difficult to prove that a particular wage is below some prevailing scale and even more difficult to prove that a seller set the wage to destroy competition or injure a competitor.

**RENT**

The second overhead expense enumerated in the acts is rent. It is an explicit cost incurred for the use of property owned by others. No major problems arise from this item. Since the acts do not require the use of a

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prevailing scale of rents in the locality, the accounting cost concept is intended. The amount of rent actually paid by a seller should be included in his cost of doing business. If the property is owned by the seller, depreciation, instead of rent, is an overhead expense. This is considered in a following section. The problem of an imputed interest on this property is considered in the next section.

**INTEREST ON BORROWED CAPITAL**

The Unfair Practices Acts list interest on borrowed capital as an element of the cost of doing business while the Unfair Cigarette Sales Acts omit it. Interest on borrowed capital is a deduction from revenue, but there is little agreement about its expense classification. Some consider it a distribution of the profits of the business and, therefore, do not classify it as an operating expense. Others consider it an operating expense and still others deem it to be a nonoperating expense.¹¹ The cigarette acts consider it to be either a distribution of profits or a nonoperating expense because they do not include it in their enumeration.

The requirement that interest be included among the overhead expenses may result in some business firms having

a greater cost of doing business than others. Some utilize more borrowed capital. Also, some firms, usually the larger ones, are able to borrow at a lower rate of interest.\textsuperscript{12} To prevent this inequity an economic cost concept for interest is set forth in the Wyoming act which requires that the "legal rate of interest on capital" be included in the cost of doing business.\textsuperscript{13} Thus, in Wyoming, that part of profit that is a return to the owner for the use of his capital must be included in the cost of doing business. This latter amount is measured by the legal rate of interest. If explicit interest is less than the amount produced by the legal rate, the former is increased to the latter amount. This requirement eliminates an inequity among firms but it does increase the cost of doing business. In spite of arguments for the inclusion of this expense in the National Recovery Administration codes, it was omitted from the computation of the cost of doing business for the purpose of setting minimum prices.\textsuperscript{14} It seems best to omit it as an item of the cost of doing business for the sales-below-cost acts. An explicit interest requirement produces an inequity among merchants and an implicit interest requirement assures a return to the owner, which under the account-


\textsuperscript{14} Taggart, \textit{op. cit.}, p. 53.
DEPRECIATION

Depreciation is the next element of the cost of doing business listed by the acts. It is a genuine operating expense, for it is a periodic allocation of a prepaid expense incurred by the business for operating purposes. The major problem of depreciation is the determination of the amount that should be included in the cost of doing business, but not one sales-below-cost act prescribes how this is to be done. This amount is determined by two factors, the rate and the base. The rate of depreciation deals with the rate at which the base is assigned to operating periods. This requires an estimate of the length of life of the asset being depreciated, since the base should be spread over the asset's useful life. This estimate is usually a matter of individual judgment. However, a fair amount of consistency among firms is possible if the length of the asset's useful life is determined according to the recommendations of the Internal Revenue Service.

Another factor that affects the rate of depreciation is the method by which the base is spread over the asset's

useful life. Four methods may be used: (1) straight-line method, (2) interest procedure, (3) decreasing balance methods, and (4) production methods. These methods tend to apportion different amounts to operating periods. The straight-line method assigns an equal amount to each period, the interest procedures assign progressively increasing amounts, and the decreasing balance methods assign progressively decreasing amounts. The amount assigned to each period under the production method depends on the amount of production or the degree of actual use of the asset during the period. The method used by most business firms and the easiest one to apply is the straight-line method. However, any one of the four methods may be acceptable. Courts have not ruled on this problem.

The base, the total amount that must be depreciated, also presents a problem. Accountants recommend that this base be measured by the actual cost of the asset plus improvements. On the other hand, the economist and sometimes the businessman suggest that the base be the replacement cost of the asset. One authority recommends replacement cost because it is more equitable. It produces the same amount of depreciation for all firms while actual cost gives varying amounts. He claims that the former is more

easily estimated by enforcing agencies. However, if the property of a firm is fully depreciated, it is not proper to require a hypothetical cost. In addition, actual cost is a more definite amount. All these arguments are valid. Therefore, the lower of either actual cost or replacement cost could be used as the base to which the rate is applied. This permits the seller to choose the lower of the two as his depreciation expense.

SELLING COST

"Selling cost," the next expense enumerated, is one of the ambiguous terms listed in the acts. This is because the majority of the expenses listed are natural items; that is, they are accumulated according to the object of expenditure.¹⁹ For example, labor, rent, interest, and depreciation are natural expenses. However, selling cost is a functional expense. This type of expense measures the cost of performing some major distribution activity of a business enterprise.²⁰ Once the expenditures are accumulated according to a natural classification, they are then assigned to a functional expense before being allocated to products. For example, selling cost, as a functional expense, includes the wages of sales persons from the natural expense.

²⁰. Heckert and Miner, Ibid., p. 18.
"labor," "depreciation" of store counters, a "rental" for the use of selling space, and other expenses incurred for the activity of selling. Since the other expenses listed in the acts are natural expenses, the term selling cost must include all selling expenses not otherwise enumerated.

**MAINTENANCE OF EQUIPMENT**

The next item, maintenance of equipment, causes little difficulty in the determination of the cost of doing business. Nevertheless, a noticeable variation of the amount of maintenance expense may occur from one month to another. Breakdowns do not occur regularly or in equal magnitudes. Also, firms tend to postpone such expenditures to those periods in which they can better afford them. However, these monthly variations tend to average out if a year is used as the period in which the cost of doing business is measured. In spite of this, the annual maintenance expense still should vary somewhat among firms because of the difference in the age of the assets held by the firms. The cost of maintenance tends to increase as the assets increase in age. Some firms have assets of various ages; a condition which tends to reduce the variation among firms. Nevertheless, the firms with older assets will tend to have a higher maintenance cost than the firms with new assets, but the former firms may have a lower depreciation charge, either because the assets have
been fully depreciated or were purchased when prices were lower.

**DEVELOPMENT COSTS**

Delivery costs is enumerated by all the acts that list overhead expenses. Like selling costs, this item is a functional expense. It includes depreciation and maintenance of delivery equipment and, among other natural expenses, the wages of drivers. As a functional expense, it is a legitimate operating expense if the seller bears the cost of delivering goods to his customers. As listed in the acts, it includes all transportation expenses not otherwise enumerated.

The California Unfair Practices Act includes a provision that specifies that delivery cost is presumed to be the amount fixed by the state transportation commission. However, a lower cost may be proved by the seller. On the other hand, the Oregon general law specifies that this cost is the amount set by the state public utilities commissioner regardless of the seller's actual cost. However, this is difficult to enforce because many of the smaller firms deliver by truck, station wagon, or jeep. The state public utilities commissioner generally does not

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21. Deering's California Codes, 2 Business and Professions Code, Sec. 17074. Also see Appendix A.
set the cost for these vehicles.

**CREDIT LOSSES**

Only the Unfair Practices Acts and the Oregon general law list credit losses as an operating expense. It is omitted in the Unfair Cigarette Sales Acts and the Minnesota law. It should be included, however, in all acts that prescribe total overhead even though it results in a larger cost of doing business for firms that sell on credit terms than for firms that sell only for cash. When extending credit, firms incur not only losses from bad debts but also the expenses of operating a credit department and carrying receivables. The cost of extending credit certainly is an operating expense.

The term "credit losses" is a natural expense if taken literally. Only the loss due to non-collectible accounts is included. However, if the term "credit losses" encompasses the cost of all credit extending and collection activities, it is a functional expense. As such, it includes the natural expenses of the salaries of accounts receivable clerks, commissions of collection agencies, and, among others, losses from bad debts. The literal interpretation is probably intended in the acts.

**ADVERTISING**

All statutes but the Iowa Cigarette Sales Act list advertising as an overhead expense. However, the Iowa
legislature probably intended that it be included under an all-inclusive phrase listed in the law.\textsuperscript{23} Advertising may be considered a functional expense. If so, it should include the wages paid for advertising labor, the depreciation or rent applicable to assets used, and any other expense incurred in performing this activity. However, it is probably meant to be a natural expense. As such, it includes all advertising expenses not otherwise enumerated.

A problem of advertising is the allocation of large unusual expenditures of an institutional nature to the periods benefited. Since this is difficult to do, any allocation made by a firm should be accepted, if reasonable. The same difficulty is encountered in the allocation of the advertising of the home office of chains to the units benefited. This, too, may be solved by accepting a reasonable allocation made by the home office.

\textbf{MISCELLANEOUS COSTS}

Most Unfair Practices Acts and Unfair Cigarette Sales Acts list "... all types of licenses, taxes, and insurance,..."\textsuperscript{24} Licenses are an overhead expense. They must be paid before the business can operate. Insurance is


\textsuperscript{24} Deering's California Codes, 2 Business and Professions Code, Sec. 17029 and 2 Alabama Laws, 1951, Act. No. 805, Sec. IV. Also see Appendices A and C.
needed to protect assets. These two expenses are easily
determined and, therefore, should not cause any difficulty
when determining the cost of doing business. However,
taxes may cause some problems since the acts specifically
require that all types of taxes are to be included when
determining the cost of doing business. Different busi­
nesses and products are subject to various kinds of taxes
which not only may be difficult to determine but also may
not fall equally on all competitors. For example, only
chain stores pay chain store taxes, some products are sub­
ject to excise taxes while others are not, unemployment and
social security taxes may not fall equally on all sellers,
and the amount of income taxes, aside from the questionable
inclusion of these taxes as an operating expense, is not
known at the time of sale. Although there may be some dis­
 crimination among the various types of business enterprises,
all taxes except those on income are susceptible of deter­
mination. However, the amount of income taxes is not known
until the end of the accounting period when profit is
determined and, therefore, can not be known at the time of
sale. One of the reasons the Colorado district court held
that state's Unfair Practices Act unconstitutional was the
impossibility of determining income taxes. The court
stated, "It may be that a particular grocer may not have
any taxable income at the end of the year, but yet he is
required, apparently, to make some calculation of income
tax and include that in his pricing."25 In addition, corporations are subject to the corporation income tax whereas partnerships and sole proprietorships are not subject to any income tax; instead, the owners are subject to the personal income tax. In the latter case, the rate of tax is not determined by the profit of the business but by the total income of the individual owners. Also, income taxes are seldom included among the operating expenses of a business. They are a deduction from the reported profit of the business. The only ruling on this particular subject by courts or administrative agencies was that made by the Colorado court. Because of this ruling and the problems discussed, it seems best not to include income taxes as an element of the cost of doing business.

The cost of doing business provision in the Unfair Practices Acts specifies that all costs of doing business must be included and that those enumerated must be included without exception. Other operating expenses are incurred by businesses that are not included in the enumeration. For example, office supplies and utilities, travel and communication, donations, and expenditures for research and development are not listed but are usually included as operating expenses by business firms. According to this

provision, these should be included when determining the cost of doing business. However, when considering this problem, the Wyoming supreme court in the case of State v. Langley ruled that the cost of doing business embraces all the items listed in the Unfair Practices Act and no others. Thus, in Wyoming only those expenses specifically enumerated may be included in the cost of doing business. On the other hand, in the Minnesota miscellaneous act the phrase "...other fixed and incidental expenses..." is added to the listed expenses and the phrase "...other expenses" is added in the Iowa cigarette act. It appears, in these states, that all operating expenses, whether enumerated in the acts or not, are to be included. However, these phrases do produce one problem. The Unfair Practices Acts specifically list credit losses, interest, and advertising and the Unfair Cigarette Sales Acts omit the first two expenses but include advertising among the expenses enumerated. The Minnesota act does not list credit losses and the Iowa cigarette act omits all three of these expenses. It is not known if the catch-all phrases of these two acts are meant to include these expenses or if their omission from the enumeration significantly means that they are not to be included in the cost of doing busi-

27. 21 Minnesota Statutes, Sec. 325.01.
28. 34 Iowa Code, Sec. 551A.8-2.
ness. Neither the courts nor administrative agencies have ruled on this question.

SUMMARY

Most Unfair Practices Acts and Unfair Cigarette Sales Acts list the expenses to be included in the cost of doing business. The accounting cost concept is employed. However, in a few acts, labor, interest, and delivery costs are economic costs. Because interest is not considered as an operating expense by many authorities and some businesses and because of the inequities that may result if it is included, it seems best to omit it as an element of the cost of doing business -- as do the Unfair Cigarette Sales Acts. There is nothing in the acts that explains how the amount of depreciation is to be determined. Any generally accepted method based on the lower of original cost or replacement cost of the assets seems fair to all competitors and consumers. Since credit losses are considered an operating expense by most businesses and authorities, such losses should be listed as an element of the cost of doing business as in the Unfair Practices Acts. Because of the impossibility of determining income taxes at the time of sale, they should not be included as an element of the cost of doing business. Any overhead expense generally considered by authorities and business firms as an operating expense should be included in the cost of doing business,
even though one court ruled that only those listed in the acts are to be included. If the includable expenses are to be enumerated, the list should be comprehensive and should be composed of either natural expenses or functional expenses, not a mixture of the two.
CHAPTER VI

ALLOCATION OF TOTAL OVERHEAD

Once the scope of total overhead is determined, the next major problem is the allocation of this overhead to the product sold. This is a difficult problem because "... a substantial portion of marketing costs consists of joint and indirect costs rather than direct costs." These expenses are incurred for all commodities handled and, therefore, they can not be apportioned readily to any one item. This chapter deals with two methods of allocating these indirect costs to products. One is an average allocation and the other is a specific allocation. After their manifold problems are presented, the implications of these methods of allocation are presented.

AVERAGE ALLOCATION

An average allocation of total overhead means that one percentage markup is applied uniformly to each product. The markup is based on and added to the item's cost base. It is determined by the percentage relationship of the total overhead expenses incurred by the firm during a period of time to the acquisition cost of all products sold during

this period. Thus, if the total overhead expenses are fifteen percent of the acquisition cost of all products, fifteen percent of the cost base would be added to the cost base of each product sold.

**AVERAGE ALLOCATION IN THE ACTS**

None of the general acts that require total overhead specify how it is to be allocated. They simply require that the cost of doing business of the merchant be added to the cost base. However, an average allocation may be implied from other provisions. Also, it is required by some courts and administrative agencies. The general acts of California, Oregon, and Washington specify that the average over-all cost of doing business is to be allocated. The use of the words "average over-all" cost of doing business implies an average allocation. The average total overhead of the firm is to be assigned to each product on a uniform percentage basis.

Some courts have ruled that an average allocation of overhead expenses is prescribed by the acts. In two Cali-


fornia cases, it was ruled that each product should bear its share of the total overhead expenses. This implies the addition of a uniform percentage markup to the cost base. The Minnesota supreme court held that the markup applicable to the entire business must be assigned to the product unless the merchant can prove that the item is segregated from all other items carried. The Colorado supreme court in the Dikeou case ruled that the cost of doing business of the entire store determines the markup that must be added to each product. However, in a later case, Standard Store v. Safeway Stores, Inc. and King Soopers, Inc., a Colorado district court ruled that a specific allocation and not an average allocation was intended by the state's Unfair Practices Act.

Some agencies enforcing the provisions of the acts also require an average allocation of overhead expenses. The markup used by these agencies is determined in several ways. In one way the operating expenses of a firm are to-


tated. Next, the purchase cost of all products sold during the period is determined. Last, the cost percentage is found by dividing the overhead expenses by the purchase cost. For example, if purchases amount to $2,000,000 and the firm's operating expenses are $200,000, the markup added to each product is ten per cent of its cost base. The trade associations in California determine this percentage by subtracting either a seller's acquisition cost or replacement cost from his total expenditures and dividing this difference by the cost base. The resulting percentage markup is added to the cost base of each product. The Attorney General of California also insisted on an average allocation. Thus, even though the acts are vague about this, some courts and administrative agencies enforce an average allocation.

**BASES FOR DETERMINING COST**

Three bases may be used in determining the overhead cost that is applicable to the sale of a product. These


bases are:

1. The cost of the specific transactions under examination, or
2. General costs established in the industry for the type of transaction involved, or
3. The cost experienced by the particular ... [seller]... concerned, for the type of transaction under consideration.

The first basis, the cost of the specific transaction, is difficult to determine because most of the overhead expenses are not directly related to any one transaction. Many expenses are not known until some time after the transaction. In addition, the cost of maintaining the records that are necessary to obtain this information is too great to warrant its use. It could be possible to make a special study to determine the costs that are applicable to a particular sale, but this can only be done sometime after the transaction. However, sellers need to know this information prior to the sale in order that they may be assured that they are not selling below the minimum price. Because of these difficulties, the use of some other basis is preferred.\(^\text{11}\)

The cost experienced by a particular seller is the prescribed basis for determining the cost applicable to a sale in most of the sales-below-cost acts. However, one


authority claims that it has serious weaknesses because it requires a uniform definition of cost and uniform methods of estimating expenses. Nevertheless, a uniform definition of cost does exist throughout a state since all sellers are subject to the same law. Although uniform methods of estimating costs are desirable, they are not essential.

The Wyoming supreme court in State v. Langley held that as long as a seller demonstrates good faith and presents cost information judged to be adequate by the court, an average individual cost is acceptable. However, this cost does create a problem of administration. Under an individual cost definition, competitors and administrative agencies do not know the merchant's average over-all cost of doing business unless they can acquire the merchant's income statement. However, this may be difficult to do because most merchants do not publish their statements.

A more commonly known cost, that of a particular trade, may be used instead of the individual's cost. It may be either an average for the trade or the cost of the low-cost merchant in the trade. The use of an average cost may invoke the charge that the acts are price fixing statutes since these acts establish minimum prices. The other

cost, that of the low-cost firm in the trade, then, may be used. The use of the cost of the low-cost firm, however, necessitates a cost survey of the firms in the trade. Several problems arise when determining this cost. All merchants in a trade do not operate in the same manner and, therefore, it would be difficult to classify merchants within a trade for the purpose of establishing a minimum cost. In addition, if the survey is conducted according to sampling techniques, there is no assurance that the low-cost merchant will be included in the sample. Even if the low-cost firm is included, it may not be a representative firm in the trade. Although problems are encountered in these surveys, twenty-five of the sales-below-cost acts provide for a survey.\textsuperscript{15} The cost survey provision of the Unfair Practices Acts does not prescribe whether the basis is to be the lowest cost in the trade or an average. However, in their cost surveys the trade associations of California determined the lowest cost in the trade. Most of the Unfair Cigarette Sales Acts specify that the lowest cost is to be determined when a cost survey is conducted. The cost of the low-cost firm in the trade, assuming it may be determined by a survey, may be used effectively by administrative agencies as a basis for enforcing the act. This is possible because this cost is made known to all mer-

\textsuperscript{15} Other problems that arise from cost surveys are examined in Chapter VIII.
chants who, then, are aware of the minimum markup. However, such an industry cost should be used only as prima facie evidence of a merchant's cost of doing business because a merchant should not be found guilty of violating an act if he can prove that his individual cost is lower than his price. This is supported by the Massachusetts supreme court. It ruled that:

The cost, below which cigarettes may not be sold, is the actual cost to the particular retailer, and not the usual cost in the trade or the cost as determined by any survey or by any public officer.\textsuperscript{16}

\textbf{PROBLEM OF TIME}

Although it may be decided that an average individual cost is to be used when allocating overhead expenses, there is still the problem of determining the period of time to be used for measuring the average. Most of the sales-below-cost acts do not consider this problem. One of the reasons why the Colorado Unfair Practices Act was declared unconstitutional is the omission of the period of time to be used in determining the cost of doing business. The court queried:

...Assuming for the moment that the cost of doing business for each individual item on a grocer's shelves could be ascertained, at what time, or during what period should such a calculation be

made and applied? ... Are we to apply last year's figures on these items, or last month's figures, or the figures of the last accounting period? ... 17

The California and Washington Unfair Practices Acts provide that "...any particular inventory period..." is to be the time over which the cost of doing business is to be measured. 18 Unless further defined, an "inventory period" could mean any period of time. Because of this the 1935 California act was declared unconstitutional. 19 An inventory period may refer to the number of days it takes for the average inventory of a business to be sold. If this is the meaning attached to the phrase, varying periods of time will be used by merchants when determining their average over-all cost of doing business. For example, the average inventory of one merchant may be sold over a period of one month whereas one of his competitors may sell his average inventory in fifteen days. Such inventory periods tend to be less than one year for most merchants. Therefore, the cost of doing business would be determined by current costs which are susceptible to wide variations due to seasonal factors.

Only the Oregon general law specifies a definite

18. Deering's California Codes, 2 Business and Professions Code, Sec. 17076 and 2 Revised Code of Washington, Sec. 19.88.130. Also see Appendix A.
period of time for use when computing the average over-all cost of doing business. It requires the "average of all costs of doing business incurred in the conduct of such business during the 12 months immediately preceding any alleged violation of this act."\(^{20}\) It also provides that if a merchant has not been in business for twelve months, he may use the period of time in which he has been in business. A monthly average computed on the basis of twelve months is intended, for the statute specifies a monthly average for retailers in food commerce. This twelve month average irons out seasonal differences in operating costs. However, it does not permit the minimum price to fall if the level of overhead costs falls. The higher costs of the early part of the twelve month period keep the average cost of doing business above current costs. Because of this, a time period, similar to that of the Oregon act, included in the original Minnesota law, was declared unconstitutional. The court stated that:

The difficulty with this definition of "cost of doing business" is that it fails to give any effect whatever to a merchant's current selling costs. He may during the year when the alleged violation of the act takes place have greatly reduced his overhead expenses; ... he may have completely revolutionized his business for the very purpose of being able to sell a greater volume of goods at a lower price and with a less profit; and yet, because of this definition of the "cost of doing business," he cannot make the reduction in his prices which is entirely justified by his

\(^{20}\) 4 Oregon Laws, Sec. 43-104.
reduced overhead, because, if he does so, he will violate the law.21

Since this ruling, the Minnesota law has been amended so that the cost of doing business is determined from current costs.

Theoretically, current costs should be used to determine the cost of doing business when fixing a minimum price. However, these overhead expenses seldom are known at the time of a sale. A California court ruled that current costs could not be used, for a strict application results in an overhead on some days being completely out of proportion to other days.22 This would be true if the term "current cost" referred to the expenses incurred on the day of sale. A more realistic interpretation is not the expenses incurred on the day of sale but the expenses incurred over the most recent month. However, the average monthly overhead costs measured over a period of twelve months is likely to be more accurate than those incurred in the most recent month. Therefore, a twelve-month average to be used as prima facie evidence of cost seems proper. If there has been a definite change in the overhead costs of the seller, he may use his current costs, if known, to prove that he has not violated the act.

OTHER PROBLEMS

Chain stores create an additional problem of the allocation of overhead costs. According to the acts the markup is to be determined from the operating expenses of the entire business. Two sets of overhead expenses exist in the case of chains and stores with branches. One is the overhead incurred by the chain store or branch and the other is the cost of administering the whole enterprise. If an average allocation of the entire business is prescribed, the total expenses incurred by the home office must be apportioned equally among the units. Each unit, then, must add to its own overhead expenses the general overhead of the home office before its average markup is determined.\(^\text{23}\) This procedure assures that the home office expenses are fully allocated to all stores. However, an equal allocation among the units may not be fair. An allocation of specific overhead items to particular stores may produce a more equitable allocation.

Another problem of the allocation of overhead exists when a business operates more than one department in one establishment. Department stores have many departments and some merchants operate a service and a cash-and-carry department under the same roof. Rulings on this problem have not been consistent. The Attorney General of Minne-

\(^{23}\) Grether, \textit{op. cit.}, p. 369.
sota ruled that the overhead cost of the entire department store must be allocated to each product even though separate records are maintained for each department.24 A court ruled that the overhead costs of the entire business must be allocated equally to all products of the business only if the accounting records are not kept separately for the several departments.25 However, another court ruled that an average allocation of overhead to all products must not be made, regardless of whether the accounting records are kept separately for each department. In this case an average allocation was held to be unfair because it would increase the minimum price of the products of a cash-and-carry department.26 Therefore, a specific allocation to products is required of these firms.

SPECIFIC ALLOCATION

A specific allocation is the apportionment of individual overhead expenses to the products that are directly or indirectly responsible for them. A uniform markup is not added to each product as under an average allocation. Varying percentage markups are added. The dollar amount of overhead expense assigned to a product depends on an analy-

sis of these expenses and the effort needed to sell the product.

Any reasonable allocation of the cost of doing business is permitted in nine cigarette acts. This is indicated in the provision that specifies that the cost of doing business "...as evidenced by the standards and methods of accounting regularly employed by him in his allocation of overhead costs and expenses, paid or incurred,..." is to be added to the seller's cost base. The method of allocation to be used, then, depends on the practice of the merchant. If he has been applying a store wide average allocation, the courts will accept it. On the other hand, if he has been allocating in a reasonable manner specific overhead expenses to cigarettes, then this also is acceptable.

Even though the laws imply an average allocation, some courts have required or allowed a specific allocation. A Tennessee court held that the markup per cent should not be uniform for all products, but each product should bear its proper share of the total overhead. This proper share is found by a specific allocation. In the case of State of Washington v. Great Atlantic & Pacific Tea Co.

the attorneys for the state maintained that an average allocation is prescribed by the act. However, the court held a specific allocation valid because fast turnover items should bear a smaller proportion of the total overhead than slow moving products. Also, some commodities, such as staples, require less selling effort than specialty items. Therefore, a minimum price should not be established by the use of an average allocation. A specific allocation is preferable. This is substantiated by a Colorado district court which held that the legislative intent was that each product should bear only those overhead costs that can be specifically assigned to it.

PROCEDURE

The markup normally applied to a product depends on competition, custom, or cost analysis. Cost analysis requires a proper classification of operating expenses, the selection of bases by which they may be assigned to products, and an analysis of these expenses according to commodities, territories, or some other basis. These re-

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31. The material in this and the following two sections is taken largely from Heckert and Miner, op. cit., Chapters 1 through 11 and 23. Other excellent sources are Frederick M. Eisner. Profit Analysis; Distribution Costs;
quirements are presented in brief outline in the following sections. They are illustrative only, as the exact procedure that may be used depends on the circumstances of each case.

The first step is the assignment of the natural expenses to the proper functional expense. Then each of the expenses in each functional class is classified as either direct, semidirect, or indirect. Each expense that is directly associated with a product and can be charged directly to the product is a direct expense. Indirect expenses are those joint or general overhead expenses that are not related in any measurable way to the product. In between these two classes are the semidirect expenses which can not be immediately charged to the product but which have a relationship to the product that is close enough so that a dependable basis of measurement is possible. After these expenses are classified in this manner, the direct

expenses are added to the product's cost base. Some authorities believe that the amount of the direct expenses, or escapable expenses, is all that should be added to the product's cost base. An allocation of the indirect expenses involves too much arbitrary judgment. Any sale at a price above this cost is a contribution to the general overhead of the enterprise. In such cases, the analysis ends here.

Bases of Allocation

Since the Unfair Practices Acts require total overhead to be assigned to products, all the semidirect and indirect expenses also must be allocated. In order to do this it is necessary to find some basis or bases that can be used to relate these expenses to the product. A logical basis may be found for each expense, but it may not be measurable, or the cost of acquiring the necessary data to enable measurement may be prohibitive. Judgment is necessary to balance a proper assignment of expenses against the cost of the assignment. The greater the overhead expense, the more important it is to secure the proper basis of allocation. The factor selected, then,

32. For a discussion of these concepts see Heckert and Miner, op. cit., pp. 31-32 and Chapter 12 and Sevin, op. cit., pp. 12 and 52-54. Escapable expenses tend to be direct expenses, although, strictly speaking, they are not the same. The former are the expenses that are reduced if a product or department is eliminated.
is used as the basis on which these expenses are allocated to products. For example, in a department store, rent may be assigned to departments according to square or cubic feet of space, location of the department in relation to customer traffic, floor or other suitable basis or bases and then assigned to products according to the square feet of space used by the product. An arbitrary basis must be used when suitable ones can not be found. Often the arbitrary factor used is sales volume or executive judgment. In all cases, a suspected violator must justify the particular basis of allocation used.

**METHODS OF ALLOCATION**

Although the cost per product is needed, other analyses may be necessary before this is obtained. The overhead expenses may be analyzed also by territories, methods of sale, customers, organization and type of operation, and size of order. Which of these analyses are to be used and their sequence depends on many factors.

The plane of distribution is an important factor that determines the analyses used. Normally, wholesalers employ more analyses than retailers. For instance, wholesalers tend to have different types of customers while retailers tend to have only one. Therefore, the wholesaler may allocate his operating expenses first to customers and then to products. Also, wholesalers sell in various size
lots while retailers do not, therefore, an analysis by size of order may precede one by products. The extent of the territory over which sales are made is another factor that influences the methods used. A national or sectional chain or mail order house may allocate its overhead first to territories, then to stores, and finally to products. If the firm is organized by departments, the overhead is allocated to them first. The method of sale may indicate the order of analysis. A retailer may sell by mail, telephone, over-the-counter, or house-to-house. The overhead may be allocated first to these methods. However, an analysis only by products is preferred in some situations. A retailer that sells the same size orders to the same type of customer on a cash-and-carry basis may allocate his operating expenses to products only. Also, where the firm is organized on the basis of the products it sells, a product analysis may be all that is necessary.

The order in which analyses are undertaken often depends on the amount of direct overhead expenses that can be assigned. The analysis undertaken first is the one that permits the most overhead expenses to be allocated directly. For example, a department store can charge more overhead expenses directly to each department than it can to each of the products sold and, thus, an allocation of overhead to departments is made before an allocation to commodities. Many factors determine the analyses to be made and their
sequence. In all cases, good judgment and the use of expert marketing and accounting knowledge is necessary. Because of this, only the larger and more progressive firms are fully equipped to make a specific rather than an average allocation of overhead expenses.

**IMPLICATIONS**

The purpose of the Unfair Practices Acts is to prevent the sale of products below their full cost for the purpose of injuring competitors, destroying competition, or deceiving customers. This requires the assignment of the firm's total overhead to products. The individual firm's cost of doing business is prescribed in the acts although the cost of the low-cost firm in the trade as determined by a cost survey may be used as prima facie evidence of the firm's cost. Only two acts prescribe the time period in which the cost of doing business is to be measured.

Business firms usually attempt to maximize profits by setting a price on each product that results in the greatest total dollar profit. This price normally is not the one that is produced by an average allocation of total overhead. The most profitable price depends on many factors, such as the amount of markdowns, handling and selling costs that can be directly attributed to the product, the elasticity of the sales curve, and competitive
For example, some products normally carry less than the average percentage markup because the direct selling and handling expenses are very low, the product is not perishable, and the product's sales curve facing the seller is quite elastic. This is likely to be true for such items as cigarettes, sugar, and coffee. Consequently, the application of a percentage markup determined by the average over-call cost of doing business to the cost base of such products will increase the prices of the products and, hence, decrease their sales and the merchant's profit. As stated by the court in the Standard Store v. Safeway Stores, Inc. and King Soopers, Inc. case,

... It is evident to the Court that if a cost of doing business at a fixed percentage markup on all grocery items should be imposed upon the defendants in this case by injunction, that such an order would need immediate amendment, because under the evidence adduced at this hearing such a uniform markup would immediately change that very cost of doing business; and if items which were traditionally marked at two to three per cent over invoice cost were required to be raised to 14 or 16 per cent over invoice cost, it is also apparent that the movement of those items in defendants' stores would be seriously retarded, thus reducing the total volume of sales of the defendants, and, conversely, again changing the cost of doing business.34

In addition, consumers, when purchasing these products, would tend to be adversely affected because of the higher

prices. However, it might be argued that the prices on products that normally carry a higher than average store-wide markup will be reduced and, thus, benefit the consumer. This does not follow because these acts prescribe a minimum markup, and, therefore, do not prohibit prices above this minimum.

This problem may be reduced if a specific allocation is permitted. However, such an allocation favors the larger stores for "A proper determination of these costs involves the keeping of minute and complex records which are entirely beyond the capabilities of a very large number of enterprises."35 The small retailers, then, do not know at the time they price their products if the prices are above or below the minimum price permitted by a specific allocation. Furthermore, the minimum price among the larger stores may vary because a specific allocation inevitably involves a great amount of arbitrary judgment which produces differences among businesses, even if they operate under similar conditions.36 The number of possible methods of analysis and the amount of judgment necessary in a specific allocation makes it difficult to use in a definition of cost that establishes a minimum price. This has been substantiated by three courts that have ruled

35. Taggart, Minimum Prices, op. cit., p. 227.
specifically on the question of the allocation of overhead costs to products. A California district court of appeals held that state's Unfair Practices Act unconstitutional because "men of common intelligence will differ substantially" as to the amount of the cost of doing business that is applicable to particular products.37 Although the Wyoming supreme court ruled that state's act constitutional, it did state that if reasonable standards of cost accounting did not exist, or "if cost cannot be ascertained - then the act in question should be held to be unconstitutional."38 In 1955, a Colorado court ruled that state's Unfair Practices Act unconstitutional because it is impossible to determine the overhead expenses that are applicable to a particular product.39

Although it may be possible under certain conditions to allocate on a reasonable basis the overhead expenses to products, the problems encountered by most merchants in making such an allocation are extremely great. Nevertheless, these acts do require that the product's share of the overhead expenses be included in the minimum price. A specific allocation is preferable, but, in the absence of such an allocation, an average assignment may be accepted.

38. State v. Langley. (Wyoming supreme court, 1938), 84 Pac (2d) 767.
Any specific allocation presented by a merchant proving his costs could be deemed reasonable by the courts, if the seller demonstrates that it is in accord with generally accepted accounting standards. However, if the plaintiff can show that there is a "preponderance of evidence that the principles relied on by the merchant are not sound," or that the merchant's method of allocation was made only to circumvent the provisions of the act, the allocation should be deemed unreasonable and one not made in good faith.

CHAPTER VII

SPECIFIED MARKUPS

The second overhead concept, a specified markup, is discussed in this chapter. The Unfair Sales Acts and the Unfair Cigarette Sales Acts provide that a minimum percentage markup be added to the vendor's cost base. In the Unfair Sales Acts this markup is to cover only a part of a firm's overhead whereas in the cigarette acts it is to cover total overhead. In this chapter the background and theory of specified markups are presented first. Then the various markups prescribed in the acts are examined. Since these acts prescribe a markup for retailers that is different from the markup for wholesalers, the problem of a markup for vertically integrated sellers also is considered. Last, the effects of these markups on minimum prices are discussed.

BACKGROUND

A specified minimum percentage markup to be added to the cost base was prescribed in the general retail and retail grocery codes of the National Recovery Administration.¹ A markup was specified rather than a total over-

¹ Herbert F. Taggart. Minimum Prices Under the N.R.A. University of Michigan, School of Business Admin-

-145-
head requirement because of the problems incident to the latter. The established markup included only part of a firm's overhead expense.

After the National Industrial Recovery Act was invalidated, some trades tried to bring about legislation that would continue this minimum price concept. A model state law containing this concept was drafted by the National Food and Grocery Conference Committee. Its purpose is to prevent deep price cutting rather than loss-leader sales. Losses are limited, not prevented. As expressed by a member of the committee, "...we are not asking for a profit. We are only asking for a limitation of losses in the sale of loss leaders." Many states, then, passed laws that were patterned after this model.

**THEORY**

A seller may have valid reasons for pricing an article between its full cost and its cost base. If a seller...
finds that an article is not moving because its price is too high, it would be profitable for him to reduce the price even if it is below the product's full cost. Any part of this reduced price that is above the article's cost base and its direct overhead expenses is a contribution to the firm's general overhead which may not be received if the original price is maintained. "Taken by itself any [sales] order is desirable if the price will cover its direct cost and contribute something to overhead."5

It is intended that the specified markup in the Unfair Sales Acts is to cover only a part of the merchant's cost of doing business. Thus, prices may be established that are less than the full cost of the product. Two philosophies that deal with the particular portion of the cost of doing business that is to be covered by the specified markup were dominant when the Unfair Sales Acts were enacted. One was a markup sufficient to cover the full cost of the most "efficient" merchant as exemplified by the Tennessee Unfair Sales Act and the other was a markup that would cover at least the special overhead costs directly incident to the product as in the Model Unfair Sales Act.6 In the former philosophy, the term "efficient" mer-


chant refers to the low-cost merchant. Although the minimum prices of the low-cost vendor must cover his total overhead costs, all other merchants are permitted to sell products at prices that are less than full cost. The second philosophy permits all merchants to price their products below full cost as long as the overhead expenses directly applicable to the product are covered. This philosophy seems the more reasonable because in theory it applies equally to all merchants. However, it is more difficult to apply because of the problem of determining a markup that would cover the direct costs of each merchant. Not only is there a wide variation of the amount of direct costs applicable to a product among merchants but there may not be any overhead costs that can be directly attributed to a particular product.

In contrast to the purpose of the Unfair Sales Acts, the purpose of the Unfair Cigarette Sales Acts is to prevent all loss-leader sales of cigarettes. Merchants used cigarettes as loss-leaders so extensively that they became an unprofitable item for most all sellers. Therefore, these acts prescribe a full cost definition. Minimum percentage markups, presumed to cover the full share of the cost of selling cigarettes, are also prescribed. Such markups can be prescribed because the acts deal with only

the Regulation of Unfair Sales Practices.” Reprint of National Grocers Bulletin, September, 1940, p. 3.
one product and thus the portion of the merchant's cost of doing business applicable to cigarettes tends to be approximately the same for all merchants.

MARKUPS

The markups prescribed in the Unfair Sales Acts and the Unfair Cigarette Sales Acts are to be added to the product's invoice cost, cartage, transportation, and, in some acts, excise taxes. A different markup is specified for retailers than for wholesalers. The markup is only prima facie evidence of the merchant's cost of doing business, and merchants are permitted to apply a lower markup than the one specified if they can prove a lower cost. Since the markups in the cigarette acts are presumed to be the merchant's total cost, the merchant must allocate his total overhead when proving the lower cost. However, the Unfair Sales Acts provide that the markup is to cover only a "proportionate part of the cost of doing business."7 The acts do not specify whether the lower cost to be proved is to be some part of the product's share of the merchant's cost of doing business or whether the vendor must prove that the product's full share is lower. According to the markup philosophy of the Model law, the merchant need prove only that the direct overhead costs in-

7. National Food and Grocery Conference Committee, op. cit., p. 9, Sec. 2. Also see Appendix B.
curred for the product are lower. However, in individual cases it is sometimes difficult to distinguish between direct and semi-direct costs, and in many more cases there may not be any overhead costs that can be directly attributed to a particular product. Such a requirement would make the laws unenforceable. On the other hand, the markup philosophy that sets the markup according to the full cost of a low-cost merchant requires that when a lower cost is to be proved, the cost must include the product's full share of the merchant's cost of doing business. This has been substantiated by several court decisions. However, the lower costs proved in these cases were the cost of doing business as measured by an average allocation rather than a specific allocation.

**MARKUPS PRESCRIBED FOR RETAILERS**

The prescription of different markups for wholesalers than for retailers is proper, for wholesalers tend to have a cost of doing business lower than that of retailers.  


Wholesalers deal in larger quantities, the turnover of their merchandise is more rapid, and such expenses as credit and rent are lower, because wholesalers do not offer services to the general public. Only the Utah Agricultural law requires the same markup for both retailers and wholesalers.10

**Six Per Cent Markup.** A retailer markup of six per cent is specified in twenty-four sales-below-cost acts. All Unfair Sales Acts but the laws of Pennsylvania and West Virginia require a six per cent markup. It is required also in the Oregon miscellaneous general act for retailers in food commerce. In addition, seven of the Unfair Cigarette Sales Acts and the special acts of Louisiana and Utah prescribe a six per cent markup for retailers.11 The majority of sales-below-cost acts that prescribe a markup for retailers specify that it be six per cent of the product's cost base.

The state legislatures specified a six per cent markup for retailers rather than some other percentage, according to one authority, because it is the markup that was set for the retail food and grocery code by the National Recovery Administration, industries are familiar with it, and

11. The seven cigarette acts are those of Arkansas, Colorado, Massachusetts, Mississippi, Ohio, Oklahoma, and Pennsylvania.
few merchants can cover expenses with such a low markup. The six per cent markup established by the National Recovery Administration was to cover the cost of store labor. However, store labor expense is not a proper basis on which to measure the minimum percentage markup. Labor expense tends to vary greatly among merchants and some small retailers may not incur any labor expense because the owner may be the only salesperson. The use of the overhead expenses directly applicable to a particular product as a basis for measuring the percentage markup also is not proper because of the wide variation of these costs among stores. In some stores none of the overhead expenses can be identified with a particular product, whereas in other stores, particularly those organized on a product basis and that handle very few different products, a large proportion of the overhead expenses may be charged directly to a particular product. However, a markup of six per cent appears to be proper according to surveys of the cost of doing business of low-cost merchants, and also according to the pricing practice of grocery retailers. In a cost survey conducted in 1936 by the Food and Grocery Bureau, Inc. of Southern California it was ascertained that the lowest average cost of doing business in the grocery trade

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amounted to six per cent. However, after later surveys, the markup was raised to eight and then ten per cent. The lowest retail markup established by the Montana Trade Commission is ten per cent. In only a few court cases has the average cost of doing business of low-cost retailers been determined. In one case it was discovered that a gasoline retailer's cost of doing business amounted to seven per cent. It seems that the average cost of doing business of low-cost merchants tends to vary from six per cent to ten per cent of the cost base with the latter figure the more prevalent. If a specific allocation of overhead costs is made, fast moving staple products tend to bear less overhead expense than the average cost of doing business. Thus, a markup that is less than ten per cent may be proper. In actual practice, the lowest markup set by grocery retailers that is considered to be profitable is five per cent of net sales. This percentage is greater if it is measured according to the cost base rather than net sales. In addition, it includes a markup for profit. The share

of the cost of doing business that is applicable to low-cost products, therefore, tends to be no lower than six per cent. Therefore, six per cent appears to be the minimum markup percentage that is necessary in order to cover the low-cost product's share of the average cost of doing business of low-cost merchants.

Some problems were created by the retail markup provision of the Tennessee Unfair Sales Act. This statute provides that to the cost base must be added:

...a markup amounting to less than the minimum cost of distribution by the most efficient retailer, which markup, in the absence of proof to the contrary, shall be six per cent (6%).

In the case of Rust v. Griggs it was claimed that a retailer is under an oppressive burden because he must locate the most efficient retailer in order to determine the minimum price. However, the Tennessee supreme court asserted that the word "not" is omitted from the act and should have been included before the words "less than." Also, the term "most efficient retailer" does not pertain to a particular individual but is used in a generic sense to mean low-cost retailers as may be determined from trade surveys and publications. Therefore, the interpretation placed on this provision is the same as that of the other Unfair Sales Acts.

18. 4 Code of Tennessee, 1941, Sec. 6770.7.
A difficult problem is encountered when determining the proper markup for the Unfair Cigarette Sales Acts. These laws, contrary to the Unfair Sales Acts, were enacted in order to prevent loss-leader sales. It is necessary that the specified markup be determined according to a specific allocation of the merchant's total overhead costs to cigarettes rather than an average allocation. Even though only one product is involved, many different kinds of retailers sell cigarettes. The use of the average cost of doing business of these merchants as the basis for determining the markup results in widely varying percentages. For example, drug stores will have an average cost of doing business that is greater than the average for grocery stores. If the markup percentage is determined according to the average overhead costs of drug stores, the act could be subject to the charge of price fixing because grocery stores can apply a lower markup. On the other hand, if the markup is set according to the cost of doing business of grocery stores, the acts are no longer loss prevention statutes because drug stores would be permitted to set a markup that is less than its cost of doing business.

A bare majority of the Unfair Cigarette Sales Acts prescribe a markup of six per cent; the other acts prescribe a higher percentage. The markup normally applied to cigarettes by merchants is less than nine per cent of
net sales. Since cigarettes do not require much sales effort by merchants and they do not utilize much selling space, the portion of the merchant's cost of doing business that is applicable to cigarettes is small regardless of whether the cigarettes are sold by drug stores or grocery stores. After enactment of the Unfair Practices Act in California, the grocery trade established a six per cent markup for cigarettes. It thus seems that six per cent is the minimum proper markup for retailers in the Unfair Cigarette Sales Acts.

Other Markups. The Pennsylvania and West Virginia Unfair Sales Acts specify a markup other than six per cent; four per cent by the former and seven per cent by the latter. The miscellaneous Minnesota law originally prescribed a minimum percentage markup of ten per cent. However, this markup was argued against in court on the basis that a profitable markup on some grocery products is substantially less than ten per cent. The presumed minimum markup in the Minnesota act subsequently was reduced to eight per cent.

A markup greater than six per cent is required in six

cigarette acts. Of these, five prescribe eight per cent while the Oregon act specifies ten per cent. These mark-ups may be proper if an average allocation of the firm's total overhead is made, but if a specific allocation is made, the overhead applicable to cigarettes is probably lower than eight per cent for many retailers.

MARKUPS PRESCRIBED FOR WHOLESALERS

The markup of two per cent for wholesalers, like the six per cent markup for retailers, is a carry-over from the National Recovery Administration codes. The wholesale food and grocery code provided for an allowance to cover labor costs. This was set at two per cent. Although the model Unfair Sales Act does not provide for a markup for wholesalers, only three Unfair Sales Acts follow its example. The others specify the markup provided in the National Recovery Administration's food and grocery code. A two per cent markup is prescribed by eight Unfair Cigarette Sales Acts whereas the other laws specify markups that vary from three and one-half to four and one-half per cent. The Utah Agricultural special act prescribes a six per cent

23. These five acts are those of Alabama, Indiana, Iowa, New Mexico, and Tennessee.
25. These are the acts of Oklahoma, Tennessee, and Utah.
26. The markup in the Tennessee cigarette act is three and one-half per cent. In the Indiana, Iowa, Oregon, and Pennsylvania acts it is four per cent while it is four and one-half per cent in the Alabama law.
Of the twenty-nine acts that prescribe a markup for wholesalers, twenty-two specify a two per cent markup. This percentage seems to be in accord with the minimum markup percentages determined from surveys, court proceedings, and actual practice. In a study of the expenses of low-cost grocery wholesalers it was found that the minimum cost of doing business applicable to the low-cost product, tobacco products, was 3.7 per cent of net sales.28 The Northern California Association of Tobacco Distributors found in a survey that the markup normally used by tobacco jobbers was four per cent of net sales.29 However, two per cent of the cost base was established by the Montana Trade Commission as the markup for tobacco jobbers.30 In three court proceedings it was found that the minimum cost of doing business for cash-and-carry tobacco wholesalers varies from two per cent to two and one-half per cent of net sales.31 In addition to the court cases, some

27. 1 Utah Code, 1953, Sec. 5-4-6.
30. Peak, op. cit.
wholesalers in actual practice set markups that are deemed to be profitable at two per cent of the cost base. Thus, since the minimum average cost of doing business of the low-cost wholesalers, or the portion of the overhead expenses applicable to the low-cost product of wholesalers has been found to be approximately two per cent, the markup for wholesalers in the Unfair Sales Acts may logically be set at two per cent.

The same problem is faced when determining the proper percentage markup for wholesalers under the Unfair Cigarette Sales Acts that is faced for retailers. There is greater variation of the markups specified for wholesalers in the Unfair Cigarette Sales Acts than the variation of markups for retailers. The markup percentages prescribed for wholesalers vary from two per cent to four and one-half per cent. It appears that the markup percentages that are greater than two per cent may be too high. Since merchants normally tend to price their products according to the prescribed minimum markup rather than their own cost percentage due to a fear of court proceedings, and the minimum cost of doing business for tobacco wholesalers approximates two per cent, it seems best to set the markup at two per cent. The prescription of such a markup makes it more difficult to claim that these acts are price fixing.

The prescription of the presumed cost of doing business at two per cent for wholesalers in the Unfair Cigarette Sales Acts was found to be discriminatory by the Ohio supreme court.\textsuperscript{33} Wholesalers, who can prove a lower mark-up, can reduce prices. However, the higher cost wholesalers are not required to raise their prices if their cost of doing business is greater than the specified mark-up. The court found this unfair, because the higher-cost service wholesalers are permitted to sell at the same price as the low-cost cash-and-carry wholesalers. Eleven cigarette acts, including the amended Ohio act, now have a provision similar to the following:

In the absence of proof of a lesser or higher cost of doing business by the wholesaler making the sale, the "cost of doing business by the wholesaler" shall be presumed to be \ldots\textsuperscript{34}

However, the specified markup is only presumptive evidence of the cost of doing business. If it is established in court that the wholesaler set his price at two per cent when his cost of doing business is greater, the merchant has violated the law if the price was set with the intent to injure competitors or destroy competition. In spite of

\begin{itemize}
  \item [33.] Serrer v. Cigarette Service Co. (Ohio supreme court, 1947), 76 N. E. (2d) 91.
\end{itemize}
this, higher cost merchants are permitted to set prices based on the two per cent markup if the prices of their low-cost competitors are also set by this markup because merchants are permitted by the acts to meet the prices of competitors. Therefore, the phrase, "or higher," in the markup provision is not necessary. It does, however, tend to reinforce the idea that the specified markup is only prima facie evidence of the merchant's cost of doing business.

PROBLEM OF INTEGRATION

Some merchants operate on both planes of distribution; they sell at retail and also at wholesale. Others sell only at the retail level although they perform many of the wholesaling functions. For example, chain stores sell only at retail but also operate warehouses which are actually wholesale establishments. Since the markups specified in the acts apply to retailers or to wholesalers, other provisions are necessary to deal with these integrated merchants.

All of the Unfair Sales Acts except the Tennessee Act provide that, when a merchant sells at both retail and wholesale, he must apply the definition of "cost to

36. The Tennessee Unfair Sales Act does not deal with the integration problem.
the retailer" only to his retail sales and "cost to the wholesaler" only to the wholesale portion of his sales. However, this does not meet the problem of the integrated merchants who sell only at the retail level. Often both of the functions generally considered as wholesale and retail are included in the firm's cost of doing business. Since the integrated retailer's cost base approximates that of the wholesaler's and only the retail markup is required to be added to the cost base, the integrated merchant will have a competitive advantage over the independent retailer. This is because the wholesale markup is not included.

A provision similar to the following is included in eight Unfair Sales Acts:

In determining the cost to the retailer in cases in which such retailer buys at wholesale and receives the wholesalers' profits and discounts on merchandise to be sold at retail, both the wholesale mark-up of two per cent and the retail mark-up of six per cent shall be added to the invoice cost of such merchandise in order to cover in part the cost of doing business in the absence of proof of a lower cost by such retailer.

Both the wholesale and retail markups must be applied when a retailer buys directly from manufacturers. However, this provision does not reduce all of the inequity between

37. National Food and Grocery Conference Committee, op. cit., Sec. 4. Also see Appendix B.
the integrated and independent retailers. It requires that the sum of the wholesale and retail markups be added to the cost base. This is an incorrect procedure. The six per cent markup of the independent retailer is applied to a base that is different than the one to which the sum of the wholesale and retail markups is applied. The independent retailer's cost base includes the wholesaler's two per cent markup. Therefore, the application of the sum of these markups to the wholesaler's cost base will give an advantage to the integrated merchant. For example, the sum of the wholesale and retail markups, eight per cent, when applied to a wholesaler's cost base of $5.00, gives a minimum retail price of $5.40 for integrated merchants. When the retail markup is applied to the sum of the independent wholesaler's cost base and his cost of doing business, the minimum retail price is $5.41.39 This one cent difference may be important in pricing fast moving staple items.

<table>
<thead>
<tr>
<th></th>
<th>Integrated Merchant</th>
<th>Independent Merchants</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wholesaler's cost base</td>
<td>$5.00</td>
<td>$5.00</td>
</tr>
<tr>
<td>Wholesaler's markup</td>
<td>.10 ($5.00 x .02)</td>
<td></td>
</tr>
<tr>
<td>Cost base to the retailer</td>
<td>$5.10</td>
<td></td>
</tr>
<tr>
<td>Retailer's markup ($5.00 x .08)</td>
<td>.40</td>
<td>.31 ($5.10 x .06)</td>
</tr>
<tr>
<td>Retailer's minimum price</td>
<td>$5.40</td>
<td>$5.41</td>
</tr>
</tbody>
</table>

This problem is considered also in the Unfair Cigar-

39. The computation is as follows:

This computation assumes that the wholesaler sells to the retailer at the minimum price. The difference between the two minimum prices of the retailer is greater if the wholesaler sells at a price greater than his minimum price.
etted Sales Acts. The acts of seven states have a provision similar to the following:

Any retailer who, in connection with the retailer's purchase, receives not only the discounts ordinarily allowed upon purchases by a retailer but also, in whole or in part, discounts ordinarily allowed upon purchases by a wholesaler shall, in determining "cost to the retailer" pursuant to this subsection (l), add the "cost of doing business by the wholesaler," as defined in subsection (k) of this section, to the "basic cost of cigarettes" to said retailer, as well as the "cost of doing business by the retailer."

In the absence of proof of a lesser or higher cost of doing business, the "cost of doing business by the retailer," who, in connection with the retailer's purchase, receives not only the discounts ordinarily allowed upon purchases by a retailer but also, in whole or in part, the discounts ordinarily allowed upon purchases by a wholesaler, shall be presumed to be eight percent (8%) of the sum of the "basic cost of cigarettes" and the "cost of doing business by the wholesaler."40

This provision specifically requires that the retailer's markup be applied after the wholesaler's markup has been added. This reduces the integrated merchant's price advantage that exists when the sum of the markups is added.

These provisions apply in all cases regardless of whether the integrated retailer receives all or only a part of the wholesaler's discount. If the integrated retailer receives only part of the wholesaler's discount and must add to this cost both the wholesaler's and retailer's markups, he will be at a competitive disadvantage.

40. 2 Alabama Laws, 1951, Act No. 805, Sec. IV. Underlining added. Also see Appendix C.
with the independent retailer. The minimum price of the latter will tend to be lower than that of the former. A confusing provision in three cigarette acts is as follows:

In the case of any retail dealer who in connection with the said retail dealer's purchase of any cigarettes shall receive not only the discounts ordinarily allowed upon purchases by a retail dealer but also in whole or in part the discounts ordinarily allowed upon purchases by a wholesale dealer, the cost of doing business by the said retail dealer with respect to the said cigarettes shall be, in the absence of proof of a lesser or higher cost of doing business by the said retail dealer, the sum of the cost of doing business by the retail dealer and, to the extent that he shall have received the full discounts ordinarily allowed to a wholesale dealer, the cost of doing business by a wholesale dealer as herein above defined in subdivision J (2).41

In one part of this provision the sum of the markups is required if any part of the wholesaler's discount is received and in another part it is required only to the extent that the retailer has received the full discounts granted to wholesalers. The meaning of the latter phrase is not clear. Either the sum of the markups is required only if the full discount is granted or a part of the wholesaler's markup is required if part of the discount is granted. In either case, the integrated retailer would have an advantage because the sum of the markups are to be applied.

Another problem exists when goods are sold by one wholesaler to another before being sold to retailers. The flexibility of marketing channels would be lessened if each wholesaler must add to his cost base the prescribed wholesaler's markup. Only one general act contains a provision that deals with the problem. The Maine Unfair Sales Act provides the following:

Sales made by a cigarette distributor to a licensed wholesale dealer or to the operator of 15 or more vending machines shall not be subject to a markup of 2% as stated in the provisions of paragraph C of subsection II, but such sales shall be subject to full trade discount only.42

This provision, however, deals only with cigarettes. All cigarette acts but three have a similar provision. Only the cigarette wholesalers that sell to retailers must add the prescribed markup.

**IMPLICATIONS**

A prescribed markup is an aid to many firms whose cost records are not sufficiently adequate to enable them to determine a full cost minimum price. With a specified minimum percentage markup, the price below which merchants can not price their products is readily known. If no markup is specified, these firms must rely on competitors who know where to set the required minimum price.

It is believed by some authorities that the specification of markups fixes prices. One authority claims that:

...when you accept average cost or some arbitrary cost figure in lieu of the actual individual cost, you have price fixing, or at least retail-margin fixing. The effect is that an efficient retailer cannot reduce prices to consumers below the level required by his less efficient competitors...43

If the specified markup is an industry average, it would tend to fix prices. However, if it is set at or below the overhead cost applicable to the low-cost product of the low-cost merchant, the markup may not fix prices. Not only are most of the prescribed markups in these loss-limitation statutes set at this low level, but also a merchant may sell below this minimum price if he can prove that his full cost is lower.

The Unfair Sales Acts do not prohibit all loss-leader selling. Since products normally bear different markups, the low-cost seller, as well as his higher-cost competitors, will not recover all costs if he prices all his products according to the prescribed markup. The minimum price is less than the full cost of the high-cost items. However, these markups do assure some contribution to overhead expenses. Losses are limited, not prevented.

In contrast to the laws that require full cost, the

Unfair Sales Acts permit merchants to set minimum prices according to factors other than cost. If the elasticity of the product's sales curve warrants a price lower than the product's full cost in order to maximize profits, the merchant is permitted to do so. The only restriction is that the price must cover the product's cost base plus the specified minimum markup which is less than full cost for most products. This reasoning is applicable to all products except low-cost products under general laws and those products subject to special acts. However, where the specified markup in the latter laws is set according to the product's share of the low-cost merchant's overhead expense, most merchants are permitted to reduce prices to the benefit of consumers.
CHAPTER VIII

MISCELLANEOUS PROVISIONS

There are two provisions in many state sales-below-cost acts that, although not part of the definition of cost, are of sufficient importance to warrant analysis. One is the cost survey provision and the other permits merchants to sell below cost for the purpose of meeting a competitor's price. The cost survey provision, discussed first, allows trade associations to conduct a survey for the purpose of establishing a prima facie cost of doing business.

COST SURVEY

It is difficult to enforce the provisions of an act that prescribes an individual cost definition. Because of this, many acts have a cost survey provision. Like the specified markup, the purpose of this provision is the establishment of a prima facie cost of doing business. Anyone selling below the cost base plus the markup determined from a survey violates the act unless a lower cost can be proved. The markup established by the survey is an administrative aid. Administrative agencies know the minimum price and, therefore, can detect violators immediately.
ACTS THAT PRESCRIBE A COST SURVEY

All of the Unfair Practices Acts have a substantially similar cost survey provision. It is as follows:

Where a particular trade or industry, of which a person complained against is a member, has an established cost survey for the locality and vicinity in which the offense is committed, that cost survey is competent evidence to be used in proving the costs of such person.¹

This provision is included in only the Utah Unfair Sales Act and the miscellaneous act of Oregon. The original Minnesota act provided for a cost survey, but it was ruled unconstitutional.²

Most of the special acts have a cost survey provision. All cigarette laws, except that of Connecticut, have one.

A typical provision included in these acts is as follows:

Where a cost survey pursuant to recognized statistical and cost accounting practices has been made for the trading area in which a violation of this act is committed or charged, to determine and establish on the basis of actual existing conditions the lowest cost to retailers or the lowest cost to wholesalers within the said area, the cost survey shall be deemed competent evidence in any action or proceeding under this act as tending to prove actual cost to the wholesaler or actual cost to the retailer complained against, but any party against whom any such cost survey may be introduced in evidence shall have the right to offer evidence tending to prove any inaccuracy of such cost survey or any state of facts

¹. Deerings California Codes, Business and Professions Code Annotated, Vol. II. Chapter 4, Secs. 17000 to 17101. San Francisco: Bancroft-Whitney Company, 1951, Sec. 17072. Also see Appendix A.
which would impair its probative value. ³

Three cigarette acts, those of Colorado, Massachusetts, and Ohio, in addition to this provision have another provision similar to the one in the Unfair Practices Acts.

BACKGROUND

The manner in which cost surveys have been conducted in California is presented in several works. ⁴ The first markup established as a result of a cost survey for the retail grocery trade in California was six per cent. As the result of two other surveys, one in each of the years 1938 and 1939, the minimum markup was increased to eight per cent and then to ten per cent. These surveys were conducted by the Food and Grocery Bureau of Southern California which is the trade association that enforces the act for the food and grocery trade. The Bureau, on its own motion and for members of the trade, warns any retailer selling below this established cost, and if the offender persists, initiates action in the courts. The 1936 survey


was conducted by a post-card questionnaire on which was the following question, "Based on my total grocery sales for the year 1936, I find that my minimum cost of doing business is \( \ldots \% \) of my net sales."\(^5\) The Bureau mailed four thousand cards and received two hundred replies. In 1938 it submitted the following question to the trade:

Based on my total grocery sales for the year 1937, I find that my minimum cost of doing business has increased approximately \( \ldots \% \) over my previous cost of doing business during 1936 and that at the present time my minimum operating cost is \( \ldots \% \) of my net sales.\(^6\)

On the basis of this survey, the eight per cent markup was instituted.

After the codes established under the National Industrial Recovery Act were invalidated, the Northern California Association of Tobacco Distributors conducted a cost survey. As a result, the Association set a four per cent minimum markup for tobacco wholesalers. The markup under the National Recovery Administration code was three per cent.

A cost survey was conducted by the Cheyenne Retail Petroleum Dealers Association from which the association set a retail markup of 26.05 per cent of net sales and a wholesale markup of 9.8 per cent of net sales.\(^7\) The retail

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5. As quoted in Tannenbaum, Ibid., p. 50.
6. Ibid., p. 51.
survey was based on twenty-seven returns while the wholesale survey was based on four replies of which only one questionnaire was completely answered.

PROBLEMS

The cost surveys provided for are to be considered by courts as competent evidence of the merchant's cost of doing business. However, the acts do not define what is meant by a competent survey. A federal district court clearly indicated this as follows:

While it seems probable that the Legislature in enacting this section had in mind some definite and understandable thing, we think that they failed to express it in plain language. What is a "cost survey," and by whom or by what is it made? ... This section of the statute we regard as so vague, indefinite, arbitrary, and discriminatory that it cannot be sustained.8

Different interpretations of the meaning of a cost survey exist, as can be gathered from the examples of the surveys conducted. It is doubtful if these surveys are competent. However, merchants are protected from being convicted of violating an improper markup that is prescribed from an unsound survey. The markup is only prima facie evidence of cost.

Four characteristics necessary for a valid cost survey have been prescribed by one authority.9 The first

9. Herbert F. Taggart. The Cost Principle in Minimum Price Regulation. University of Michigan, School of Business Administration, Bureau of Business Research,
characteristic requires that the information be collected in a manner that tampering by the trade group in order to obtain a desired result is not possible. There should be no bias. An actual examination of the records of a proper sample of firms by an impartial agency should produce the most accurate results. However, should this procedure prove to be impractical, mail questionnaires may be used if they are completed and certified by public accountants. This should reduce greatly the tendency toward rough estimates of costs that tend to be too high. If questionnaires are used, all returns should be included except for good reason which must be fully disclosed. All of the surveys presented in the preceding section fail to meet this requirement. Bias is evident in the second survey conducted by the Food and Grocery Bureau of Southern California because the per cent increase in a merchant's cost was requested. Also, none of the returns were certified by accountants.

The second characteristic of a cost survey is that it must be representative of the trade. This means that a large number of the questionnaires must be returned and they must be received from all types of firms that make up the trade. It is probable that most of the replies received

in the California survey were prepared by the larger retail distributors. In the Cheyenne survey four returns out of fourteen questionnaires were received. With such a small population, all questionnaires should have been returned.

The third characteristic requires the computation of an average cost by acceptable statistical and accounting techniques. However, this characteristic applies only if an average cost is used. The lowest cost was used in the California surveys. Nevertheless, a simple average was computed in the Cheyenne survey. This is not a very refined or valid average for determining cost for the purpose of establishing a minimum price.

The fourth characteristic requires an adequate display of the data. In the second survey made by the Food and Grocery Bureau of Southern California, none of the records or procedures were made public. In fact, members of the Federal Trade Commission were denied access to the records of the survey.10

If these characteristics are not present in a survey, it is not competent. It is relatively easy for those conducting a survey to arrive at a desired markup, and, hence fix prices. These problems and others are inherent in a cost survey provision. Therefore, when courts are reviewing the competency of a particular cost survey,

great care and judgment is necessary.

The particular cost to use in ascertaining a minimum markup is another problem of cost surveys that must be resolved. Either an average or the cost of the low-cost firm in the trade can be used. The Unfair Practices Acts do not specify which of these is to be the cost although the average cost of the low-cost merchant is implied. The cost survey provision of the cigarette acts requires the lowest cost. It is recommended in Chapter VI that an average cost not be used because of the stigma of price fixing. Because of this stigma the Montana Trade Commission specified a markup lower than that of the low-cost firm. It found in a survey an average cost of doing business for retail grocers of fifteen per cent. However, one chain reported twelve per cent. Because of this, the Commission prescribed a markup of ten per cent.\footnote{George W. Peak. "Administration of the Montana Unfair Practices Act." \textit{The Journal of Business of the University of Chicago}, 15, No. 2 (April, 1942), p. 146.} The Commission felt that a markup below the lowest individual cost should be prescribed as the minimum for the purpose of the act. Either this or the cost of the low-cost firm in the trade is proper.

If the lowest cost principle is followed, further refinement is necessary. Either the average cost of doing business of the low-cost firm or the overhead of this firm
that is applicable to the low-cost commodity may be ascertained. The Washington Unfair Practices Act specifies that it be the cost "...applicable to the particular commodity..." Theoretically the cost of the low-cost product of the low-cost firm as derived from a specific allocation is preferred if only one markup is prescribed. If more than one markup is prescribed, then the cost of each product incurred by this firm should be ascertained. The Montana Trade Commission set a minimum markup for sugar and another for other grocery items sold by the wholesale grocery trade. However, a markup for each product necessitates many surveys. This would be a herculean task. Also, not many firms could supply the necessary data as their records are not sufficiently adequate to permit a specific allocation.

The determination of the trading area over which a survey is to be conducted is another problem. The terms "locality or vicinity" and "trading area" are used in the acts. These terms are not explicit and courts have not been consistent when interpreting them. One court held that:

The "trade area" standard is so vague and indefinite that the merchant could have no means of ascertaining whether he was lawfully meeting competition or

13. Peak, op. cit., p. 147, Table 1.
whether he had in his attempt to do so made himself liable to the provision.\textsuperscript{14}

However, another court ruled that:

It is safe to assume that merchants generally know who are their competitors, and from what locality or trade area they draw their customers. The language complained of is shown in this case to be susceptible of practical application without more particular definition.\textsuperscript{15}

It is difficult to define a trade area. One arbitrarily defined, such as a state-wide area, is not proper because the trading area of firms vary. The Montana Trade Commission is directed by the act to delimit the area over which a survey is conducted. However, because of a great amount of overlapping of trade areas and unrefined data presented to the Commission, it arbitrarily designated the entire state as the trading area.\textsuperscript{16} This action was subsequently set aside by the Montana supreme court in 1943. The court held that a state wide area is not what the law provides for and it would not produce a fair estimate of the cost of doing business in any particular locality.\textsuperscript{17} The extent of a trading area for a cost survey is a problem that the courts or administrative agencies must decide, according to the evidence of each case.


\textsuperscript{15} People v. Pay Less Drug Store. (California supreme court, 1944), 153 Pac (2d) 14.

\textsuperscript{16} Peak, op. cit., p. 148.

\textsuperscript{17} Board of Railroad Commissioners v. Sawyers' Stores, Inc. (Montana supreme court, 1943), 138 Pac (2d) 964.
The cost survey provision delegates legislative power to private persons. This is one of the most damaging aspects of the provision. Some trade associations, to which this power is delegated, have used this provision to fix prices. Six trade associations were found guilty of violating the Sherman Act because they used the sales-below-cost act for such a purpose. They established the markup by conducting surveys and then threatened members of the trade with court proceedings if this markup were violated. They led members to believe that the sales-below-cost act would be violated if sales were made below this markup regardless of the member's individual cost. The Western Confectioners Association, Inc. was found guilty by the Federal Trade Commission for unfair methods of competition.

prices. In another case, an indictment against a Tennessee association was dismissed because of vagueness and a legal technicality. 21

Since the minimum price prescribed in the sales-below-cost acts is an individual cost, cost surveys may be a means by which the acts can be adequately enforced because administrative agencies and competitors know the presumed cost and, therefore, violators can be immediately apprehended. However, a host of problems are encountered. Not only has the provision been held to be uncertain and, therefore, unconstitutional, but in those states where cost surveys have been conducted, it is doubtful if the surveys are competent. In addition, trade associations have used the cost survey as a means of fixing prices. Finally, once a minimum percentage markup is established, enforcing agencies have tended to prosecute only those merchants who have violated the established markup. Hence, for all practical purposes the acts are similar to the Unfair Sales Acts. Loss-leader selling is permitted.

**EXCEPTION THAT PERMITS SALES AT A PRICE TO MEET COMPETITION**

The state sales-below-cost acts provide for several exceptions to the provisions of the acts. Among these is

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one that permits merchants to sell below the defined cost in order to meet the price of a competitor. The minimum price, then, tends to be set by the low-cost seller since it is defined as the seller's own cost. If this exception were not included, the low-cost merchant would have a competitive advantage, made possible by law, over his higher cost competitors. Monopoly could result. Thus, the exception is necessary in such an act.

ACTS THAT CONTAIN THE EXCEPTION

All Unfair Practices Acts include this provision. A typical wording of this exception is:

The prohibitions of this chapter against locality discriminations, sales below cost, and loss leaders do not apply to any sale made: ...

(d) In an endeavor made in good faith to meet the legal prices of a competitor selling the same article or product, in the same locality or trade area and in the ordinary channels of trade.22

The wording of the exception in the model law is followed by six Unfair Sales Acts.23 This wording is:

The provisions of this Act shall not apply to sales at retail or sales at wholesale...(g) where the price of merchandise is made in good faith to meet competition.24

The provision in seven Unfair Sales Acts permits sellers

22. Deering's California Codes, 2 Business and Professions Code, Sec. 17050. Also, see Appendix A.
23. These are the acts of Idaho, Kansas, Massachusetts, Nebraska, Pennsylvania, and Wisconsin.
24. National Food and Grocery Conference Committee. Proposed Model State Unfair Sales Act. Reprint of National Grocers Bulletin (September, 1940), Sec. 6. Also, see Appendix B.
to meet only competitors' legal prices. The acts of Connecticut and Rhode Island do not have this provision. Another wording of this exception is in the Oklahoma Unfair Sales Act. It is:

Any retailer or wholesaler may advertise, offer to sell, or sell merchandise at a price made in good faith to meet the price of a competitor who is selling the same article or products of comparable quality at cost to him as a wholesaler or retailer. The price of merchandise advertised, offered for sale or sold under the exemptions specified in Section 6, shall not be considered the price of a competitor and shall not be used as a basis for establishing prices below cost, nor shall the price established at a bankrupt sale be considered the price of a competitor within the purview of the first sentence of this section.

All miscellaneous acts except the South Carolina law which ignores the problem follow the wording in the Unfair Practices Acts. All of the cigarette acts have provisions similar to the Oklahoma wording except the Connecticut act which allows no exception. Four other special acts allow the exception. They are the dairy laws of California and Idaho, the bakery and petroleum act of Michigan, and the Texas law applicable to grocery stores.

PROBLEMS

The exception that permits sellers to meet any price

25. These are the acts of Louisiana, Maine, New Hampshire, Tennessee, Utah, Virginia, and West Virginia.

of a competitor may defeat the purpose of the act. If one merchant reduces the price of a product below the prescribed minimum, his competitors are apt to do likewise. This can precipitate price wars. A vicious circle of below cost selling may result. In such cases, it is often difficult to ascertain the original offender of the act. The law, then, may not be adequately enforced as each seller can claim this exception.

To prevent this situation many acts permit merchants to meet only the legal prices of competitors. In addition, a Maryland court ruled that this is implied in the provisions that do not specify legal prices. According to this, a merchant is guilty of violating the provisions of the act if he meets a below cost price of a competitor. This prevents the price level from falling below the prescribed minimum.

Although the provision that permits the meeting of legal prices enables the enforcement of the law, another problem is created. A merchant who faces the problem of meeting a competitor's low price ordinarily does not know if the competitor's low price is legal. This produces a genuine hardship because a merchant can not obtain the information that enables him to determine if his competitor's

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price is legal. Because of this, the exception in the New Jersey Fair Sales Act was ruled arbitrary and unreasonable and, therefore, unconstitutional. It is necessary that a merchant meet the prices of competitors, whether legal or not, in order not to lose business.

In those states where the acts prescribe a markup or where cost surveys have been made the burden is less. In such situations the presumed minimum price is known. The cigarette acts specify that the cost determined from a cost survey sets the limit below which prices may not be met. To further alleviate this hardship, the unconstitutional Colorado general act allowed merchants to meet any price if they had "... made a bona fide effort to determine the legality of such price or prices of such competitor or competitors." However, it is not known what is meant by a "bona fide effort." Merchants do not normally give cost information to competitors even if a competitor requests it. To further alleviate this burden, the Attorney General of Utah ruled that a seller does not violate the act if he reduces his price below cost in order to meet a competitor's price, providing he does so without knowledge that his com-

petitor's price is not legal. This interpretation was made also by the Washington supreme court. Even though a great part of the hardship of a "legal price" exception has been reduced in some states, merchants still must prove that some effort was made on their part to determine if the competitor's price is legal.

Inherent in this exception is the problem of determining the products that are competitive. Price competition exists in varying degrees among products. In fact, all products compete for the consumer's dollar. Therefore, the products to be considered competitive for the purpose of allowing the meeting of prices must be defined. Most of the Unfair Sales Acts do not deal with this problem. On the other hand, the Unfair Practices Acts specify that the "same article or product" is competitive. However, the question of what constitutes the "same" product may be raised. Various interpretations have been made. The Attorney General of California ruled that only the same brands of products are competitive. However, it may be inferred from the Idaho general act that the same products are competitive regardless of brands, because the law per-

mits merchants to meet the price of "substantially" the same product. The Tennessee Unfair Sales Act defines competitive products as "... merchandise which is the same as to comparable competitive factors, such as weight, quantity, quality, pack, brand, or packaging." The provision in the cigarette acts specifies that products of comparable quality are competitive. In most cases, competitive products are those that are similar in some respect. Only one of the factors to be considered is brands.

Not only must the products be competitive but some acts prescribe that they must also be sold in the same trading area and in the normal channel of trade. The same problems of defining a trade area are encountered under this exception that are encountered under the cost survey provision. The prescription of the normal channel of trade prevents merchants from meeting the price of products sold in unusual transactions. For example, merchants may not reduce prices to the level set by a merchant who is going out of business.

Although the exception that permits sellers to meet


36. Refer to the quote on p. 180.

37. The Unfair Practices Acts, the cigarette acts, and the Oklahoma Unfair Sales Act require these conditions.
the price of competitors involves many problems and may make the acts unenforceable, it is necessary. Merchants must not be denied the right to meet the prices of competitors. Such a denial may produce such inequities that some merchants may be forced out of business by the operation of law rather than competition.
CHAPTER IX

SUMMARY AND CONCLUSIONS

The purpose of the forty-seven sales-below-cost acts is to prevent price cutting that injures competitors, destroys competition, or deceives customers. The laws prohibit sales at prices that are below a defined cost. Therefore, the definition of cost is an important part of each act. This chapter is devoted to a summary of the foregoing analysis of the cost definitions that are prescribed in the sales-below-cost acts. Suggestions for the improvement of the cost provisions are made only in those cases in which improvements are deemed necessary or when it is felt that there is a better alternative. Although it is important, cost is not the only standard by which a violation is measured. In order to violate the act, a merchant must not only sell products at prices that are below the defined cost but he must also intend to injure competitors, destroy competition, or deceive customers. In addition, certain types of sales are exempt from the provisions of the act.

BACKGROUND

The sales-below-cost acts are logically classified
in this dissertation according to the prescribed definition of cost. Four types of acts are thus distinguished, namely, (1) Unfair Practices Acts, (2) Unfair Sales Acts, (3) miscellaneous acts, and (4) special acts. The Unfair Practices Acts, as found in six states, prohibit loss-leader sales and, therefore, require the minimum price to be the full cost of the product, whereas the Unfair Sales Acts, in effect in sixteen states, limit the losses that may be incurred from loss-leader sales and, therefore, minimum percentage markups that do not cover the full cost of the product are specified. Loss-leaders are defined in this study as sales made at prices that are less than the full cost of the product. A leader, on the other hand, is a sale made at a price that is above the product's full cost but less than the full cost plus a normal margin for profit. A predatory loss-leader is a sale made at a price that is less than the acquisition cost of the product.

The third classification of acts includes four laws that prescribe definitions of cost that are, in varying degree, unlike those in the first two classes; hence the designation, "miscellaneous." Special acts are those that apply to one trade or product, or to a few specified trades. These laws are separately classified because the problems of defining cost for a single trade differ somewhat from those applicable to all trades. They are included in the
dissertation because they were passed primarily to prevent sales below cost, in contrast to other special acts that fix prices and regulate output.

Only twelve laws apply to all sellers; the remaining acts are applicable only to wholesalers and retailers. Because of this limited application and because the problems of defining cost for manufacturers differ from those of marketing firms, only the problems of wholesalers and retailers have been considered in this study.

It is difficult for legislators to prescribe an acceptable cost definition for the purpose of setting a minimum price. Evidence of this difficulty is apparent in the judicial fate of many of the acts. Fifteen laws have been declared unconstitutional, of which nine were voided because the cost definitions were found to be arbitrary, discriminatory, or uncertain and, therefore, impossible to comply with. On the other hand, the same provisions in eight other laws have been found to be reasonable and certain. There has been a tendency for the cost definitions to be ruled unconstitutional in those cases in which the court had to ascertain a merchant's cost of doing business. In most cases, the acts that have been declared unconstitutional have been satisfactorily amended, declared constitutional by higher courts, or replaced by laws that are constitutional.
The particular cost concept that is utilized in a sales-below-cost act depends on the purpose of the act. Any one or a combination of the concepts of the economist, businessman, or accountant, or a concept prescribed by the legislature may be used in order to carry out a particular purpose. Since the purpose of the Unfair Practices Acts is to prohibit loss-leader selling, the minimum price is the full cost of the product as viewed by accountants. Only those expenditures actually made or contracted for by the seller are included in the minimum price. Therefore, the historical expenses of the particular merchant that are directly connected with and are assigned to the unit of product determine the minimum price. This is an expression of the accountant’s cost concept.

The use of either the economist’s or businessman’s concept of cost in the acts would prevent leader selling rather than loss-leader selling. The businessman’s concept consists of the accountant’s unit product cost to which is added a portion of the profit that the particular businessman desires to earn. The economist also considers profit as a cost because it is a necessary return to the owner for the use of his land, labor, and capital. In addition, the opportunity cost of all resources utilized in production is included regardless of the money expend-
itures made. Thus, from the viewpoint of the economist, the full cost of a product is an average unit cost of the sum of the opportunity costs of the marginal firm. Since it is not the purpose of the sales-below-cost acts to guarantee a return to the owner, which would tend to result if leader selling were prohibited, other concepts should be employed. In addition, the inclusion of implicit costs in a minimum price definition would tend to increase the difficulty of measuring the cost of the product in a specific case. Hence, the cost concept intended in the Unfair Practices Acts is the accountant's concept.

In contrast to the Unfair Practices Acts the Unfair Sales Acts permit loss-leader sales, but the extent of loss is limited. Thus, the cost concept employed is a combination of the accountant's concept and one prescribed by the legislature. A percentage markup prescribed by the legislature that is to cover only a part of the merchant's cost of doing business is to be added to the acquisition cost of the product. Therefore, the extent of loss is limited by the amount of the prescribed markup. However, the minimum price may be lower than that prescribed if the merchant can prove that the product's full cost is lower. The latter cost is measured according to the accountant's concept.

Legislatures have prescribed other minimum cost con-
cepts. A few statutes were enacted in order to prevent predatory loss-leader sales. In these acts, the minimum cost prescribed is the acquisition cost of the product. Thus, the cost concepts utilized in the sales-below-cost acts are either the accountant's concept or a combination of this concept and a minimum cost concept prescribed by the legislature.

The cost provisions in the Unfair Practices Acts specify that the merchant's cost of doing business is to be added to the product's cost base, which is the lower of invoice cost or replacement cost. The expenses that must be included in the cost of doing business are enumerated. The economist's cost concept rather than the accountant's is specified for three of the enumerated expenses. These expenses are labor, interest, and delivery cost. For administrative purposes trade associations may conduct cost surveys to determine a prima facie cost of doing business, and merchants are permitted to sell below the defined cost if it is necessary to meet the legal prices of competitors.

The minimum cost prescribed in the Unfair Sales Acts is the cost base plus a specified minimum percentage markup. The cost base is the lower of invoice cost or replacement cost, plus transportation and cartage. The markup which is based on and added to the cost base covers only a part of the merchant's cost of doing business. A merchant
may sell a product at a lower price than this minimum, but only if he can prove that his price is not below the full cost of the product. A different markup is prescribed for retailers than for wholesalers, which necessitates another markup for integrated merchants. In some states, sellers are permitted to meet any price of competitors, whereas in other states only competitors' legal prices can be met.

The legislatures of four states have prescribed other cost definitions. The Minnesota law utilized primarily the accounting cost concept, but for purposes of administration special concepts are utilized. The minimum price is the product's full cost. However, prima facie cost is the manufacturer's published list price less his published discounts plus the seller's cost of doing business. In addition, the act specifies two markups for retailers; a minimum markup, and a higher one that precludes prosecution if the seller's price is above it. The North Dakota law prohibits only predatory loss-leader selling because the minimum price is defined as just the cost base, which is the lower of invoice cost or replacement cost. A full cost definition is prescribed in the Oregon act, but the cost base is replacement cost only. In addition, other definitions are specified in the Oregon act for particular trades. The minimum price prescribed in the South Carolina law is the cost base, which is defined as the invoice cost
of the product.

The special acts include fourteen laws that apply to the cigarette trade and seven that apply to one or to several other specified industries. The California and Idaho dairy product laws prescribe a full cost minimum price. A full cost definition is specified also in the cigarette acts, and, in addition, markups that are presumed to cover the average cost of doing business are prescribed. The Michigan bakery and petroleum act also provides for a full cost minimum price; however, the cost base is the invoice cost only. The Connecticut and Louisiana drug acts both define the cost base as the manufacturer's published list price less his published discounts. This is the minimum price for the former law, whereas the latter additionally prescribes a minimum markup. A minimum markup of six percent for both wholesalers and retailers is prescribed in the Utah Agricultural Act. The Texas Sales Limitation Act, applicable only to grocery stores, prohibits only predatory loss-leader selling. It defines the minimum price as the cost base, which is the invoice cost or replacement cost, whichever is lower.

**COST BASE**

The cost base is composed of all expenditures that are necessary to acquire products. In the great majority of the sales-below-cost acts the cost base is defined as
the invoice cost or replacement cost of the product, whichever is lower. Three other definitions are prescribed in the remaining acts, namely, invoice cost, replacement cost, and the manufacturer's published list price less his published discounts. The term "purchase cost" rather than "invoice cost" has been used throughout this dissertation because "purchase cost" is a more inclusive term. Other expenditures than those indicated on the invoice are also elements of the cost base. This section is a summary of the analysis of the definitions of the cost base included in the acts.

Purchase cost consists of the actual payments made by a merchant when purchasing his merchandise. Many acts provide that the invoices used in proving purchase cost must represent regular transactions incurred in the usual channel of trade. Invoices are further limited in some acts to those received during a period of thirty, sixty, or ninety days prior to the date of sale. The Unfair Practices Acts do not indicate the scope of purchase cost, whereas the Unfair Sales Acts and Unfair Cigarette Sales Acts enumerate the elements that are to be added to or subtracted from the gross invoice cost. All transportation costs incurred in bringing the merchandise to the seller's place of business are to be added to the invoice cost. Generally, trade discounts and quantity discounts are deductible from the gross invoice price, but most of the
acts specifically do not permit cash discounts to be subtracted. In addition, a few acts require that excise taxes are to be an element of the cost base.

One problem encountered in determining purchase cost is the limitation of invoices. It is necessary that the invoices used to determine purchase cost represent actual purchases made in a reasonable period of time prior to the sale. They should not be fictitious, but, on the other hand, it is not necessary to verify their reasonableness by existing market conditions. A provision requiring such a verification was ruled unconstitutional by five courts. Bona fide invoices received in any transaction should be acceptable evidence as long as they do not represent purchases made in order to defeat the purposes of the act. The limitation of invoices to those received during a specified period of time may make unacceptable all invoices of some merchants. Instead of a fixed period of time, a flexible period, the inventory period, could be prescribed. The use of the inventory period tends to limit invoices to those that represent the merchandise on hand at the time of sale.

The acts are not in agreement in regard to whether cash discounts, allowances, and excise taxes should be included in the cost base. Although eight acts omit any reference to cash discounts, seventeen general laws and eight of the cigarette acts do not permit the subtraction
of cash discounts, while only one general act and six cigarette acts specifically require their deduction from the invoice cost. Although some merchants may not agree that cash discounts should be subtracted from the invoice cost, the larger and more progressive merchants, most trade associations, and most marketing and accounting authorities consider them as a deduction from merchandise cost. In addition, the majority of the courts and administrative agencies have ruled that cash discounts should be subtracted when determining purchase cost. Since cash discounts generally are quite large, sellers may be assured of profits, and prices to consumers may be raised unnecessarily, if these discounts are not permitted to be subtracted from the gross invoice price. The weight of authority indicates that cash discounts should be deducted when determining purchase cost. Although very few acts specify how allowances are to be handled, they should be subtracted from the gross invoice cost for the same reasons that cash discounts should be deducted, unless the allowances are bona fide payments for services performed by the buyer for the seller. In case of the latter, the allowances should be subtracted from advertising expense. Excise taxes imposed upon the seller are required to be added to the seller's invoice cost by eighteen acts. However, the few rulings made by courts and administrative agencies indicate that excise taxes imposed upon the seller should not be an
element of the cost base, but an element of the seller's cost of doing business.

None of the acts refer to the problem of the valuation of the merchandise sold. This problem arises when different prices are indicated on several invoices that represent the products sold or on hand. If the product sold can be identified with a particular invoice, there is no problem. However, this often is not the case. The product sold may be valued according to any of four methods: first-in, first-out; an average cost; last-in, first-out; or the lowest cost indicated on the invoices. Since the use of these methods results in an assumed cost, and since these acts are criminal as well as civil statutes, it seems best to use the lowest cost method. This method enables the merchant to use the lowest actual invoice cost when proving purchase cost and thereby prevents his being convicted of violating the act because of an assumed higher cost that could result from the use of the other three methods.

Replacement cost is not defined in all acts in which it is prescribed. When a definition is included, replacement cost is defined as the expenditures that would be incurred if a product were purchased in the usual quantity on the date of sale or during a specified period of time. Usually, replacement cost means a currently existing cost; not one that might have existed during a period of time.
Nevertheless, a time period, such as the inventory period, is an advantage to merchants and consumers because it permits the lowest possible price to be set by the seller. The scope of replacement cost is the same as that of purchase cost except that it seems best not to deduct purchase discounts and allowances, unless they are an accepted practice, known to be available, and have been taken advantage of regularly by the buyer in the past.

All acts except seven define the cost base as the lower of purchase cost or replacement cost. This definition enables a merchant to select the lowest possible cost as his cost base, and, therefore, it prevents merchants and consumers from being put in a disadvantageous position because of price fluctuations. If purchase cost only is prescribed and prices fall, merchants cannot immediately reduce their prices and, thus, the consumer may be harmed. Merchants who purchase merchandise later at the lower price, however, can reduce their prices which places the merchant with stocks bought at old prices in a disadvantageous position. The same problems are encountered if just replacement cost is used. For example, if costs rise, all merchants must raise their prices even though they purchased merchandise at lower prices. Therefore, the prescription of the lower of purchase cost or replacement cost permits merchants to use the lowest possible cost regardless of the movement of prices.
The prescription of the lower of purchase cost or replacement cost also eases the administration of the acts. The use of only purchase cost makes the determination of the minimum price by administrative agencies difficult because it is not readily known when and at what price the product was purchased. If replacement cost were to be universally prescribed as the cost base, the acts could be administered better because most merchants know this cost. However, it would not be fair to convict a merchant of making a sale below a cost that he never actually incurred. Therefore, purchase cost should be included as an alternative. Such a definition of the cost base gives the merchant the greatest protection and freedom in setting prices.

The fourth and last definition of the cost base, as set forth in a few acts, is the manufacturer's published list price less his published discounts. Full use of this definition is limited to acts that apply only to trades in which manufacturers publish list prices and discounts. For this reason the definition can not be employed in a general act unless it is used only as presumptive evidence of the merchant's cost. Three laws applicable only to retailers in one trade prescribe this definition, and in three general laws it is employed only as prima facie evidence of the cost base.
AMOUNT ADDED TO THE COST BASE

Although it is difficult to define the amount that is to be added to the cost base, the great majority of the acts require that some amount be added. Two concepts of an addition to the cost base are employed by most acts. One is the addition of the total overhead expenses and the other is the addition of a specified minimum percentage markup that is to cover only a part of the total overhead. The particular concept employed depends on the purpose of the act. A summary of the analysis of these provisions is presented after a brief discussion of the few acts that do not require any addition.

Only two general acts do not prescribe any addition to the cost base for both wholesalers and retailers, and five acts set a cost-base minimum price that applies either to retailers only or to wholesalers only. As previously noted, the purpose of such a minimum price is to prohibit predatory loss-leader selling. Merchants are not permitted to set prices that are lower than the cost base. Such a definition, however, does not necessarily prevent the destruction of competition or injury to competitors as intended by the acts. The cost base of integrated retailers would tend to be the same as that of wholesalers and, therefore, independent retailers, when meeting the
prices of their integrated competitors, would not be able to cover the acquisition cost of their products. Prices may be set at such a low level that merchants could be forced out of business.

The Unfair Practices Acts, Unfair Cigarette Sales Acts, the miscellaneous general laws of Minnesota and Oregon, the dairy products acts of California and Idaho, and the bakery and petroleum statute of Michigan specify that the merchant's over-all cost of doing business must be added to the cost base. These acts, then, prohibit loss-leader sales by wholesalers and retailers. According to the acts, all overhead expenses are to be included in the minimum price, and most such acts enumerate the individual expenses. In spite of this, the cost of doing business provision is not adequate. For example, the listing does not include all overhead expenses, some are natural expenses and others are functional, and all types of taxes are to be included. Although one court has limited the includable expenses to those listed, most courts have not. Generally, courts have determined the cost of doing business without referring specifically to the enumeration. One court has ruled that income taxes should not be included because the amount of income taxes is based on the merchant's total income, which is not known at the time of sale. Also, interest expense poses a
problem. If interest on borrowed capital is to be included, an inequity among competing firms may result because varying proportions of the capital acquired by firms are borrowed. In addition, if interest on all capital utilized is required, some profit to the owner is assured. The Unfair Practices Acts include interest on borrowed capital, whereas the cigarette acts do not.

Although the scope of total overhead is given some attention in the acts, very few laws specify the period of time over which the cost of doing business is to be measured. Courts have not been consistent when ruling on this problem. One court held that only current costs should be considered, whereas another held that the overhead expenses should be measured over a longer period of time. Generally, courts, in measuring total overhead, have considered it to be those costs that were incurred over the prior accounting period, which generally is one year. Such a measurement irons out seasonal fluctuations, but may not reflect recent costs. A possible solution could be the use of the average annual expenses as prima facie evidence of the merchant's cost of doing business. Then if a merchant can establish a lower cost of doing business by the use of current costs, the latter could be used rather than an annual average.

One very essential aspect of any total overhead requirement is the prescription of some method of allocating
the overhead expenses to the products sold. None of the laws except the cigarette acts refer to this problem. Because of this, courts and administrative agencies have not agreed on whether an average allocation or a specific allocation of overhead is to be made. Some courts have ruled that an average allocation is implied in the acts, and others have held that an average allocation is not proper. The Unfair Cigarette Sales Acts specify that the allocation of overhead expenses regularly used by the merchant should be accepted by courts. Thus, either an average or a specific allocation is permissible.

An average allocation of the cost of doing business assigns the same percentage markup to each product sold. Thus, if the total overhead expenses are twenty per cent of the cost base, twenty per cent of each product's cost base is added to each product. This is the easier method to apply and has been the cost of doing business that has been determined by most courts. However, it is not a proper method of allocation. Varying percentage markups are actually applied to products by merchants. The particular markup used depends on competitive conditions, the expected volume of sales, expected markdowns, and the direct costs of handling and selling the product. The use of an average allocation, then, would raise the minimum prices of many staple fast moving products above their cost of hand-
ling and selling. Such a minimum price would tend to harm consumers and merchants because the higher prices may reduce sales and, hence, profit.

Although a specific allocation of total overhead to products is the theoretically better method, it is very difficult for merchants to prove to courts that a particular allocation is reasonable. Not only are extensive records and studies necessary in order to determine the product’s proper share of the overhead expenses, but a considerable amount of arbitrary judgment is involved. The records of the smaller merchants may not be adequate for a proper allocation. Although the records of large stores may be adequate, the overhead expenses allocated to a product by each of these merchants may vary because of differences of judgment. Because of this, one court held that it is impossible for grocery retailers to make such an allocation. On the other hand, some courts have accepted an average allocation when a reasonable specific allocation could not be made. Since the problems involved in determining the total overhead applicable to products are great and as long as total overhead is required by these acts, courts should be willing to accept any reasonable specific allocation submitted by a defendant, provided it is in accord with accepted accounting standards and the allocation was not made in order to circumvent the provisions of the
act. However, the smaller merchants may be discriminated against because of their inability to make a specific allocation. The extent of this discrimination is not known. Research in this area would be valuable.

The Unfair Sales Acts, the Unfair Cigarette Sales Acts, the Minnesota general act, and the Utah agricultural act specify one minimum percentage markup for retailers and another for wholesalers. The Louisiana drug act and a provision applicable to retailers in food commerce in the Oregon law prescribe a markup for retailers only. The markup in the Unfair Sales Acts is intended to cover only a part of the product's share of the total overhead of the business. Therefore, these acts attempt to limit the loss incurred in a loss-leader sale rather than prevent such sales. The majority of the acts specify the same markups as those originally prescribed in the National Recovery Administration food and grocery codes -- six per cent for retailers and two per cent for wholesalers. The markup in the general laws is assumed to cover either the special costs incident to the product or the total overhead of the low-cost seller that is applicable to the low-cost product. On the other hand, the markup specified in the special laws is presumed to cover the full cost of selling the product subject to the act. Just a bare majority of the special acts prescribes a six per cent markup for retailers and a
two per cent markup for wholesalers. Other percentages for retailers vary from eight to ten per cent and those applicable to wholesalers vary from three and one-half per cent to six per cent. The Minnesota general act, in addition to a minimum markup of eight per cent, prescribes a maximum markup of fifteen per cent. Merchants may not be prosecuted if the price of a product covers at least the cost base plus fifteen per cent.

The six per cent markup for retailers and the two per cent markup for wholesalers in the Unfair Sales Acts appear to be reasonable percentages. Surveys have indicated that the average cost of doing business of low-cost retailers varies from six to ten per cent. Also, the lowest markup applicable to low-cost products is approximately six per cent of the cost base. Surveys and practice also tend to support the two per cent markup for wholesalers. Thus, most merchants may set prices that are lower than the product's full cost, but it is not known whether the direct expenses are covered. Cost studies for the purpose of determining the amount of direct costs that are applicable to the sale of various products by different types of merchants would be very helpful. Since cigarettes are low-cost products and the markups specified in the cigarette acts are presumed to cover all overhead expenses applicable to cigarettes, six per cent for retailers and two per cent for wholesalers appear to be reasonable percentages. Sur-
veys have indicated that the minimum overhead costs applicable to cigarettes sold by low-cost merchants are approximately these percentages. Nevertheless, many merchants may incur a higher cost. However, if a higher markup is prescribed in order to protect the high-cost merchants, low-cost sellers will tend to apply the higher markup even if their cost is lower because of the fear of court proceedings. This would tend to fix prices at levels that are too high. Thus, the markup of the low-cost merchant seems to be a more reasonable basis for determining the markup for the cigarette acts.

The Unfair Sales Acts and the Unfair Cigarette Sales Acts permit sellers to set lower prices if they can prove a lower cost. The lower cost proved under the cigarette acts must be the full cost. However, the markup in the Unfair Sales Acts is to cover only part of the cost of doing business, and the acts do not specify what part is to be covered. If only the direct costs of the product are to be covered, the markup provision will no longer be applicable because some merchants may not incur any overhead expenses that can be charged directly to a particular product. If the markup is based on the total overhead of the low-cost merchant, the seller proving a lower cost must prove that the total overhead applicable to the product is lower. The latter has been the procedure required by all courts and administrative agencies. The Unfair
Sales Acts do not specify in any way how the total overhead applicable to the product is to be determined. Thus, when a merchant attempts to prove a lower cost the same problems are encountered under these acts as under the Unfair Practices Acts and Unfair Cigarette Sales Acts.

Since one minimum markup applies to retailers and another to wholesalers, the Unfair Sales Acts and the Unfair Cigarette Sales Acts provide that integrated merchants are to add either the sum of the specified retail and wholesale markups to the cost base or that the markups are to be applied progressively. If this is not prescribed, the integrated retailer could add only the retail markup to the wholesaler's cost base, and thereby have a competitive pricing advantage over the independent retailer. The integrated retailer still has a slight advantage in some states because the acts provide that the sum of the markups is to be added. In other states the markups are to be added progressively which tends to equalize the minimum price between independent and integrated retailers.

Most of the Unfair Cigarette Sales Acts, but only one general act, deal with accommodation sales by a wholesaler to another wholesaler or among retailers. They provide that the prices of such sales must not be less than the cost base. A literal interpretation of the sales-below-cost acts that do not contain this provision might prevent such sales because normally these sales are
made at prices equal to the cost base or at this base plus a nominal markup. Therefore, it would seem to be in order to recommend that the sales-below-cost acts that do not provide for such sales add a provision similar to the one in the Unfair Cigarette Sales Acts.

Because of the specified markups, the Unfair Sales Acts and the Unfair Cigarette Sales Acts, are easier to administer and are better understood than the Unfair Practices Acts. Merchants, whose cost records are not sufficiently adequate to enable them to set prices according to their own costs, are aided by these markups. They know the minimum price established by law. Also, such markups permit merchants to sell products at prices that are less than full cost. This may be advantageous in certain situations. However, if the specified markups are too high, it is possible that price fixing may result.

**MISCELLANEOUS PROVISIONS**

Two provisions that are not an integral part of the cost definitions but which are closely related are included in most of the sales-below-cost acts. The cost survey provision permits trade associations to conduct cost surveys in order to determine a prima facie cost of doing business for a particular trade, and the other provision permits merchants to meet the prices of competitors. A summary of the problems involved with these two provisions
follows.

The statutes that prescribe the minimum price to be the product's full cost as incurred by the individual merchant include a cost survey provision. Since administrative agencies do not know the individual merchant's cost, a minimum percentage markup as determined from a cost survey may be used in court as competent evidence of the merchant's cost of doing business. Many surveys have been conducted under this provision. However, courts have been reluctant to place much weight on the results of the surveys because most surveys have not been conducted according to acceptable accounting and statistical standards. The provision in the Minnesota law was ruled unconstitutional for being uncertain. In addition, trade associations have been found guilty of using these surveys in order to fix prices. Certain associations induced merchants not to sell below the markup established from a survey regardless of the merchant's actual cost.

Other problems are encountered in the operation of this provision. Most acts do not specify the basis on which the cost is to be determined. Consequently, in two surveys an average cost of the firms in the trade was used. An average cost may fix prices at unnecessarily high levels. In most surveys the minimum percentage markup was established according to the average cost of doing business of the low-cost merchant in the trade. However,
once such a markup is established, these acts, for all practical purposes, become similar to the Unfair Sales Acts because merchants tend to set prices according to the established markups rather than their own cost. Also, trade associations and competitors have not prosecuted merchants unless they violated the minimum price as determined by the survey. Such a procedure permits considerable loss-leader selling. Since the Unfair Cigarette Sales Acts prescribe a markup that is presumed to be the full cost of the product, cost surveys are not necessary.

The cost survey provision raises other problems. The classification of the firms to be included in the survey and the determination of the trading area over which the survey is to be conducted are examples. Because the use of surveys by trade associations tend to permit loss-leader sales, and because of the susceptibility of the surveys to price fixing by private agencies, it would seem that the purpose of these laws can be better accomplished without such a provision.

In order to be certain that all merchants are treated equally, a provision is included in the acts which permits higher cost merchants to meet the lower prices of competitors. Some acts permit any price to be met whereas others allow the meeting of only legal prices. Both provisions produce problems; the former may render an act ineffective because below-cost prices may be met, and the latter
places a heavy burden on those who wish to meet the lower prices of competitors because merchants do not know if their competitor's prices are legal. It would seem that only legal prices should be permitted if the acts are to be effective. The burden created by such a requirement may be eased by permitting merchants to prove that they acted in good faith. That is, they should be able to demonstrate that their prices were set in order to fore­stall the loss of business and that they did not know that the competitor's price was illegal. The permission to meet competitors' prices is limited further in a few acts. These acts provide that the prices of sales transactions that are exempt from the provisions of the acts may not be met by competitors. Examples of some of these exempted transactions are sales of damaged or perishable products, close-out sales, and sales to charities. Permission to meet the prices of competitors is necessary in sales-below-cost acts in order to protect the higher-cost merchants. If they are not allowed to meet the legal prices of their competitors, they may be injured by this restraint in the law rather than by competition.
APPENDIX A

COST PROVISIONS OF THE CALIFORNIA UNFAIR PRACTICES ACT

Sec. 17026. ("Cost."-) "Cost" as applied to production includes the cost of raw materials, labor and all overhead expenses of the producer.

"Cost" as applied to distribution means the invoice or replacement cost, whichever is lower, of the article or product to the distributor and vendor, plus the cost of doing business by the distributor and vendor.

Sec. 17027. (Cost of article purchased at forced, bankrupt, or closeout sale.-) In establishing the cost of a given article or product to the distributor and vendor, the invoice cost of the article or product purchased at a forced, bankrupt, closeout sale, or other sale outside of the ordinary channels of trade may not be used as a basis for justifying a price lower than one based upon the replacement cost as of the date of the sale of the article or product replaced through the ordinary channels of trade, unless the article or product is kept separate from goods purchased in the ordinary channels of trade and unless the article or product is advertised and sold as merchandise purchased at a forced, bankrupt, closeout sale, or by means other than through the ordinary channels of trade.

Such advertising shall state the conditions under which the goods were purchased, and the quantity of the merchandise to be sold or offered for sale.

Sec. 17028. ("Ordinary channels of trade."-) "Ordinary channels of trade" means those ordinary, regular and daily transactions in the mercantile trade whereby title to an article or product, in no way damaged or deteriorated, is transferred from one person to another.

"Ordinary channels of trade" does not include sales of bankrupt stocks, closeout goods, dents, sales of goods bought from a business or merchant retiring from business, fire sales and sales of damaged or deteriorated goods, which damage or deterioration results from any cause whatsoever. This listing is not all inclusive but as example only.

Sec. 17029. ("Cost of doing business" or "overhead expense") "Cost of doing business" or "overhead expense" means all costs of doing business incurred in the conduct of the business and shall include without limitation the following items of expense: labor (including salaries of executives and officers), rent, interest on borrowed capital, depreciation, selling cost, maintenance of equipment, delivery costs, credit losses, all types of licenses, taxes, insurance, and advertising.

Sec. 17042. (Selection of customers and functional classifications permitted.) Nothing in this chapter prohibits any of the following:

(a) A selection of customers.
(b) A functional classification by any person of any customers as broker, jobber, wholesaler or retailer.
(c) A differential in price for any article or product as between any customers in different functional classifications.

Sec. 17043. (Unlawful to sell below cost or give away.) It is unlawful for any person engaged in business within this State to sell any article or product at less than the cost thereof to such vendor, or to give away any article or product, for the purpose of injuring competitors or destroying competition.

Sec. 17044. ("Loss leader" prohibited.) The practice of using any article or product as a "loss leader" is included among the prohibitions of this chapter.

Sec. 17049. (Prohibitions embrace special rebates, collateral contracts, etc.) The prohibitions of this chapter against locality discrimination and sales below cost embrace any scheme of special rebates, collateral contracts or any device of any nature whereby such discrimination or sale below cost is in substance or fact effected in violation of the spirit and intent of this chapter.

Sec. 17050. (Exceptions.) The prohibitions of this chapter against locality discriminations, sales below cost, and loss leaders do not apply to any sale made:

(d) In an endeavor made in good faith to meet the legal prices of a competitor selling the same article or product, in the same locality or trade area and in the ordinary channels of trade.

Sec. 17072. (Cost survey.) Where a particular
trade or industry, of which a person complained against is a member, has an established cost survey for the locality and vicinity in which the offense is committed, that cost survey is competent evidence to be used in proving the costs of such person.

Sec. 17073. (Presumptive evidence of cost.-) Proof of average overall cost of doing business for any particular inventory period when added to the cost of production of each article or product, as to a producer, or invoice or replacement cost, whichever is lower, of each article or product, as to a distributor, is presumptive evidence of cost of each such article or product involved in any action brought under this chapter.

Sec. 17074. (Presumptive evidence of delivery cost.-) Proof of transportation tariffs when fixed and approved by the Railroad Commission of the State of California is presumptive evidence of delivery cost.

Sec. 17075. (Evidence of prevailing wage scale.-) In any action where it is alleged and shown that the person complained against is selling below his cost of doing business, and such person is including labor at less than the prevailing wage scale in the trade in which such person is engaged for the locality or vicinity in which he is doing business, evidence of such prevailing wage scale shall be admissible to prove the intent or purpose of such person to violate this chapter.

Sec. 17076. (Services at rate below prevailing wage scale to be charged at prevailing rate.-) In any action brought under this chapter, where persons are employed or performing services for any person or in the conduct of the business wherein such person is charged with a violation of this chapter, and are so employed or performing such services without compensation or at a wage lower than that prevailing at the time and place of the service for the particular services performed, such services shall be charged as an expense of the business in which rendered and at the rate of the wage for the services rendered prevailing at the time of the service at the place where rendered.

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APPENDIX B

COST PROVISIONS OF THE MODEL STATE UNFAIR SALES ACT

Section 2. (a) When used in this Act, the term "cost to the retailer" shall mean the invoice cost of the merchandise to the retailer or the replacement cost of the merchandise to the retailer, whichever is lower; less all trade discounts except customary discounts for cash; to which shall be added (1) freight charges not otherwise included in the invoice cost or the replacement cost of the merchandise as herein set forth, and (2) cartage to the retail outlet if done or paid for by the retailer, which cartage cost, in the absence of proof of a lesser cost, shall be deemed to be three-fourths (3/4) of one per cent of the cost to the retailer as herein defined after adding thereto freight charges but before adding thereto cartage and mark-up, and (3) a markup to cover a proportionate part of the cost of doing business, which markup, in the absence of proof of a lesser cost, shall be six (6) per cent of the cost to the retailer as herein set forth after adding thereto freight charges and cartage but before adding thereto a markup.

(b) When used in this Act, the term "cost to the wholesaler" shall mean the invoice cost of the merchandise to the wholesaler, or the replacement cost of the merchandise to the wholesaler, whichever is lower; less all trade discounts except customary discounts for cash; to which shall be added, (1) freight charges, not otherwise included in the invoice cost or the replacement cost of the merchandise as herein set forth, and (2) cartage to the retail outlet if done or paid for by the wholesaler, which cartage cost, in the absence of proof of a lesser cost, shall be deemed to be three-fourths (3/4) of one per cent of the cost to the wholesaler as herein set forth after adding thereto freight charges but before adding thereto cartage.

(c) When used in this Act the term "replacement costs" shall mean the cost per unit at which the merchandise sold or offered for sale could have been bought by the seller at any time within thirty (30) days prior to

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the date of sale or the date upon which it is offered for sale by the seller if bought in the same quantity or quantities as the seller's last purchase of the said merchandise.

(e) The term "cost to the retailer" and "cost to the wholesaler" as defined in paragraphs (a) and (b) of this section shall mean bona fide costs; and purchases made by retailers and wholesalers at prices which cannot be justified by prevailing market conditions within this state shall not be used in determining cost to the retailer and cost to the wholesaler.

(h) The term "retailer" shall mean and include every person, partnership, corporation or association engaged in the business of making sales at retail within this state; provided that, in the case of a person, partnership, corporation or association engaged in the business of making both sales at retail and sales at wholesale, such term shall be applied only to the retail portion of such business.

(i) The term "wholesaler" shall mean and include every person, partnership, corporation, or association engaged in the business of making sales at wholesale within this state; provided that, in the case of a person, partnership, corporation or association engaged in the business of making both sales at wholesale and sales at retail, such term shall be applied only to the wholesale portion of such business.

Section 3. It is hereby declared that any advertising, offer to sell, or sale of any merchandise, either by retailers or wholesalers, at less than cost as defined in this Act, with the intent, or effect, of inducing the purchase of other merchandise or of unfairly diverting trade from a competitor or otherwise injuring a competitor, impair and prevent fair competition, injure public welfare, and are unfair competition and contrary to public policy and the policy of this Act, where the result of such advertising, offer or sale is to tend to deceive any purchaser or prospective purchaser, or to substantially lessen competition, or to unreasonably restrain trade, or to tend to create a monopoly in any line of commerce.

Section 6. The provisions of this Act shall not apply to sales at retail or sales at wholesale . . . (g) where the price of merchandise is made in good faith to meet competition; . . .
APPENDIX C

COST PROVISIONS OF THE ALABAMA UNFAIR CIGARETTE SALES ACT1

Section III. . . . . . . . . . . .
(b) Evidence of advertisement, offering to sell, or sale of cigarettes by any wholesaler or retailer at less than cost to him shall be prima facie evidence of intent to injure competitors and to destroy or substantially lessen competition.

Section IV. For purposes of interpretation and construction of this act, the following words, terms and phrases and any variations thereof shall have the meaning ascribed to them hereinafter, except where the context of this act clearly indicates a different meaning.

(j) "Basic cost of cigarettes" shall mean the invoice cost of cigarettes to the retailer or wholesaler as the case may be, or the replacement cost of the cigarettes to the retailer or wholesaler, as the case may be, within thirty days prior to the date of sale, in the quantity last purchased, whichever is lower, less all trade discounts and discounts for cash, to which shall be added the full face value of any stamps which may be required by any cigarette tax act of this State or any political subdivision thereof now in effect or hereafter enacted, if not already included by the manufacturer in his list price.

(k) 1. The term "cost to the wholesaler" shall mean the "basic cost of cigarettes" to the wholesaler plus the "cost of doing business by the wholesaler," as evidenced by the standards and methods of accounting regularly employed by him in his allocation of overhead costs and expenses, paid or incurred, and must include, without limitation, labor costs (including salaries of executives and officers), rent, depreciation, selling costs, maintenance of equipment, delivery costs, all types of licenses, taxes, insurance and advertising.

2. In the absence of proof of a lesser or higher cost of doing business by the wholesaler making the sale, the "cost of doing business by the wholesaler" shall be presumed to be four and one-half per centum (4½%) of the "basic cost of cigarettes" to the wholesaler, plus cartage to the retail outlet, if performed or paid for by the wholesaler, which cartage cost, in the absence of proof of a lesser or higher cost, shall be deemed to be one-half of one per centum (½ of 1%) of the "basic cost of cigarettes" to the wholesaler.

(1) The term "cost to the retailer" shall mean the "basic cost of cigarettes" to the retailer plus the "cost of doing business by the retailer," as evidenced by the standards and methods of accounting regularly employed by him in his allocation of overhead costs and expenses, paid or incurred, and must include, without limitation, labor (including salaries of executives and officers), rent, depreciation, selling costs, maintenance of equipment, delivery costs, all types of licenses, taxes, insurance, and advertising.

(2) In the absence of proof of a lesser or higher cost of doing business by the retailer making the sale, the "cost of doing business by the retailer" shall be presumed to be eight per centum (8%) of the "basic cost of cigarettes" to the retailer.

(3) Any retailer who, in connection with the retailer's purchase, receives not only the discounts ordinarily allowed upon purchases by a retailer but also, in whole or in part, discounts ordinarily allowed upon purchases by a wholesaler shall, in determining "cost to the retailer" pursuant to this subsection (1), add the "cost of doing business by the wholesaler," as defined in subsection (k) of this Section, to the "basic cost of cigarettes" to said retailer, as well as the "cost of doing business by the retailer."

(4) In the absence of proof of a lesser or higher cost of doing business, the "cost of doing business by the retailer," who in connection with the retailer's purchase receives not only the discounts ordinarily allowed upon purchases by a retailer but also, in whole or in part, the discounts ordinarily allowed upon purchases by a wholesaler, shall be presumed to be eight per centum (8%) of the sum of the "basic cost of cigarettes" and the "cost of doing business by the wholesaler."

Section VI. (a) When one wholesaler sells cigarettes to any other wholesaler the former wholesaler shall not be required to include in his selling price to the latter, "cost to the wholesaler" as provided by Section IV of this act, but the latter wholesaler, upon resale to a
(b) When a wholesaler sells cigarettes to any person included in Section IV, (1) 3 of this Act, the wholesaler may sell cigarettes to such person at a price not less than such person would otherwise be required to pay for the purchase of like cigarettes.

(c) When a wholesaler sells cigarettes to any service retailer, the wholesaler shall not be required to include "cost to the wholesaler" as provided in Section IV of this Act in his selling price to the service retailer; provided, however, the service retailer shall compute his "cost to the retailer" in the manner provided in Section IV (1) 3 of this Act.

Section VIII. (a) Anything contained in this act to the contrary notwithstanding, any retailer may advertise, offer to sell or sell cigarettes at a price made in good faith to meet the price of a competitor who is selling the same article at cost to the said competing retailer as defined in this act, and any wholesaler may advertise, offer to sell or sell cigarettes at a price made in good faith to meet the price of a competitor who is rendering the same type of service and is selling the same article at cost to said competing wholesaler as defined by this act. The price of cigarettes advertised, offered for sale, or sold under the exceptions specified in Section VII shall not be considered the price of a competitor and shall not be used as a basis for establishing prices below cost, nor shall the price established at a bankrupt sale be considered the price of a competitor within the purview of this Section.

(b) In the absence of proof of the actual cost to the said competing retailer, as the case may be, such cost may be presumed to be the lowest cost to the retailer or the lowest cost to the wholesaler, as the case may be, within the same trading area as determined by a cost survey made pursuant to Section XI.

Section IX. In determining cost to the retailer and cost to the wholesaler, the court shall receive and consider as bearing on the bona fides of such cost evidence tending to show that any person complained against under any of the provisions of this act purchased cigarettes, with respect to the sale of which complaint is made, at a fictitious price or upon terms or in such a manner or under such invoices as to conceal the true cost, discounts or terms of purchase, and shall also receive and consider as bearing on the bona fides of such cost evidence of the normal, customary and prevailing terms and discounts in connection with other sales of a similar nature.

Section X. In establishing the cost of cigarettes
to the retailer or wholesaler, the invoice cost of said cigarettes purchased at a forced, bankrupt, closeout sale, or other sale outside of the ordinary channels of trade may not be used as a basis for justifying a price lower than one based upon the replacement cost of the cigarettes to the retailer or wholesaler within thirty days prior to the date of sale, in the quantity last purchased through the ordinary channels of trade.

Section XI. Where a cost survey pursuant to recognized statistical and cost accounting practices has been made for the trading area in which a violation of this act is committed or charged, to determine and establish on the basis of actual existing conditions the lowest cost to retailers or the lowest cost to wholesalers within the said area, the cost survey shall be deemed competent evidence in any action or proceeding under this act as tending to prove actual cost to the wholesaler or actual cost to the retailer complained against, but any party against whom any such cost survey may be introduced in evidence shall have the right to offer evidence tending to prove any inaccuracy of such cost survey or any state of facts which would impair its probative value.
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I, Jay Deardorff Cook, Jr., was born in Chester, Pennsylvania, April 26, 1921. My secondary school education was received in the public schools of Haddonfield and Moorestown, New Jersey, and Fishburne Military School, Waynesboro, Virginia. I received the degree Bachelor of Arts in 1943 from Washington and Lee University. After serving for three years in the United States Marine Corps during World War II, I entered the Wharton School of the University of Pennsylvania. I received the degree Master of Business Administration in 1948. That same year I was appointed an instructor in the Department of Economics of Denison University, Granville, Ohio, and in 1951 I was appointed an assistant professor. In 1953 I was appointed an assistant professor in the School of Commerce and Administration of Washington and Lee University, Lexington, Virginia.