FUNCTIONAL DISCOUNTS: THEIR ECONOMIC
AND LEGAL IMPLICATIONS

DISSERTATION

Presented in Partial Fulfillment of the Requirements
for the Degree Doctor of Philosophy in the
Graduate School of The Ohio State
University

By

HENRY DEAN OSTBERG, LL.B., M. B. A.

****

The Ohio State University
1957

Approved by:

[Signature]
Adviser
Department of Business Organization
ACKNOWLEDGEMENTS

This study is dedicated to Dr. Theodore N. Beckman, Professor of Marketing, The Ohio State University, without whose continuous inspiration this research would never have been undertaken or finished. He gave this study much of his valuable time and extended to me personally countless favors and courtesies. For his generous encouragement, sympathetic guidance and indispensable help, I shall always be grateful. Much appreciation is also due to Dr. James H. Davis and Dean Frank R. Strong, both of The Ohio State University, who, although exceedingly busy with more important affairs, gave unstintingly of their time and ability during the preparation of this manuscript. There are two other individuals to whom I am greatly indebted for their assistance and fidelity. These are my wife, Evelyn Ostberg, whose patience and understanding during the many months I worked on this study were most gratifying, and Mrs. Marian Baldash, who not only typed and re-typed this manuscript, but who also made many excellent suggestions for its improvement.

February 1957

Henry D. Ostberg
PREFACE

Marketing, according to a widely accepted definition of the term, embraces all business activities necessary to effect the transfer of ownership in goods and to provide for their physical distribution. Determining the physical route and the chain of title which goods shall take in their journey from the point of production to the point of consumption is, therefore, one of the prime problems of marketing.

During the handicraft stage of production, this route was a simple one. Such consumer goods as were sold or bartered moved directly from maker to user. The formal distribution system was largely limited to market days, to periodic fairs, and to foreign trade activities. The advent of the Industrial Revolution brought with it a concomitant revolution in distribution. Middlemen of various kinds grew in importance and quickly became in-

1Harold H. Maynard and Theodore N. Beckman, Principles of Marketing (New York: Ronald Press, 1952), p. 3. Marketing is often defined to include services and intangibles as well as goods and merchandise. Ibid., p. 4. Since this study deals only with manufactured goods, the definition cited in the text above is entirely adequate.


dispensable to the complex marketing structure required in an economy of mass production.

In the United States, wholesalers assumed a dominant role in the distribution of many consumer goods by about the middle of the nineteenth century. Changing economic conditions, however, served to challenge the dominance of wholesalers in a number of these trades. The development of department stores after the Civil War, and the increasing productive capacity of American industry near the turn of the century and especially during the World War I period had the effect of inducing many manufacturers to deal directly with retailers, or at least with those who could buy in substantial quantities. While many manufacturers were eager to supplement established wholesale channels, few were willing to displace those channels. Manufacturers were, therefore, anxious to sell directly to

---

4"... (T)here is abundant evidence that during the first half of the nineteenth century wholesaling in the United States grew more rapidly than commodity production in general or than retailing." Harold Berger, Distribution's Place in the American Economy Since 1869 (Princeton: Princeton University Press, 1955), p. 69.

5For a brief history of the development of department stores in the United States, see Maynard and Beckman, op. cit., pp. 188-189. These department stores, many of which grew to large size even before 1900, often bought directly from manufacturers and circumvented wholesalers.

retailers, without unduly impairing the legitimate interests of wholesalers selling their lines. The practice of granting lower prices to wholesalers than to direct-buying retail establishments appears to have arisen largely in answer to this problem. These lower prices to wholesalers served a three-fold purpose: (a) to cover the expenses incurred by wholesalers in handling and selling the manufacturer's line; (b) to permit wholesalers to compete with the manufacturer in the sale of his line; and (c) to reflect the cost savings which frequently accrued to a manufacturer as a result of selling through wholesalers rather than directly to retailers.

The practice of granting lower prices to wholesalers than to retailers became increasingly prevalent in the American economy as more and more manufacturers started to rely on several competing channels to bring their goods to the consumer. The name "functional discount" was given to the difference between the prices charged to wholesalers and retailers, apparently because this difference was usually quoted as a reduction or discount from a list price and was designed to compensate wholesale

---


merchants for the functions they performed.

With the rapid expansion of chain store organizations during the second decade of the present century, the position of wholesalers as intermediaries in the distribution of consumer goods was further challenged. These chain store organizations frequently assumed marketing functions formerly performed by independent wholesalers. Most manufacturers not only agreed to sell chain stores directly, but often accorded them prices and terms more favorable than those offered to wholesalers. 9

The law left no doubt that wholesalers could not act in concert to prevent manufacturers and retailers from dealing directly with each other. Therefore, in order to protect their interests, a number of wholesaler groups undertook to induce suppliers who sold to both retailers and wholesalers to give the latter a price differential sufficient to cover their costs of operation (including a reasonable net profit). These attempts by wholesalers


to obtain wider and more loyal adherence to functional
discounts gave rise to several celebrated legal proceed-
ings. These will be analyzed later.

Although there is reason to believe that the
importance of functional discounts has increased as a di-
rect result of the rivalry between large-scale direct-
buying retailers, on the one hand, and small retailers and
their wholesale suppliers on the other, it should not be
assumed that functional discounts are only granted by
sellers who employ multiple channels of distribution. As
noted in Chapter II, functional discounts are also frequent-
ly offered by manufacturers who sell exclusively to whole-
salers.

It should be noted that functional discounts consti-
tute only one method of compensating wholesalers for the
functions they perform, and not the only method. Whole-
salers handling products on which they have not received
functional discounts obtain payment for their services by
adding to the cost price of these products an amount which

12 The record in the Mennen case, for example,
indicates that the National Wholesale Druggists Association
induced the Mennen Company in January of 1917 to adopt a
policy whereby wholesalers were granted functional dis-
counts which were not allowed to retailer cooperatives.
In the Matter of the Mennen Company, 4 F.T.C. 258 (1922).
Also see In the Matter of the Wholesale Dry Goods Institu-
tute, 34 F.T.C. 177 (1941).
is calculated to cover their operating expenses and, if possible, to permit a net profit. In business terminology, the amount which is added to the cost price of goods to arrive at the selling price is called a "markup." It could just as well be termed a "functional" markup, since it is designed to reward middlemen for the performance of marketing functions. The only real difference between a "functional" markup and a functional discount is that the latter affords a margin of profit (or markup) to wholesalers which is recognized and, in a sense, protected by the manufacturer of the product in question. A functional discount is just like a markup in that both are intended to pay wholesale merchants for the "value added" by their marketing activities.

---


14 See "Conclusions," Chapter IV, infra.

TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Chapter</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACKNOWLEDGMENTS.</td>
<td></td>
</tr>
<tr>
<td>PREFACE.</td>
<td></td>
</tr>
<tr>
<td>I. INTRODUCTION.</td>
<td>1</td>
</tr>
<tr>
<td>Statement of the Problem</td>
<td>1</td>
</tr>
<tr>
<td>Definition</td>
<td>2</td>
</tr>
<tr>
<td>Case Illustrations of Trade Discounts</td>
<td>8</td>
</tr>
<tr>
<td>Sources of the Data.</td>
<td>11</td>
</tr>
<tr>
<td>Delimitations.</td>
<td>15</td>
</tr>
<tr>
<td>Limitations.</td>
<td>16</td>
</tr>
<tr>
<td>The Plan of the Present Study.</td>
<td>17</td>
</tr>
<tr>
<td>II. FUNCTIONAL DISCOUNTS: THEIR HISTORICAL DEVELOPMENT AND RELATION TO ECONOMIC THEORY</td>
<td>19</td>
</tr>
<tr>
<td>The Development of Functional Discounts</td>
<td>19</td>
</tr>
<tr>
<td>Functional Discounts and Economic Theory</td>
<td>33</td>
</tr>
<tr>
<td>III. PRICE DISCRIMINATION.</td>
<td>37</td>
</tr>
<tr>
<td>Definition of Price Discrimination</td>
<td>37</td>
</tr>
<tr>
<td>The Theory of Price Discrimination</td>
<td>45</td>
</tr>
<tr>
<td>Functional Discounts as a Form of Price Discrimination</td>
<td>52</td>
</tr>
<tr>
<td>Evaluation of the Theory of Price Discrimination</td>
<td>57</td>
</tr>
</tbody>
</table>

ix
<table>
<thead>
<tr>
<th>Chapter</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>IV. FUNCTIONAL DISCOUNT THEORIES</td>
<td>63</td>
</tr>
<tr>
<td>&quot;Buying Distribution&quot; Theory</td>
<td>64</td>
</tr>
<tr>
<td>Compensation Theory</td>
<td>71</td>
</tr>
<tr>
<td>Selling Cost Theory</td>
<td>75</td>
</tr>
<tr>
<td>Inter-Competitive Theory</td>
<td>83</td>
</tr>
<tr>
<td>Cost Savings Theory</td>
<td>91</td>
</tr>
<tr>
<td>Incremental Revenue Theory</td>
<td>93</td>
</tr>
<tr>
<td>Conclusions</td>
<td>96</td>
</tr>
<tr>
<td>V. FUNCTIONAL DISCOUNTS UNDER THE CLAYTON ACT</td>
<td>101</td>
</tr>
<tr>
<td>The Right to Compete Under English Common</td>
<td>101</td>
</tr>
<tr>
<td>Law</td>
<td></td>
</tr>
<tr>
<td>The Right to Compete in the United States</td>
<td>106</td>
</tr>
<tr>
<td>The Sherman Act</td>
<td>111</td>
</tr>
<tr>
<td>The Clayton Act</td>
<td>115</td>
</tr>
<tr>
<td>Functional Discounts Under the Clayton Act</td>
<td>117</td>
</tr>
<tr>
<td>VI. LEGISLATIVE HISTORY OF THE ROBINSON-PATMAN ACT</td>
<td>135</td>
</tr>
<tr>
<td>The Robinson-Patman Act</td>
<td>137</td>
</tr>
<tr>
<td>Statutory Construction</td>
<td>142</td>
</tr>
<tr>
<td>Chain Store Investigation</td>
<td>144</td>
</tr>
<tr>
<td>Action in the House of Representatives</td>
<td>145</td>
</tr>
<tr>
<td>Action in the Senate</td>
<td>155</td>
</tr>
<tr>
<td>Conclusions</td>
<td>158</td>
</tr>
<tr>
<td>Chapter</td>
<td>Page</td>
</tr>
<tr>
<td>---------</td>
<td>------</td>
</tr>
<tr>
<td>VII. INJURY-TO-COMPETITION REQUIREMENT OF THE ROBINSON-PATMAN ACT</td>
<td>169</td>
</tr>
<tr>
<td>Potential Injury</td>
<td>176</td>
</tr>
<tr>
<td>Injury to Competitors</td>
<td>187</td>
</tr>
<tr>
<td>Substantial Injury</td>
<td>190</td>
</tr>
<tr>
<td>Injury Traceable to Price Discrimination</td>
<td>195</td>
</tr>
<tr>
<td>Reasonably Unavoidable Injury</td>
<td>200</td>
</tr>
<tr>
<td>Levels of Competition</td>
<td>202</td>
</tr>
<tr>
<td>Summary</td>
<td>206</td>
</tr>
<tr>
<td>VIII. FUNCTIONAL DISCOUNTS UNDER THE ROBINSON-PATMAN ACT</td>
<td>209</td>
</tr>
<tr>
<td>Functional Discounts and Injury to First-Line Competition</td>
<td>220</td>
</tr>
<tr>
<td>Functional Discounts and Injury to Second-Line Competition</td>
<td>225</td>
</tr>
<tr>
<td>IX. FUNCTIONAL DISCOUNTS UNDER THE ROBINSON-PATMAN ACT: SOME OF THE PROBLEMS INVOLVED</td>
<td>234</td>
</tr>
<tr>
<td>Split-Function Problem</td>
<td>236</td>
</tr>
<tr>
<td>&quot;Leakage&quot; Problem</td>
<td>249</td>
</tr>
<tr>
<td>X. CLASSIFICATION OF CUSTOMERS</td>
<td>262</td>
</tr>
<tr>
<td>Classification of Single-Function Purchasers</td>
<td>262</td>
</tr>
<tr>
<td>Classification of Split-Function Purchasers</td>
<td>264</td>
</tr>
<tr>
<td>The Doubleday Decision</td>
<td>266</td>
</tr>
<tr>
<td>Classification of Wholesalers Financially Affiliated With Retailers</td>
<td>275</td>
</tr>
<tr>
<td>Chapter</td>
<td>Page</td>
</tr>
<tr>
<td>---------</td>
<td>------</td>
</tr>
<tr>
<td>X. CLASSIFICATION OF CUSTOMERS (continued)</td>
<td></td>
</tr>
<tr>
<td>Summary of Classification Principles</td>
<td>283</td>
</tr>
<tr>
<td>&quot;Meeting Competition&quot; Theory of Functional Discounts</td>
<td>285</td>
</tr>
<tr>
<td>Legality of the &quot;One-Price&quot;</td>
<td>287</td>
</tr>
<tr>
<td>XI. CONCLUSIONS AND RECOMMENDATIONS</td>
<td>297</td>
</tr>
<tr>
<td>PUBLICATIONS CITED</td>
<td>308</td>
</tr>
<tr>
<td>LEGAL PROCEEDINGS CITED</td>
<td>320</td>
</tr>
</tbody>
</table>
CHAPTER I
INTRODUCTION

STATEMENT OF THE PROBLEM. A functional discount is a price reduction granted by a seller to a wholesaler, presumably in order to reward him for the functions he performs. Functional discounts are granted by many American manufacturers. Considerable confusion, nevertheless, exists regarding the legal position of these discounts under current federal antitrust laws. In 1914 the Congress of the United States passed the Clayton Act, which prohibited sellers from discriminating in price among purchasers of like grade, quality or quantity of a commodity "where the effect may be to substantially lessen competition...." Functional discounts were not specifically mentioned in the Act. They were, however, conceivably within its purview, since such discounts result in charging a lower price to wholesalers than to other classes of customers. As will be shown later, the courts interpreted the Clayton Act in such

---

a way that it was widely concluded that functional discounts were normally exempt from the coverage of the Act. This was the situation until 1936. In that year Congress enacted the Robinson-Patman Act to amend the Clayton Act. The Robinson-Patman Act altered the provisions which had been thought to exempt functional discounts from the restrictions imposed by the Clayton Act. The Robinson-Patman Act, however, neither specifically prohibited nor specifically sanctioned functional discounts. The legality of these discounts has been in controversy ever since.

Considerable uncertainty also exists with respect to the economic implications of functional discounts. Their effect on the vitality of the competitive process, for example, has never been thoroughly explored. The purpose of this study is, therefore, (1) to analyze the basic characteristics of functional discounts; (2) to discuss their effect on competition; and (3) to outline the present legal status of such discounts under the Clayton Act, as amended by the Robinson-Patman Act.

DEFINITION. This is an inquiry into the legal and economic implications of functional discounts. A precise definition of the term "functional discount" is, therefore, essential. Unfortunately, there have been a number of misleading interpretations of the term which have brought about
unnecessary confusion in the field.

Zorn and Feldman, authors of one of the early authoritative texts on the Robinson-Patman Act, state that functional discounts involve a "systematic discrimination between classes of customers related entirely to differences in the respective roles played by these classes in the further distribution, processing, or consumption of the product in question, available equally to all buyers performing identical functions, regardless of individual differences in quantity or manner of purchases." Two elements in this definition deserve emphasis. The first of these is that functional discounts are granted for the roles played by persons or firms in the economic structure, i.e., for the functions performed by these persons or firms in the "further distribution, processing, or consumption of the

---

4For example, Richard S. Kelley, writing in the California Law Review, states that a functional discount is a "differential in price extended by a seller to a buyer who, because of the buyer's performance of distribution functions or elimination of the need for the performance thereof by the character of his buying, is possessed of greater bargaining power than other buyers." Professor Kelley, Professor at the Creighton University Law School, considers functional discounts to be the price concessions which a buyer is able to extract from a seller by the use of effective bargaining power, and to have no relation to any accepted classification of buyers. This interpretation of functional discounts is completely at variance with the generally accepted view among lawyers and marketing experts. Richard S. Kelley, "Functional Discounts Under the Robinson-Patman Act," California Law Review, XL (Winter-1952-1953), 526.

product in question." The second point is that functional discounts should be available equally to all persons or firms within a particular classification, "regardless of individual differences in quantity or manner of purchase." This second element asserts the basic difference between so-called quantity discounts and true functional discounts.

Quantity discounts are price reductions granted by a vendor to a customer on purchases which are larger than those to which the base price applies. The amount of these discounts varies either with the size of the individual shipment to the customer or with the volume of his total purchases over a period of time. In either case, the amount depends upon the purchasing practices of the specific customer receiving the discount. Functional discounts, on the other hand, are reductions which vary with the classification assigned to the customer, viz., whether he is deemed to be a manufacturer, wholesaler, retailer, or any one of the other buyer classifications which the seller may recognize. Functional discounts are not affected by the buyer's individual purchasing practices. Some relationship may, of course, exist between the amount of such discounts granted to a particular group and the quantity

---

\(^6\)Maynard and Beckman, \textit{op. cit.}, pp. 666-667. The "base" price is that which is set for those who do not buy in sufficient amounts to qualify for a quantity discount.

\(^7\)\textit{Ibid.}, p. 667.
purchased by the typical member of that group. However, a customer properly belonging to a recognized classification is entitled to the functional discounts of that group "regardless of (his) individual differences in quantity or manner of purchase." In other words, functional discounts are granted to broad groups of customers, whereas quantity discounts are given to individual customers, reflecting the savings to the seller resulting from the amount the individual customer purchases.

Albert G. Seidman, Chief of the New York Office of the Federal Trade Commission, holds a view similar to that of Zorn and Feldman. "A functional discount," he has stated, "is one based solely upon the distributional status of the customer. A functional discount is extended without regard to differences in quantity or the cost of manufacture, sale or delivery, but in accordance with the classification of the customer as a manufacturer, distributor, jobber, wholesaler, chain store, retailer or consumer."

Professor Malcolm P. McNair of the Harvard School of Business Administration also agrees with this definition. He has said: "The trade, or functional, discount is a percentage reduction from a list price offered to a

---

8Lecture by Albert G. Seidman before the Practicing Law Institute, New York City, on July 14, 1952. It is to be doubted, however, that functional discounts, or trade discounts, are ever granted to ultimate consumers. It is, therefore, assumed that Mr. Seidman referred to industrial users when including consumers as a possible classification which might be entitled to functional discounts.
particular classification of customers and differing from the percentage reduction granted to some other classification of customers.... Trade discounts have no direct relation to the quantity involved.\(^9\)

Zorn and Feldman, Seidman and McNair employ the term "trade discount" interchangeably with that of "functional discount." This is not entirely justifiable. Maynard and Beckman point out that the term "functional discount" has been traditionally used to refer specifically to the discount granted to wholesalers (and to those assuming wholesaling functions) for the performance of distribution activities. The term "trade discount" is broader than this, including any price reduction granted to a purchaser on the basis of his classification at a particular level of the distribution structure. Consequently, a price reduction available to retailers, but not to ultimate consumers, would be a trade discount, not a functional discount. It would seem desirable to preserve this distinction between the two concepts, even though it has been blurred in almost all of the current literature on the subject.


\(^{10}\)Maynard and Beckman, *op. cit.*, pp. 662-663.

\(^{11}\)Ibid.
As used in this study, the term "trade discount" is defined as a price reduction which makes allowance for the trade status of the customer, as determined by the level of distribution at which he operates. The term "functional discount" is used to signify a trade discount granted to wholesalers and to those performing wholesale functions.

It should be noted that while the terms "trade discount" and "functional discount," in their strict sense, imply a discount or deduction from a base price, they also refer to any price schedule which offers lower net prices to some classes of customers than to others. Consequently, a pricing structure which provides for appropriate price differentials among different classes of accounts may be said to involve trade or functional discounts.

It is important to re-emphasize at this early stage in the study a fact already noted in the Preface. This is that functional discounts are nothing more than trade margins earned by wholesalers by virtue of their performance of indispensable functions. Functional discounts are unique only in that they provide wholesalers with markups which are recognized and, in a sense, protected by the manufacturer of the product in question. Like other markups, functional discounts are designed to compensate middlemen for the "value added" by their marketing activities.
CASE ILLUSTRATIONS OF TRADE DISCOUNTS. Citation of typical trade discount structures in representative industries will serve to amplify and clarify the meaning of the previous definition. The first illustration of trade discounts is supplied by the Lionel Corporation. This firm, which manufactures model railroads and other "scientific" toys, offers different discounts from their retail prices to three separate classes of buyers. One classification of customers includes jobbers, chain stores and mail order houses; all purchasers in this group receive multiple discounts of 40% and 20% from the retail price. Department stores constitute a second classification, which is allowed a single discount of 45%. A few "miscellaneous accounts" make up the third classification, and they are accorded discounts of 40% and 5%. Small retail stores are not normally sold directly by the company; they usually buy from jobbers handling the Lionel line at a single discount of 40%. This allows the jobber a functional discount of 20%, since he purchases from the Lionel Company at multiple discounts of 40% and 20% off the suggested retail price. The retailer, in turn, realizes a gross margin of 40% if he sells at list price. A department store, buying directly from the Lionel Corporation, receives a trade discount of 45% off list price.

---

12This information is based on personal interviews and upon legal briefs exchanged between the parties in Philip Klein v. Lionel Corporation et al., 138 Fed Supp 560 (1956).
Another illustration, involving a similar trade discount structure, is found in the automotive parts and accessories industry. One carburetor manufacturer, for example, has established the following discounts for five different classes of accounts which he recognizes:

- Warehouse Distributors: 65%
- Jobbers: 55%
- Franchised Car Dealers: 45%
- Repair Shops, with Inventory: 40%
- Repair Shops, without Inventory: 25%

This manufacturer usually sells directly only to warehouse distributors and to some jobbers, the former at 65% off the retail price and the latter at 55% off the retail price. He expects these distributors and jobbers to resell to other accounts at the above discount structure. Thus, a warehouse distributor is supposed to sell to those jobbers who do not buy directly from the manufacturer at 55% from the retail price, to franchised car dealers at a 45% discount, to repair stations maintaining an inventory of automotive parts at 40% off list, and to repair stations without inventory at 25% from list. Jobbers receive a 55% discount whether they purchase from a warehouse distributor or directly from the manufacturer; they in turn are expected to sell to franchised car dealers, to repair stations with inventory and to repair stations without inventory at
discounts of 45%, 40% and 25%, respectively.

It should be observed that these trade discounts are largest at the level nearest the manufacturer and that they decrease as they move closer to the retail market. This is true of all trade discounts which are quoted to different classes of buyers at a reduction from retail price, since the discounts at any one level of distribution under such a plan must include all discounts which will be granted at subsequent levels in the distribution chain. However, the net trade discount, i.e., that part of the reduction from list price which is not passed on to subsequent distributors - in other words, the gross margin - is not necessarily larger at levels close to the point of production than it is at levels further away. In fact, it is usually smaller, since the costs of performing retail functions in any one industry are normally higher than the costs of performing wholesale functions in the same industry. It will be seen later that the size of functional discounts at any given level must be related to the cost of performing the necessary marketing functions at that level.

---

13 This information is based on personal interviews and data included in Charles N. Davisson, The Marketing of Automotive Parts (Ann Arbor: University of Michigan, 1954), pp. 431-447.

SOURCES OF THE DATA. A careful survey of the better-known basic texts in the field of economics discovered not a single reference to functional or trade discounts. A similar scrutiny of treatises in the more specialized area of pricing theory found only one which devoted more than a short paragraph to such discounts. On the other hand, informative discussions regarding the nature of functional discounts were found in several books dealing with the economic implications of governmental anti-trust regulation.

Considerable attention has been given to functional discounts in marketing literature. Many of the basic texts in the field refer to them in their discussions of price policies. Several articles in leading business periodi-


cals have also analyzed selected aspects of such discounts.

A search of the literature in the legal field uncovered several law review articles dealing with the status of functional discounts under the Robinson-Patman Act. None of these articles, however, came to grips with the whole range of issues and problems involved in the granting of such discounts.

The data used in this study was collected from eight major sources: (1) basic and advanced texts in a large number of fields, including economic principles, economic analysis, pricing theory, marketing principles, wholesaling principles,

---


and governmental regulation of business; (2) articles found in the general business and marketing publications, such as the Harvard Business Review, Printers' Ink, Journal of Business, and the Journal of Marketing, dealing with the development of marketing institutions, modern pricing principles, the nature of competition in the American economy, and related topics; (3) law review articles pertaining to various aspects of price discrimination; (4) leading


22These articles were used to guide and give direction to the original research undertaken in connection with this study. Some of these articles were listed in footnote 19, supra.
Federal Trade Commission decisions and court cases dealing with the legal status of functional discounts; (5) those parts of the Congressional Record which contain debates and reports in the House of Representatives and the Senate concerning the Robinson-Patman Act; (6) some of the governmental publications dealing with the nature, quality and kind of competition sought by the federal administrative agencies charged with the responsibility of regulating business activities in various lines of commerce; (7) interviews with trade association executives in the major consumer-goods industries, Federal Trade Commission officials, attorneys engaged in antitrust litigation, and executives responsible for pricing decisions in their firms;

23 These cases are cited throughout this report, and especially in Chapters V, VII, VIII, and IX.

24 See Chapter IV.

25 Two of the most significant publications falling into this category are: Effective Competition (Washington: Superintendent of Documents, 1953); Sixth Annual Report of the Select Committee on Small Business, United States Senate (Washington: Government Printing Office, 1956).

26 A few of the persons interviewed were: Mr. William MacMillan, Executive Secretary, Hobby Industry Association of America; Dr. Albert B. Fisher, Research Director, National Wholesale Druggists' Association; Mr. Ralph Langsam, Vice-President, Masbac Inc. and former President, Toy Jobbers Association; Dr. Rudolph L. Treuenfels, Vice-President, National-American Wholesale Grocers' Association; and Albert G. Seidman, Chief of the New York Office of the Federal Trade Commission.
(8) various miscellaneous sources, including newspapers, trade association records, and the business correspondence of several firms which permitted access to their files.

DELIMITATIONS. First, this study is limited to a consideration of the economic conditions and marketing institutions existing in the United States. Second, with few exceptions, the discussion herein is restricted to the marketing of consumer goods. Functional discounts are not unknown in the industrial market; however, they are relatively less important and often assume somewhat different characteristics in the industrial market. Finally, the analysis of the legal status of functional discounts is confined to federal statutes, federal court cases, and Federal Trade Commission decisions. While a number of states have adopted anti-discrimination laws, which might possibly affect the legality of functional discounts granted in those states, these are not discussed in this study. It appears that no attack upon functional discounts has ever

---

27 Consumer goods are those which are bought and used by ultimate consumers in essentially their present state. Maynard and Beckman, op. cit., p. 29. Industrial goods, on the other hand, are those which are bought for further processing, or that are used for business purposes. See Beckman and Engle, op. cit., p. 180.

been successful under these state statutes.

LIMITATIONS. Very little, almost nothing, has been written about the history and development of the institution known as functional discounts. Although an outline of the evolution of such discounts is presented in this study, it is limited in scope. Exhaustive research into this phase of the subject was not deemed essential in order to attain the basic objectives of this study. This is perhaps a subject for future inquiry, possibly of sufficient importance to warrant an independent research undertaking.

In analyzing the Federal Trade Commission decisions and the federal court cases relating to the issue of the legality of functional discounts, only the leading cases on each point have been cited. The inclusion of all Federal Trade Commission holdings and of all federal court opinions which might bear, directly or remotely, on the permissibility of functional discounts under the Clayton Act, as amended by the Robinson-Patman Act, would make this

\[29\] The Federal Trade Reporter, which lists all important court cases involving trade law issues, refers to no court decision involving the legality of functional discounts under any state anti-discrimination statute. The Reporter does note that price differentials between customers in different classifications are expressly permitted under California law. Federal Trade Reporter (Chicago: Commerce Clearing House), ¶ 3926.

\[30\] See Chapter II, infra.
study entirely too long. Selectivity has, consequently, been used in the rulings and opinions discussed herein.

THE PLAN OF THE PRESENT STUDY. In a recent speech, former Federal Trade Commission Chairman Edward Howrey urged that every case in the field of antitrust law should be grounded in an "acceptable economic theory as well as a valid legal theory." This does not mean, of course, that whatever is economically desirable is per se the law of the land; it does not mean either that whatever is the current law necessarily reflects sound economic reasoning. It does signify, however, that there should be a continuous effort to place the best available knowledge in the field of economics at the disposal of legislators and judges.

In this study, involving an inquiry into the economic and legal implications of functional discounts, it is necessary to differentiate clearly between the dictates of law and the admonitions of economics. The first four chapters, therefore, deal primarily with the economic aspects of functional discounts. Chapter II briefly traces the historical development of these discounts since World War I and examines their place in classical and neo-

classical economic theory. Chapter III discusses the theory of price discrimination, with emphasis upon those aspects which contribute to a better understanding of functional discounts. Chapter IV develops a number of different theories to explain the existence and nature of functional discounts.

Chapters V through X deal mainly with the legal problems presented by functional discounts, although the economic principles previously developed are integrated into the discussion. The legal status of functional discounts under the Clayton Act of 1914 is outlined in Chapter V. The legislative history of the Robinson-Patman Act of 1936, specifically as it affects the current status of functional discounts, is examined in Chapter VI. The requirements of the Robinson-Patman Act with regard to injury to competition are discussed in Chapter VII. The various Federal Trade Commission holdings and court decisions which deal with the legality of functional discounts under the Robinson-Patman Act are analyzed in Chapters VIII, IX, and X. Some conclusions and recommendations are presented in Chapter XI.
CHAPTER II
FUNCTIONAL DISCOUNTS: THEIR HISTORICAL DEVELOPMENT
AND RELATION TO ECONOMIC THEORY

THE DEVELOPMENT OF FUNCTIONAL DISCOUNTS. Some of the events and forces which have shaped the development of functional discounts were outlined in the Preface to this study. It was noted there that functional discounts were originally granted by manufacturers who sought to sell directly to retailers, while at the same time continuing to sell to wholesalers. It would not be correct, however, to assume that such discounts are granted only by manufacturers who employ more than one channel of distribution to bring their products to the ultimate consumer. Sellers who regulate the resale price of their line, even though they distribute through only one channel, must incorporate functional discounts into their pricing structure. Thus, a product which is fair traded at, for example, five dollars must be sold to wholesalers and retailers at a discount sufficient to cover their average expenses in handling and selling the product and to leave a reasonable net profit.

On the other hand, functional discounts offered by a seller who uses only one channel of distribution and who does not enforce retail price maintenance may be illusory. In the absence of fair trade agreements, a suggested resale price will have little or no bearing upon the price which is actually established in the market. Thus, the "function-
al discounts" granted under such circumstances are nothing
more than reductions from a non-existing base.

While the desire to make several channels of
distribution mutually competitive is only one of a number
of reasons for the use of functional discounts, it is un-
doubtedly an important one. It is not surprising, therefore,
to find that the use of functional discounts grew in the
United States as increasing numbers of manufacturers turned
to multiple channels of distribution to carry their products
to the consumer. Thus, the American Tobacco Company intro-
duced "jobber discounts" in 1913 and, at the same time,
intensified its campaign to sell directly to the larger
chain organizations.

In 1922 the history-making Mennen case was taken to
the Second Circuit Court of Appeals for review. At issue
was the legality of a price differential in favor of whole-
salers, which was not made available to retailer-coopera-
tives. This case was interpreted widely as a test of the

---

1To illustrate: One small wallet manufacturer in
New York City, who sells only to leather-goods and depart-
ment stores, quotes his line at retail price, less 65%. He
does not fair trade. This 65% "trade discount" is avail-
able to all of his accounts. The purpose of this pricing
method is to impress retailers with the large potential
profit the line can earn. The "discount" is, however,
fictitious, since the wallets made by this manufacturer are
sold almost everywhere at much less than the suggested re-
tail price.

2See "American Tobacco Company's New Jobbing
status of functional discounts under the Clayton Act. It is significant, therefore, that a number of trade associations of wholesalers immediately requested permission to participate in these proceedings as amici curiae. The fact that these groups were willing to pay counsel fees to represent them indicates, in the words of Ralph S. Alexander, that functional discounts were at that time "sufficiently general in use in these trades to be worth defending." The wholesaler associations which were granted leave to participate in the Mennen litigation included the National Wholesale Dry Goods Association, the Wholesale Hardware Association, the National Wholesale Jewelers' Association, the National Floor Covering Association, and the National Supply and Machinery Distributors Association.

In 1922 the editors of Printers' Ink even went so far as to state that functional discounts were a "practically uniform custom" in the United States. This was un-

---


4Amici curiae means, literally, "friends of the court." Permission to file briefs as amici curiae may be granted by a court to persons who have no right to appear in a suit, but who seek to introduce arguments or evidence to protect their own interests. Henry Campbell Black, Black's Law Dictionary (St. Paul: West Publishing Co., 1933), p. 105.


integrated retailers, became a matter of contention. A forceful argument could be made for the position that retailers performing wholesaling functions should be entitled to such discounts. This problem, however, brought to the forefront the bitter conflict between the "new" and the "orthodox" members of the marketing community; it focused attention on the rivalry between "small" and "big" business, with all the prejudices and emotions that this struggle invariably evokes.

It was widely asserted that the granting of functional discounts to integrated retailers might afford them a major competitive advantage over "independent" wholesalers and retailers. In the prevailing life and death struggle between the competing types of retail institutions, such an advantage involved social and political

---

9Large-scale retailers were often able to purchase goods at a lower price than wholesalers, according to the Federal Trade Commission investigation of chain stores. See Chapter VI, infra. These lower prices, however, were usually the result of quantity discounts, advertising allowances, brokerage fees and other special concessions granted to large-scale retailers. It appears that such retailers were rarely granted functional discounts, as the term is correctly understood. See Alexander, op. cit., pp. 314-315.

as well as economic considerations.

The number of chain stores and other mass distributors, and their sales volume, multiplied rapidly after World War I. Since most of these large-scale retailers bought directly from manufacturers, often at lower prices than wholesalers, they constituted a threat not only to their retail competitors, but to the wholesalers who supplied these retail competitors. In an effort to curb the further expansion of chains, independent retailers cooperated with many wholesalers to secure the passage of laws designed to check the growth of chain store organizations. Their joint efforts were not unsuccessful. They were able to

11 Assuming, for a moment, that it were universally agreed that independent retailers and wholesalers were less efficient than integrated chain organizations, this, in itself, does not necessarily signify that chain stores should be permitted to displace "independents." The argument might, indeed, be made that, although less efficient, independent stores provide certain social and political values which should be preserved, such as economic freedom, individualism, etc. The problem, therefore, transcends economic considerations, and involves social and political implications.


13 For a discussion of the attitude of various retail and wholesale trades towards price control laws and related legislation, see E.T. Grether, "Solidarity in the Distributive Trades in Relation to the Control of Price Competition," Law and Contemporary Problems, IV (June 1937), 375.
secure the enactment of chain store taxes in nearly thirty states, to promote the passage of various state laws relating to price cutting, and were influential in inducing courts and administrative agencies to interpret certain licensing statutes to the disadvantage of the chains.

Passage of the National Industrial Recovery Act in 1933 was seen by many wholesalers as an opportunity to re-establish their dominant positions in many lines of commerce. The Act was designed to "restore order" and remedy the "dislocations" prevalent in the economy. To the wholesaler, this meant essentially one thing: a chance to write the wholesaler's differential into the law of the land. The National Industrial Recovery Administration, thus, became the new battleground for the conflict between

---


15 Ibid., pp. 515-518.

16 In many states, for example, it is not possible to obtain the licenses necessary to operate a chain of liquor stores.


18 Ibid., p. 28.

mass distributors and "independents." The Administration, anxious to secure favorable terms for labor in the distribution trades, undertook to negotiate with the interested parties in order to obtain agreement on such terms. In return for approving the wage and hour conditions desired by the Recovery Administration, wholesalers insisted upon provisions which would unequivocally recognize their right to functional discounts. After protracted negotiations and many revisions, the now-famous Article VIII of the basic Wholesaling Code was adopted. This article authorized divisional authorities (under the Wholesaling Code) to call a conference of all interested parties, including primary sellers (manufacturers, importers, etc.) "for the purpose of defining and establishing price differentials which shall be fair and reasonable in relation to the nature and extent of the distributing services and functions rendered by each buying class."

The article further authorized the divisional code authorities, after adequate hearings, to announce formally

---

20In these negotiations with the representatives of various wholesale trades, the National Industrial Recovery Administration was represented by two well-known marketing professors, Kenneth Dameron and Ralph S. Alexander. For a contemporary commentary on Article VIII of the Wholesaling Code, see L.D.H. Weld, "Fixed Price Differentials," Printers' Ink, May 31, 1934, p. 37.

fair price differentials on specific products. The code declared that it would be an unfair trade practice for a wholesaler to handle any product on which he had not received the price differential established by the divisional code authority for that type of product.

Although Article VIII was not compulsory, it was quickly implemented in a number of industry codes. For example, the Lumber and Timber Products Code stipulated:

(a) Each division, and each Subdivision, through its designated agency, shall establish for its members and file with the Authority a schedule for maximum discounts to be allowed to wholesalers for distribution services. Said discounts when approved by the Authority shall remain in effect until changes are approved.

Similar provisions were contained in a number of other codes. The Wallpaper Manufacturers' Code stated that "failure to maintain an adequate differential in the selling prices to the wholesaler and retailer" was an unfair method of competition. The Toy and Playthings Industry's Code gave the divisional authority the power to

22Ibid., p. 80.
23Ibid.
make recommendations "regarding price differentials for all channels of distribution." The Fire Extinguishing Appliance Code empowered the divisional authority to establish "standard differentials in price to the various classes of trade factors," which would be binding upon members of the industry.

All these provisions met with the full approval of wholesalers and with the unqualified disapproval of large-scale retailers. Chain stores, mail order houses and large department stores argued that discounts should be based upon a customer's volume of business, the size of his orders, the marketing functions which he performs, and not upon an arbitrary classification as either "retailer" or "wholesaler."

These large-scale retailers further argued that if trade discounts were to be accorded on the basis of a wholesaler-retailer classification, they were entitled to recognition as wholesalers. They cited the wording of Article VIII of the Wholesaling Code to support their posi-

---

27 Ibid., p. 514, 518.
28 Zorn and Feldman, op. cit., pp. 31-36.
30 Ibid.
tion that price differentials should be allowed in relation to "functions rendered by each buying class." Independent merchants took issue with this claim. They maintained that the method of selling, and more specifically, the type of customers to which a distributor sold were the determining factors in classifying him as a wholesaler or a retailer. The "independents" eagerly cited a 1915 court decision to substantiate their position and, what was perhaps equally important, they did not hesitate to exert their substantial political power to gain recognition of their views. In any event, buyers were classified as wholesalers or retailers under most of the Recovery Administration codes on the basis of their selling methods, and not on the basis of the functions which they performed.

The classification of customers for the purpose of granting trade discounts presented many problems. Each buyer insisted upon a classification which would enable him to secure the lowest possible price. His competitors, on the other hand, were not unhappy to see him grouped with those required to pay the highest price. Much bickering and conflict ensued. Mail order houses, for example, were

31See Great Atlantic and Pacific Tea Company v. Cream of Wheat Company, 227 Fed 46 (1915). This case is discussed in Chapters V and X, supra.

32Zorn and Feldman, op. cit., p. 31. A few integrated retailers did, however, secure recognition as wholesalers under the codes.
originally classified as retailers under the Plumbing Fixtures Industry Code; they were reclassified as wholesalers only after considerable wrangling in the trade. No elaboration is needed to show the serious repercussions which could ensue from an unfavorable classification. The State of New York, to cite just one example, was designated as a retail buyer in the purchase of petroleum products; this increased the cost of such products to the taxpayers of New York by about three-quarters of a million dollars annually.

The "great experiment" of the National Industrial Recovery Administration came to an end with the United States Supreme Court decision in the Schechter Poultry case, which declared vital sections of the National Industrial Recovery Act unconstitutional. Since that time, several writers have undertaken the task of assessing the impact of the N.I.R.A. upon the American economy. Most agree that the price differential provisions of both the manufacturing and the wholesaling codes were of limited effectiveness.

N.I.R.A. officials, although agreeing to such provisions in

33Zorn and Feldman, op. cit., pp. 36-37.
36Burns, op. cit.; Zorn and Feldman, op. cit.; others.
return for certain wage and hour stipulations, appear to have harbored serious doubts about the desirability of requiring sellers to grant trade and functional discounts. As a consequence, several manufacturing code authorities repeatedly postponed approving the discount schedules applicable to various customer classes. Similarly, wholesaling code authorities refused to sanction boycotts by wholesalers designed to induce compliance by manufacturers with the few discount schedules which had been approved. It would seem, therefore, that the opposition of the large-scale retailers to functional discounts, as they were embodied in the various industry codes, was not without effect upon N.I.R.A. officials.

One conclusion seems inescapable from the attempt of the National Industrial Recovery Administration to regulate price differentials among classes of customers. This is that economic considerations alone, even if they could be agreed upon by the contending parties, do not necessarily supply a complete solution to the problem. Since such regulation may carry with it the power to determine the survival or destruction of existing institutions and vested interests, social and political issues must be fully

---


considered. Economic efficiency cannot be the only, perhaps not even the dominant, criterion by which to measure the value of an institution.

The demise of the National Industrial Recovery Administration returned functional discounts to the status they held before 1933, that is, permitted—but not required—by law. Passage of the Robinson-Patman Act in 1936 tended to cast some doubt, at least temporarily, on the legality of such discounts. The Act does not, however, appear to have curtailed their use to any significant extent.

No statistics are available to determine the current importance of functional discounts in the American economy. Almost no information has been collected to indicate the number of sellers who grant functional discounts to wholesalers, the number of transactions involving such discounts, or the dollar volume of functional discounts granted in any industry. Lack of such data is not surprising. The reluctance of business firms to divulge information about their pricing practices is well known.

In an attempt to obtain some general idea of the importance of functional discounts in the American economy

---

40 See Chapter V, infra.
41 See Chapters VIII and IX, infra.
today, the author interviewed trade association executives in some of the major consumer-goods industries. The conclusion drawn from these interviews is that, at the present time, about 35% to 40% of all sales to wholesalers involve bona fide functional differentials in favor of such wholesalers. It must be emphasized that this figure varies from industry to industry, and may change from month to month. It must also be emphasized that this composite estimate is based upon the opinions of a relatively small sample of experts in representative consumer-goods industries.

FUNCTIONAL DISCOUNTS AND ECONOMIC THEORY. The wide prevalence of trade and functional discounts in many American industries has been previously indicated. It is surprising, therefore, to find that formal economic theory almost completely neglects to consider such discounts as an aspect of price adjustments. A study of the leading treatises in the field of price economics reveals very few references to such discounts. Thus, Robert B. Pettengill in his highly-regarded text makes no mention whatever of such discounts. The same is true of Joe S. Bain. Even Jules Backman, who sought to integrate theory with practice in his

treatise, merely mentions such discounts, without delving into their purpose, implications or importance.

Several reasons seem to account for this failure of economists to analyze and evaluate functional discounts in terms of economic principles. In the first place, much of present-day economic theory still conforms to the fictions of pure competition and pure monopoly, with little study of the vast intervening expanse. Under a state of pure competition, goods move from producer to consumer, by assumption, without any costs of selling. This eliminates the existence of middlemen and, of course, obviates the need for trade discounts.

Secondly, in taking their cues from Adam Smith, classical and neo-classical economists have become enraptured by the idea of a long-run "normal" price, a mythical point towards which all prices are thought to gravitate. This focusing of attention on a single equilibrium price tends to negate the existence of price differentials, except on a temporary basis. Even such pioneers in economic theory as Edward Chamberlin and Mrs. Joan Robinson, both of whom have long sought to bridge the gap between the models of formal economic theory and the realities of the business world, have not been able to divest themselves completely of the

thought patterns of their early training in economic logic. Like their classical predecessors, they are all too often preoccupied by a search for the price which will be established after long-run economic adjustments. In the absence of market imperfections, this "normal" price is deemed a single one, available to all. Price discrimination is, consequently, considered worthy of study only in relation to the "market imperfections" which make it possible and in terms of the monopoly profits which it permits. Trade discounts, to the extent that their existence is even acknowledged, are then forced to fit into the mold of these preconceptions about price discrimination.

A third reason for the failure to include functional discounts in the house of economic theory is that such discounts are essentially an institutional manifestation, arising out of the unique marketing forces which have shaped the American economy. They have no place in any syllogistic theory built upon assumed conditions. They can be fully explained only in terms of the factors and forces in the marketing structure which have brought them about.

While functional discounts are not given specific status in the field of economics, there is little doubt that

most economists consider them as a species of price discrimination. The limitation of such a view has been implicit in the preceding discussion. It would be reckless, however, to assert that no affinity of any kind existed between price discrimination of pricing theory and functional discounts of pricing practice. It is appropriate, therefore, to study the theory of price discrimination to discover what it can contribute to a better understanding of the institution of functional discounts.

---

DEFINITION OF PRICE DISCRIMINATION. Economists have not found it easy to agree on a single definition of price discrimination. There are perhaps as many definitions of this concept as there are authors who have written in the field.

The term "discrimination" is usually defined, in its non-technical sense, as the "act or power" to "set apart as different," "to differentiate," "to discern distinctions." As such, it is not necessarily an evil act or power. People can take justifiable pride in their ability to "discriminate" between good and evil, in the possession of "discriminating" taste in the arts, and in being "discriminating" in the selection of their clothes. However, it appears that the term "discrimination" has acquired an unfavorable connotation among many people in recent years, largely as a result of the fact that it is often associated with practices designed to deprive minority groups of equal citizenship status.

---

1 This chapter deals with the economic implications of price discrimination. The legal aspects of discrimination are discussed in subsequent chapters.

Despite the absence of a generally accepted definition of the term "price discrimination," certain conceptual elements are common to the various explanations found in the leading economic texts. It might be more useful to indicate these elements than it would be to add another definition to the already abundant supply. All economists seem to agree that price discrimination involves some form of unequal treatment among different buyers by a single seller. Difficulty is, however, often experienced when the attempt is made to indicate the exact nature of this "unequal treatment."

This problem may be resolved by considering two important points separately. The first of these is that "unequal treatment" refers to some dissimilarity in the sales transactions of a single seller with two or more buyers. No "unequal treatment" can occur until there are sales to at least two different buyers and unless the seller deals differently with each.

The second point is that sales transactions involve an exchange between buyer and seller, with the buyer usually paying money for what he receives from the seller. Unequal treatment, or price discrimination, occurs whenever the seller requires one buyer to pay more for a particular

---

product or commodity than another buyer purchasing under identical conditions. This is the most obvious case of discrimination. It is not the only one.

Price discrimination, as the concept is commonly understood, can occur even if the transactions with the two different buyers concerned do not involve an exchange of exactly the same products under exactly the same circumstances. Thus, if a manufacturer sells one table to buyer Smith at $5 and two of the same tables to buyer Jones at a total of $6, price discrimination could possibly exist, even though the conditions of sale are not identical. Smith bought one table and Jones bought two. This raises the crucial problem of the theory of price discrimination: What is the common denominator that determines "equality" or "inequality" of treatment where either the products involved in the several transactions or the conditions under which the transactions take place are not identical?

There has been a traditional notion for many centuries that some definite relationship should exist between the cost of a product and its selling price. This notion appears to be based on the belief that a "fair" or "just" price is

---

Price discrimination is not always the deliberate and purposeful policy of a seller. It is sometimes forced upon an unwilling seller by a powerful buyer. A large chain, for example, may be successful in inducing a seller to discrimination in its favor and against other customers of the seller. This point is generally overlooked by economists.
one that just equals a seller's expenses plus a "reasonable" profit. Since the term "reasonable" is open to a wide range of interpretations, the idea of a "fair" price has received approval from many sources, including the Catholic Church. With the passage of time, some people have even come to feel that this rather vague relationship between cost and price could and should be converted into a rigid formula for price determination. This view has gained wide adherence as modern governments have assumed increasing jurisdiction over the pricing practices of business organizations. A "reasonable" return on sales and investment has, for example, become the guiding principle in rate regulation of public utilities.

Tradition, therefore, supports the belief that there should be some relationship between the cost of a product

---


6Producers and merchants usually give the term a much more liberal interpretation than consumers or public authorities.

7Hotchkiss, op. cit., p. 22.


and the price at which it is sold. Suspicion attaches to any rupture in this relationship. For this reason, cost has been generally recognized as the standard by which to measure a seller's equality of treatment of his customers. Any difference in the relationship between the selling price and the cost of the products involved in any one transaction and the relationship of these elements in another transaction of the same seller is taken as evidence of discrimination. The buyer who must pay more for one product, relative to its costs, than another for a similar product is receiving "unequal treatment." This, then, is the common denominator that determines equality or inequality of treatment where the products involved in the several transactions or the conditions under which the transactions take place are not identical.

Cost does not, however, have a fixed relationship with price under all circumstances, since price is determined by the interaction of supply and demand, and not by the costs which the seller incurs in bringing the product to market. Despite these theoretical weaknesses, seller's cost is probably the best available standard for comparing transactions with different buyers to determine the equality or inequality of treatment among them.

No discrimination exists when a seller maintains a similar relationship between his costs and selling prices in all transactions with different buyers. With few exceptions,
economists have failed to specify what this "similar relationship" between cost and price should be. A full study of this question is beyond the scope of this chapter, but a few observations might be appropriate. The problem involves two questions: (1) what concept of cost shall be used? and (2) what shall constitute an equal "spread" (or "similar relationship") between cost and price? In brief, the cost base could be either (1) average cost or (2) marginal cost of the products involved in each transaction. The "spread" or relationship between cost and price could be either (1) an equal dollar markup on cost in all transactions or (2) an equal percentage markup on cost in all transactions.

Prices to different buyers, all of which give the seller the same dollar amount of markup, could be deemed non-discriminatory. Similarly, prices which give the seller the same percentage of markup in the different transactions could also be deemed non-discriminatory, even though the seller would realize a higher dollar amount of markup on those goods costing more than those costing less. These two non-discriminatory prices are based upon an average cost concept. Non-discriminatory prices could also be based upon

---


the marginal cost concept of the products involved in the transactions with the several buyers. Thus, prices which are either equal to marginal cost, or which give an equal dollar markup on marginal cost in all transactions, or which provide for an equal percentage markup on marginal cost in the various transactions could, theoretically, be considered non-discriminatory. This existence of various non-discriminatory prices, depending upon different concepts of cost and markup, has been overlooked by almost all economists. 13

Theoretically, therefore, there are a number of different non-discriminatory prices in any situation, each of which provides "equal treatment" to all buyers, but each of which uses either a different cost concept or a different "spread" (relationship) between cost and price. Almost all of the definitions of price discrimination found in the leading economic texts, however, are tied to one specific concept of cost and cost-price relationship. Price discrimination is deemed to exist whenever differences in price charged by a seller do not exactly correspond to differences in average cost. Thus, a seller must receive an equal dollar "spread" between his average cost and his selling price in all transactions in order to avoid discriminating in price. Prices to different buyers for similar products which fail

13Dean, op. cit., p. 505.
14See, for example, Due, op. cit., pp. 301-304; and Bain, op. cit., pp. 400-401.
to give the seller an equal markup in terms of dollars for all similar products constitute "unequal" treatment of such buyers, pursuant to this view of price discrimination. This definition of price discrimination, therefore, uses average cost as the cost base and an equal dollar markup on cost as the only non-discriminatory "spread" between cost and selling price.

It should be emphasized at this point that a price differential is not the same as a price discrimination. A higher price paid by one buyer which merely reflects the higher cost of the products he has purchased from the seller, as compared to those bought by others, is not discriminatory. On the other hand, a seller is guilty of discrimination when he charges all purchasers the same price but gives more or better merchandise to some than to others. Discrimination, in essence, involves a relationship between what a buyer pays and what he receives, as compared with what other buyers pay to and receive from the same seller. Thus, discrimination may occur without a price differential and a price differential may arise without discrimination.

It should also be noted that cost is employed as the "common denominator" by which a seller's dealings with various buyers are compared, not because it is deemed a determinant of market price, but because it appears to be the best available standard by which to determine whether a
seller is giving “equal treatment” to all of his customers. This approach to the theory of price discrimination, which recognizes that supply and demand (and not some concept of cost) determine market price, obviates much of the criticism which has been levelled against some of the existing statements of the theory.

THE THEORY OF PRICE DISCRIMINATION. Having defined price discrimination, it now becomes necessary to examine the theory of price discrimination and, thereafter, to determine how this theory can provide an insight into the complex nature of functional discounts.

At the heart of the theory of price discrimination lies the simple fact that a seller who operates in several

---

15 The fact that “cost” is used as a means to compare different transactions of a particular seller raises another question which has not been adequately studied by economists. What transactions of a seller can be compared to find price discrimination? This question presents no problem when the products involved in the various transactions are identical, but vary in quantity. The same cannot be said when the products differ in characteristics. When such differences are small, a comparison may be proper; at least so it has been held by the courts when they were faced with this problem in terms of legal, rather than economic, considerations. However, when the products are entirely different, serving completely distinct purposes, such a comparison is not warranted. But where shall the line be drawn between these extreme cases? This is a question to which economic theory should provide an answer.

16 The viewpoint that cost, as used in the theory of price discrimination, is merely a standard, a gauge, by which to compare a seller’s transactions with different buyers has unfortunately not yet found its way into any of the leading economic texts.
separate markets will find it profitable to adjust his price to the demand conditions existing in each market. Where these separate markets possess identical demand curves for the seller's offerings, the same price will be the most profitable in all markets. Where, however, the different markets possess different elasticities of demand, the seller will be able to obtain a higher price for his offerings in those markets where he finds a keen demand for them than in those where he encounters a weak demand. In the terminology of economic theory this is to say, that where markets differ with respect to their elasticity of demand, the marginal revenue received for a particular product or unit of service will be more in some markets than in others.

\[17\] Bain, op. cit., p. 407.

\[18\] Elasticity of demand refers to the extent, or more accurately, the relative extent to which the quantity demanded responds to a change in price. Due, op. cit., p. 105.

\[19\] According to the theory of price discrimination, a seller who operates in several markets possessing different elasticities of demand can maximize his profits by allocating his total sales among the several markets in such a way that the marginal revenue obtained from selling an additional unit in one market is equal to that in any other. At any point before this adjustment, the seller could increase his profits by shifting sales from those markets where the marginal revenue is lower than in other markets to those where it is higher; he would find it advisable to continue doing this until the marginal revenue in all markets was equal. The total sales of a seller seeking to maximize his profits would, therefore, be allocated among the several separate markets so that he would obtain the same marginal revenue from an additional unit in all markets. Ibid., pp. 302-305.
Price discrimination enables a seller to increase his total profits by permitting him to charge a relatively high price in markets in which the demand is less elastic—and where, consequently, the higher price will not significantly curtail demand, and to charge a lower price in markets in which the demand is more elastic—and where, consequently the decrease in price will bring about a substantial increase in sales. Instead of charging one price to all buyers, the seller can establish different prices for customers in the various markets on the basis of their respective willingness and ability to buy.

The theory of price discrimination recognizes that certain conditions must exist before price discrimination can occur. These prerequisites have been implicit in the foregoing discussion; they must now be analyzed in detail.

Many economists feel that price discrimination presupposes the existence of a state of monopoly; they speak of discrimination as a phase of monopoly. This view is quite incorrect. It is true that price discrimination is not compatible with perfect competition, but this certainly does not mean that it requires a condition of monopoly. Price discrimination can exist in any industry which fails to conform to the unrealistic and theoretical standards of pure

---

competition. It merely requires some degree of what has been called, for lack of a better term, "market imperfection." For a seller to be able to charge different prices to different buyers of the same product, some factor must be present to prevent the movement of buyers from the dearer to the cheaper market; something must block the entry of the lower-priced goods into the more lucrative market. This "imperfection" may take the form of incomplete knowledge by a buyer of the price established in the market; for example, a consumer may pay more for a particular television set than his neighbors when he does not know the discount from list price commonly given on such merchandise. This would be price discrimination in a retail market which most would characterize as "highly competitive." The market imperfection may also take the form of product differentiation, viz., an attempt by sellers to distinguish their products from those of competitors. Thus, the manufacturer of a well-known line of aspirins can discriminate in price among different purchasers because of the relatively low cross-elasticity between his brand of aspirin and competing brands. Purchasers will not change to the lesser-known brands in the absence of

---

21 This term is unfortunate and misleading. It implies that "market imperfections" are per se objectionable. This is not necessarily so. For a similar view of the term "imperfect competition," see Harold H. Maynard and Theodore N. Beckman, Principles of Marketing (New York: Ronald Press, 1952), p. 644.
strong inducements.

The market imperfections which make price discrimination possible may, in fact, be any significant deviations from the idealized requirements of pure competition. These requirements are:

a. A large number of small buyers;
b. A large number of small sellers;
c. A completely identical or homogeneous product;
d. Complete and accurate knowledge of market conditions by all buyers and sellers;
e. All transactions involve the same conditions with regard to credit terms, delivery, guarantee, etc;
f. All business actions are governed by the desire to maximize profits; and
g. A perfectly elastic supply of the factors of production.\(^{22}\)

It is obvious that few, if any, markets conform to these idealized standards. Price discrimination is, consequently, a common, almost a universal, phenomenon.\(^{23}\) However, the existence of some degree of market imperfection is not the only prerequisite to price discrimination.

A second condition necessary for the practice of price discrimination is the presence of some obstacles to prevent the supposedly high-priced buyers from purchasing at

\(^{22}\)Ibid., pp. 640-641.

\(^{23}\)Professor Clark makes these interesting statements in his classic treatment of overhead costs: "...discrimination in price has been an ever present fact, and, far from being a violation of any natural economic laws of competition (as is sometimes assumed), it is one of the natural forms which competition takes." P. 3. In a later part of the same book, he says: "...discrimination...is a natural result of overhead costs, and is found in practically every phase of business...sometimes it is due to close figuring of cost and keen pursuit of profits; sometimes to ignorance
a lower price. Only then can different buyers be charged different prices. The extreme illustration of this would be a situation where every purchaser could be deemed a "separate market," and the price could be adjusted to his individual ability and willingness to pay. This occurs frequently in the sale of professional services, such as those of a surgeon or an attorney; the personal nature of such services prevents their transfer from one buyer to another, with the result that a fee may often be set at "whatever the traffic can bear." On the other hand, a seller may be able to divide his buyers into only two groups, charging a higher price to buyers in the market with the less elastic demand and a lower price to those in the market with the more elastic demand.

In any event, when a seller charges some buyers a higher price than he does others, there must be something which keeps those entitled to the goods only at the high price from purchasing at a lower price. This may be achieved in various ways. Local markets may be sold at discriminatory prices; purchasers may be grouped into various classifi-

\[\text{\textsuperscript{24}Normally, local markets are not completely isolated from one another; thus, price differences between separate local markets should not exceed the transportation costs between such markets; otherwise, goods will move from the high-priced market to the low-priced market and prevent future price discrimination. Due, op. cit., p. 304.}\]

cations and given a high or low price depending upon this classification; purchasers may be prohibited by contract from reselling the product; the price discrimination may be kept a secret so that the high-priced buyer is unaware of the discrimination against him.

One other prerequisite is necessary for successful price discrimination. This is the existence of differences in the elasticities of demand in the separate markets in which the seller operates. If the demand curves of these markets were iso-elastic, so that the elasticity of demand at any one price would be the same in all markets, the identical price would have to be charged in all markets in order to maximize profits. The result would be the same as though there were only a single market, with one price available to all buyers. Mrs. Joan Robinson cites an interesting illustration to explain this point. It might be possible, she says, for a village barber to charge a differential price for shaving red-haired clients, but if the red-haired members of the

25 The seller must, however, keep the price differential between the various classes at less than the transfer costs (including handling, transportation and taxes) between buyers receiving different prices; otherwise, the low-priced buyers will resell to the high-priced buyers and thereby "spoil" the seller's high-priced market.

26 The consumer's frequent lack of market information is one of the main reasons why retailers can often practice price discrimination.

27 When the marginal revenue and marginal cost in several markets are identical for a particular sales volume (or output), the optimum price in these markets will also be the same.
village had the same wealth and the same desire to be shaved as the rest of the inhabitants, the barber would find it profitable to charge them the same price as the rest.  

Before determining how the theory of price discrimination can provide a better understanding of the institution known as functional discounts, it might be desirable to summarize the discussion so far. It has been noted that economists believe price discrimination to be motivated by the desire to maximize profit. Three prerequisites are said to be necessary for such discrimination. These are: (a) some degree of "market imperfection"; (b) the existence of two or more separate markets; and (c) the presence of different elasticities of demand in these markets.

FUNCTIONAL DISCOUNTS AS A FORM OF PRICE DISCRIMINATION. A number of well-known economists have identified functional discounts as discriminations in price, in the sense that such discounts are not directly related to differences in the seller's costs as between different classes of customers. Arthur R. Burns, former chairman of the President's Council of Economic Advisors, has observed that there are three main forms of price discrimination: (1) discrimination according to the use of the product; (2) geographic discrimination; and (3) discrimination according to the trade status.

---

of the buyer. Jules Backman states that discrimination can be based upon either (1) use; (2) geographic location; (3) quantity of purchases; or (4) trade status. John M. Clark recognizes six different types of discrimination, including "discrimination between different classes of buyers." The view that functional and trade discounts are a form of price discrimination is, therefore, well supported by authority.

A seller can classify his buyers according to their trade status and accord different prices to the various classifications recognized by him. As long as the price differentials involved do not exceed the cost of transferring the goods from a low-priced buyer to a high-priced buyer, one of the three prerequisites to price discrimination is present. That is to say, it is not difficult to segregate customers into separate markets when the discrimination is based on trade status, although some problems may arise in assigning the proper classification to individual mixed-

---


31 Clark, *op. cit.*, pp. 428-430.

32 This is the requirement that there must be at least two separate markets, with some barrier to prevent those entitled to the goods only at the high price from purchasing at a lower price. The "transfer costs" involved when a low-priced buyer sells to a high-priced buyer constitute this barrier.
function enterprises.

Not only can separate markets be created for customers classified according to trade status, but the demand curves for a particular product in these various markets are likely to be different. This fulfills a second requirement for effective price discrimination.

The reasons why different elasticities of demand usually prevail in markets divided on the basis of trade status deserve some explanation. Both wholesalers and retailers buy in order to resell at an anticipated profit. The amount of money they are willing to pay for any product depends upon the price they expect to obtain for the item, the probable costs of handling and reselling it, and the desired margin of profit. Since wholesalers can normally expect to sell a product to retailers only at a price lower than that at which these retailers anticipate reselling it to consumers, the demand curves of wholesalers and retailers for a particular product are likely to be different.

The retailer must anticipate the demand of the consumer; there is, consequently, a time lag between the retailer's purchase of a product and its resale to a consumer. The wholesaler, in turn, must anticipate the demand of the retailer and, indirectly, that of the consumer; again, there is a time lag between his purchase of the product and its sale to the retailer. Obviously, the time lag between the wholesaler's purchase of the product and its ultimate sale to a consumer must be greater than the time lag between the retailer's purchase of the item and its resale to one of
his customers. Consequently, an offering made simultaneously to wholesalers and to retailers will be valued by them in terms of resale possibilities to consumers at different future times. It is unlikely that the demand curves of wholesalers and retailers would be identical under such circumstances.

Other reasons may also be adduced to indicate the reasons why the demand curves of wholesalers as a group and of retailers as a group are likely to be different at any one time. Wholesalers are commonly faced with a much broader range of alternative offerings and substitutes than are retailers. With the exception of some well-established lines, which wholesalers may feel compelled to carry regardless of their profitability, they have a wide latitude of discretion in deciding the products which they will handle. Retailers also possess such discretion, but the number of products offered directly to them by manufacturers is usually more limited. Considerably fewer manufacturers solicit the orders of small retailers than seek the business of recognized wholesalers. This fact tends to make the demand

---

33There are, to be sure, some exceptions to this statement, e.g., when the wholesaler is a drop shipper.

34A retailer who is willing to store a product for a longer period than the time such product is normally stored by retailers is, of course, assuming a wholesaling function.
curve of wholesalers somewhat more elastic than that of retailers.

Furthermore, general-line wholesalers usually carry a much larger number of different items and lines than do retailers. Their intensity of demand, consequently, for any one item is less than that of retailers who ordinarily carry a more limited variety and assortment of stock. This naturally affects the shape and location of the demand curves in the respective markets. A fact which is perhaps equally significant is that wholesalers often have the facilities and resources to take advantage of temporary bargains, whereas retailers normally are not equipped to buy and store substantial quantities of merchandise for future sale even at highly favorable purchase prices. As a result, the demand curve of wholesalers is likely to be more elastic at its lower extremes than that of retailers.

Thus, in the absence of coincidence, wholesalers and retailers, when segregated into "separate markets," are likely to have different elasticities of demand for a particular product at any one moment of time. This fulfills the second of the three prerequisites for profitable price discrimination.

It requires no elaboration to prove that the third

---

condition necessary for price discrimination—some degree of "market imperfection"—is present in most industries. Few markets, including those for agricultural products, conform to the rigid standards of pure competition. "Market imperfections" can therefore be found throughout the economy.

EVALUATION OF THE THEORY OF PRICE DISCRIMINATION.
While it is true that trade and functional discounts can be neatly fitted into the mold of the theory of price discrimination, it is equally true that this theory provides, at best, only a partial explanation of such discounts. For one thing, the theory of price discrimination is predicated upon the premise that every business decision is oriented by the desire to realize the highest possible net return on each transaction. This premise it shares in common with the main body of classical and neo-classical economic doctrines. Such a premise, however, provides a dangerously oversimplified view of the motives underlying business

---

36Bain, op. cit., p. 188.

37The classical and neo-classical structure of economic theory would disintegrate without this basic premise. The "profit-maximization" axiom eliminates the uncertainty and irrationality of human conduct. By assuming that people as a group constantly seek to maximize profits, economic activity ceases to be governed by unpredictable individual behavior. A standardized pattern of reaction takes its place and is made the subject of study. Economic theory fails to reflect actual economic conditions to the extent that actual behavior does not correspond to the assumption that businessmen are constantly seeking to maximize profits.
activity. Although it may be presumed that sellers price their goods, and grant functional discounts, in an attempt to enhance their profits, it cannot be assumed that this means that they are concerned only with the short-run profits to be realized from the individual transaction. The typical businessman is more concerned with the profits he can earn over a period of time than with the profits he can realize on a particular sale.

The theory of price discrimination is logically sound. Its deficiency lies in the fact that it describes a phenomenon which is quite unlike trade and functional discounts, as they exist in the American business world. The theory of price discrimination is concerned with the segmentation of a market into smaller submarkets for the purpose of achieving maximum short-run profits. This segmentation of the market can be on the basis of any distinguishing characteristic of the buyers, including their trade status. The theory of price discrimination is really an explanation of how customers can be classified into different trade classifications in order to maximize profits, rather than an explanation of why trade or functional discounts are, in fact, granted.

The theory of price discrimination, nevertheless, can afford some insight into the nature of functional discounts. There is considerable truth in the implication that such discounts constitute a reflection of the fact that whole-
salers and retailers have diverse demand curves for a particular product at any one time. Supply and demand are the basic determinants of price in the American economy. A manufacturer who wishes to sell his output must, therefore, adjust his price according to existing demand conditions. If he establishes the price of his products at an amount in excess of the value placed upon them by prospective buyers, the manufacturer will be unable to make any sales. If he sets the price at a level higher than that at which the great majority of potential purchasers will buy, he will be able to make only very few sales. A seller should, therefore, seek to find the price which will give him the most profitable volume of sales possible.

It requires little explanation to see that a product may appeal to a large number of retailers at a particular price, but that it will not appeal to wholesalers at the same price. Wholesalers, after all, must add to the purchase price of the product an appropriate markup to cover their operating expenses (including a reasonable net profit). Such wholesalers may, therefore, feel that the price at which they must resell the product would be too high to afford a satisfactory volume of sales. The practice of granting lower prices to wholesalers than to retailers, by allowing functional discounts to the former, can therefore be seen to be an attempt to adjust prices in the separate retailer and wholesaler markets to the demand
situations found in these separate markets.

Consequently, the broad ramifications, rather than the detailed specifications, of price discrimination theory shed light on the institution known as functional discounts. Such discounts are not granted in order to maximize profits in any single transaction, as the economist is wont to assume; more often than not, such discounts are granted by a manufacturer in order to be able to sell at all. Only by setting a price which does not exceed the amount wholesalers are willing to pay for the product in question can the seller hope to make any sales. Only by establishing a price which is attractive to a substantial number of wholesalers can he expect to make sales in any significant quantity. In brief, only by quoting a price to wholesalers which reflects the nature of their demand curves can a seller hope to realize a profitable volume of sales to, or through, such wholesalers.

Most simply stated, therefore, the theory of price discrimination views a functional discount as a differential resulting from the different demand curves existing in the retailer and wholesaler markets. Were the same

---

38 The above statement raises the interesting question whether the theory of price discrimination considers a functional discount to be a "discrimination" as well as a "differential." Bearing in mind that no unfavorable connotation need attach to the term "discrimination," as it is used by economists, it is clear that a functional discount is considered to be a "discrimination" by economists. As previously discussed, the term "discrimination" is defined on the basis of the relationship between a seller's
price to be established for a product in both of these markets, it is possible that little, and perhaps no, demand would exist for it among wholesalers. In many cases, only at some price lower than that available to retailers, lower by an amount sufficient to permit wholesalers to distribute the product at a reasonable net price, can wholesalers be induced to buy and carry a particular product.

The theory of price discrimination also provides a rudimentary explanation of functional discounts granted by a seller who sells only to wholesalers. The size of such discounts is determined, not by the difference in the demand elasticity in the retailer and wholesaler markets, but by the demand situation existing in the latter market alone. Unless the seller allows his wholesaler customers functional discounts sufficient to cover their expenses (and to leave a reasonable net profit), he may find no demand for his product among wholesalers. A seller will, therefore, frequently be well advised to incorporate functional discounts in his pricing structure, whether he relies upon multiple channels or whether he depends strictly upon wholesalers to bring his goods to the retail market.

---

costs and his selling price in transactions with two or more buyers. A functional discount does not depend upon differences in a seller's costs as between several purchasers; it results from differences in the nature of the demand in the retailer and wholesaler markets. Consequently, a functional discount constitutes a "discrimination" in the economic context of this term.
The explanation, or partial explanation, of functional discounts provided by the theory of price discrimination is, to be sure, quite complex. Possibly it is even more intricate than need be. However, since most economists, schooled in the traditional concepts and doctrines of their profession, are more prone to accept this view of functional discounts than any others, it is one that cannot be lightly disregarded by the serious student in the field.

Several less complicated, and perhaps more practical, explanations of functional discounts are to be found in the following chapter.
CHAPTER IV
FUNCTIONAL DISCOUNT THEORIES

The theory of price discrimination and its relation to functional discounts was surveyed in the preceding chapter. The discussion in Chapter III was, however, largely within the framework of formal economic doctrines. A full understanding of these discounts requires a broader and less rigid view than that inherent in prevailing economic doctrines.  

Functional discounts can be studied and analyzed from a number of different perspectives. No single explanation can effectively describe their nature and their characteristics under all circumstances. At least six, and possibly more, distinct interpretations can be offered to account for the existence and size of such discounts. These different explanations of functional discounts can be designated as follows:

a. "Buying Distribution" Theory
b. Compensation Theory
c. Selling Cost Theory
d. Inter-Competitive Theory
e. Cost-Savings Theory
f. Incremental Revenue Theory

1On at least one occasion, the purpose of economic theory was stated to be "not to supply factual answers but to pose the proper questions to the facts." There appears to be considerable merit in this view. Cost Behavior and Price Policy (New York: National Bureau of Economic Research, 1943), p. 271.
Each of the above theories, if indeed this term may be used, provides only a partial explanation of functional discounts. Each one approaches these discounts from a somewhat different viewpoint, emphasizing one particular or several related aspects of their nature. None of them, standing alone, therefore affords a completely satisfactory insight into functional discounts. All this is to say that none of the various theories developed in the early part of this chapter should be taken as the authoritative explanation of functional discounts. Each represents a somewhat oversimplified viewpoint, serving a valuable purpose simply by directing attention to a specific factor in their make-up. In the concluding section of this chapter, the main characteristics of functional discounts will be drawn together in an attempt to provide as accurate and clear an insight into their nature as it is possible to do within the limitations previously specified.

"BUYING DISTRIBUTION" THEORY. The American economy exceeds that of any other country in the world with respect to the market value of the output of goods and services it provides. The American economy is not only rich in gross national product; it is also complex in structure. The hardware industry of the United States, to cite one specific example, includes over 6,500 manufacturers and over 34,000 retailers. It would be impossible, or possible only at

---

prohibitive cost, for every manufacturer to reach and serve each one of the over 34,000 retail outlets. On the other hand, a wholesaler handling, on the average, the products of nearly 715 manufacturers and serving about 1,500 hardware dealers can assume, at reasonable cost, the important task of receiving a steady flow of merchandise and warehousing it temporarily, at convenient locations, for redistribution to retailers in smaller quantities. In brief, wholesalers in the hardware industry are indispensable; if they did not exist, manufacturers would have to create them. The same is true of wholesalers in many other industries; they play crucial roles in the distribution of food, drug and tobacco products, to mention just some of the trades in which attempts by retailers and manufacturers to deal directly have repeatedly proven unprofitable.

In most industries, the number of effective and successful wholesalers is relatively small. There is, consequently, vigorous competition among manufacturers to sell to these wholesalers—or, more accurately, to enlist their marketing services in the distribution of a manufacturer's line. As a result, wholesalers normally find themselves besieged by offers. Since they cannot buy and stock everything,

---

3These are average figures, based upon an extensive study undertaken by the editors of Hardware Retailer, and reported in their May 1956 issue, pp. 2-3.

4It is estimated, for example, that there are 574 hardware wholesalers in the United States, ibid. To be sure, not all of these are "effective and successful."
they must choose. Just as consumers attempt to apportion their funds so as to get the most satisfaction from their expenditures, wholesalers must be careful to select the lines that will yield them the highest return.

It probably involves no undue liberty with the English language to state that a manufacturer must, in effect, "buy" the services of a wholesaler in order to induce him to carry the manufacturer's products. This "buying" is accomplished by making it profitable for the wholesaler to represent the line in question. A wholesaler is in business, after all, to earn a net profit on his activities. The rivalry between competing manufacturers to obtain distribution through a particular wholesaler is, therefore, largely on the basis of what might be called the "profit potential" of their respective lines. This is determined by the margin per unit

5Charles N. Davisson, The Marketing of Automotive Parts (Ann Arbor: Bureau of Business Research, 1954), pp. 910-911. The fact that distribution must be "bought" is inconceivable to the traditional economist, trained to think in terms of purest competition. The economist is, of course, correct in stating that there is no need to buy distribution under perfect competition, since by assumption the market will absorb whatever is sold at the prevailing price. In the actual business world, however, the sale of a company's productive output cannot be assumed; it must be brought about by an active and imaginative marketing campaign.

6It is true, of course, that before a wholesaler undertakes to represent a particular line, he normally considers many factors, including its consumer acceptance, the assortment and variety available, the quality of workmanship and materials, the industry leadership of the manufacturer, the credit policies of the manufacturer, the distribution policies of the manufacturer, etc. Most of these may be summarized, at least in the long run, in the "profit potential" concept stated above.
which a line will yield multiplied by the number of units which are likely to be sold, less the expenses of handling such units. The individual manufacturer seeking distribution through a specific wholesaler must offer him a profit potential which, considering the other merchandise offerings available to that middleman, will lead him to believe that the line under consideration offers a net return as large, or larger, than any other. This is the way a manufacturer "buys" distribution.

The profit potential of a product is converted into an actual net profit when it is resold at a price exceeding its purchase cost and the expenses involved in handling and selling it. A line may, of course, possess a profit potential to wholesalers even when it is sold without functional discounts. Its profit potential may be based upon the fact that it can be readily resold at a markup over the purchase price. There is little doubt, however, that the profit potential of a line, as seen by wholesalers, tends to be larger, or at least less speculative, when wholesalers carrying the line are allowed discounts of a specified amount.

However, some products have such strong consumer acceptance and preference that retailers and wholesalers must carry them even though they offer little or no profit potential. Sugar to the supermarket operator and wholesale grocer, certain brands of cleansing tissues to the pharmacist and drug wholesaler fall in this category. The retailer carries them because they are "traffic builders" and because they are "convenience goods" demanded by the consuming public. The wholesaler handles them because his retailer customers expect him to do so.
which are not available to their prospective customers. The mere adoption of a functional discount policy is, therefore, a competitive weapon, used to "buy" distribution. Once such discounts are offered by several competing manufacturers, their size may become a factor in the rivalry to "buy" the services of the same wholesalers.

It should not be assumed from the foregoing discussion that the forces of competition, rather than basic economic necessity, account for the existence of functional discounts. While it is correct to state that such discounts constitute a factor in the rivalry among manufacturers for representation by the same wholesaler, it is not correct to conclude that such discounts are in any sense unearned. Functional discounts are designed to cover the costs incurred by wholesalers in performing their essential functions. Without a margin of profit on the goods they sell, they could not operate.

Under the "buying distribution" theory, competition is deemed to be the determinant of the general level of functional discounts. A scarcity of merchandise is said to have a tendency to deflate such discounts. An over-abundance of middlemen willing and able to handle the existing lines is believed also to have a depressing effect on trade margins. Thus, the influx of hardware, stationery

---

and even drug wholesalers into the toy business appears to have deflated functional discounts on toy and related products. Many long-established toy jobbers have been forced to liquidate during the past two years. On the other hand, the existence of a large number of competitive lines, each seeking representation through a relatively limited number of middlemen, is thought to lead to relatively high trade discounts.

Over a period of time, many industries have experienced a "standardization" of the size of functional discounts which manufacturers allow to wholesalers. This has come about mainly because individual manufacturers recognize that if they offer larger discounts than those prevalent in the industry, other manufacturers are likely to follow suit. Little can, therefore, normally be gained by allowing functional discounts in excess of those customarily granted by competitors, except possibly a temporary advantage. Nevertheless, competitive conditions are sometimes such that a manufacturer will deviate from the "normal" size of the

---


10Functional discounts are relatively high in the small-leather-goods industry where there are many small manufacturers and very few large-volume wholesalers. The keen competition among manufacturers to obtain distribution through these wholesalers has tended to bring functional discounts in the industry to their present high level.
functional discounts in the industry.

Manufacturers of new, unknown or unadvertised brands must frequently offer higher functional discounts than manufacturers of well-known brands of the same product. By permitting a higher per unit markup, they can offset the higher saleability of the better-known competing lines, and provide a profit potential to the wholesaler which meets, and possibly surpasses, that of the competing lines.

In summary, the "buying distribution" explanation of functional discounts is predicated on the belief that a manufacturer must take affirmative steps to obtain distribution for his products. Unlike the imaginary seller in the Utopia of perfect competition, he cannot assume that his output will be swept away on the magic carpet of equilibrium. He must actively induce wholesalers and retailers to handle his line. He must procure their cooperation; he must, in effect, "buy" their marketing services. This is not always a simple task, since his competitors are equally anxious to secure the same wholesale outlets for their own offerings.

Functional discounts play an important role in this rivalry among manufacturers to obtain representation by the same wholesalers. They are a part of the price which manufacturers must pay in order to "buy" the services of middle-men, with competition determining the size of discounts

\[\text{\textsuperscript{11}}\text{Davisson, op. cit., p. 678.}\]
necessary to induce distributors to carry a particular line.

THE COMPENSATION THEORY. The typical American manufacturer is not content to sell his goods to a wholesaler. He normally sees such a transaction as only the first link in a chain which extends from him to the ultimate consumer. Any break in this chain is a matter of immediate and vital concern to him. Wholesalers and retailers are, therefore, accepted as "partners" of the manufacturer in a common activity, the movement of particular goods from the source of production to the point of consumption. This concern by manufacturers with the ultimate sale of their lines is evidenced by the billions of dollars spent annually by them on consumer advertising, by the millions expended on sales promotional aids, and by the large sums invested in public and consumer relations programs.

As a result of this "teamwork" concept, which prevails to some degree in most of the consumer goods industries, a rigid demarcation between wholesale and retail functions is no longer possible. To an ever increasing extent, wholesalers are assuming responsibility for guiding their re-

---

taller customers to sound and profitable operations. A true community of interests has developed among manufacturers, wholesalers and retailers in many lines of business, with functions assigned to members of a channel of distribution on the basis of ability to perform.

Certain practical consequences ensue from this "partnership" approach to marketing. Foremost among these is the recognition that the success of the "partnership" depends upon rather continuous cooperation among the various members of a particular channel. This necessitates that participation in such alliances be rewarded fairly in relation to services performed. Trade discounts provide an excellent medium by which such payments can be made. Trade discounts can, therefore, be considered as compensation granted by manufacturers to distributors for their membership in the marketing team.

The concept that functional discounts serve as compen-

13 The "partnership" approach to marketing appears to have made most progress in the food industry. It is not uncommon to find wholesalers in that industry assuming actual managerial supervision over their retailer customers, providing them with accounting services, financial help, modernization assistance, training and other services which are normally performed personally by the owner of a small store. Grant Gore, The New Concept in Wholesaler-Retailer Teamwork (New York: General Foods Sales Division, 1951).

14 The term "trade discounts" includes, of course, "functional discounts." The discussion here and in several subsequent sections of this chapter is in terms of the broader concept of "trade discounts," since whatever is said applies equally to trade discounts granted to retailers as it does to functional discounts allowed to wholesalers.
sation for the marketing functions performed by wholesalers has gained considerable adherence in both legal literature and in marketing studies. The Attorney General's National Committee to Study the Antitrust Laws also gives support to this view. In its report the Committee said:

Functional discounts are a traditional pricing technique by which suppliers compensate for distributive services.

(Emphasis supplied.)

According to the compensation explanation of functional discounts, the size of such discounts should be governed by the costs which wholesalers incur in performing the functions assigned to them, plus a "reasonable" profit for their enterprise. There is no reason in the world why this amount should be equal to, or have any relation to, the cost savings which may accrue to a manufacturer as a re-

---


18 It is, of course, extremely difficult to determine the exact costs incurred by each wholesaler in handling and selling a particular product and it would be impractical to price products accordingly, even if such information were available. Joel Dean, therefore, suggests that trade discounts should "cover the estimated operating costs (plus normal profits) of the most efficient 2/3 of the dealers." Managerial Economics (New York: Prentice-Hall, 1951), pp. 522-523.
sult of selling to wholesalers, rather than directly to retailers.

In brief, the compensation concept states that functional discounts are granted in order to compensate wholesalers for the services which they perform in distributing the particular product. This interpretation would appear to be not too different from the "buying distribution" theory. An important distinction between these two views must, however, be made. It is a distinction of emphasis. The "buying distribution" explanation stresses the competitive aspects of various manufacturers seeking the same wholesale outlets. The compensation theory emphasizes the need for fair and reasonable treatment of "partners" in a common activity. As a consequence, the size of functional discounts seen as a method of "buying" distribution is determined largely by competitive forces and pressures, while the amount of such discounts when they are regarded as a form of "compensation" to wholesalers is governed mainly by the costs which such distributors incur in handling the line. No judgment need be made at this point with regard to which of these views is correct, or more correct. That will be left for later. It is sufficient here if the distinction between these two approaches to the problem of functional discounts is made entirely clear.

The theoretical distinction between the "buying competition" and the compensation explanations of functional discounts is more than academic. Functional discounts
which are seen as a factor of competition could be driven, at least temporarily, to a level where they do not afford a net profit to wholesalers, and possibly even to a point where they do not cover all expenses attributable to that line. Functional discounts, when deemed a method of "compensation," would presumably never reach such a low level. The corollary of this is also true. Functional discounts which are governed by competitive considerations may, in rare cases, be forced to a point where they allow an unnecessarily high net profit to wholesalers. Functional discounts granted by a manufacturer adhering to the compensation theory would never be likely to go to such an extreme.

THE SELLING COST THEORY. The literature of pure competition does not recognize the need of a manufacturer to sell his output actively; it assumes that the "market," without any effort on his part, will automatically absorb whatever output the manufacturer is willing to dispose of at the prevailing price. The theory makes no allowance for selling expenses; goods are deemed exchanged at a price

\[19\] No selling costs arise under perfect competition since, by assumption, (a) buyers have complete knowledge about all market offerings, (b) products serving the same purpose are deemed homogeneous, and (c) buyers are presumed to be indifferent in regard to the seller from whom they purchase. There is, consequently, nothing to be gained by sales promotional activities.
which, in the long run, just equals average costs of production. Neo-classical economists, in their attempt to reconcile the "remote and unreal" assumptions of formal economic doctrines with the facts of business life, concede the impracticality of this view. Professor Edward Chamberlin, a pioneer in this area, recognizes that a manufacturer must normally incur expenses in order to induce consumers to purchase his products. What is significant for the discussion at hand is that Professor Chamberlin regards trade discounts as a form of selling cost, undertaken by sellers in order to promote their lines.

It is important to have a clear concept of sales costs, as they are conceived of by Professor Chamberlin and his followers. Chamberlin distinguishes sales costs from strict production costs on the basis that sales costs influence demand without resulting in any change in

---

the physical characteristics of the product. Professor Chamberlin observes that such sales costs can take several forms, including advertising, salesmen's salaries, and margins granted to retailers and wholesalers "in order to increase their efforts in favor of particular goods."

What are the economic effects of such selling expenses? Professor Chamberlin assumes that a firm with selling costs

---

21 "Cost of production includes all expenses which must be met in order to provide the commodity or service, transport it to the buyer and put it into his hands ready to satisfy his wants. Cost of selling includes all outlays made in order to secure a demand, or a market, for the product. The former costs create utilities in order that demands may be satisfied; the latter create and shift the demands themselves. Many costs incurred after a product leaves the factory are costs of production—those for transporting, handling, storing and delivering, all of which add utilities to the good, i.e., make it more capable of satisfying wants." Chamberlin, op. cit., p. 123. Joe S. Bain offers the following explanation: Sales promotion is an activity "designed simply either to inform buyers of the existence, character, and price of a seller's product or to influence buyers to purchase it, but which does not involve any alteration of the product itself. The essential character of sales promotion is that it is designed to influence buyers' knowledge of and preference for sellers' products without altering the products themselves." Joe S. Bain, Pricing, Distribution and Employment (New York: Henry Holt and Co., 1953), p. 312. In practice, it is often difficult to draw a precise line between selling and production expenses. This, however, does not destroy the theoretical validity of the distinction.

22 Chamberlin, op. cit., p. 117. Strictly speaking, not all functional discounts can be considered selling expenses. Trade discounts which merely cover wholesalers' costs of physical handling, storing and delivering (plus a reasonable profit) are production expenses, since they create time and place utilities. Only those discounts which compensate wholesalers solely for sales promotional activities are true selling expenses. Most functional discounts are of a mixed nature, involving both selling and production costs.
will seek to adjust such expenditures to the level which will allow maximum profits. This equilibrium, he concludes, will not be much different from that of a firm without selling expenses. Both firms will find it advantageous to increase output to the point where marginal revenue just covers marginal cost. At any prior point, either firm could enlarge profits by increasing output; that is, the price received for any additional unit would be more than the cost of such unit. Thus, equilibrium is not achieved until marginal revenue is equal to, or almost equal to, marginal cost.

The firm with selling expenses differs from the firm without selling expenses in that such expenses must be considered as part of the firm's average and marginal costs; that is, selling, as well as production, costs must be covered in the long run if a producer is to remain in business. This can be illustrated graphically. In the diagram below, PC is the curve of production costs; TC is the total cost curve, which includes selling expenses. Thus, selling costs per unit of product at each output are shown by the vertical height between PC and TC at that point.

---

23 Here, again, is the spectre of "maximum profits." This concept is an intellectual heritage which few economists, schooled in the mechanistic patterns of classical theory, seem to be able to discard.

24 Chamberlin, op. cit., pp. 130-149.

25 Ibid.
particular output. This diagram assumes that price is held constant at five dollars; average revenue is here equal to marginal revenue, which is shown as the MR line. MC represents the marginal cost curve. The most profitable output, considering selling expenses, is indicated by the intersection of the marginal cost curve with the marginal revenue curve. This is at value 8.

---

26It can be seen from the diagram that increasing selling costs can turn decreasing costs of production into increasing average total costs long before the point of minimum costs of production is reached. Albert L. Meyers, Elements of Modern Economics (New York: Prentice-Hall, 1947), p. 181.
The above diagram does not necessarily indicate the selling expenditures which will yield the largest possible profit under all circumstances. It merely shows the most advantageous outlay at a particular price, in this case, five dollars. Selling expenses vary with product, output and price. A two-dimensional diagram is limited to representing the relationship between two variables. Most economists, consequently, elect to vary output with selling expenses, holding product and price constant. Thus, in order to find the adjustment of product, output, price and selling expenses which will produce the highest profits under any circumstances, separate diagrams must be drawn for each possible price and for each conceivable product.

27 The term "product" signifies the characteristics of the unit of merchandise or service exchanged, together with the rights that go with it. Ibid., p. 78.

28 K. E. Boulding prefers another approach to the problem. He uses an indifference-curve technique, with the selling costs necessary to dispose of a specific number of units being related to different possible prices of the product. This form of presentation is possibly more concrete than the two-variable diagram used in the text. It is, however, considerably more difficult to understand and has not yet gained wide acceptance. K. E. Boulding, Economic Analysis (New York: Harper Bros., 1948), pp. 721-725. Also see John F. Due, Intermediate Economic Analysis (Chicago: Richard D. Irwin, 1951), pp. 311-319. Joel Dean believes that a marginal analysis provides the most practical technique for determining the proper promotional outlay. In brief, he asserts that selling expenditures should be pushed to the point where the additional outlay equals the profit from the added sales caused by the outlay. For a discussion of this method, see Joel Dean, "How Much to Spend on Advertising?" Harvard Business Review, XXIX (January 1951), 65.
While the above analysis is logically sound, it does not provide a practical formula for determining the selling expenses which a firm should undertake. In the first place, the selling cost theory requires a simultaneous adjustment of four different variables. This is a difficult task in hypothetical environment; it is an impossible assignment in a fluid business situation. In the second place, the theory presupposes information which probably no executive possesses, including (a) the precise costs of production associated with different outputs; (b) the exact effect of changes in price upon demand, and (c) the results which will be achieved by different kinds and amounts of sales promotional outlays.

Despite the fact that economic theory does not offer a practical technique for selecting the most profitable sales promotional outlay, it does indicate—in a general way—the effect of such expenses upon business operations. It recognizes that sales costs increase the total disbursements of a firm, but that these expenditures may enlarge total output in a decreasing-cost industry to the point where production costs are less than they would be in the absence of sales promotional activities. This decrease in production expenses may be more than the sales promotional

---

29 Many economists use the term "sales promotional outlay" as synonymous with selling expense. Bain, op. cit., p. 312.
outlay necessary to bring output to this economical level, with the result that total costs are lower than they would be without selling expenses.

The Chamberlin theory makes a useful contribution towards a better understanding of functional discounts. It shows that such discounts constitute a necessary selling expense, required to bring the product to market. "A large slice of these discounts," states Professor Chamberlin, "must be regarded as the cost of securing a demand.... Often the granting of a little higher margin is the most effective kind of advertising." Since trade discounts are a form of selling expense, they may actually have a tendency to lower the price of the goods on which they are granted, as indicated above.

The selling cost theory, as developed by Professor Chamberlin, can be readily distinguished from the "buying distribution" and compensation theories. The Chamberlin interpretation of functional discounts is seller-oriented; it seeks to determine the proper amount of functional discounts which a seller should grant in terms of his own marginal revenue. The compensation theory is buyer-

---

30Chamberlin, op. cit., pp. 130-172.
31Ibid., p. 122.
32The theory does not, however, explain how selling expenditures should be apportioned between advertising, salesmen's salaries, trade margins, and other sales promotional outlays.
oriented; it attempts to obtain an answer to the same question in terms of the margin requirements of wholesalers. The "buying distribution" explanation is similarly buyer-oriented, with emphasis upon the competitive implications of the alternative opportunities available to individual wholesalers.

THE INTER-COMPETITIVE THEORY. Manufacturers of consumer products normally desire broad market coverage. This is especially true of those who produce convenience goods. Such goods, by definition, are articles which consumers wish to purchase with a minimum of effort. Successful marketing strategy for such products requires availability in a large number of conveniently located retail stores. A single channel of distribution rarely is capable of providing such widespread coverage. The same product may be carried in a number of different types of retail outlets. Drug stores handle toothpastes, but so do many supermarkets, and variety stores. Television sets can be bought from radio and television dealers; but they can also be obtained from department stores, furniture stores, appliance stores, jewelry stores, and even hardware stores.


\[34\] A channel of distribution is the course taken by title as goods move from production to consumption. Ibid., p. 40.
Phonograph records are available in music stores, but also in supermarkets, drug stores, toy stores, department stores, variety stores and furniture stores. Each of these different types of retail establishments can be most effectively reached through a different channel of distribution. A neighborhood pharmacist looks to a drug wholesaler to keep him supplied; the proprietor of the local hardware store probably buys most of his stock from a hardware wholesaler; the pharmacist is no more likely to buy from the hardware wholesaler than the hardware store owner is likely to buy from the drug jobber, even though both wholesalers may carry some lines in common.

Not only do different types of retail establishments purchase from different sources of supply, but large and small retail outlets handling essentially the same kinds of merchandise may depend upon different channels of distribution. The toy section of a major department store will frequently buy directly from manufacturers; the owner of a small local toy shop, on the other hand, will probably rely on one or two jobbers to keep him supplied. The large supermarket chain may purchase its poultry directly from the farm; the independent food merchant will probably obtain it from his wholesaler. Thus, the same product may move

to similar retail outlets through different channels of distribution.

As a general principle, the largest number of outlets, consistent with the method of distribution used, is likely to produce the highest sales. This means that a manufacturer of consumer goods will normally find it beneficial to use several channels, rather than merely one, to reach the ultimate consumer. A single channel may not be able to absorb the manufacturer's entire present or future output, or it may not be able to reach all segments of the market with equal effectiveness. The use of several separate channels, however, involves certain complex pricing considerations.

If a vendor desires to realize a significant sales volume from several channels, he must keep these channels inter-competitive. The manufacturer of dentifrice cannot expect to obtain much volume for his product from the drug-wholesaler-drugstore channel if supermarket chains, purchasing directly from him, consistently undersell drug

---

This theorem applies no less to specialty goods than to convenience goods, since it states "the largest number of outlets, consistent with the method of distribution used." Professor Davisson expressed this same theorem as "...volume is a function of outlet coverage." Davisson, op. cit., p. 912.
stores on this item. The same is true of the spark-plugs manufacturer who sells replacement plugs to vehicle assemblers at substantially lower prices than to parts jobbers, where the assemblers pass on the benefit of their preferential prices to their own dealers; the inability of the parts jobbers to compete effectively with car dealers in the resale of these plugs naturally curtails the spark-plugs manufacturer's sales to parts jobbers. In brief, satisfactory representation will not be obtained in any channel of distribution unless the manufacturer permits the members of that channel to buy at prices which allow them to resell at a competitive price, and still earn a satisfactory margin of profit. This means that a manufacturer must make the participants of his several channels competitive with each other at those points where they are able to serve the same customers. A manufacturer who fails to do so will usually find that his line will be dropped by wholesalers and retailers who cannot earn a profit on it.

The use of fair trade agreements is one method by

---

37 In other words a retailer expects a manufacturer to maintain a price structure which will not only make him competitive with other retailers of the same kind as himself, but which also recognizes that he is in competition with other channels of distribution. A wholesaler, similarly, expects a manufacturer to appreciate the competition which he encounters from wholesale distributors in other channels of distributions.

38 Davisson, op. cit., pp. 623-647.
which separate channels can be made inter-competitive. Trade and functional discounts can often be used to accomplish the same objective. This fact can be demonstrated most easily by citing a practical illustration. Let it be assumed that a manufacturer of a flavor extract sells to only two types of accounts: (a) grocery wholesalers and (b) food chains with more than ten centrally-owned units. Let it be also assumed that wholesalers require a margin of approximately 4 1/2 cents to handle the product at a profit and that independent food retailers need a margin of about 12 cents. Let it be further agreed that direct-buying chains can profitably handle the item at a markup of 13 1/2 cents, including the performance of wholesaling functions. If the manufacturer were to sell an "economy" size of the flavor extract to both classes of customers at the same price, say, at 46 1/2 cents, independent retailers would have to resell it at 63 cents, while direct-buying retail chains could resell it at 60 cents. A three-cent differential on a product such as this would be readily apparent to the average housewife. Consequently, in the absence of substantial consumer insistence upon this brand, few wholesalers and independent retailers would be likely

39Independent retailers would be able to buy the "economy" size from wholesalers at 51 cents (46 1/2 plus 4 1/2); adding a markup of 12 cents, the probable retail price would be 63 cents. The direct-buying retail chains could resell the same item for 60 cents, since they purchase it at the same price as wholesalers, 46 1/2 cents, and need to add a markup of only 13 1/2 cents.
to stock it. The manufacturer could overcome this reluc-
tance only by making the wholesaler-retailer channel competi-
tive with the chains. This could be accomplished by grant-
ing a functional discount to wholesalers which is not made
available to the retail chains. To achieve its objective,
this would have to be equal to the costs normally incurred
by wholesalers in the performance of their functions with
respect to the product in question. Where, however, the
performance of such functions results in a lower markup
requirement by retailers buying from such wholesalers rela-
tive to retailers buying directly from the manufacturer,
it would be advisable to deduct the difference between
these margin requirements from the amount of the functional
discount allowed to wholesalers. Such a situation exists
in the above illustration. Retailers purchasing directly
from the manufacturer require a markup of 13 1/2 cents on
the "economy" size of the flavor extract in order to sell
it at a profit, while retailers purchasing from wholesalers
require only a markup of 12 cents. In order to make the
two channels of distribution inter-competitive, the func-
tional discount allowed to wholesalers should be equal to
their normal costs of handling and selling the extract
(4 1/2 cents), less the savings which the performance of
these functions permits to retailers buying from them as
compared to the costs incurred by direct buying retailers
(13 1/2 cents minus 12 cents or 1 1/2 cents). This means
that the functional discount necessary to make the two channels inter-competitive would have to be 3 cents.

Many similar illustrations could be cited to show how trade discounts make different distributors of a manufacturer inter-competitive, with the result that the manufacturer obtains wider market coverage. The essence of the "inter-competitive" concept is that the primary producer accepts varying net receipts in order to have the same resale price prevail among different distributors at subsequent stages of distribution. As a direct consequence, trade discounts permit a vendor to enlist more wholesalers and retailers in his service than would be possible under a one-price policy.

The inter-competitive theory of functional discounts has received support from several sources. Representative Wright Patman, one of the sponsors of the Robinson-Patman Act, has argued that a manufacturer has a "moral obligation" to protect his wholesalers by keeping them and their retail customers competitive with direct-buying retailers.

Professor McNair has even suggested that a manufacturer selling both to a shoe store and to a department store should grant a larger discount to the latter since it has different methods and costs, although the costs to the

---

manufacturer of serving the two accounts may be the same.

The department store is a different type of retail institution from the independent shoe store, with a different organization, different methods of doing business, and consequently a different cost of operation, a higher cost, as it happens. Therefore, the department store expects a higher trade discount even though in the particular instance the shoe manufacturer sends the same salesman to call with about the same frequency on both department stores and independent shoe stores. 41

Although Professor McNair does not state it as such, this constitutes implied recognition of the inter-competitive theory. The department store will not normally carry a line of shoes unless it can compete, price-wise, with independent shoe stores selling the same line. In order for the higher-markup department store to do so, it must purchase at a lower price than the independent shoe stores. A manufacturer who varies his prices to different accounts on the basis of their markup requirements, so that they can resell a particular product at the same price as their competitors, is adhering to the inter-competitive theory.

The over-all pattern of trade prices designed to make several channels inter-competitive must be such that the manufacturer's product can profitably be sold only at approximately the same price by all distributors at any

level where members of the different channels come into
direct competition. In constructing such a pricing
schedule, the "typical" costs and "reasonable" profits of
all merchants handling the manufacturer's line must be
carefully considered. The difficulties inherent in such a
step are obvious. Nevertheless, over a period of time,
discount schedules which achieve the desired objective
can usually be evolved.

THE COST SAVINGS THEORY. Attempts have also been
made to explain functional discounts in terms of cost
savings accruing to the vendor. In many cases, it is
cheaper for a manufacturer to sell to wholesalers rather
than to retailers. Wholesalers frequently purchase in
larger quantities than retailers; they commonly have ware­
house facilities to anticipate demand and to stock goods
in the interim between their physical completion and their
display in retail stores; they relieve the manufacturer
of the burden of serving small, scattered retail outlets;
they help to stabilize the manufacturer's production; they
normally pay promptly for merchandise bought, often dis­
counting their bills upon presentation. All these factors

---

[^42]: Burton A. Zorn and George J. Feldman, Business
Under the New Price Laws (New York: Prentice-Hall, 1937),
pp. 166-177.

[^43]: Theodore N. Beckman and Nathanael H. Engle,
Wholesaling Principles and Practice (New York: Ronald
permit the manufacturer to realize savings when selling to wholesalers rather than to retailers. It is, therefore, sometimes concluded that functional discounts merely reflect the lower expenses involved in serving wholesalers rather than retailers.

Such an explanation of functional discounts, however, suffers from a major deficiency. This is that it is based upon the implicit assumption that a manufacturer has a choice of alternative channels through which to distribute his goods. Such an assumption may be true in some cases. It is probably not true in the majority. In more instances than not, a manufacturer of consumer goods can distribute his products efficiently and effectively only by depending upon wholesalers to do the job. To speak of cost savings in such a situation is quite absurd. There being no choice, it is senseless to state that one channel of distribution affords savings over another when, in fact, the channel against which the comparison is made cannot be employed by the manufacturer.

The cost savings theory has validity only where the manufacturer actually has a choice of selling to wholesalers or directly to retailers. Even in such cases the relationship between functional discounts and costs is not

a simple one. In the complex marketing structure which has emerged during the past six or seven decades, some wholesalers have curtailed the functions they formerly performed, while many retailers have assumed functions of a wholesaling nature. Consequently, it can no longer be definitely stated that a sale by a manufacturer to a retailer will always involve higher expenses than one to a wholesaler. Nevertheless, there is considerable evidence to support the proposition that, over a period of time, it is more expensive for a manufacturer to sell to retailers than to wholesalers, even though no appreciable difference may be detected in the costs involved in filling a specific order of a retailer as distinguished from a specific order of a wholesaler.

In brief, when a seller has a choice whether to sell through wholesalers or directly to retailers, the savings which he may realize as a result of selling through wholesalers constitute a raison d'être of functional discounts. Such savings can normally, however, be detected only by comparing the expenses involved in using the two different channels of distribution over an extended period of time.

THE INCREMENTAL REVENUE THEORY. A vendor who is considering the advisability of expanding his market coverage by adding channels to his present system of distribution

---

45McNair, op. cit., p. 347.
will normally think in terms of incremental costs. Any sales at a price above "out-of-pocket," or incremental, costs will add to net profit (or help to reduce present loss), provided such new sales will not affect the prices the seller can obtain from other channels of distribution. The reason for this is simple. The "basic" channel has already been charged with all fixed or overhead costs; the "new" channel does not increase these fixed or overhead expenses; consequently, any price paid by this channel above the variable cost of the new production will make a contribution towards profit or tend to reduce a loss.

The view can therefore be offered that a manufacturer sees the producer-retailer-consumer route as his "basic" channel and the wholesaler channel as merely supplementary to this, adding sales not otherwise obtainable. It would be advisable to serve this "supplemental" channel at any price above the actual out-of-pocket cost of producing and selling the additional output. The lower net price granted

---94---

46John G. Blocker and W. Keith Weltmer, Cost Accounting (New York: McGraw-Hill Book Co., 1954), pp. 443-451. Joel Dean takes a similar position, op. cit., p. 265. Incremental costs are those which are directly traceable to a specific transaction. They are the variable and "out-of-pocket" costs which can be directly associated with a particular output or sale. The incremental cost idea is similar to J. M. Clark's "differential" cost concept. Clark, op. cit., p. 49. For a distinction between marginal and incremental costs, see Joel Dean, op. cit., p. 265.

47Fixed or overhead costs are those which do not vary with short-run fluctuations in the volume of business done by a firm. Blocker and Weltmer, op. cit., pp. 443-445.
to wholesalers as compared to that granted to retailers could be deemed to be the highest incremental revenue obtainable from this "supplemental" channel of distribution.

The logic of the incremental revenue theory could, of course, be turned around to justify giving a trade discount "in reverse," that is, a greater discount to retailers than to wholesalers. It could be argued that the wholesaler channel is the "basic" one, and that the advantage of incremental pricing should be accorded to direct-buying retailers. As a practical matter, however, such reasoning could not be sustained. It would be impossible to employ incremental pricing practices with respect to different channels of distribution unless the bulk of the overhead costs were charged to wholesalers, rather than to retailers. Clearly no wholesaler would purchase a product for resale for which he had to pay a higher price than his prospective customers. Therefore, if the incremental revenue theory is to be applied at all, it must be applied so as to afford the lower price to wholesalers and not to the retailers.

Incremental pricing is commonly used in the public utility field in order to obtain more intensive utilization of existing facilities. However, rates charged by such utilities are subject to stringent governmental control to prevent abuse.
CONCLUSIONS. On the basis of the theories analyzed in this chapter, certain conclusions are inevitable. First, and probably foremost, is the fact that functional discounts are granted to wholesalers for the performance of marketing functions, and in many cases for functions which only wholesalers can perform efficiently and effectively. This being so, the individual manufacturer may have no alternative. If he wishes to sell his goods at all, or at reasonable expense, he must go through wholesalers. It is, therefore, illogical to suggest that functional discounts must reflect the cost savings which wholesalers may permit to the manufacturer. In truth, there may be no cost savings. There being only one practical method by which to get the goods to the retail market, it would be absurd to state that such a method resulted in any cost savings over another channel of distribution which, in fact, did not exist.

Where wholesalers constitute the only channel of distribution which a manufacturer can, as a practical matter, use to bring his products to market, the size of functional discounts must depend upon the margin required by such wholesalers in order to perform their indispensable activities, plus a reasonable profit. Anything less than that will fail to obtain wholesaler cooperation with respect to the line in question. This conclusion is in full accord
with the so-called compensation theory. However, there is also some validity in the buying distribution theory. The term "reasonable profit" is exceedingly vague. What may seem to be a reasonable wholesale profit to the manufacturer may appear entirely inadequate to the wholesaler himself; and what may be a reasonable profit on one item may be generous on another item. Competitive forces, therefore, tend to determine the general level of functional discounts prevalent in any industry. Manufacturers of either especially fast- or slow-moving merchandise may find it desirable to deviate from the normal size of the functional discounts customary in the industry. The amount of such deviation will tend to be determined by the alternate product lines available to wholesalers at the time—in brief, by the competition of manufacturers for wholesale outlets.

In those instances where the manufacturer does possess a choice regarding which channels of distribution to employ, the cost savings theory may have considerable merit. However, even in such cases the economics which may result from selling through wholesalers as compared with selling to retailers directly should represent only one factor in the size of functional discounts. The margin requirements of wholesalers must still be paramount. Unless such requirements are satisfied, wholesalers will be
unable to perform their valuable functions and the economy will lose the benefit of their indispensable services.

There is also considerable validity in the thesis underlying the so-called inter-competitive theory. Functional discounts not only permit a manufacturer to obtain distribution through the wholesaler channel, but they also facilitate the use of multiple channels. Normally, a merchant, whether he be a wholesaler or retailer, will not carry a line unless it is likely to afford him a reasonable net profit. Trade and functional discounts, by adjusting the price to various channels of distribution so that the particular line can profitably be sold by members of several channels, tend to provide widespread market coverage for a line. This is a desirable result. It serves consumer convenience and actually increases the vitality of the competitive process in the economy.

The selling cost theory, while theoretical in structure, should not be lightly disregarded. It affirms the conclusion that functional discounts constitute a necessary expense in order to move products from manufacturer to consumer. Its main significance, however, lies in the fact that it provides an acceptable explanation of how selling costs, including functional discounts, may actually have a tendency to reduce the price of a product, at least in cases where such selling costs lead to greater demand
for the item and to better utilization of the manufacturer's productive capacity. The incremental revenue theory offers support for this proposition.

The foregoing discussion has indicated mainly the factors which determine the size of functional discounts. It has dealt only indirectly with the basic question of why such discounts are granted. Wholesalers do not, of course, receive functional discounts on all products which they carry. In selling products bought without such discounts, they normally add a markup to their purchase price which is designed to cover their operating expenses and, if possible, to leave them a reasonable profit. Functional discounts, obviously, serve the same purpose. The essential, and possibly only difference, between a markup and a functional discount is that the latter is recognized and, in a sense, protected by the manufacturer. This protection is accomplished by selling to prospective customers of the wholesalers only at the same price at which such wholesalers would be likely to sell them or, in the event that such manufacturer sells exclusively to wholesalers, by inducing all wholesalers buying from the manufacturer to resell only at a suggested or fixed resale price. A functional discount is, therefore, simply a margin of profit which is sanctioned by the manufacturer. It is granted to "buy" distribution, to compensate wholesalers, to make whole-
salers and their customers competitive with other middlemen who carry the same line and seek to sell to the same buyers, or to pass on to wholesalers the savings which a seller realizes as a result of selling through them, rather than directly to retailers. A functional discount may be granted for any one, or several, of these different reasons. A functional discount is, in brief, a highly complex phenomenon.
CHAPTER V

FUNCTIONAL DISCOUNTS UNDER THE CLAYTON ACT

THE RIGHT TO COMPETE UNDER ENGLISH COMMON LAW.

There is considerable evidence to indicate that the English common law has rather consistently favored freedom of enterprise and competition. The acts of private individuals which enhanced or depressed the price of essential goods above or below their market level were declared to be criminal offenses even before the sixteenth century. Such practices were originally given the name of "forestalling" (from the Old Saxon fare, to go, and stall, to hinder). In the course of time, the terms "engrossing" and "regrating" were also used to describe

---


3Mund, op. cit., p. 44.
particular aspects of market interference, and "forestalling" came to refer specifically to the practice of buying goods before they had reached the public market.

One of the early court decisions to recognize the legal right to compete was rendered in the Schoolmasters' case, decided in 1410. The Court of Common Pleas held that two schoolmasters in Gloucester could not obtain a writ to prevent another teacher from starting a second school in the same town, even though the plaintiffs showed that the entry of the other teacher would force them to reduce their tuition from £4 to 12 shillings per semester for each student. The court declared that when "another equally competent with the plaintiffs comes to teach the children, this is a virtuous and charitable thing, and an

---

4The offense comprehended within the term "engrossing" (from the Old French grosse, great or whole) was the buying up of the whole or large part of a commodity by one person or a number of persons in order to enhance price by controlling the supply. The offense of "regrating" (from the Old French regrateor, peddler or huckster) was considered to be the purchasing of "dead victuals," such as corn, fish and fresh meats, in order to sell them again later. It appears that this was made a criminal offense, not with the purpose of eliminating middlemen, but with the intent of preventing the sale of deteriorated and excessively-handled food products. Ibid., pp. 44-46.

5There were several earlier cases which dealt with the right of workmen and businessmen to compete for employment and business. However, the Schoolmasters' case is the best known of these historic precedents. Vernon A. Mund, Government and Business (New York: Harper and Bros., 1950), pp. 56-57.
Thus, the principle of competition was established in court decisions by the fifteenth century, and probably even before that time. However, competition was often seriously curtailed in practice. The ruling families of Europe during the fifteenth, sixteenth and seventeenth centuries were actively engaged in extending their domains through conquest and exploration. These "adventures" required vast sums of money. Many of the monarchs of Europe found that they could secure these funds by granting monopolies and other special privileges to various trade groups who were willing to pay for such commercial ad-

---

6 The Schoolmasters' case, T. E. Henry IV, f. 47, pl. 21 (1410).


8 Under the early English common law, a monopoly was "a license or privilege allowed by the King for the sole buying and selling, making, working or using, of anything whatsoever; whereby the subject in general is restrained from the liberty of manufacturing or trading which he had before." Sir William Blackstone, Commentaries on the Laws of England (New York: W. E. Dean, 1851), II, Book IV, Section 159, p. 119.
vantages. As a consequence, many royal families participated, usually secretly, in the profits of the leading merchants in their realm.

The establishment of guilds, many of which were granted exclusive jurisdiction over a given line of trade, restricted the freedom of individuals to pursue a calling of their choice; persons could not engage in many occupations unless they became members of the appropriate guild or company. The development in England of this system of monopolistic privileges led to the decline of the open market in which competition had operated so freely. The advent of mercantilism, with its regulations designed to establish a "favorable" balance of foreign trade, resulted in further restrictions on competition.

World attention was focused on the basic fallacies of mercantilistic policies by Adam Smith. The gentleman from Kirkcaldy not only subverted the sophistic precepts

---

9These grants of monopoly were vigorously fought in the courts and in Parliament by the excluded merchants. With the increasing power of Parliament, the making of such grants was declared illegal in the Statute of Monopolies of 1624. Mund, Open Markets, pp. 75-78.

10Ibid., pp. 89-90.

of mercantilism, but he gave a moral and philosophical base to the competitive system, extolling it for its "provident" and "beneficial" results. An era in which the forces of self-interest were permitted to operate, freed from the restraining fetters of rigid governmental control, opened in England even before the turn of the nineteenth century. A similar spirit of economic liberalism took root in Germany, France and other European countries not many years later.

However, even in this period of "laissez-faire," governmental intervention in economic affairs was not entirely absent. Public authorities then, no less than now, assumed responsibility for developing and maintaining the institutions necessary for commercial activity, such as private property, freedom of contract, a monetary system and a process by which the disputes of individuals can be adjudicated. Furthermore, the English common law declared "restraints of trade" illegal, punishable by fines and imprisonment. The term "restraint of trade"


13Ibid., pp. 275-298.


15Ibid.

16Ibid., pp. 139-140.
was used to designate restrictions, imposed by private persons, limiting the freedom of individuals to exercise a trade of their choice. Such restrictions were deemed objectionable, however, not because of their effect on competition, but because they deprived a man of his means of support and the public of his services. At first, the English common law forbade all "restraints of trade." Gradually, however, the rule was modified to permit partial restraints under certain circumstances.

THE RIGHT TO COMPETE IN THE UNITED STATES. During the difficult years of the Revolutionary War, many of the states enacted statutes regulating the prices of common products and the wages of labor. Most of these laws


18 Ibid.

19 The necessary prerequisites for a "permissible" restraint of trade under the English common law were (a) that it be partial in scope; (b) that it be given in return for valid consideration; and (c) that it be "ancillary" (i.e., closely related) to a contract which did not have restraint of trade as its objective. For a compilation of early cases on the question, see Thomas Spelling, Trusts and Monopolies (Boston: Little, Brown, 1893).

encountered immediate opposition. As one student of the subject has written:

In some states the laws were short lived, in others they were more lasting, but in all there was deep concern about the matter.... They were generally disregarded and as soon as the credit and currency of the new nation were established and there was an end to the chaos that had prevailed during the Revolution, there was an end to the price-fixing laws.21

Soon after the Revolutionary War, the United States, with its Anglo-Saxon heritage, turned to competition to guide the course of its economic development. The concept of "restraint of trade" received early recognition in the United States; it was, however, broadened from its original meaning of depriving persons of the right to select their occupations to include all agreements among competitors for the purpose of restraining competition among themselves. Thus, in the Morris Run Coal case an agreement by five coal operators to divide sales in certain proportions and to fix prices jointly was held to be an "unreasonable" restraint of trade and illegal. Together with the extension of the term "restraint of trade" in the United

21 Ibid., n. 275.
States, the test of the legality of such restraints was changed to a determination of their "reasonableness" under the circumstances of the case. Not all restraints of trade are illegal in the United States, but only those which are "unreasonable." The common law, as it developed in the United States, also recognized that individuals engaged in trade had certain proprietary rights involving their good will, trade secrets, and established business relations. The law, therefore, afforded rights of action for (a) the deceitful diversion of patronage; (b) the misappropriation of trade secrets; and (c) the malicious interference with business relations or operations. Fostering competition indirectly by prohibiting conspiracies among competitors, through the restraint of trade concept, and by affording private remedies for certain private wrongs was the manner in which the common law sought to preserve the free enterprise system.

The freedom of individuals to select the price at

---


25 Ibid., p. 21
which they will sell their property or services has been
jealously guarded by the American judiciary, except possibly
during times of war and national emergency. Even the
right of the states to regulate the rates charged by public
utilities was not recognized until late in the nineteenth
century. The common law did not condemn price discrimi-
nation. Sellers were free to discriminate, and even to
refuse to serve customers.

In the decade following the Civil War, the tech-
niques of mass production were adapted to many industries,
including gunpowder, cotton, and yarn manufacturing, sugar

26"There is nothing to prevent an individual from
selling property that he has at any price he can get for

27In the early days of the nation, a clause requiring
the rates charged to be reasonable was usually included in
the charters granted to companies which undertook to operate
turnpike roads and canals. Similar provisions were also
included in the charters and franchises granted to the rail-
roads. It can hardly be said that such provisions consti-
tuted governmental regulation. In the famous case, Munn v.
Illinois, 94 U.S. 113 (1877), the Supreme Court first up-
held the right of states to actually regulate the prices of
businesses "affected with a public interest." The broad
interpretation which could be placed upon the phrase "af-
fected with a public interest" was subsequently narrowed to
enterprises usually regarded as public utilities—specifi-
cally, those in which monopoly was "natural" or inevitable
because of technical conditions. Wolff Packing Company v.
State of Kansas, 262 U.S. 523 (1923). For a discussion of
the legality of price fixing by legislative action, see
(May 1909), 454 and Nathan Isaacs, "Price Control by Law,"
Harvard Business Review, XVIII (Summer 1940), 504.

28Ralph Cassady, Jr., "Legal Aspects of Price Dis-
1947), 258.
and oil refining, and liquor distilling. This introduction of modern methods of production required the infusion of vast sums of capital into these industries. It appears that the financial leaders of the time felt that their investments would be made more secure by taming some of the ruinous effects of competition. Agreements among competitors to limit production, to fix prices, to allocate sales territories, to coordinate policies became widespread. Such agreements were often strengthened by the establishment of "trusts," which involved the assignment of the voting stock of competing corporations to a group of trustees in exchange for "trust certificates." These trustees had the power to enforce industry agreements as to production quotas, prices, sales territories, etc., since control of the voting stock made it possible for trustees to remove uncooperative executives. It was thus possible to maintain high prices and profits, almost irrespective of economic conditions.

The most effective use of the trust device appears to have been made by the Standard Oil Company. Incorporated in 1870 to take over the diverse oil interests of John D. Rockefeller and associates, the company increased its

---

29McAllister, loc. cit., pp. 281-283.
30Ibid.
31Mund, Government and Business, pp. 94-95.
control of the oil refining industry, largely through the use of trust agreements, from ten to about ninety-five percent within a period of ten years. Similar trusts were formed in other manufacturing industries, including those of cottonseed oil (1884), linseed oil (1885), whiskey (1887), sugar (1887), lead (1887), and cordage (1887).

Trusts came under increasing legal attack as the 1880's drew to a close. Rising to the crisis, corporation attorneys suggested to their clients a new method which could be employed to acquire and maintain control of an industry. This was the "holding company," that is, a corporation which has the power to own and vote the stock of competing concerns. New Jersey was the first state, in 1888, to permit domestically chartered corporations to exercise such powers.

THE SHERMAN ACT. The growing concentration of industrial control in the basic industries was a disquieting development to many people. Since many of the trusts

33 McAllister, op. cit., p. 282.
34 Mund, Government and Business, pp. 143-144.
35 Anshen and Womuth, op. cit., p. 90.
and large corporations were engaged in activities spanning the entire continent, the individual states found it difficult to regulate them. By the middle of the 1880's, the prevention of monopoly and the maintenance of competition were widely recognized as a problem of national scope, requiring federal intervention. In the presidential election of 1888, the platforms of both parties promised federal action to control trusts and monopolistic combinations. Two years later, the Sherman Act was passed.

This Act declared contracts and conspiracies in restraint of trade or commerce, as well as attempts to monopolize trade or commerce, to be illegal. In effect, this was a restatement of the English common law; its significance was in the fact that it firmly dedicated the federal government to the policy of maintaining the conditions

---

37 For a discussion of the "merger movement" in its broad historical context, see Charles A. Beard and Mary R. Beard, A Basic History of the United States (Philadelphia: Blakiston Co., 1944), pp. 303-319.


39 Act of July 12, 1890; United States Code Annotated, Title 15, Sections 1-8. The two main prohibitions of the law read as follows: "Every contract, combination in the form of trust or otherwise, or conspiracy, in the restraint of trade or commerce among the several states, or with foreign nations is hereby declared to be illegal...." Section 2: "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several states, or with foreign nations, shall be deemed guilty of a misdemeanor...."
deemed necessary to preserve free competition in interstate commerce.

The Sherman Act fulfilled few of the many hopeful expectations of its friends. Its main purpose was to check the development of industrial combinations. However, in the first important case under the new Act, the United States Supreme Court held that it could not constitutionally be applied to a trust which admittedly controlled the refining of ninety-eight per cent of the sugar consumed in the United States, on the ground that a combination of manufacturing plants, in itself, "bore no direct relation to commerce between the states." The court did not abandon this restrictive interpretation of the United States Constitution until nine years later, when it allowed the Sherman Act to be applied to a collusive combination of railroads operating in the western part of the country.

Most of the large industrial firms of today were organized

---


41 United States v. E. C. Knight Company, 156 U.S. 1, 9 (1895). Federal regulation of private business must fall within the scope of the powers conferred by the Constitution to the federal government by the "commerce clause," unless such regulation can be justified under the taxing, war, money, or bankruptcy powers of the federal government. Anshen and Wormuth, op. cit., pp. 41-50.

42 Northern Securities Company v. United States, 193 U.S. 197 (1904); also see Swift and Company v. United States, 196 U.S. 375 (1905).
during the intervening decade between the so-called Sugar Trust case (1895) and the Northern Securities case (1904).

Some of the predatory practices used by large-scale organizations to obtain domination of an industry came under close public scrutiny as a result of legal proceedings instituted by the federal government against the Standard Oil Company of New Jersey, and against the American Tobacco Company. The evidence presented in both cases showed that these companies pursued a relentless policy of "cutthroat competition," with the express purpose of eliminating their weaker rivals. One of the techniques used to accomplish this objective was shown to be the practice of reducing prices, often to unprofitable levels, in areas where the company faced vigorous competition, while maintaining, and even increasing, them in localities

---

43A depression occurred in the United States between the years 1893 and 1896. In the ensuing struggle for survival, most of the agreements among competitors as to price, output and other business policies collapsed. As the economic situation returned to relative normalcy in 1897, mergers took place in many industries. These mergers involved either the outright purchase of the assets of competing firms or, more commonly, the purchase of a part of their voting stock. Mund, Government and Business, pp. 96-97.

44Standard Oil Company of New Jersey v. United States, 221 U.S. 1 (1911).


where the company faced little or no competition. Such
geographic price discrimination compelled many independents
either to sell out to their large competitors or to get
out of business.

THE CLAYTON ACT. The inability of the Sherman Act
to prevent these tactics and to preclude the further ex­
pansion of the already large industrial enterprises led to
widespread concern on the part of many small businessmen
and consumers. Demands were made on Congress for
corrective legislation. These demands became so insistent
that both major political parties committed themselves
during the political campaign of 1912 to the enactment of
laws which would curb the "unfair" practices common in
business.

The Federal Trade Commission Act and the Clayton
Act were both passed in 1914. The first of these statutes
established a federal administrative agency to prevent

47 Ibid.
49 See McAllister, op. cit., pp. 233-287.
50 Act of September 26, 1914; United States Code
Annotated, Title 15, Sections 41-51.
51 Act of October 15, 1914; United States Code
Annotated, Title 15, Sections 12-27.
"unfair competition," leaving it to the newly-created agency to interpret this term. The Clayton Act singled out several competitive practices which experience, and especially the records in the Standard Oil and American Tobacco cases, had shown to be techniques frequently used by firms to achieve control of an industry. Price discrimination was one of these practices, "tying contracts" another, and interlocking boards of directors still another. All of these practices were declared illegal, under specified circumstances, by the Clayton Act.

Section 2 of the Clayton Act stated:

that it shall be unlawful for any person engaged in commerce...to discriminate in price between different purchasers of commodities...where the effect of such discrimination may be to substantially lessen competition or tend to create a monopoly in any line of commerce....

---

52For a brief discussion of the regulation of "unfair competition" by the Federal Trade Commission, see Mund, Government and Business, pp. 298-325.

53Section 3 of the Clayton Act prohibited the use of exclusive dealership agreements or tying contracts "where the effect of such lease, sale,...or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce." Sections 7 and 8, respectively, limited inter-corporate stockholding and interlocking boards of directors under specified circumstances. Sections 4, 5 and 11 through 19 were purely procedural in character. Section 6 dealt with the status of labor organizations under the Act, and Sections 20 through 25 related to the use of judicial process in antitrust cases.
By the terms of the Act, however, a discrimination in price for the bona fide purpose of meeting competition was declared not to be unlawful. Also exempted were price differences "on account of" differences in the grade, quality or quantity of the commodity sold, or that made only "due allowances" for differences in the cost of selling or transportation. Conspicuously absent was any requirement that quantity discounts bear any specific relationship to the savings in costs resulting from the size of the purchase to which they applied.

FUNCTIONAL DISCOUNTS UNDER THE CLAYTON ACT. The Clayton Act did not specifically mention functional discounts. However, the Act had not been passed long before the legality of such discounts came under attack by the Federal Trade Commission. During the twenty-two years intervening between the passage of the Clayton Act in 1914 and its amendment by the Robinson-Patman Act in 1936, not a single one of these attacks on functional discounts was successful.  

The holdings of the Commission and the decisions of the courts indicate that as many as four different justifications could be used to authorize the legality of functional discounts under the Clayton Act. The first of these involved the proviso that permitted different prices to be charged "on account" of differences in quantity. The courts placed no limitations on the extent to which differences in quantity permitted differences in price. As a result, a purchaser who bought only a slightly larger quantity than another could be granted a substantial discount. Whenever a wholesaler purchased a larger quantity than a retailer, the functional discounts granted to such a wholesaler could be said to come within this escape of the Clayton Act. However, with the rapid growth of chain store organizations during the second decade of the present century, this justification of functional discounts came to have ever less significance.

A more meaningful argument for the legality of functional discounts was developed by the courts in the Mennen

---


56While functional discounts could be justified under the Clayton Act on the basis of quantity differences, this is not to say that functional and quantity discounts are in any way similar. As previously discussed, these two types of discounts possess basically different characteristics. See Chapter I, supra.
case. The Mennen Company was a New York corporation engaged in the business of manufacturing and selling talcum powder, toothpaste, shaving soap and various other toilet articles. Prior to January, 1917, the company quoted the same prices to all customers who bought the company's products in identical quantities, the amount purchased being the only basis for a price discount. The National Wholesale Druggists' Association, a trade association of drug wholesalers, raised objections to this policy. As a result of these protests, the Mennen Company adopted a new pricing structure in January of 1917, which classified customers as either "jobbers" or "retailers" and allowed a higher discount from list price to jobbers than to retailers. The company classified cooperative chains, buying in "wholesale quantities, maintaining stocks of products...and distributing said products in wholesale quantities to retail dealers in such products" and otherwise "functioning as distributors at wholesale," as retailers. The Federal Trade Commission


58In the Matter of the Mennen Company, 4 F.T.C. 258 (1922).

59Ibid., p. 276. The Mennen Company took the position that the members of such cooperative chains were the "real parties in interest" and that they could not qualify for jobber discounts, since they resold directly to consumers. For a discussion of the development and functions of cooperative chains, see Theodore N. Beckman and Nathanael H. Engle, Wholesaling Principles and Practice (New York: Ronald Press, 1951), pp. 266-285.
found that the pricing structure of the Mennen Company adopted in 1917 was "approved" by wholesalers and that it served as a basis for an understanding between the Mennen Company and jobbers whereby the latter agreed to push the sale of Mennen Company products "more vigorously than the sale of products of other manufacturers." The Federal Trade Commission, in its holding, concluded that the Mennen Company's failure to grant wholesaler status and discounts to cooperative chains placed such organizations at a "competitive disadvantage" as compared with other wholesalers and that it tended "to hinder and lessen competition." The Commission found the Mennen Company guilty of "unfair methods of competition," under Section 5 of the Federal Trade Commission Act, and of price discrimination, as prohibited by Section 2 of the Clayton Act.

The Commission issued a cease and desist order against the respondent which was exceedingly broad in

60Mennen, p. 277.

61Ibid., p. 278. These facts seem to indicate the existence of a conspiracy. It is surprising that the Federal Trade Commission did not make the agreement between the Mennen Company and the National Wholesale Druggists' Association an issue in the proceedings.

62Ibid., p. 278.

63Ibid., p. 281.
scope and foreboding in content. This order read, in part:

It is now ordered, That the respondent, the Mennen Company, its officers and agents and employees do cease and desist from discriminating in net selling prices, by any method or device, between purchasers of the same grade, quality and quantity of commodities, upon the basis of a classification of its customers as "jobbers," "wholesalers," or "retailers," or any similar classification which relates to the customers' form of organization, business policy, business methods, or to the business of the customers' membership or shareholders, in any transaction in, or directly affecting interstate commerce, in the distribution of its products....

The sweeping scope of this order aroused widespread concern that the Federal Trade Commission was seeking to outlaw functional discounts. The attorney for the Mennen Company announced, with undisguised anxiety, that the case involved "one of the most far-reaching and revolutionary propositions that has ever been advanced by the Commission or any other Government prosecutor—namely, that a manufacturer is obliged, as a matter of law, to charge the same price on the same quantity of his branded goods to all purchasers, whether such purchasers are

---

64 Ibid., p. 283.

65 "What Is the Law As to Trade Discounts," Printers' Ink, March 30, 1922, p. 13. The importance which was attached to the Mennen litigation is indicated by the fact that a substantial number of trade associations requested leave to appear as amici curiae when the case was taken to the Circuit Court of Appeals for review. See Chapter II, supra.
consumers or distributors, wholesalers, single retail stores, big department stores," etc.

The Commission's cease and desist order was taken by the Mennen Company to the Circuit Court of Appeals. Judge Rogers, speaking for the court, quickly disposed of the Commission's finding that the Mennen Company's failure to allow wholesale discounts to retailer-cooperatives constituted "unfair competition," violating Section 5 of the Federal Trade Commission Act. He said:

...the Mennen Company, acting independently, has undertaken to sell its own products in the ordinary course, without deception, misrepresentation, or oppression, and at fair prices, to purchasers willing to take them upon terms openly announced.... The acts complained of are not those "which have heretofore been regarded" as "unfair competition."°7


67Mennen Company v. Federal Trade Commission, 288 Fed 774, 777-778 (1923). Judge Rogers' opinion, while probably correct in its results, is noteworthy in several respects. He stated that the Mennen Company "acting independently" sold its products, etc. The uncontroverted evidence submitted before the Federal Trade Commission showed that the Mennen Company was not "acting independently," but that its pricing structure was "approved" by an organized group of wholesalers and that it served as the basis of an understanding between the Mennen Company and these wholesalers. Judge Rogers also concluded that the terms of the Mennen Company were "openly announced." This, again, is contrary to the clear facts in the records. The Commission specifically stated in its findings that the price lists applicable to jobbers were not circulated among customers classified as retailers--who were thus often unaware of the lower prices given to wholesalers. Federal Trade Commission v. Mennen Company, 4 F.T.C. 258, 276 (1922). These two major discrepancies in one sentence show how facts may be perverted in the process of judicial review.
Judge Rogers had only slightly more difficulty in dismissing the Commission's conclusion that the pricing practices of the Mennen Company in regard to retailer-cooperatives violated Section 2 of the Clayton Act. He stated:

The record filed in this court shows no contention by the Commission that the practices complained of have lessened competition as between Mennen Company and its competitors, but it shows at the most that the practices have decreased competition among the Mennen Company's customers or those desiring to become such. (Emphasis supplied.)

Judge Rogers observed that the Clayton Act, as passed by Congress, prohibited only those acts of price discrimination which might injure competition between the party discriminating and its competitors, and not price discrimination which might injure competition among the customers of such a seller. Judge Rogers noted that the Clayton bill, as originally introduced, outlawed any discrimination in price which was undertaken "with the purpose or intent thereby to destroy or wrongfully injure the business of a competitor of either such purchaser or seller." The court, speaking through its chief justice, expressed the opinion that if the bill had been passed in this form, there would be "just ground" for the claim that it applied

68 Mennen, p. 778.

69 Ibid. Emphasis supplied.
to discriminatory practices which might injure competition among customers of the seller, and not merely to those which might injure competition between the seller and his immediate competitors. Judge Rogers concluded, however, that the phraseology finally adopted in the Clayton Act, viz., "where the effect of such discrimination may be to substantially lessen competition or tend to create a monopoly in any line of commerce," showed an intent by Congress to protect only first-line competition, that is, the competition existing between the seller and his business rivals.

Judge Rogers did not mention trade or functional dis-

70 The court said: "It is a matter of common knowledge that prior to the enactment of the Clayton Act a practice had prevailed among large corporations of lowering prices asked for their products in a particular locality in which their competitors were operating for the purpose of driving a rival out of business.... (T)his practice was continued until the smaller rival was driven out of business, whereupon the prices in that locality would be put back to the normal level maintained in the rest of the country. The Clayton Act was aimed at that evil. This appears from the Report of the Judiciary Committee of the House of Representa-tives.... There is nothing in the Report of the Committee which shows that in reporting the bill the Committee had in mind anything more than the suppression of the evil referred to." The phraseology finally adopted in the Clayton Act "plainly indicates the intent of Congress to exclude from the operation of the section mere competition among 'purchasers' from the 'seller' or 'person' who allowed or withheld the discount and to include therein only competition between such 'seller' or 'person' and the latter's own competitors. It had been the latter class of competition and not the former which had been 'the common practice of great and powerful combinations engaged in commerce' to which the Committee in its report referred." Mennen Company, pp. 778-779.
counts by name. He clearly implied, however, that such dis-
counts were not likely to injure first-line competition. He
seemed to base this conclusion on the reasoning that the
larger the discounts offered by one seller to some buyers,
the greater the opportunity of competitors of that seller to
capture those customers or prospective customers to whom the
seller refuses these discounts, or to whom he offers less at-
tractive discounts. This conclusion was subsequently
stated, more lucidly, by the court in the National Biscuit
Company case:

> It is very apparent that no cracker manu-
facturer could be prejudiced by the re-
fusal of his largest rival to satisfy
customers or prospective customers by
granting the discounts desired. Such a
refusal could only have the effect upon a
competitor of driving the dissatisfied
customer to it.\(^7\)

A second legal justification for functional discounts
under the Clayton Act could, therefore, be based on the
proposition that such discounts were not likely to injure
competition between the seller and his competitors, and that
this was the only level of competition which the Act was de-

\(^7\)For a criticism of the reasoning contained in the
Mennen and National Biscuit Company cases, see Chapter VIII,
infra.

\(^7\)Although the National Biscuit Company case primarily
concerned graduated quantity discounts, rather than trade
or functional discounts, the above statement is pertinent.
National Biscuit Company v. Federal Trade Commission, 299
Fed 733, 738 (1924).
signed to protect. This argument was, however, largely
invalidated by a 1929 decision of the United States Supreme
Court. In the George Van Camp and Sons case, the Supreme
Court held that the Clayton Act also applied to the line of
competition in which purchasers of the discriminator were
engaged. This reversed the precedent established in the
Mennen case. Consequently, after 1929, functional dis­
counts were not exempt from the provisions of the Clayton
Act merely because they did not injure competition between
the seller and his competitors. After 1929 another
consideration came to have equal importance. This was
whether functional discounts affected competition among
purchasers and their competitors. Several statements in the

73 For a contemporary analysis of the Mennen case,
see John Leland Mechem, "Price Discrimination as Unfair
Competition," Michigan Law Review, XXI (June 1923), 852;
and "Recent Decisions," Columbia Law Review, XXIII (June
1923), 596.

74 George Van Camp and Sons v. American Can Company,
et al., 278 U.S. 245 (1929). The court held that the term
"in any line of commerce" in the Clayton Act was unambiguous,
clearly including everyone—buyer and seller alike—engaged
in a line of commerce. Since the phrase was not subject
to interpretation, the court refused to refer to the
Congressional Record in order to determine the intent of
Senators and Congressmen in passing the Clayton Act.

75 The court stated: "We have not failed carefully
to consider Mennen Company v. Federal Trade Commission....
The decision in that case was based upon the premise that
the statute was ambiguous and required the aid of committee
reports, etc., to determine its meaning, a premise we have
rejected as unsound." Ibid., p. 254.
Mennen case provided an answer to this question.

Judge Rogers, after ruling that the discounts granted by the Mennen Company to wholesalers and denied to retailer-cooperatives did not injure first-line competition, stated:

Whether a buyer is a wholesaler or not does not depend upon the quantity he buys. It is not the character of his buying, but the character of his selling, which marks him as a wholesaler.... A wholesaler does not sell to the ultimate consumer, but to a "jobber" or a "retailer." 76

This was the definition of wholesalers and retailers adopted in the A & P case. Reaffirming it, Judge Rogers concluded that the Mennen Company was "within its rights" in classifying retailer-cooperative organizations as retailers. After all, he reasoned, the persons constituting these cooperatives were buying for themselves to sell to ultimate consumers, and not to other jobbers or to other

76 Mennen, p. 782.


78 Ibid., p. 782.
retailers. This being so, the Chief Justice of the Circuit Court of Appeals of the Second Circuit said:

It (the Mennen Company) did not discriminate as between retailers but sold to all retailers on one and the same scale of prices. And it did not discriminate as between wholesalers but sold to all wholesalers on one and the same scale of prices. There is nothing unfair in declining to sell to retailers on the same scale of prices that it sold to wholesalers, even though the retailers bought or sought to buy the same quantity the wholesalers bought.80

This statement, although in the nature of obiter dictum, gave clear-cut recognition to the fact that trade and functional discounts did not violate the Clayton Act, at least as long as the different net prices were granted to groups which were not in competition with each other and as long as all members belonging to a particular group

79Ibid. A corporation is "an artificial person or legal entity created by or under the authority of the laws of a state or nation, composed...of a single person... (or) an association of numerous individuals,...which is regarded in law as having a personality and existence distinct from that of its several members...." Henry Black, Black's Law Dictionary (St. Paul: West Publishing Co., 1933), p. 438. It is well settled that the corporate personality should not be lightly disregarded. Only when it is "used to defeat public convenience, justify wrong, protect fraud," defend crime or when its recognition would produce unjust or undesirable consequences is a court warranted in "piercing the corporate veil." For a discussion of the pertinent law, see Robert S. Stevens, Handbook on the Law of Private Corporations (St. Paul: West Publishing Co., 1949). One may wonder whether the court in the Mennen case was justified in disregarding the corporate personality of the cooperative group and stating that its members sold to ultimate consumers. Ibid., pp. 95-99.

80Mennen, p. 781.
were sold at the same price. This principle of the
Mennen case was impliedly confirmed by the Federal Trade
Commission in its disposition of the South Bend Bait
Company proceedings. In 1922 the Company prepared a com-
plaint against the South Bend Bait Company, charging it
with discriminating against some of its customers in
violation of Section 2 of the Clayton Act and Section 5 of
81
the Federal Trade Commission Act. The evidence produced
before the trial examiner showed that the respondent
divided its accounts into four groups: jobbers, whole-
82
salers, retailers and consumers. The first three groups
were accorded discounts of 50%, 40% and 33 1/3%, respective-
ly, regardless of quantity purchased. The Commission
issued a cease and desist order against this practice, en-
joining the South Bend Bait Company from discriminating on
the basis of any "classification which relates to the
customers' business policy, business methods, or to the
83
customers' manner of doing business...." This order was
similar in content to that entered against the Mennen
Company only a few days earlier. Unlike the Mennen order,
however, it was not taken for review to the federal courts.

81 Federal Trade Commission v. South Bend Bait
Company, 4 F.T.C. 355 (1922).

82 It appears that the company classified as jobbers
all middlemen who sold to wholesalers.

83 Ibid., p. 362.
The fact which makes the South Bend Bait Company proceedings significant is that the Commission rescinded its order in the matter shortly after the federal court handed down its decision in the Mennen Company case. The Commission's willingness to annul its order would certainly seem to reflect its recognition that trade discounts allowed to non-competing groups, such as jobbers, wholesalers and retailers, did not violate the Clayton Act.

Further support for the proposition that trade discounts granted to non-competitive groups of customers were permitted under the Clayton Act may be found in S. S. Kresge v. Champion Spark Plug Company, and Baran v. Goodyear Tire and Rubber Company. The facts in the Kresge case were rather complicated; it is not necessary to detail them here. Suffice it to say, that the Kresge Company charged the Champion Company with selling its spark plugs to the Ford Motor Company for original equipment at prices which "covered only the materials and direct labor" and which were less than "total factory cost," while selling the same plugs to wholesalers and other distributors at
substantially higher prices. The court held such discrimination not to violate the Clayton Act, since "that act—rightly interpreted—forbids discrimination in price between purchasers only where the effect may be unreasonably to lessen competition or tend to create a monopoly...." Such a result could not be anticipated in this case, due to the fact that manufacturers of automobiles and wholesalers of automotive supplies and accessories could not be considered to be in competition with each other.

A similar set of facts was presented in Baran v. Goodyear Tire and Rubber Company. The plaintiff in these proceedings charged that Goodyear discriminated in the sale of its tires by granting a lower price to automo-

---

84Kresge v. Champion Spark Plug Company, 3 Fed 2(d) 415 (1925). Kresge's allegations were in defense to an action by the Champion Spark Plug Company, charging Kresge and another firm with infringing certain of Champion's spark plug patents. This defense was in the form of an assertion that the Champion Spark Plug Company did not have the "clean hands" required for equity relief. It is surprising that such a plea was considered on its merits under the circumstances of this case. It is a well-established principle of equity that the "unclean thing" must have some direct relation to the issues in the litigation in which it is invoked. Shaver v. Heller, 108 Fed 821, 65 L.R.A. 878 (1901). The discriminatory prices which a seller might charge to customers not party to the litigation would not seem to be of sufficient relevancy to an action by that seller to prevent the infringement of its patents to serve as a bar to the granting of equitable relief.

85Kresge, p. 420.

tive manufacturers, who attached them as original equipment, than to retail dealers who sold such tires to consumers for replacement purposes. The Goodyear Company interposed a demurrer to this allegation. The demurrer was sustained by the court, which stated:

There is apparently no competition between the manufacturers of automobiles and the dealers, nor is it alleged that any exists. The differentiation in price would not therefore substantially lessen competition.\[88\]

Much legal precedent could, therefore, be cited to exempt a pricing structure which granted different net prices to various non-competing purchasers from the provisions of the Clayton Act. This, then, constituted a third legal theory by which the permissibility of functional discounts could be sustained.

One additional argument could be mustered, although this rarely seemed necessary, to defend the legality of functional discounts under the Clayton Act. This was to

\[87\] A "demurrer" is an allegation that even if the facts alleged by the opposing party were true, that their legal significance would not be such as to warrant a judgment in favor of the opposing side. Black, op. cit., p. 553.

\[88\] Baran, p. 574.

\[89\] No litigation arose under the Clayton Act which presented the question of the legality of functional discounts granted to a "mixed-function" middleman. This issue was not considered by the courts until after the passage of the Robinson-Patman Act.
the effect that the injury to competition necessary to violate the Act had to be of a general nature, affecting an entire industry or a large part of an industry. Functional discounts would not be likely to produce such a result. Driving a single retailer out of business by not allowing him the same discounts as those available to wholesalers could hardly be deemed to have such a general effect on competition as to render the Clayton Act operative.

In summary, although functional discounts were not specifically authorized by the terms of the Clayton Act, such discounts received what was, in effect, a blanket grant of approval by the courts. As many as four cogent arguments could be offered in support of their legality. Functional discounts could be justified (1) as price reductions based on the fact that wholesalers normally bought in larger quantities than retailers; (2) as failing to injure competition at the first line of competition (This justification of functional discounts was, however, 

---


92 Ibid.
rendered ineffective in 1929 as a result of the Van Camp decision; (3) as failing to injure competition as long as such discounts were granted, without discrimination, to all competing wholesalers; and (4) as failing to have a "general" effect on competition.

The Robinson-Patman Act narrowed some of the broad "escapes" of the Clayton Act. No longer could quantity discounts be unlimited in amount. No longer was it necessary to prove that price discriminations injured "general" competition in order to render such discriminations illegal. The effect of these important changes in the federal antitrust law on the legal status of functional discounts will be analyzed in subsequent chapters.
CHAPTER VI

LEGISLATIVE HISTORY OF THE ROBINSON-PATMAN ACT

The Clayton Act was passed in 1914 in order to prohibit certain practices which some large-scale manufacturers had employed to secure a monopoly or a dominant position in a particular trade. The Report of the Judiciary Committee of the House of Representatives, which had held extensive hearings on the Clayton Act, specifically stated:

Section 2 of the bill...is expressly designed with the view of correcting and forbidding a common and widespread unfair trade practice whereby certain great corporations, and also certain smaller concerns which seek to secure a monopoly in trade and commerce by aping the methods of great corporations, have heretofore endeavored to destroy competition and render unprofitable the business of competitors by selling their goods, wares and merchandise at a less price in the particular communities where their rivals are engaged in business than at other places throughout the country.1

Large-scale manufacturers, distributing their goods throughout an entire region or the whole nation, were able to reduce their prices in communities where they faced competition, while maintaining higher prices elsewhere.

---

1House of Representatives Report, No. 627, 63rd Congress, 2d Session (1914), pp. 8-9.
The price discrimination section of the Clayton Act was specifically designed to curb this type of territorial price cutting by manufacturers.

The conclusion that the Clayton Act was concerned with competition at the seller's level was stated by the court in the Mennen case, and reaffirmed by the bench in the National Biscuit Company case. It was not until 1929, fifteen years after the passage of the Clayton Act, that the federal judiciary reversed its earlier stand and held that "any line of commerce" included competition among purchasers of the discriminating seller as well as competition at the first level of competition. This reversal of attitude in the Van Camp case probably resulted from the changes which had occurred in the American economy since the passage of the Clayton Act.

The relatively short period of time between the enactment of the Clayton Act and the Van Camp decision in 1929 witnessed a spectacular growth in the volume of sales accounted for by chain-store organizations. In the ten years between 1919 and 1929 alone, the estimated volume of

---


3For a discussion of these cases, see Chapter V, supra.

4See Chapter V, supra.

business done by chains increased sixfold, from 5% of all retail sales to about 30%. The area where increasing economic concentration appeared to threaten the survival of the "small businessman" in 1929 was, therefore, less in the manufacturing industries than in the retailing trades. Price discrimination, the potent weapon of manufacturers in the past, had now been embraced by the mass-distributors in their bid for domination of the retail markets. The Federal Trade Commission investigation of chain stores showed that large chains were often able to secure discounts greatly in excess of those available, not only to competing retailers, but even to wholesalers. The investigation also disclosed that such discriminatory discounts were commonly forced upon manufacturers, who were obliged to grant such discounts at the risk of losing the business of their chain-store customers.

THE ROBINSON-PATMAN ACT. The Robinson-Patman Act


7Final Report on the Chain Store Investigation, Senate Document No. 4, 74th Congress, 1st Session (1934).

8Ibid., pp. 24-26. "There were interviews with 129 manufacturers in the grocery group, 76 of which admitted that preferential treatment in some form was given. Thirty-three of the manufacturers interviewed stated positively that threats and coercion had been used by chain-store companies to obtain preferential treatment." Ibid., p. 24.
was specifically designed to meet this problem. It was
drafted in order to curb some of the "unfair methods of
competition" of the chains. It was expressly devised to
prevent price discrimination which might injure competition
among the purchasers of a discriminating seller and among
the customers of such purchasers. The Robinson-Patman Act,
in brief, was enacted in order to remedy an entirely differ­
cent economic problem from that facing the nation at the time
of the passage of the Clayton Act.

The Robinson-Patman Act was not, however, intended to
chart a new course in American antitrust policy. This was
repeatedly emphasized by various Congressmen and Senators

9 Although the federal courts had broadened the ap­
lication of the Clayton Act to include injury to second­
line competition in the Van Camp decision in 1929, this "re­
vision" of the Act did not appear sufficient to meet the
contemporary demands for corrective legislation. Quantity
discounts were still unrestricted in amount; injury to
individual competitors was not recognized as constituting a
substantial lessening of competition in a "line of commerce,"
even though there was a widespread belief that it was just
such injury which was likely to lead to a reduction of
competition in an entire industry. The Robinson-Patman Act
sought to remedy these "deficiencies" of the Clayton Act.
House of Representatives Report No. 2287, 74th Congress,

10 The Report of the House Committee on the Judiciary
made the following statement: "More than 20 years experience
and observation with respect to the operation of the Clayton
Act together with new methods of trade and industrial
organizations that have developed have convinced your
committee of the shortcomings of existing legislation and of
the need for the strengthening of existing laws and of
fitting them more perfectly to the methods and needs of
today." Ibid.
active in its passage.\footnote{Congressional Record, Volume 80, p. 8137.} According to most of the members of Congress who spoke on the point, the Robinson-Patman Act was merely an amendment which would strengthen and revitalize the price discrimination provisions of the Clayton Act. "It...is in harmony with the Sherman antitrust law and its amendment, the Clayton Act," said Senator Robinson, its co-sponsor. Legal commentators may disagree with this conclusion,\footnote{Melvin T. Copeland, "Revising the Antitrust Laws," Harvard Business Review, X (April 1932), 292. Apparently due to the ease with which a charge of price discrimination could be justified under the Clayton Act, only seventeen suits were instituted under Section 2 of the Act during the twenty-two years between 1914 and 1936. Of these seventeen suits, a violation of the Clayton Act was established in only six. Milo Fowler Hamilton and Lee Loevinger, "The Second Attack on Price Discrimination: The Robinson-Patman Act," Washington University Law Quarterly, XXII (February 1937), 153, 157.} but they cannot disagree
with the fact that the supporters of the Patman Bill held the view, at least for the record, that the bill was merely a measure to remedy some of the deficiencies of the existing law. Representative Patman stated this forcefully when he said: this "...is an amendment...to take out the weasel words that have made the law (the Clayton Act) unenforceable."

Whatever its purpose and whatever its motivation, the Robinson–Patman Act has become a source of interminable

---


14Congressional Record, Volume 80, p. 8232.
controversy among antitrust experts. In the closing moments of the debate on the bill, one perplexed member of the House Committee on the Judiciary observed:

You might as well know that the Bill finally agreed upon by the conferees contains many inconsistencies and the courts will have the devil's own job to unravel the tangle.15

This was possibly an understatement. Two leading economists have recently called the Act "one of the most tortuous legislative pronouncements ever to be on the statute books." Another authority has declared that it "perverts the economics of competition." Still another authority has described it as a "grotesque manifestation of the scissors and paste-pot method of drafting a potentially drastic criminal statute." A federal court, more

15 Ibid., p. 9414


temperate in language, has remarked that the Act is "vague" and "general in its wording" and that it cannot be translated with assurance into any "detailed set of guiding yardsticks." Even fervent supporters of the Act have been forced to admit that the Robinson-Patman Act is "scarcely a model of clarity."

STATUTORY CONSTRUCTION. It is a well-established principle of statutory construction that a law which is vague or ambiguous in its provisions should be interpreted by the courts in the light of the intent of the legislators enacting the statute. This intent may be gathered from


21"If there is any doubt as to the meaning of a statute, or the intention of the legislators in passing it, recourse may be had to the records and journals of that body, showing the history of the measures and the debates thereupon for the purpose of ascertaining that meaning and intention." Milton C. Jacobs, Legislation (New York: Aberdeen Press, 1954), p. 14. When the meaning of an act to be construed is clear on its face, resort to legislative intent is unnecessary and improper. Standard Fashion Company v. Magrane-Houston Company, 258 U.S. 346 (1922); George Van Camp and Sons v. American Can Company, 278 U.S. 245 (1929).
the reports of committees charged with the responsibility of conducting hearings on the legislation, the explanatory statements of members of such committees, statements made on the floor of the legislature by sponsors of the bill, and statements made in floor debate, at least when there is common agreement on the point by all those taking part in the discussion.

Since the Robinson-Patman Act contains numerous equivocal and enigmatic clauses, recourse to its legislative history is important in arriving at a proper interpretation. A study of the debates in Congress relating to this legislation indicates that its supporters had a constant awareness that their words might be used to determine Congressional intent. At one point, Representative Boileau of Wisconsin even stated: "...the debate, I am sure, will


24Ibid.

25Federal Trade Commission v. Raladam Company, 283 U.S. 643, 650 (1931). The statements of individual members of a legislature may not, normally, be used to construe the intent of that law-making body; there must be "common agreement in the debate" before such statements may be considered. Duplex, p. 474.

26See, for example, Congressional Record, Volume 80, p. 8122.
clarify the Congressional intent, if such is needed....27

No treatise on the current legal status of functional discounts would, therefore, be complete without an outline of the legislative history of the Robinson-Patman Act, with specific reference to those events and records which indicate the Congressional intent in regard to such discounts.

CHAIN STORE INVESTIGATION. The genesis of the Robinson-Patman Act may be traced to a resolution introduced by Senator Brookhart and approved by the Senate in 1928, directing the Federal Trade Commission to determine "how far the rapid increase in the chain-store system of distribution is based upon actual savings in costs of management and operation and how far upon quantity prices available only to chain-store distributors."28 This investigation took seven years, and resulted in thirty-three individual reports, covering various phases of chain-store operation. The final report was submitted on December 14, 1934; it concluded that to "the extent that chain stores consistently undersell independents we may expect a steady trend toward final chain-store supremacy and dominance in

27Ibid., p. 8124.

28Senate Resolution 224, 70th Congress, 1st Session (1928)
distribution which is apparently uncheckable.\footnote{29} The Federal Trade Commission recommended that the Clayton Act be amended to prevent "unfair or unjust" discrimination in prices between different purchasers of a particular commodity, leaving it to the Commission, subject to court review, to define and determine the existence of such "unfair or unjust" discrimination. The Federal Trade Commission drafted two bills to this effect, which Representative Mapes introduced in the first session of the 74th Congress in January, 1935.

\textbf{ACTION IN THE HOUSE OF REPRESENTATIVES.} Representative Patman sponsored a bill of his own to curb some of the discriminatory practices which had been widely publicized as a result of the Federal Trade Commission investigation of chain stores. This bill was introduced in the House of Representatives on June 11, 1935, \footnote{32} and, according to statements in the \textit{Congressional Record}, had

\footnote{30}Final Report on the Chain Store Investigation, \textit{op. cit.}  
\footnote{31}House of Representatives Bill 4995 and House of Representatives Bill 5062, 74th Congress, 1st Session (1935). See \textit{Congressional Record}, Volume 80, p. 8103.  
\footnote{32}House of Representatives Bill 8442, 74th Congress, 2nd Session (1936).
been drafted by Mr. H. B. Teegarden, attorney for the United States Wholesale Grocers' Association.

The original Patman bill contained a provision, reading:

That nothing herein contained shall prevent differentials in prices as between purchasers depending solely upon whether they purchase for resale to wholesalers, to retailers, or to consumers, or for use in further manufacture....

The bill was referred to the House Committee on the Judiciary, together with the two bills introduced by Representative Mapes. Hearings were held on these three bills in July of 1935. After concluding its hearings, the Judiciary Committee referred the bills to a subcommittee, which convened in February 1936. On March 31, 1936, the House Judiciary Committee reported the Patman bill favorably, with a number of amendments.

---

33See Congressional Record, Volume 80, p. 8137, 3232.

34Congressional Record, Volume 80, p. 8138.


36Zorn and Feldman, op. cit., p. 52.

The bill reported out by the Judiciary Committee stated:

...nothing herein contained shall prevent or require differentials as between purchasers depending solely upon whether they purchase for resale to wholesalers, to retailers, or to consumers, or for use in further manufacture; for the purpose of such classification of customers as wholesalers or jobbers, or retailers, the character of the selling of the purchaser and not the buying shall determine the classification, and any purchaser who, directly or indirectly, through a subsidiary or affiliated concern or broker, does both a wholesale and retail business shall, irrespective of quantity purchased, be classified (1) as a wholesaler on purchases for sale to retail dealers only, not owned or controlled directly or indirectly, by the purchaser; and (2) as a retailer on purchases for sale to consumers.38

As compared to the trade discount provision contained in the original Patman bill, the Committee amendment added the two words "or require" to the phrase "nothing herein contained shall prevent or require differentials," etc., to indicate clearly that it was not mandatory for a seller to grant trade discounts. It further appended a test for classifying wholesalers and retailers on the basis of

38Ibid., pp. 1-2.
their selling methods. This test was in line with that developed in the A & P case and reaffirmed in the Mennen case.

The floor debate on the Patman bill, as amended by the House Committee on the Judiciary, was turbulent, and often impassioned. Debate opened on May 27, 1936, a day which marked the first anniversary of the Supreme Court decision in the Schechter Poultry case and the demise of the National Recovery Administration. Supporters of the bill claimed that it would protect the small businessman, and the consumer, from "unfair competitors." These "unfair competitors" were invariably the chain stores, which were charged with disregarding the law of the land, selling

39 The Congressional Record indicates clearly that the Robinson-Patman Act was designed to prevent the further expansion of chains by limiting their buying advantages. The bill was even called an anti-chain-store law by members of Congress. See Congressional Record, Volume 80, pp. 8133–8134, 8136, 8442. This being so, functional discounts could not be based on the buying methods of the customer. If such a test had been adopted, the right of chain-store organizations to receive substantial discounts for their large-scale purchases would have received legal sanction, and the purpose of the Robinson-Patman Act would have been defeated.

40 Chapter V, supra.

41 See Congressional Record, Volume 80, p. 8107.

42 Representative Sabath (Ill.), a member of the Judiciary Committee, announced: "The chain-store octopus, mainly controlled by Wall Street financiers, must be restricted from unfair and discriminatory practices." Ibid., p. 8102.

43 Representative Shannon (Mo.) said: "The very bigness of these chain organizations makes them a menace to our civilization. They have a disregard not only for the laws of the land but for the laws of God." Ibid., p. 8128.
imported (rather than domestic) products, doing business on Sunday, underpaying their clerks, overpaying their executives, failing to give credit to their customers, refusing to contribute to local community projects, seeking to establish a monopoly, coercing manufacturers to

44 Representative Rich (Wash.): Chain stores sell only "imported fish from foreign countries, instead of using the fish from our country." Ibid., p. 8129.


46 Ibid., p. 8126.

47 Ibid., p. 8113.

48 Representative Nichols (Okla.): "When you plant a man in a corner store he carries on his business for the benefit of the community, granting his neighbors credit for the very victuals they eat and the clothing they wear on their backs.... He grants them credit knowing that he will lose some accounts, but he still is willing to lend a helping hand. No chain store in my community has ever carried the widow Jones and her two little kids on their books for 30 days or 60 days or any length of time while she was getting together a few pennies to pay for the things which she had to buy from the store." Ibid., p. 8135.

49 Representative Crawford (Mich.): The independent retailer "who has helped to build the YMCA and YWCA, the one who helps carry the Salvation Army, the one who helps build every local institution that we have in every community in this country; those are the people who have held the American civilization together. The local retail merchant contributed to that building as much as anybody, and the chain store contributes about as little as anybody." Ibid., p. 8126.

50 Representative Cochran (Mo.): "I predict if this legislation does not become a law it will not be long before the chains will have a monopoly and then there will be no cut in prices, no sales but they will charge what they like, and the people will be at their mercy." Ibid., pp. 8104-8105.
grant them special discounts, and other heinous activities.

The great evil ascribed to chain store organizations was equalled only by the great virtue attributed to the Patman Bill. The bill was equated with "the golden rule," "common honesty," the protection of private property, the preservation of democracy, the development of "self-reliance and individualism," and the perpetuation of "individual opportunity." The bill was, however, not without opposition. This came from the large retailers, organized into the American Retail Federation, the National

---

51 Ibid., p. 8103. Representative Moritz (Pa.) even went so far as to say: "I believe that the chain stores should not only be curbed, but they should be eliminated, because the great harm they do far outweighs the little good they do." Ibid., p. 8136.
52 Ibid., p. 8114.
53 Ibid.
54 Ibid., p. 8109.
55 Ibid.
56 Ibid., p. 8130.
57 Ibid., p. 8131.
58 This organization was investigated by a special committee, pursuant to House of Representatives Resolution No. 239. The investigation, under the chairmanship of Representative Patman, uncovered considerable information about the concessions, discounts and allowances granted to certain chains, and especially to those in the food field. See Hearings Before the Special Committee on Investigation, American Retail Federation, Committee Print--Unrevised (Washington: Government Printing Office, 1935).
Association of Manufacturers, a number of leading economists, several farm groups, and some other organizations. The opposition was led by Representative Celler of New York, who felt that the bill would curtail the economies of mass-distribution and thereby increase the price of goods sold to consumers. Representative Celler offered five amendments to the bill; all of them were rejected by the House.

There was particular opposition to the classification

---

59 Congressional Record, Volume 80, p. 8107.

60 Among the economists who voiced objections against the Patman Bill, either in part or in toto, were: Prof. Malcolm F. McNair, Harvard University; Dr. Harold G. Moulton, Brookings Institution; Prof. C. C. Huntington, Ohio State University; and Prof. Lewis Haney, New York University. Prof. McNair said: "With very few exceptions, the large-scale retail enterprises of today are fighting the consumer's battle. Their bargaining power is a wholesome weight in the balance against the monopolistic tendencies of many manufacturers." Ibid. This statement is an early expression of the theory of "countervailing power" later developed at Harvard University. John K. Galbraith, American Capitalism (Boston: Houghton Mifflin Company, 1952).

61 Congressional Record, Volume 10, pp. 8116-8117.

62 Representative Celler said: "...the consumers' prices will be increased because those merchants who, because of efficiency and possibly greater capital and acumen, are able to buy more cheaply will not be able to pass the savings on to the consumers, and to that extent the prices will be elevated to the consuming public." Ibid., pp. 8108-8109. Representative Celler was supported in this position by several other Congressmen from New York City. Ibid., p. 8124.

63 Ibid., pp. 8235-8241.

64 Ibid.
proviso, which specifically authorized the granting of functional discounts. Professor Paul H. Nystrom of Columbia University, who was also President of the Limited Price Variety Stores Association, declared that the provision would place large-scale retailers at a "decided disadvantage." Representative Celler charged that it would compel sellers to adopt "fixed differentials." The National Retail Hardware Association argued that many hardware retailers did some business at wholesale and that the classification provision, as phrased, was "unworkable" and "inequitable." In a letter to Representative Celler, Herbert P. Sheets, Managing Director of the National Retail Hardware Association, said:

Enforcement of this amended section would destroy hundreds of large retail hardware establishments in the United States whose sales to individual plants, contractors, and institutions aggregate a much larger volume than their strictly retail sales. It would further destroy a large number of business concerns generally known in the trade as distributors or mill supply houses, which sell almost solely to industrial plants.... (S)uch concerns would be denied the right to purchase commodities on a basis which would enable them to meet the competition of the wholesalers who sell to

---

65 Congressional Record, Volume 10, p. 6337. This was not an especially forceful argument, since many Congressmen were only too eager to put chain stores and other large-scale retailers at a "decided disadvantage."

66 Congressional Record, Volume 80, p. 8107, 8109.

67 Ibid., p. 9812.
the same types of customers. These classifications would also destroy wholesale houses owned solely by retailers. As amended, it (the bill) becomes a measure primarily for the protection and preservation of the wholesaler and would place the hardware retailer in a more difficult position than he now is.°8

Opposition to the proviso also came from a number of farm groups, which feared that farmer-owned and farmer-controlled cooperative associations might be deprived of their wholesalers' discounts under the wording of this proviso. As a result of these objections, and it appears especially as a result of the disapproval of the farm interests, the classification proviso was eliminated. Representative Boileau, a vigorous and vocal proponent of the Patman Bill in the House of Representatives, said:

There is absolutely no opposition to striking this (classification) paragraph from the bill.... Everyone here is in accord and in agreement that this should be taken out, primarily, because it would be detrimental to the best interests of the farmer cooperatives. When this was pointed out by the farm organizations, all those who had been supporting the bill agreed that this should be taken out.°1

°8Ibid.

°9Letter from representatives of several major farm organizations, including the American Farm Bureau Federation, the National Grange, the National Cooperative Milk Producers' Federation, to Representative Patman, reprinted on pages 8117-8118, Volume 80, of the Congressional Record. Representative Celler espoused the viewpoint of the farm organizations and was facetiously referred to by his colleagues, on several occasions, as "the Representative from the farm state of Brooklyn."

°1Ibid., pp. 8122-8123.

°Ibid.
Representative Miller, on behalf of the Judiciary Committee, made a motion to strike out the so-called classification provision from the bill on May 27, 1936. According to the Congressional Record, this motion was "agreed to, without vote, on May 28, 1936." The amended Patman Bill was approved by the House of Representatives on the same day.

Organized independent wholesalers were themselves partly to blame for the failure of the House of Representatives to include a specific statement regarding functional discounts in the Patman Act. The classification proviso approved by the House Judiciary Committee, which, like that in the original Patman Bill, was drafted by Mr. Teegarden, counsel for the United States Wholesale Grocers' Association, was so restrictive in its definition of wholesaling that it was bound to incite opposition. It did not recognize sales to industrial consumers as wholesale transactions; this caused concern among retail hardware dealers and others active in the industrial market. It failed to recognize farmer buying cooperatives as wholesale institutions; this aroused concern among the powerful farm interests. However, neither the National

\[\text{\cite{Ibid., pp. 8139-8140.}}\]
\[\text{\cite{Ibid., p. 8223.}}\]
\[\text{\cite{Ibid.}}\]
\[\text{\cite{See Harry L. Hansen, \textit{Marketing} (Homewood: Richard D. Irwin, 1956), p. 620.}}\]
Retail Hardware Association nor the farm groups opposed functional discounts as such; their opposition to the classification provision was based strictly on its narrow definition of wholesaling. Had the proviso been phrased in more general terms, therefore, it would undoubtedly have passed the House. It is equally likely that if supporters of the Patman Bill in Congress had been less anxious to secure the bill's immediate enactment, a satisfactory compromise on the classification proviso could have been achieved. However, in the haste to obtain passage of the Patman Bill, the classification proviso loomed as a major stumbling-block, which Members of the House had no hesitation in eliminating from their path.

ACTION IN THE SENATE. Senate action on the companion to the Patman Bill was somewhat less frenzied, but no less confused. Introduced by Senator Robinson on

---

76 The fact that a "desire to protect a certain group of wholesale organizations in the way of trade discounts from suppliers...may be the cause for differences in definition and interpretation of such terms as wholesaling, wholesaler or wholesale establishment" is discussed in Theodore N. Beckman and Nathanael H. Engle's Wholesaling Principles and Practice (New York: Ronald Press, 1951), p. 12.

May 13, 1935, the Senate Committee on the Judiciary dispensed with hearings on the bill, depending for its information on the hearings conducted by the House Committee. The original bill was amended on the floor by Senator Logan, on behalf of the Judiciary Committee. This amendment included the following clause:

Provided, that nothing herein contained shall prevent differentials in prices as between purchasers depending solely upon whether they purchase for resale to wholesalers, to retailers, or to consumers, or for use in further manufacture....

78 Senate Bill 3154, 74th Congress, 1st Session (1935). This bill was identical to the Patman Bill. Congressional Record, Volume 80, pp. 6278-6279.

79 The Senate, however, held hearings on the Borah-Van Nuys Bill (S. 4171), which later became Section 3 of the Robinson-Patman Act. Ibid.

80 Senator Logan, who was chairman of the subcommittee that considered the Robinson Bill, sought to explain it to his colleagues. The Congressional Record reveals that his own comprehension of the bill was something less than profound. At one point, for example, he made the statement: "...the bill now under consideration has nothing to do with competition between or among such sellers." Congressional Record, Volume 80, p. 6281. His explanation even displayed boyish naivety; such statements as these reflect this attitude: "I am frank to say that having gone all through it, I can see no harm in the Robinson bill. I can see some good in it. It may be that its language could be improved by amendment." Ibid., p. 6284. At another point, he said: "In my deliberate judgment, the bill can do no harm and will accomplish good. It may be that there should be some very simple amendments. I do not know just what they should be. I can only repeat what I said in the beginning—that I am very anxious for the bill to be passed in the best form in which it can be framed." Ibid., p. 6287.

81 Ibid., pp. 6279-6280.
Senator Austin made a motion to strike out the word "solely" from the above proviso; this was rejected. He made a further motion to amend the committee amendment as follows:

Provided, that nothing herein contained shall prevent differentials in prices as between purchasers depending solely upon whether they purchase as factors, or wholesalers, or retailers, or consumers, or for use in further manufacture.

This motion was approved. The Robinson Bill, so amended, was passed by the Senate on April 30, 1936.

Since the Robinson Bill, as amended, differed rather substantially from the Patman Bill, as amended, the two were taken into conference. The Report of the Conference Committee was submitted to the Senate on June 6 and to the House on June 8. The bill reported back by the Conference Committee was substantially the same as that already approved by the House, with the Senate Borah-Van Nuys Bill thrown in for good measure. The Senate receded

---

82Ibid., p. 6427.
83Ibid., pp. 6247-6248.
84Ibid.
85Ibid., p. 6436.
86See Austin, op. cit., p. 5.
87Congressional Record, Volume 80, p. 9421. The Borah-Van Nuys Bill was patterned after the Canadian Price Discrimination Act, declaring price discriminations within its scope a criminal offense. This bill became Section 3 of the Robinson-Patman Act.
on almost all differences with the House.®® This included the classification provision. The Senate agreed to drop the classification provision which it had included in the amended Robinson Bill.

The bill approved by the Conference Committee was passed by the House of Representatives on June 15, by the Senate on June 18, and it was signed by the President on June 19, 1936. Thus, the Robinson-Patman Act became the law of the land, but without any provision dealing with functional discounts.

CONCLUSIONS. The elimination of the classification section from the anti-discrimination statute has raised some doubts regarding the legality of functional discounts. The legislative history of this section permits several different interpretations as to the possible Congressional intent. For purposes of analysis, these interpretations may be summarized as follows:

1. That the elimination of the classification section indicates an intent to make such discounts illegal.

®®Ibid.

®®The Report of the Conference Committee stated no reason for the deletion of this provision. It merely declared: "The Senate amendment also contained a provision for classification of buyers, on which they receded."

2. That Congress did not deem functional discounts to be within the purview of the Robinson-Patman Act and that they, therefore, required no specific authorization.

3. That since functional discounts were sanctioned under the Clayton Act, their continued legality may be assumed in the absence of a specific provision to the contrary in the Robinson-Patman Act.

4. That the elimination of the classification section cannot be construed to reflect any specific Congressional intent; that this deletion was a compromise, an expedient measure, designed to insure the passage of the main provisions of the bill.

The House Committee on the Judiciary, in explaining the classification provision approved by the Committee, stated:

This exemption is contained by implication in present section 2 of the Clayton Act, since it places no limit upon quantity differentials of any kind nor upon differentials not affecting general competition. Since added restrictions are here imposed in these respects, a separate clause safeguarding differentials between different classes of purchasers becomes necessary.90

It might possibly be argued, therefore, that the deletion of the classification section, which the Committee had declared to be "necessary" to safeguard functional dis-

---

counts, indicates a Congressional intent to outlaw such discounts. It appears that the Federal Trade Commission has, on at least two occasions, sought approval of this thesis.

A broad view of the legislative history of the Robinson-Patman Act, however, quickly dispels this argument. The anti-discrimination bill introduced by Representative Patman in the House and by Senator Robinson in the Senate was drafted by the attorney for a wholesale grocers' association. They were strongly supported by various trade associations representing wholesalers. It is not likely that such wholesalers would actively promote the enactment of a statute which would seriously handicap their competitive effectiveness. It should also be remembered that the Robinson and Patman Bills were specifically designed to help independent retailers meet the competition of the chains. Prohibiting functional discounts, and thereby crippling wholesalers, would hardly be a logical manner by which to achieve this objective. The success of independent retailers is, after all, in no small measure dependent

91This conclusion, without substantiating argument, is repeated in "Legislative and Judicial Developments," Journal of Marketing, XXI, 114.

92See Mimeographed Transcript of Oral Argument Before the Supreme Court, October 9, 1950--Standard Oil Case; Mimeographed Transcript of Oral Argument Before the Commission--Champion Spark Plug Case, pp. 28-30.
upon the efficiency and effectiveness of the wholesalers who serve them. A recent federal decision has recognized this, stating that one of the purposes of the Robinson-Patman Act was "to protect independent wholesalers."

There is nothing in the entire legislative history of the Robinson-Patman Act to indicate that Congress deemed functional discounts to be harmful. The evidence is completely to the contrary. The House Judiciary Committee specifically observed:

"Such differentials, so long as equal treatment is required within the class, do not give rise to the competitive evils at which the bill is aimed; while to suppress such differentials would produce an unwarranted disturbance of existing habits of trade."

The weight of reason, therefore, does not support the view that the elimination of the classification section from the Robinson-Patman Act indicates a Congressional intent to prohibit functional discounts. The case

---


law which has developed since 1936, in fact, clearly shows that the Robinson-Patman Act is not violated when func-

...a discrimination is more than a mere difference. Underlying the meaning of the word is the idea that some relationship exists between the parties to the discrimination which entitles them to equal treatment.... If the two are competing in the resale of the goods concerned, that relationship exists.... But where no such relationship exists, where the goods are sold in different markets and the conditions affecting those markets set different price levels for them, the sale to different customers at those different prices would not constitute a discrimination within the meaning of this bill.98

If the term "discrimination" were always so interpreted, functional discounts would automatically be exempt

97See Chapters VIII and IX, infra.
98Congressional Record, Volume 80, p. 9559.
from the Robinson-Patman Act. Neither logic nor economic considerations "entitles" retailers to "equal treatment" with wholesalers. Furthermore, according to Representative Utterback, different prices charged to different customers who are not in the same market (such as wholesalers and retailers) would not constitute a discrimination within the meaning of the Patman Bill.

The House Committee on the Judiciary, explaining the "general objective" of the Patman Bill, stated:

```
The objective of the bill...is to amend Section 2 of the Clayton Act so as to suppress more effectively discriminations between customers of the same seller not supported by sound economic differences in their business positions or in the cost of serving them. (Underscoring supplied.)
```

This wording would also seem to indicate an intent to exempt functional discounts from the coverage of the bill. Although the classification section was later eliminated, the above statement of purpose was not modified, and not even questioned, on the floor of the House of Representatives.

The legislative history of the Robinson-Patman Act, therefore, gives some, but by no means conclusive, support to the thesis that Congress intended to exclude functional discounts from the prohibitions contained in the

---

Act. The federal courts have, however, been reluctant to affirm this interpretation of the legislative history of the Act. No decision of any federal court has ever gone so far as to state that functional discounts are outside the ambit of the Robinson-Patman Act.

The third of the four possible interpretations previously listed, that the legality of functional discounts may be presumed in the absence of a clear intent by Congress to the contrary, has gained wide acceptance among students in the antitrust field. It is a well-established principle of statutory construction that a legislative measure will not normally be construed to prohibit a practice permitted under a prior enactment unless the unmistakable intent on the part of the legislature requires such a conclusion. There is nothing in the legislative history of the Robinson-Patman Act which can be said to manifest any intent to prohibit functional discounts. Neither the sponsors of the original Robinson-Patman Bill nor the conferees who agreed on the final bill were in any

100 See Chapters IX and X, infra.


way hostile to functional discounts. Even the farm groups and the National Retail Hardware Association, which voiced opposition to the classification provision, did not object to functional discounts as such; their criticism concerned the narrow concept of wholesaling which was sought to be adopted. It can be effectively argued, therefore, that the lawfulness of functional discounts under the Robinson-Patman Act must be presumed, since such discounts were permitted under the Clayton Act. The strength of this argument is fortified by the fact that any prohibition, or limitation, of the right of sellers to grant functional discounts would cause a major disturbance of existing pricing methods. It is a further principle of statutory construction that no law should be interpreted to encumber prevailing habits and practices unless the language of the law clearly and specifically requires such an interpretation. There is much validity, consequently, in the assertion that the legislative history of the Robinson-Patman Act, as seen in the light of accepted canons of statutory construction, must lead to the conclusion that the "continuing" legality of functional discounts should be presumed. This does not necessarily mean that such discounts must be deemed to have a special status which exempts

them from the provisions of the Robinson-Patman Act. It does mean, however, that there should be a presumption of their continuing legality within the framework and terms of the new statute. As will be shown later, members of the Commission in their private opinions and the Commission in its official decisions have uniformly upheld the validity of functional discounts.

A reasonably sound argument can also be made for the fourth of the four different interpretations previously listed, viz., that there was no specific intent involved in the deletion of the classification provision. Neither Representative Miller, who made the motion to strike the classification clause from the House bill, nor the Report of the Conference Committee gave any reason for the decision to eliminate this clause.

Supporters of the Robinson-Patman Bill in Congress were exceedingly anxious to secure its prompt passage. Most of them were, evidently, willing to delete the classification provision, which had encountered serious objections, in order to insure the enactment of the main body of the bill. The intent, if any, was to let the "chips fall
where they may." If such a view of the legislative history of the Robinson-Patman Act is adopted, functional discounts cannot be presumed to have been either outlawed or to have been sanctioned. Under this interpretation of the classification clause, functional discounts must be deemed to possess the same status as other price differentials, i.e., permissible whenever they can be justified as representing cost savings traceable to transactions with wholesalers as compared to those with retailers, as failing to have an adverse effect on competition, or as constituting an attempt to meet competition in good faith.

In brief, the legislative history of the classification section of the Robinson-Patman Bill is ambiguous, not in facts, but in interpretations possible. At least

104 In this connection, a statement in a 1948 speech of Mr. Justice Douglas of the United States Supreme Court is of interest. He observed that when a legislature is unable to gain agreement on the wording of a particular provision, the "solution" is often either to include a general statement on the point or to leave the matter for judicial determination. "...The battle that raged before the legislature is...transferred to the court.... A hiatus may be left in the law. The crucial matter may have been too explosive for the legislators to handle. For that or other reasons they passed it over entirely or left it vague and undefined. The necessity to fill in the gap is then presented to the court." Address by Mr. Justice Douglas of the Supreme Court, entitled "The Dissent: A Safeguard of Democracy," before the Section of the Judicial Administration of the American Bar Association, Seattle, Washington, September 8, 1948.

four different conclusions may be drawn from the official records and debates. Some evidence may be adduced to confirm each of these interpretations; some evidence may, likewise, be presented to refute each of these conclusions. The weight of available testimony, however, appears to confirm the view that, in the absence of a statement to the contrary in the Robinson-Patman Act, functional discounts which were permissible under the Clayton Act must be presumed to be lawful under the Robinson-Patman Act. The force of logic, as well as the authority of long-established principles of statutory construction, lend support to this conclusion.
In Chapter VIII of this study, it will be seen that this fact still serves as one of the main reasons why such discounts are permitted under the Robinson-Patman Act. A clear understanding of the effect-on-competition requirement of Section 2(a) of the Robinson-Patman Act is, therefore, necessary before the reader can fully comprehend the current legal status of functional discounts.

Section 2(a) prohibits a seller engaged in interstate commerce from discriminating in price, directly or indirectly, between different purchasers, at least one of whom purchases in interstate commerce. The section applies only, however, to commodities of like grade and quality which are sold for use, consumption or resale within the United States, its territories or insular possessions, and where the effect of such discrimination may be substan-
tially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with the customers of either of them." The underscored words were taken from Section 2 of the original Clayton Act. The sponsors of the Robinson-Patman Act were, however, aware of the difficulty which the government had experienced under the Clayton Act in its attempts to prove that a discrimination in price caused a general injury to competition. They, therefore, shifted the emphasis of Section 2(a) of the Robinson-Patman Act from injury to a line of commerce to injury with individual competitors.

It has been suggested that consideration of the meaning of the phrase "substantially to lessen competition or tend to create a monopoly" is now academic due to the liberalization of the injury requirement. It is, of

---

1Senate Report No. 1502, 74th Congress, 2nd Session (1936).

2On their face, the words "to injure, destroy or prevent competition with any person who..." might seem to require the same general showing of injury to competition as do the words preceding this clause. However, the legislative history of this phrase shows that the addition was designed to change the law so that the main concern of the section was "injury to the competitor victimized by the discrimination." See Morris A. Adelman, "Effective Competition and the Antitrust Laws," Harvard Law Review, LXI (September 1948), 1289, 1334.

course, easier to prove the effect of discriminatory practices on individual competitors than to establish a tendency toward monopoly. Consequently, few of the Commission holdings, and still fewer of the court decisions, deal with the factors necessary to prove a tendency toward monopoly under Section 2(a) of the Robinson-Patman Act, even though the complaints of the Commission still frequently allege such a tendency.

Under Section 2 of the Clayton Act, which contained identical language to that in Section 2(a) of the Robinson-Patman Act with respect to the lessening of competition or the creation of a monopoly, the courts held that the effect contemplated by this language would involve an entire industry or a considerable portion of an industry, or would be likely to promote the creation of a monopoly by a particular seller or buyer. The cases arising under Section 2 of the Clayton Act generally proceeded upon the theory that a substantial lessening of competition or a tendency to monopoly required a showing similar to that required under the Sherman Act, namely, an unreasonable or undue restraint of competition likely to harm the public.


The extension of protection to individual competitors, which was undertaken by the Robinson-Patman Act, appears to have been motivated by two objectives: first, to overcome the problems encountered under the Clayton Act in proving a substantial lessening of competition or a tendency to create a monopoly, except in the most extreme and flagrant cases, and second, by the belief that competitive opportunity could best be preserved by protecting the rights of individual competitors. The House Committee on the Judiciary explained the new language in these words:

The provision accomplishes a substantial broadening of a similar clause now contained in Section 2 of the Clayton Act. The existing law has in practice been too restrictive in requiring a showing of general injury to competitive conditions in a line of commerce concerned, whereas the more immediately important concern is in injury to the competitor victimized by the discrimination. Only through such injury in fact can the larger, general injury result.\(^6\)

Section 2(a), by prohibiting price discrimination which might result in injury, destruction or prevention of competition with individual competitors constituted a significant departure from the underlying philosophy of the existing antitrust laws. The Sherman and Clayton Acts were both concerned with the preservation of competition, not

with the protection of individual competitors. Since practices which may injure competition generally may be beneficial to individual competitors, with the reverse of this statement also being true, the extension of Section 2(a) to competitive injury to individual competitors has presented many problems. It appears that the sponsors of the Robinson-Patman Act were not fully aware of the paradox inherent in any attempt to simultaneously protect competition and competitors.

Competition is a contest in which different individuals or organizations seek to gain the same thing or somehow to exceed each other. Business competition, reduced to its most basic concepts, involves rivalry among sellers for the same business and rivalry among buyers for the same merchandise. The success of one competitor necessarily implies the exclusion of others, at least in regard to the particular transaction concerned; if this were not

---

7House of Representatives Report No. 627, 63rd Congress, 2nd Session (1914).
8See Congressional Record, Volume 80, p. 9559.
so, there would be no competition. On the other hand, there could be no competition without the existence of competitors. Stated most simply, this means that competition requires competitors, but that persistently successful competition eliminates them.

There is a rather widespread fear among economists that competition, by permitting only the survival of the fittest, may by that very fact destroy the mechanism for future selection of the fittest. Consequently, an important problem in an economy based upon free enterprise is how to preserve competition without curtailing its beneficial effects. The answer to this dilemma appears to lie in the willingness of the states to regulate business practices.

---


12 The thought that competition may be self-destructive has been the source of considerable concern to many economists. Professor J. M. Clark concludes that "unchecked" competition tends to depress prices to the bankruptcy level, with "suicidal" results. Economics of Overhead Costs (Chicago: University of Chicago Press, 1923), pp. 434-435. Mrs. Joan Robinson has expressed similar apprehensions in an article entitled "The Impossibility of Competition," Monopoly and Competition and Their Regulation (New York: Macmillan and Company, 1954), Edward H. Chamberlin, editor, p. 245.

in striking a satisfactory compromise between vigorous and continuous competition. Business competition cannot be considered a single battle from which one rival may emerge victorious. A free enterprise economy requires unceasing, unmitigated rivalry between competitors, not only for the present but for the interminable future.

Section 2(a) of the Robinson-Patman Act does not, therefore, purport to outlaw every discrimination in price which might injure some competitor. Section 2(a) applies only when there is a potential injury of a substantial and serious nature which is reasonably unavoidable and the results of which are traceable to the discrimination. Few law review articles, and still fewer legal texts, have clearly indicated the extent and nature of injury required by the so-called "competition with" clause of Section 2(a). A review of the pertinent principles, therefore, seems necessary.

Generally speaking, the "competition with" clause requires a showing of five elements in order to establish competitive injury within the meaning of Section 2(a):

a. Potential injury
b. To competitors
c. Which is substantial and serious
d. Resulting in injury traceable to the discrimination in price; and
e. Which injury was reasonably unavoidable.

---

POTENTIAL INJURY. Acts of price discrimination are within the scope of Section 2(a) "where the effect of such discrimination may be substantially to lessen competition..." etc. Consequently, the Federal Trade Commission, to find a violation of the Robinson-Patman Act, need not find that competition has been injured, but merely that it "may" be injured. In this respect the Robinson-Patman Act does not differ from the Clayton Act; both statutes sought to deal with tendencies toward monopoly in their incipiency or, as the Senate Committee on the Judiciary said so colorfully, to "catch the weed in the seed" and "keep it from coming to flower." The Robinson-Patman Act, however, carried the incipiency concept one step further than the Clayton Act, which was limited in application to discriminations in price which might substantially lessen competition or tend to create a monopoly. The Robinson-Patman Act undertook also to prohibit discriminations in price which might injure competition "with" the seller granting the discriminatory price, the buyer receiving it, or the customer of either of these.

The Commission and the courts have held that the words "may be," as used both in the Clayton Act and in the Robinson-Patman Act, require a showing of more than a "bare possibility" of competitive injury, but that proof of

"absolute certainty" of injury is not necessary. In one decision, the Commission said:

A showing of a dangerous probability of competitive effects described in the statute is believed to be sufficient. There is no yardstick by which the effects of discriminations may be quantitatively measured, and any effort in that direction can only end in futile speculation. 17

Section 2(a) may, therefore, be satisfied by proof that there is a "probability" that a particular discrimination in price will have an injurious effect on competition or competitors. However, a decision of the Supreme Court in 1948 threw some doubt, at least temporarily, upon the validity of this "probability" test. Writing for the majority in the Morton Salt case, Mr. Justice Black said:

After a careful consideration of this provision of the Robinson-Patman, we have said "the statute does not require that the discriminations must in fact have harmed competition, but only that there is a reasonable possibility that they 'may' have such an effect." Corn Products Company v. Federal Trade Commission, 324 U.S. 726, 742. 18

Mr. Justice Jackson criticized the majority for


17 Staley Manufacturing, loc. cit.

adopting "reasonable possibility" as a standard of the potential injury required by Section 2(a). He called attention to the repeated use by the Court of the "probability" test in earlier cases. He said:

It is true that... the (Corn Products) opinion uses the language as to possibility of injury now quoted in part by the Court as the holding of that case. But the phrase appears in such form and context...(that it) must appear to a fair reader as one of those inadvertencies into which the most careful judges sometimes fall.

The controversy aroused by the majority opinion in the Morton Salt case is really quite fruitless. The practical difference between a standard of "mere possibility" and one of "probability" is, of course, readily apparent, but it is to be doubted whether any significant distinction can be made between a test of "reasonable possibility" and one of "probability." Any attempt to do so would constitute little more than a barren game of semantics. This conclusion seems to be confirmed by the Commission's attitude towards the Morton Salt decision. The Commission has not relied upon the reduced standard of "reasonable possibility," if indeed this represents any reduction in

---

19Austin, op. cit., p. 42.
the proof previously required under Section 2(a). In one recent decision, a Hearing Examiner of the Commission used the two standards interchangeably. In general, however, the Commission seems to prefer "probability" as the test of potential injury. It should be noted that the Supreme Court, which first announced the "reasonable possibility" standard in 1948, has not reaffirmed nor amplified its original remarks on this question.

Related to the issue of the standard to be used in determining the existence of potential injury to competition is the question of which party must shoulder the burden of proving this potential injury. Until relatively recently, it was universally agreed that the Federal Trade Commission had the responsibility of adducing affirmative proof to show competitive harm in order to sustain a complaint under Section 2(a). Evidence proving significant

20F.T.C. Notice to Staff. October 12, 1948, p. 8; Hearing Before Sub-Committee of Senate Committee on Interstate and Foreign Commerce, Senate Resolution No. 248, 80th Congress, 2nd Session (1948), pp. 127, 729-730; Seidman, op. cit., p. 17.


adverse market consequences resulting from the discrimi-
nation was deemed part of the Commission's prima facie
24 case. The established precedent to this effect was over-
turned in 1945 by a per curiam decision of the Circuit
Court of Appeals of the Second Circuit. In the Moss case,
the court held that once the fact that a seller charged two
prices to different buyers is shown by the Commission, the
seller has the burden of showing that competitive injury
did not result. The court said:

...Congress adopted the common device in
such cases of shifting the burden of
proof to anyone who sets two prices, and
who probably knows why he has done so,
and what has been the result.26

The Moss principle of assigning the burden of dis-
proving injury on any seller who grants different prices to
competing purchasers was reaffirmed by the Court of Appeals
of the Second Circuit in Standard Brands. The Supreme

24 Report of the Attorney-General's Committee, op.
cit., p. 161. Also see A. E. Staley Manufacturing Company
25 Samuel H. Moss, Inc. v. Federal Trade Commission,
148 Fed 378 (1945); certiorari denied, 326 U.S. 734 (1945).
26 Ibid., p. 378.
189 Fed 2(d) 510, 515 (1951).
Court cited the Moss decision, with approval, in Morton Salt. There has, however, been much unfavorable reaction to the Moss decision, which made lack of competitive injury a defense to be pleaded and proven by the respondent.

The Commission's attitude towards the Moss decision has been puzzling. The Commission actually disavowed the burden-of-proof principle of the Moss decision in its brief opposing certiorari of the Court of Appeals' opinion in the case. The Commission said:

> ... The court below apparently interpreted the Act as meaning that upon mere proof by the Federal Trade Commission that a respondent before the Commission had sold to two customers at different prices, he has the burden of affirmatively proving that the discrimination did not lessen competition or tend to injure or prevent it.... (T)he Commission has always construed the Act to require it as part of its affirmative case to present evidence that a discrimination may lessen or tend to injure competition. The petition for certiorari correctly states that the Commission's argument in the court below was not that respondent had failed to prove affirmatively that the discriminations did not lessen competition but that it, the Commission, had proved that the discriminations

---

28 Morton Salt, loc. cit.

"injured competition." In seemingly attributing a different position to the Commission, the court below apparently misunderstood the Commission's argument.30

Once the application for certiorari in the Moss case had been denied, the Federal Trade Commission did not hesitate to reverse its earlier stand. In The Matter of Standard Oil Company, the Commission said:

A prima facie case of violation of Section 2(a) may be established by proving (1) jurisdiction; (2) goods of like grade and quality; and (3) discrimination in price. Discrimination in price here was shown by proving a difference in the prices charged competing customers. Based upon the prima facie case thus shown the Commission may draw from such prima facie case a rebuttable presumption that the effect of such discrimination may be to substantially lessen competition or tend to create a monopoly or to injure, destroy or prevent competition. The burden then shifts to the respondent.31

The Report of the Attorney General's Committee to Study the Antitrust Laws concludes that recent decisions "have receded" from the "presumption" doctrines developed by the Court of Appeals of the Second Circuit in Moss and


31 41 F. T. C. 263, 282 (1945); reversed on other grounds, 340 U.S. 231 (1951).
reiterated in *Standard Brands*. It cites several cases to support this conclusion. One of these is *General Foods*, where the Federal Trade Commission expressly stated that in a proceeding to enjoin discriminations in price "the burden of proof to establish injury to competition is on counsel supporting the complaint."

---


33 *In the Matter of General Foods Company*, F.T.C. Docket No. 5675 (April 27, 1954). The federal courts will not be able to review this decision, since it was in favor of the respondent. The Commission does not appeal its own dismissals. Henry Ward Beer, *Federal Trade Law and Practice* (New York: Baker, Voorhis and Company, 1942), pp. 430-432. The ruling in *General Foods* was very recently reaffirmed by Hearing Examiner Frank Hier. In a decision rendered in August of this year, he dismissed complaints against five of the nation's leading manufacturers of materials handling equipment, stating that the Commission must shoulder the burden of proving actual or potential injury in order to sustain its charges under Section 2(a), especially in cases involving products where factors other than price are important in reaching a buying decision. *Federal Trade Commission Newsletter*, August 9, 1956. However, in another recent decision, a Hearing Examiner, who was later affirmed by the Commission, cited the Morton Salt case for the proposition that "where purchasers, buying and competing in the resale of the same merchandise, are charged different prices therefor, the conclusion is inescapable that injury to competitive efforts of the unfavored purchasers is present." *Initial Decision* Earl J. Kolb, *In the Matter of Whitaker Cable Corporation*, Docket No. 5722 (February 10, 1954); affirmed, April 29, 1955. Another recent decision speaks of a "reasonable inference" of competitive injury. *Initial Decision* of Frank Hier, *In the Matter of E. Edelman and Company*, Docket No. 5770 (March 3, 1954); affirmed, April 29, 1955. If the Moss doctrine is dead, as the *Report of the Attorney General's Committee* claims, the body is still very warm.
The Report cites several court decisions to confirm its conclusion that the Moss principle has been virtually abandoned. None of these decisions, however, affords convincing support for this conclusion. The Report refers, for example, to the DuPont case, but fails to note that violation of Section 2(a) was not one of the issues of this litigation. As a consequence, with the exception of the Commission's opinion in General Foods, and the very recent holding by Hearing Examiner Frank Hier in the mechanical-handling equipment cases, there is little evidence to indicate that there has yet been a withdrawal from the views taken by the Court of Appeals of the Second Circuit in the Moss and Standard Brands decisions.

In fact, a case decided as recently as September, 1955, has reiterated what has become known as the Moss doctrine. In Englander Motors, Inc. v. Ford Motor Company,

---


Judge Freed of the Northern District of Ohio said:

It is obvious that the competitive opportunities of plaintiff were injured when it had to pay Ford substantially more for the commodities than its competitors had to pay and that the effect of such price discrimination may be substantially to lessen competition and to injure, destroy, or prevent competition. (Emphasis supplied.)\(^3\)

If injury to competition is "obvious" as soon as the existence of a discrimination in price is shown to exist, it is, of course, unnecessary for the Federal Trade Commission to prove such injury. Judge Freed cited the Morton Salt case as authority for this proposition.\(^4\)

Another recent decision which throws light upon the court's attitude towards the competitive injury requirement of Section 2(a) is Henry Krug v. International Telephone and Telegraph Corporation. This case involved a triple damage suit by a competitor who alleged injury resulting from price discrimination; the court held that "scanty allegations" as to competitive injury were sufficient to meet the requirements of a complaint under Section 4 of the Clayton Act. If "scanty allegations" as to competitive

\(^3\)1955 Trade Cases \(\#\) 68, 143.

\(^4\)Ibid.
injury are deemed satisfactory in a price discrimination action, it can only be concluded that "scanty" evidence of competitive injury must be equally satisfactory. A 1956 decision on a similar issue, however, held that allegations of injury to competition resulting from price discrimination must be clear and specific. Since both of these opinions were rendered by district courts, their review by appellate courts must be awaited.

In brief, therefore, Section 2(a) does not require actual injury to competition or competitors; the requirements of the section are satisfied when there is a "reasonable possibility" or a "probability" of such an injury; there does not appear to be any significant or practical

\[\text{\textsuperscript{41}}\text{Rain and Blank Inc. v. Vim Television and Appliance Stores, 1956 Trade Cases 68, 088, where the court said:}\
\text{"The complaint simply alleges that the defendant was injured without any attempt to show in what manner, or the relation between the acts and the claimed resulting injury. There should at least be some indication of whether the injury was caused by lost profits due to the necessity of meeting the prices of the so-called favored competitors or lost sales due to inability to meet their prices or both, and, if it is claimed that the defendant's conduct forced the plaintiffs or either of them out of business, this should be alleged."}]}\]
distinction between these two standards. Since 1945 the weight of the judicial decisions supports the view that the respondent charged with a violation of Section 2(a) has the burden of proving that his pricing practices did not injure competition or competitors once it has been shown that he received different prices from competing purchasers. A reversal of this stand may be in the offing. The Commission has recently held that its staff must show injury to competition or to competitors as part of its prima facie case. The Report of the Attorney General's Committee has urged the courts to take a similar position. They have not yet done so, but it would not be surprising if they followed this recommendation before too long.

INJURY TO COMPETITORS. The injury required by Section 2(a) to make a discrimination in price unlawful must

---

42 Findings by the Federal Trade Commission as to competitive injury have been, for the most part, empty recitals, without any attempt to indicate factual evidence to support such conclusions. These findings are often in the exact terminology of Section 2(a), with no reasons offered why a particular discrimination in price has the effect "substantially to lessen competition or tend to create a monopoly," etc. See In the Matter of Agricultural Laboratories, Inc., 26 F.T.C. 296 (1938); In the Matter of Life Savers Corporation, 34 F.T.C. 472 (1941); In the Matter of American Art Clay Company, 38 F.T.C. 463 (1944); In the Matter of Curtiss Candy Company, 44 F.T.C. 237 (1947).

43 Report of the Attorney-General's Committee, p. 163.
be to competition "with" the seller, the buyer, or the customers of either of these. It would not violate the Act for a manufacturer of nails to charge one price to consumers, another to building contractors, and still another to cabinet makers, provided that no competing sellers were substantially harmed by this practice. Similarly, a food wholesaler would be free to establish one set of prices to hospitals, another to restaurants, and still a third to supermarkets, again assuming that there were no injury to competitive sellers. In brief, transactions with non-competing buyers will normally be exempt from the operation of Section 2(a). Many functional discounts can be justified on this basis.

Where sales are made to non-competing purchasers, no injury to second- or third-level competition is possible. Such transactions violate Section 2(a) only in those rather rare instances where competitive harm at the first level of competition can be shown.

It is not an easy matter, however, to classify purchasers into non-competitive categories in our complex and dynamic market structure. Many retail stores sell

44The levels of competition covered by Section 2(a) will be discussed infra.
45Zorn and Feldman, op. cit., p. 106
46See Chapter VIII, infra.
some goods at wholesale; most wholesalers undertake an occasional retail transaction; more supermarkets than not carry drug products; some drug stores handle food items. This constant expansion of the area of inter-competition of different units in the economy has tended to make classification of buyers into non-competitive groups, for purposes of pricing, rather hazardous.

Neither the Federal Trade Commission nor the courts have clearly indicated how many competitors must be injured before Section 2(a) applies. In Muller and Company, a processor of chicory was found guilty of violating Section 2(a), although his discriminatory practices injured only one competitor; this was an unusual case, however, since there were only two major firms in the domestic chicory industry at the time. In general, it seems reasonable to conclude that Section 2(a) contemplates injury to competitors—that is, two or more—but that exceptions will be made when the nature of the competition in the industry or other factors so warrant.


49 The Report of the Attorney-General's Committee stated: "In some circumstances, to be sure, injury to even a single competitor should bring the Act into play." Op. cit., p. 165.
SUBSTANTIAL INJURY. The Robinson-Patman Act requires "substantial" injury to competition before Section 2(a) applies. This means that loss of one sale is normally insufficient to bring the Act into application, but it does not necessarily mean that the Act is not violated until all competitors have been forced into bankruptcy. The line, delineating the implications of the "substantial" injury requirement, must be drawn somewhere between these two extremes.

Various verbal standards have been employed by the courts and the Commission to express the injury to competition required by Section 2(a). In several cases the courts stated that Section 2(a) requires a showing that the actual or potential result of the discrimination was the gaining or maintaining by the discriminating seller or by the favored buyer of business which he would not have had in...

---

50 The term "substantially" was carried over from Section 2 of the old Clayton Act into the Robinson-Patman Act.

51 The court in Minneapolis-Honeywell, said: "We construe the (Robinson-Patman) Act to require substantial, not trivial or sporadic, interference with competition to establish the violation of its mandate." Loc. cit., p. 790.
the absence of the discrimination. In several other cases, a discrimination which forced the injured competitor either to lower his price, and thereby reduce his profits or competitive ability, or else forced him to maintain his price, but lose business, has been held to involve "substantial" injury to competition. The essential concept behind both of these standards is that some trade or

52 In Samuel H. Moss, loc. cit., the court said:
"It is true that Section 2(a) makes price discrimination unlawful only in cases it lessens, or tends to prevent, competition with the merchant who engages in the practice; and that no doubt means that the lower price must prevent, or tend to prevent, competitors from taking business away from the merchant which they might have got, had the merchant not lowered his price below what he was charging elsewhere."

53 The Federal Trade Commission and the courts have recognized that a seller who receives a smaller gross margin than his competitors may be injured in his competitive ability. Corn Products Refining Company v. Federal Trade Commission, 324 U.S. 726, 742 (1945). In The Matter of Moog Industries, Inc., the Commission, quoting its Hearing Examiner, said: "Any saving or advantage in price obtained by one competitor as against another increases his margin of profit, permits additional services to be extended to customers, the use of additional salesmen, the carrying of larger and more varied stocks, and the establishment of branch houses for expansion of the business." Docket No. 5723 (April 29, 1955), p. 7.

patronage is diverted to the discriminating seller or away from the non-favored purchasers.

De minimis non curat lex. The law does not care for, nor take notice of, trifling matters. This principle was applied in Kraft-Phenix Cheese Corporation, where it was found that the maximum difference in annual profits resulting from the discrimination was $6.50. This was held too insignificant to justify Federal Trade Commission intervention. However, in the application of the de minimis principle, strict reliance on figures and percentages is not warranted. The amount involved in the discrimination must be considered in relation to the nature of the product, the intensity of competition found in the resale of the product, the normal margin of profit on the product, and

55 In the Matter of Kraft-Phenix Cheese Corporation, 25 F.T.C. 537 (1937). In The Matter of the Curtiss Candy Company, 44 F.T.C. 237 (1947), the Commission indicated that a price difference of less than one-half-of-one-cent on a box of twenty-four candy bars would fall within the de minimis rule. Loc. cit., pp. 275-276. In The Matter of the United States Rubber Company, 46 F.T.C. 998 (1950), the Commission hinted that a price difference of two per cent or less on rubber footwear would also be within the de minimis rule. Loc. cit., p. 103.


57 In the Matter of Standard Brands, 30 F.T.C. 1117 (1940), affirmed 189 Fed. 2d 510 (1951).

even the nature of the industry. Thus, the Federal Trade Commission was quick to recognize that food chain organizations might employ the collective benefits received from a number of resources to gain competitive advantage over their independent rivals, even though the concessions received from any one supplier might appear insignificant. In the Matter of H. C. Brill Company, it was held that a 24% discount on an ice cream mix was illegal, even though this was a minor product in the typical grocery store. The Federal Trade Commission stated that only by prohibiting each individual discount was it possible to avoid the substantial cumulative advantage a chain store organization would be able to acquire if it were to receive a large number of such small concessions. A similar view was ex-

---

60 Seidman, op. cit., p. 21.
61 26 F.T.C. 666 (1938).
62 Ibid.
pressed by the Supreme Court in the Morton Salt case:

There are many articles in a grocery store that, considered separately, are comparatively small parts of a merchant's stock. Congress intended to protect a merchant from competitive injury attributable to discriminatory prices on any or all goods sold in interstate commerce, whether the particular goods constituted a major or minor portion of his stock. Since a grocery store consists of many comparatively small articles, there is no possible way effectively to protect a grocer from discriminatory prices except by applying the prohibitions of the Act to each individual article in the store.\(^3\)

A finding by the Federal Trade Commission that competitive injury resulted from a person's or firm's practice of price discrimination is seldom reversed by the courts. This is due, in part, to the respect which judges accord to the expert status of the Commission in matters of trade regulation. \(^4\) It is due also to the fact-finding powers of the Commission, which are similar to those of a trial court. \(^5\) A reviewing court may disagree with the Commission, but if the Commission's findings as

\(^{63}\)Morton Salt, loc. cit., p. 37.

\(^{64}\)"The 'Injury' Requirement of the Robinson-Patman Act," loc. cit., p. 201.

\(^{65}\)Section 45 of the United States Code, Title 15, reads: "The findings of the Commission as to the facts, if supported by evidence, shall be conclusive." This has been interpreted to mean "supported by substantial evidence," Beer, op. cit., pp. 287-288. It should be noted that Section 45 does not apply to findings of law.
to the facts are supported by substantial evidence, they are not subject to reversal. This principle was clearly recognized in a leading case involving misleading advertising, where the judge said:

I reluctantly concur in the result because the Commission has made findings of deception of the public, which there is some evidence to support, though in my opinion it is greatly outweighed by the contrary evidence.  

Findings of the Federal Trade Commission on the issue of competitive effect are, therefore, likely to be conclusive. The Commission's holdings on this point have been overruled in only one instance since the passage of the Robinson-Patman Act in 1936.

INJURY TRACEABLE TO PRICE DISCRIMINATION. In order to subject a person to legal liability, it is necessary to show not only that he is guilty of wrongful acts or omissions and that another person was injured, but that such injury was a direct result of the wrongful acts or omissions of the

---


67This was the Minneapolis-Honeywell case, loc. cit., to be discussed later. Even in this case, the court appeared reluctant to overrule the Commission. The court, in its opinion, stressed the fact that the Commission had itself overturned the findings of the trial examiner and that one of the commissioners had dissented.
first party. This is the doctrine of proximate cause. It is one of the fundamental principles of the law of torts. It is an equally valid precept in the field of antitrust regulation.

It is normally necessary, therefore, to have some causal relationship between the price discrimination charged and the injury to competition required by Section 2(a) of the Robinson-Patman Act, even though this may be difficult to do in some cases. There is no doubt that non-price factors, such as the promotional skills used in selling the product and the services offered in regard to the product, play an important role in the buying decision. It is not logical, therefore, to infer an injury to competition from a mere showing that the seller supplying the


69 "The early common law made no distinction between proximate and remote cause as the basis of liability, either civil or criminal. A man not only acted at his peril, but was liable for all the consequences of his acts, no matter how remote.... But by the modern rule liability for harm is imposed only upon the person whose wrongful act or omission is the proximate cause of the harm, not upon one whose wrong is merely the remote cause." Ibid.

70 Seidman, op. cit., pp. 19-20; Bayly, op. cit., p. 143.

retailer discriminated against him. Such a retailer may, actually, make substantial gains against his rivals, despite the fact that he may be forced to pay a somewhat higher price for his goods than they. He may be able to do this by establishing cordial relations with his customers, by the use of skillful selling techniques, or by maintaining attractive store displays. On the other hand, it is also possible that his business may decline, not because he pays a higher price for his stock than his competitors, but because he is rude to customers, closes his shop early in the day, or for any one of a large variety of reasons. It is, therefore, not proper to relate automatically a business reversal to a contemporary price discrimination against the person or firm experiencing such a reversal. In order for a discrimination in price to violate Section 2(a), it must directly cause the injury to competition required by that section.

It is true that the courts have given little attention in the past to the proximate cause doctrine in price discrimination cases. Several recent opinions have, however, resurrected this traditional doctrine of the common law in its application to Robinson-Patman Act litigation. In
Klein v. Lionel Corporation, the court said:

There must be proximate relationship between the injury to his business, of which the defendant complains and the alleged illegal act of the defendant, which is asserted as the cause of the injury. The injury must be the natural or probable effect of the asserted illegal act.\textsuperscript{72}

The proximate cause doctrine is especially significant in cases where a price discrimination is alleged in regard to products which are subsequently sold as part of a larger product. Thus, in Minneapolis-Honeywell, it was held that a difference in price of two to three dollars charged to different oil-burner manufacturers on the purchase of regulator controls, for use in heating plants, did not violate Section 2(a). The court stated:

It may be true that if the manufacturers were generally selling controls as such, a differential of two or three dollars in the price they paid for them would have a substantial effect on the price obtained. Under such circumstances a finding that a competitive advantage in purchase price paid would necessarily give rise to a competitive advantage in sale price would perhaps be justified. But where the controls were used in the manufacture of burners, the cost of which was determined by many other factors—cost of other materials and parts, service, advertising, to mention only a few—it cannot be said that discriminatory price differentials substantially injure competition or that there is any reasonable probability or even possibility that they will do so.\textsuperscript{73}

\textsuperscript{72}Klein v. Lionel Corporation et al., 138 Fed Supp 560 (1956).

\textsuperscript{73}Loc. cit., p. 786.
The court, thus, said that there was no injury traceable to the discrimination; that there was no proximate relationship between the discrimination in price on the regulator controls and the competition of heating plants, of which the controls became a part.

No case has ever been adjudicated by the Commission or the courts involving price discrimination as between customers purchasing for the purpose of industrial consumption. The probable reason for this is that the relationship between a discrimination in price in the sale of operating supplies and capital equipment, which normally constitute only a small fraction of total business expenses, and the ability of the purchaser to compete in his line of endeavor is likely to be extremely remote.

There is one important exception to the principle that there must be a causal relationship between a discrimination in price and the injury to competition required by Section 2(a). This is in cases where the discrimination is alleged to affect first-line competition. This point can best be explained by means of an illustration. Let it be assumed that Smith sells to two non-competing accounts at

---

different prices, this difference not being justifiable under any of the defenses of the Robinson-Patman Act. As a result of the price quoted to one of these accounts, Jones, a competitor of Smith, loses a former customer. This could possibly be an injury to Jones, an injury to first-line competition. The injury, however, did not result from the discriminatory character of the two sales made by Smith. It resulted from the price involved in only one of the transactions, and this could be either the higher or the lower of the two prices. It resulted from the fact that this price, whether it was the lower or the higher one, was less than the price offered by Jones to the same account. The discriminatory nature of Smith's transactions was completely unrelated to the injury, if any, caused to Jones. If Smith had charged both of his customers the same price, there would have been no violation of Section 2(a), even if he had taken business away from Jones. The mere fact that he charged different prices to non-competing accounts, however, makes the transactions subject to legal attack. The soundness of this exception to the proximate cause principle is very doubtful.

REASONABLY UNAVOIDABLE INJURY. The law does not normally afford a redress for an injury which could have been avoided by the injured party in the
exercise of reasonable care. It may, therefore, be assumed that a court would not find an injury "with" competition where a seller refused to meet his competitors' price, even though he were able to do so without serious loss. If, as a result of such a deliberate policy, he were to lose a substantial amount of business, there would be no legal recourse. The fact that he had been charged a discriminatory price would probably be immaterial under such circumstances.

Although there has been no litigation on this point, it seems safe to conclude, on the basis of the general context of American common and statutory law, that the injury to competition contemplated by Section 2(a) of the Robinson-Patman Act must have been unavoidable in the exercise of reasonable prudence on the part of the person injured.

In summary, therefore, the competition "with" clause of Section 2(a) does not apply to every minor injury to a competitor resulting from a discrimination in price. It refers only to actual or potential injury which is substantial in nature, which is unavoidable in

---

75 For an application of this principle to the law of negligence, see, 38 American Jurisprudence § 76 (p. 735).

76 Zorn and Feldman, op. cit., p. 105.
effect, and which directly results from the discrimination.

LEVELS OF COMPETITION. Section 2(a) of the Robinson-Patman Act specifically states the levels of competition at which "competition with" a competitor must be injured before the section applies. Section 2(a) reads, in part:

...where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them. (Emphasis supplied.)

The Act, therefore, speaks of three levels of competition: that at which the seller operates; that at which the buyer operates; that at which customers of the buyer operate. The Commission has, on at least one occasion:

77 The word "knowingly" in the phrase "who either grants or knowingly receives" is of little significance and may be disregarded, except where buyer liability is sought to be established under Section 2(f). Harry L. Shniderman, "Tyranny of Labels--A Study of Functional Discounts Under the Robinson-Patman Act," Harvard Law Review, LX (April 1947), 571, 581-582.

78 The phrase "either of them" in the clause "or with the customers of either of them" refers to the seller granting the discrimination or the buyer receiving it. Customers of the seller who might be injured by the discrimination are, necessarily, competitors of the buyer receiving it; otherwise, there would be no effect on competition. These customers of the seller operate at the second level of competition. The clause "or with the customers of either of them," therefore, really means "or with the customers of the buyer."
occasion, extended the coverage of the Act to include fourth-level competition, that is, competition with customers of a customer of the buyer.

The debates in Congress indicate clearly that the Robinson-Patman Act was primarily designed to prohibit discriminations in price which might adversely affect competition with the purchasers receiving such discriminations. The statute was so worded, however, that it also embraced discriminations which might inflict injury on competitors of the seller. The most common type of discrimination in price which gives rise to first-line injury is local price cutting, which is sometimes undertaken by a seller operating in a large area in order to eliminate local competitors. There have been few such cases under

---

79In the Matter of Miami Wholesale Drug Corporation et al., 28 F.T.C. 495 (1939). In this case, a drug distributor who sold to other wholesalers demanded and received a discrimination in price which he passed on to those wholesalers who bought from him, who passed it on, in turn, to their retailer accounts. Receipt of this discrimination by the Miami Wholesale Drug Corporation was held to be a violation of Section 2(f) of the Robinson-Patman Act, since it was found to injure competition at the second level (Miami and its competitors), at the third level (Miami's wholesaler customers and their competitors) and at the fourth level (the retailers buying from Miami's wholesaler customers and their competitors).

80See Chapter VI, supra.
the Robinson-Patman Act. As discussed at length in
Chapter VIII, no injury to first-line competition can re-
sult from functional discounts which are granted, without
discrimination, to all competing wholesalers.

Most of the cases arising under Section 2(a) of the
Robinson-Patman Act are primarily concerned with injury
to competition between customers of the seller and their
competitors. Where a purchaser increases his sales or
profits as a direct result of receiving a preferential
price from a particular seller, which is not made available
to his competitors, injury "with" competition at the
secondary level exists. In order for a violation of Sec-
tion 2(a) to arise, it is not essential for the favored
buyer to translate the discrimination he has received in-
to a lower resale price than his competitors; it is suffi-
cient if the benefits of the preference are employed in
some way to enhance his competitive position, such as to
increase advertising, to expand sales personnel, or even
to augment profits.

\[81\]

81 The leading case of first-line injury to competi-
tion under Section 2(a) of the Robinson-Patman Act is
E. B. Muller and Company v. Federal Trade Commission, 142
Fed 2(d) 511 (1944), where the Muller Company was charged
with cutting the price of its chicory in certain markets
where it faced competition, while maintaining a higher
price elsewhere.

82 Seidman, op. cit., p. 22.
The secondary line of commerce is, however, not limited to customers who resell the commodity purchased. It also includes customers who purchase products for industrial consumption, and buyers who purchase components for use in other goods.

Functional discounts not only do not injure first-line competition, but they also do not adversely affect competition at the purchaser, or secondary, level. This fact constitutes the main reason why such discounts are permitted under the Robinson-Patman Act.

Cases involving injury to competition with customers of a favored purchaser, that is, with competition at the third level, arise extremely infrequently. They are likely to occur only when a purchaser, who has been granted a preferential price by the seller, passes on a part of this lower price to his own customers. The Federal Trade Commission decision in the Standard Oil litigation suggested the possibility that injury to third-line competition may arise when a wholesaler passes on a portion of his functional discounts to retailers, especial-

---

83 Ibid.
84 See Chapter VIII, infra.
85 Austin, op. cit., pp. 43-49.
ly when he does so with the knowledge and acquiescence of the original seller. Relevant aspects of the Standard Oil case will be analyzed in Chapter IX.

SUMMARY. Not every price differential is outlawed by the Robinson-Patman Act. Section 2(a) of the Act establishes its own standards for determining which differentials are permissible and which are proscribed. The most controversial of these requirements concerns that dealing with competitive injury. The Robinson-Patman Act retained all of the original language of the Clayton Act in this respect, and added words of its own. The new language shifted the emphasis of the section from prohibition of those discriminations in price which might injure competition in general to those which might injure competition with individual competitors. This change constituted a radical departure from the philosophy underlying the Sherman and the Clayton Acts.

Some injury to competitors is an inevitable con­ comitant of the competitive process. It is, in fact, one of the goads which induces competitors to compete success­ fully. The Robinson-Patman Act is not, therefore, concerned

---

86In the Matter of Standard Oil Company, 41 F.T.C. 263 (1945); order modified, 43 F.T.C. 56 (1946); further modified and affirmed, 173 Fed 2(d) 210 (1949); reversed on other grounds, 340 U.S. 231 (1951).
with every minor laceration suffered by a competitor as a result of a discriminatory price. It is concerned only with those injuries which portend to debilitate the future effectiveness of the competitive process. Drawing the line between rivalry which is salutary and that which may lead to ominous consequences requires the surgical skills of a learned practitioner. Unfortunately, there have been numerous legal decisions in the past where the rough-and-ready hand of the butcher was more in evidence than the delicate fingers of the surgeon.

Since the Robinson-Patman Act is designed to "nip in the bud" practices which are deemed to have a tendency to create a monopoly, it is concerned as much with potential as with actual injury. This means that the Commission and the courts, which are saddled with the responsibility of detecting such tendencies, must often deal with future and unknown happenings not susceptible of accurate measurement. The reliance on presumptions, such as that developed in the Moss case, is therefore understandable, but it is in no way justifiable. The law of the land must be dictated by social, political and economic objectives, not by considerations of evidentiary expediency.

The fact that violations of Section 2(a) will be easier to prove if all sellers are required to have a uniform price to all buyers is certainly no reason for administering the Act in this direction; and it is no answer
to state that the Moss principle concerns procedural ques-
tions, rather than substantive rights. The truth remains
that most pricing policies other than those of identical
prices to all buyers are today unsafe, regardless of their
ultimate legality. To the businessman, the test of a
pricing policy is its freedom from protracted and expensive
legal litigation, not its ability to be vindicated before
the Supreme Court of the United States.

The competitive-effect proviso of the Robinson-
Patman Act is the crucial cornerstone of the Act. Inter-
preted in one way, it inhibits vigorous competition and goes
against the stream of the other antitrust laws. Interpreted
in another way, it becomes a well-adjusted member of the
American antitrust family. The Report of the Attorney
General's Committee urged that interpretation of this proviso
be based on the vigor of competition in the market rather
than hardship to individual businessmen. The findings of
this study concur in this recommendation.

87The late Mr. Justice Jackson once opined: "The law
of this case, in a nutshell, is that no quantity discount is
valid if the Commission chooses to say it is not." Morton
Salt, loc. cit., p. 58. As a result of the Moss principle,
the same may be said about almost any price differential in
interstate commerce. The effect-on-competition requirement
of Section 2(a) has, in effect, been read out of the statute
in a number of decisions.

88Op. cit., pp. 163-165. Also see H. Thomas Austern,
"Inconsistencies in the Law," Business Practices Under
Federal Antitrust Laws (Chicago: Commerce Clearing House,
1951), p. 158.
It was concluded in Chapter V of this study that functional discounts were, for any and all practical purposes, exempt from the provisions of the Clayton Act. In 1936 the Clayton Act was amended by the Robinson-Patman Act. This unsettled the existing law, since the new statute embraced within its purview differentials in price which had not previously been covered by the Clayton Act. The Robinson-Patman Act, unfortunately, failed to indicate either approval or disapproval of functional discounts. That there was no desire to outlaw such discounts is revealed in the legislative history of the Act. In view of this fact, and in pursuance of certain widely-recognized principles of statutory construction, it was stated in Chapter VI that functional discounts cannot be deemed to have been rendered illegal by the Robinson-Patman Act. To the contrary, much support can be mustered for the view that, in the absence of an express statement in the Robinson-Patman Act regarding functional discounts, their legality must be presumed, at least within the spirit and framework of the Act.
It is of great significance, therefore, that the Federal Trade Commission has never issued a cease and desist order prohibiting functional discounts granted to independent wholesalers on goods resold at wholesale. The absence of such an order is not a matter of chance. That the Federal Trade Commission considers functional discounts to be outside the restrictions imposed by the Robinson-Patman Act is clearly indicated in the unofficial statements which have been made at various times by individual members of the Commission. Thus, in a recent interview with a national news magazine, the former Chairman of the Commission, Edward H. Howrey, stated without equivocation that functional discounts granted on goods resold at wholesale did not violate federal law. A similar opinion was expressed by Commissioner Freer several years earlier.

Former Commissioner Mead, in a speech before the Annual Meeting of the Motor and Equipment Wholesalers Association in 1951, said: "I can assure you that the Commission has never issued an order in a price discrimination case under the Clayton Act, as amended by the Robinson-Patman Act,


2Address of Commissioner Robert E. Freer before the Pennsylvania Institute of Certified Public Accountants, Philadelphia Chapter, March 24, 1938, p. 2.
forbidding a manufacturer to grant a functional discount as such." Another former member of the Commission has stated: "...the mere fact that functional differentials are allowed does not bring them within the prohibition of the statute." There do not appear to be any published observations by any of the present members of the Commission on the question of the legal status of functional discounts; there is considerable evidence to indicate, however, that they basically concur in the expressions of their predecessors in this matter.

Although the private opinions of the Commissioners concerning functional discounts have been clear-cut, functional discounts have been specifically approved in only one decision of the Commission. This fact is not surprising, however. The Commission has discretion in selecting the parties which it will prosecute. It would not be likely,

---

3 CCH Trade Regulation Report Letter No. 230, December 20, 1951, p. 5.

4 Quoted in Ralph Cassady, Jr., "Legal Aspects of Price Discrimination: Federal Law," Journal of Marketing, XI (January 1947), 258, 269. The identity of this former member of the Commission was not divulged in the article from which the quotation was taken.

5 Recent decisions by the Commission, discussed later in this chapter, provide the evidence for this conclusion.

therefore, to spend its time litigating the legality of a practice which its members had repeatedly conceded to be lawful. By its very nature the Commission deals in negatives, prohibiting and enjoining what it considers forbidden. The Commission is more prone to specify what it deems improper than what it deems permissible. When a Hearing Examiner of the Commission therefore states, as one did in a recent case, "the differing prices, resulting from deduction from list price of the various trade or functional discounts,...are not attacked in this proceeding as being discriminatory..." this is, under the circumstances, tantamount to saying that functional discounts do not usually violate the Robinson-Patman Act.  

Since the Commission has handed down only one opinion specifically sanctioning functional discounts, the Commission's attitude towards such discounts must be largely implied from other cases. It so happens that this is not especially difficult to do. The Commission has rendered a number of decisions involving split-function wholesalers who received discounts, purported to be functional discounts, on goods resold at retail as well as on goods resold at wholesale. These cases provide a fertile source for study-

7 Initial Decision of Hearing Examiner Frank Hier, In the Matter of E. Edelman and Company, Docket No. 5770 (March 5, 1954); affirmed by the Commission, April 29, 1955.
In 1937 the Commission issued complaints against four firms in the commercial legume inoculant industry, charging them with price discrimination in violation of Section 2(a) of the Robinson-Patman Act. Urbana Laboratories, one of the respondents, admitted to classifying its customers as consumers (i.e., farmers), retail dealers, and jobbers. A purchaser who resold to farmers was considered to be a retail dealer, while a purchaser who resold to dealers was deemed a jobber. Lower prices were normally quoted to jobbers than to retail dealers. The respondent also sold to farm bureaus which, according to the Commission, sold occasionally to local elevators and other dealers, but primarily competed "with retail dealers in selling to the farmers." Farm bureaus were charged substantially lower prices than dealers on all goods purchased. The Commission held this to violate Section 2(a), stating:

These county farm bureaus are direct competitors of independent retail merchants buying at higher prices.

---

8The inoculant industry produces bacteria for use in promoting the growth of certain leguminous crops.

9In the Matter of Albert and Lucille D. Whiting, Trading as the Urbana Laboratories, 26 F.T.C. 312 (1938).

10Ibid., p. 316.
Where, in fact, jobbing services are rendered by state or county farm bureaus, nothing herein contained shall preclude jobber prices on that portion which is jobbed. (Emphasis supplied.)

The significance of the above order, for purposes of determining the Commission's attitude towards functional discounts, lies in the fact that the respondent was specifically permitted to grant such discounts to county farm bureaus, which were split-function buyers, on goods to be resold at wholesale. In other words, the order clearly and unequivocally recognized the legitimacy of functional discounts on goods which were to be "jobbed" by the county farm bureaus.

In another of the Inoculant cases, the Commission held the Hansen Inoculator Company guilty of violating Section 2(a) for selling some of its customers at varying prices which were "not related to savings in cost of production, sale, or delivery or functions performed by the buyer in the resale of the goods." The last phrase would seem to indicate that the Commission considered functional discounts to be permitted by the Robinson-Patman Act no less than discounts based on differences in

---

11Ibid., p. 317.

costs of production, sale or delivery, which the Act specifically authorizes.

In The Matter of Nitragin Company, the Commission found that the respondent granted lower prices to "jobbers" than it did to "retailers." Most of the purchasers classified as "jobbers," however, sold to farmers as well as to retail dealers. County farm bureaus also bought from the Nitragin Company, usually at jobbers' prices and sometimes at less. Both the farm bureaus and jobbers, therefore, competed with "retailers" in selling the "consumer," i.e., the farmer. The Commission found a violation of Section 2(a), stating:

The difference in prices, resulting from the said classifications...(into "jobbers" and "retailers") of inoculant of like grade and quality to customers competitively engaged in reselling the same to consumers is, as to that portion..., a discrimination in price in commerce.... (Emphasis supplied.)

The Commission did not hold the jobber prices to violate Section 2(a). The Commission prohibited only the granting of lower prices on "that portion" of the goods which was resold at retail, rather than at wholesale. The lower prices quoted to jobbers on goods actually resold

\[13\] In the Matter of Nitragin Company, 26 F.T.C. 320 (1938).

\[14\] Ibid., p. 324.
to ultimate consumers could not, after all, be said to represent functional discounts, at least according to the Commission concept of functional discounts. The Federal Trade Commission was, therefore, careful to strike down only such price differentials as did not represent functional discounts, while leaving the latter uninhibited.

Implicit approval was also given to functional discounts in the Sherwin-Williams case. The Sherwin-Williams Company, a manufacturer of paint products and basic raw materials used in the production of paint, varnishes and lacquers, operated through several subsidiaries, including the Lowe Bros. Company of Dayton, Ohio, and John Lucas and Company, Inc. of Philadelphia. The parent firm, Sherwin-Williams, sold its paint line to chain lumber yards, to its wholly-owned retail stores, and to about 6,300 dealers, many of whom sold at wholesale as well as retail. Lowe Bros., on the other hand, sold to about 70 paint jobbers, in addition to chain lumber yards, wholly-owned retail affiliates, and authorized retail dealers. Lucas and Company followed a distribution pattern similar to that of Lowe Bros., selling to about 100 wholesale distributors. Lucas and Lowe granted functional discounts, amounting to a reduction of approximately 15% from

1536 F.T.C. 25 (1943).

16 The parent company had no distributors who resold entirely at wholesale.
list price, to customers qualifying as jobbers or wholesale distributors. All three companies also offered functional discounts to authorized retail dealers who engaged in wholesale transactions. The companies made an attempt to limit the functional discounts given to such retailers to purchases which were actually resold at wholesale. The Commission found, however, that some retailers buying from Lowe and Lucas received functional discounts on goods which were resold to consumers. On the other hand, the record indicated that the parent company had been successful in its attempt to prevent retailers from receiving functional discounts on goods which were resold to consumers.

In view of these facts, the cease and desist order of the Commission against the several respondents is noteworthy. It is significant, however, more in what it does not prohibit than in what it does undertake to enjoin. In the order itself, the Commission said nothing about the functional discounts of the parent company, which the company had effectively limited to goods which were resold at wholesale. The nature of the Commission's opinion and decision—with its rigid format of "findings," "conclusions," and "order"—did not lend itself to comments about practices

\[17\] The different methods used by the three companies in order to limit functional discounts to goods actually resold at wholesale will be discussed in a subsequent section of Chapter IX.
which were approved. Failure to find the functional discounts of the parent company improper was, therefore, tantamount to finding them proper. This conclusion is reaffirmed when the order against the parent company is compared with that against Lowe Bros. Paragraph five of the Lowe order prohibited the company:

5. From discriminating in price between its customers...granting and allowing to some of its customers...special or additional discounts...on purchases made by said favored customers which are not resold by them to other dealers... 18

Although poorly drafted, the Lowe order was careful to prohibit only those discounts which were granted to retailers on goods not resold to dealers. The order did not prohibit, as it might easily have done, all "special or additional discounts" which were not equally available to all purchasers. It was specifically limited to discounts improperly granted on goods resold at retail. When this point is considered, together with the fact that functional discounts granted on wholesale transactions were not outlawed in the order against the parent company, the Commission's attitude towards functional discounts becomes clear and irrefutable: this is that true functional discounts, granted on goods resold at wholesale, do not violate

Section 2(a) of the Robinson-Patman Act.

The above conclusion was specifically affirmed in a recent opinion of the Commission. In Doubleday and Company, former Chairman Edward H. Howrey said:

Functional discounts long have been a traditional pricing technique by which sellers compensated buyers for expenses incurred by the latter in assuming certain distributive functions. The typical functional discount system provided for graduated discounts to customers classified in accordance with their place in the distribution chain, namely, wholesaler, retailer, and consumer in diminishing amounts.... Inasmuch as traditional discounts of this type, as any other price differential, remained lawful under the Robinson-Patman Act unless engendering adverse effects on competition, the ordinary discounts to wholesalers and retailers were considered entirely illegal. (Emphasis supplied.)

It is not only important to know that functional discounts are lawful under the Robinson-Patman Act. It is equally important to understand the precise legal reason why such discounts are conceded to be permissible. An accurate line can be drawn between functional discounts which are lawful and price discriminations which are not, only when this reason is known.

Section 2(a) of the Robinson-Patman Act is not

---

19 In the Matter of Doubleday and Company, 1955 Trade Cases ¶ 25, 634, pp. 35,677-35,678. Chairman Howrey, who wrote this opinion, unfortunately used the term "functional discounts" in its loose sense, as synonymous with "trade discounts," rather than in its more precise and historical meaning of trade discounts granted to wholesalers.
violated unless an injury to first-, second-, third-, or possibly fourth-line competition can be shown, or presumed, to exist. Functional discounts do not contravene the Robinson-Patman Act for the simple reason that they are not likely to injure competition at any level whatever.

FUNCTIONAL DISCOUNTS AND INJURY TO FIRST-LINE COMPETITION. The fact that functional discounts do not adversely affect first-line competition was clearly implied in two decisions under Section 2 of the old Clayton Act. In both the Mennen and the National Biscuit opinions, the belief was expressed that a seller who grants discounts to some, but not to all, of his customers actually makes it possible for his competitors to take business away from him, since the customers quoted the higher price may be only too anxious to shift their patronage to a different supplier.

While the decisions in the Mennen and National Biscuit


21For a more detailed review of the holdings in those cases, see Chapter V.
cases were completely sound, the reasoning leading to these decisions was not. The argument that competitors of a seller benefit when the latter charges different prices to different customers is quite deceptive. While it is true that a discriminating seller may lose some customers as a result of his discriminatory policy, it is equally true that a seller is not likely to practice price discrimination unless he expects the lower price to the favored buyers to increase his sales volume and net profit more than the higher price to other buyers will tend to decrease his volume and profit.

The real reason why price discrimination does not injure first-line competition is different from that suggested in the Mennen and National Biscuit cases. When competing sellers are all free and able to follow the same pricing policy, the competitive advantage which one seller may gain as a result of adopting a discriminatory pricing

---


23 The term "price discrimination" is used here in its economic sense, and not in its legal significance. See Chapter III, supra.
policy can be quickly neutralized. The freedom and ability of competitors to imitate a seller's successful discriminatory practices, consequently, prevents the use of price discrimination for the purpose of creating a monopoly, or injuring competition, at the primary level of competition. Price discrimination can adversely affect first-line competition only where this freedom and ability of sellers to adopt the same discriminatory policy as that of a competitor is absent. There are two such cases. One is where price discrimination is practiced on a geographic basis. Local competitors of a national or regional seller who charges a relatively low price in the local

24 Business competition, according to a widely accepted definition, is "a form of independent action by business units in pursuit of increased profits, or avoidance of reduced profits, by offering others inducements to deal with them, the others being free to accept the alternative inducements offered by rival business units." The competitive process, therefore, consists of a combination of (a) initiatory actions by a business unit, and (b) responses by those with whom it deals, and by rivals. A rival's response may seek to neutralize the initiator's advantage by offering the buyers something equally effective, or he may go further and offer something more effective, establishing a competitive advantage for himself. J. M. Clark, "Competition and the Objectives of Government Policy," Edward H. Chamberlin, ed., Competition and Monopoly and Their Regulation (New York: Macmillan, 1954), p. 317, 326-327.

25 It must be emphasized that the discussion in this paragraph is concerned only with injury to first-line competition. A discrimination in price may injure second-, third-, and even fourth-level competition, despite the fact that competing sellers are "free and able" to follow the same pricing policy as the discriminating seller.
market and a substantially higher one in other markets are not able to follow the same discriminatory policy, with the result that they suffer from serious competitive handicaps. Consequently, such geographic price discrimination can give rise to injury at the first level of competition. A second case where price discrimination can adversely affect first-line competition is where competitors of the discriminating seller are not free to follow his pricing practices because they are unlawful. The Commission has held in a number of cases that discounts granted by a manufacturer to split-function wholesalers (that is, semi-jobbers) on goods resold to ultimate consumers injure first-line competition. These decisions have caused much confusion because they have been repeatedly misconstrued to signify that functional discounts can adversely affect first-line competition. The discounts in these cases were, of course, not functional discounts. They were concessions granted on goods resold by semi-jobbers to

26 See, for example, In the Matter of Sherwin-Williams Company et al., 36 F.T.C. 25 (1943); In the Matter of Agricultural Laboratories, 26 F.T.C. 296 (1938).

ultimate consumers and were not equally available to all merchants competing with the semi-jobbers in selling to the consumers, with the result that they brought about injury at the second level of competition. There was injury to first-line competition only because competing sellers were not free to follow the unlawful pricing policy of the discriminating seller, even though such policy was causing them to lose business. When properly interpreted, therefore, the cases here referred to, and cited in the footnote, stand for the proposition that acts of price discrimination which injure competition at the second-, third-, or fourth-level of competition, and therefore violate the Robinson-Patman Act, invariably injure competition at the first level, simply because competitors of the discriminating seller are not free to counteract the effect of his illegal discrimination by meeting his discriminatory prices.

In brief, functional discounts do not injure first-line competition, not because they shift patronage to competitors of the seller granting such discounts, as the Mennen and National Biscuit cases imply, but because all sellers are free to offer such discounts, if they deem this to be advisable. While issue may be taken with the reasoning in Mennen and National Biscuit, none can be taken
with the decisions in these two cases. There can be no doubt about the fact that functional discounts granted on goods resold at wholesale do not injure first-line competition. Any seller is at liberty to grant functional discounts should he find that competitors who offer such discounts are making competitive gains at his expense. No legal recourse is available for injury resulting from a seller's refusal to meet his competition.

FUNCTIONAL DISCOUNTS AND INJURY TO SECOND-LINE COMPETITION. The fact that functional discounts are not likely to injure either second- or third-line competition has been recognized by the Commission ever since the passage of the Robinson-Patman Act. Thus, early in 1937, the then Chairman of the Federal Trade Commission, W. A. Ayres, wrote to Representative Wright Patman to report to Congress in regard to the Commission's disposal of certain investigations undertaken pursuant to the new Act. Chairman Ayres

28Despite the fact that the Mennen and National Biscuit cases were decided before the passage of the Robinson-Patman Act, there is no reason to believe that they were overruled by the latter statute, at least on the issue of injury to first-line competition.

29As previously noted, one of the elements necessary for competitive injury under Section 2(a) is that such injury was unavoidable in the exercise of reasonable prudence by the party injured. See Chapter VII, supra.
referred to one case where a manufacturer of machines used for retreading automobile tires sold his machines to two classes of buyers, service-station operators and distributors who bought for resale. The distributors were allowed a substantially larger discount than the service-station operators. The file in the case was closed, according to Chairman Ayres, because:

The distributors and the service-station operators were not competitors, and there is no evidence that, by virtue of the distributors' discounts service-station operators who buy from distributors obtain an advantage over those who do not. Hence the functional discount does not affect competition. (Emphasis supplied.)

In the recent Doubleday decision, former Commissioner Mead said:

Under (the Robinson-Patman) Act, a price discrimination, as described, unless justified in the manner therein set forth, is unlawful if the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly or to injure, destroy or prevent competition. This, of course, applies to discriminatory discounts based on distributional functions performed by the buyer as well as to any and all other price differentials.

Although the members of the Commission disagreed on

30Letter from the Honorable W. A. Ayres to Representative Wright Patman, reprinted in the Congressional Record, Volume 81, p. 2341.

some issues in the *Doubleday* case, there was complete agree-
ment among them that the legality of functional discounts
rests on the fact that such discounts do not injure competi-
tion, within the meaning of Section 2(a) of the Robinson-
Patman Act. Former Commission Chairman Howrey, tracing
the historical development of functional discounts, said:

A discount granted to...wholesalers did
not injure retailers who received no
equivalent price reduction, since they
did not compete for the consumer's busi-
ness. By virtue of the "injury" pre-
requisite in Section 2(a) of the act,
therefore, functional discounts to
single-function distributors were con-
sidered above legal reproach.\(^\text{32}\)

The principle that price differentials as between
wholesalers and retailers do not violate Section 2(a) of
the Robinson-Patman Act, since wholesalers do not compete
with retailers, carries over to other types of non-
competing purchasers. For example, a seller of beverage
syrups may charge a substantially lower price to "soda
pop" bottlers than he does to jobbers who supply soda-
fountain operators, since there is no competition between
the bottlers and the soda-fountain operators. For a
similar reason, a refiner of sugar is not required to offer

\(^{32}\text{ibid.}, \text{p. 35,678.}\)

\(^{33}\text{Letter, loc. cit., p. 2339.}\)
the same price and terms to distributors of sugar as he does to manufacturers who use the sugar in manufacturing processes. In the American Oil Company case, the Federal Trade Commission refused to condemn the respondent's practice of charging a lower price on gasoline to be consumed in operating a taxicab fleet than it charged to retail gasoline dealers, since there was no competition between the taxicab fleet and the service stations. Similarly, the Federal Trade Commission in the Standard Oil case did not prohibit the granting of lower prices to commercial users of gasoline than to retail gasoline dealers. The principle that price differences to non-competing purchasers, regardless of the reason for such non-competition, do not normally violate Section 2(a) is, therefore, well established. This principle appears to admit to only one qualification. This is where such price differences are


35 In the Matter of American Oil Company and General Finance, Inc., 29 F.T.C. 857 (1939). Differences in price based upon different uses for which goods are bought are sometimes called "functional" or "trade" discounts. Fred Bartenstein, "Functional Discounts Under the Robinson-Patman Act," Washington and Lee Law Review, IV (Spring 1947) 121, 122-123. Such terminology is, however, not in accordance with general usage.

36 In the Matter of Standard Oil Company, 41 F.T.C. 263 (1945); reversed on other grounds, 340 U.S. 231 (1951).
part of an attempt to monopolize an industry, in which event they become tainted by the attempt to monopolize and are rendered illegal. Thus, in *The Matter of Pure Carbonic, Inc.* and others, the Commission issued a cease and desist order against four dry ice (compressed carbon dioxide) manufacturers, holding it to be unlawful to charge a higher price for dry ice when it was bought for the purpose of being liquefied into carbon dioxide than when it was bought for use as a refrigerant, where this price difference was adopted in an attempt to monopolize the industry and to hinder, lessen and suppress competition.

The Commission and the courts' general attitude towards price differentials as between non-competing purchasers was perhaps most clearly summarized in *Chicago Sugar Company v. American Sugar Refining Company*, where the court said:

...(D)iscrimination by a seller of a commodity cannot lessen competition between customers under the Act unless the discrimination is between customers competing in the distribution of the commodity.... That is to say, the parties must be in competition with each other.

---


38 Ibid.

39 76 Fed 2(d) 1, 10 (1948).
Since lack-of-competitive-effect is the passport which admits functional discounts to the land of legality, such discounts must be granted or denied to purchasers on the basis of their competitive relationship with other purchasers who qualify for the same discounts. If one wholesaler receives functional discounts from a seller, all other customers of that seller who, in fact, compete with the wholesaler must also be granted such discounts in order to avoid injury to competition. On the other hand, the denial of this discount to retailers who, in fact, do not compete with the wholesaler cannot harm competition.

Unfortunately, neither the Federal Trade Commission nor the courts have clearly indicated the circumstances under which firms are to be deemed to be in competition with each other. In a broad sense, all sellers may be said to compete with one another, at least to the extent that they all seek to preempt the "consumer's dollar." Such a broad conception of the competitive arena has, however, never received any official support. The Commission and courts appear to rely upon two general factors to determine whether or not firms compete with each other: (a) whether they attempt to sell to the same buyers;

\[40\text{Cf. E. B. Muller and Company v. Federal Trade Commission, 142 Fed 2(d) 511 (1944).}\]
and (b) the degree of cross-elasticity of demand between the goods they sell. With regard to the first of these two factors, Bartenstein has said:

Before competition can be affected between buyers, they must compete; buyers compete when they offer their products for sale to the same customers; buyers properly classified according to their function do not sell substantially to the same customers.42

Even though firms sell to the same customers, they are not in competition with each other unless there is a relatively high degree of cross-elasticity between their offerings. This means that the products offered for sale by the one firm are capable of serving as reasonably satisfactory substitutes for those offered for sale by the other. Thus, in McWhirter v. Monroe Calculating

41In its strict economic sense, cross-elasticity of demand refers to the relationship of a percentage change in the quantity demanded of one good to a particular percentage change in the price of another good, the price of the first good remaining constant. George J. Stigler, Theory of Price (New York: Macmillan and Co., 1946), pp. 88-90.

42Bartenstein, loc. cit., p. 124.


44For a brief explanation of the concept of cross-elasticity of demand, see John F. Due, Intermediate Economic Analysis (Chicago: Richard D. Irwin, 1951), pp. 115-116.
Machine Company, two manufacturers of calculating machines of comparable type, but varying substantially both in appearance and price, were held to be competitors, since the machines were designed to serve the same purpose.

Since the legality of functional discounts has generally been tied to the fact that they do not injure competition, the Commission has followed, with few exceptions, the test established in the Mennen case to differentiate between wholesalers and retailers. This test is predicated upon the character of the buyer's selling and, specifically, to whom he resells. Purchasers identified as wholesalers under this test do not, by definition, compete with purchasers designated as retailers. Functional discounts granted to such wholesalers, consequently, would not be likely to injure competition. The "character-of-selling" classification of purchasers has, therefore, been easy to reconcile with the no-competitive-effect theory of functional discounts. Both the Commission and the courts have given this method of classifying customers repeated approval.

In summary, the legality of functional discounts to wholesalers is well-established in the decisions of the

46 See Chapter X, infra.
Federal Trade Commission, provided such discounts are equally available to all competing buyers on goods resold at wholesale.
CHAPTER IX

FUNCTIONAL DISCOUNTS UNDER THE ROBINSON-PATMAN ACT:
SOME OF THE PROBLEMS INVOLVED

Many legal problems are frequently encountered in
the process of granting functional discounts. Wholesalers
may make retail sales to friends, to business associates,
and even to the general public. In so doing, they compete
directly with the retailer customers of the manufacturer.
Retailers, on the other hand, commonly sell to other
retailers and to industrial consumers, both of these types
of transactions being made in competition with wholesalers.
All this is to say that few marketing institutions in the
complex American economy of today fit neatly into a two­
fold classification of retailer or wholesaler. Many,
possibly most, are mixed- or split-function enterprises,
emphasizing one type of sale, but also engaging in the
other kind. From the viewpoint of functional discounts,
these enterprises present the problem of determining the
extent to which such discounts may be granted to semi­
jobbers and other split-function middlemen.

A second problem sometimes encountered in connec­
tion with functional discounts is that their amount may be
in excess of the costs incurred by wholesalers in handling
the product in question, with the result that such dis­
counts are passed on, in part, to customers of the wholesalers. Since this may injure so-called third-line competition, the legal propriety of the "leakage" of functional discounts by wholesalers to their customers is presently in doubt.

One other problem frequently arises with respect to functional discounts. This involves the classification of certain types of institutions as either wholesalers or retailers. For example, integrated retail chain organizations which perform both wholesale and retail functions naturally seek recognition of their wholesale status. Mail order houses, voluntary chain groups, and department stores are some other purchasers which cannot always be readily classified for the purpose of a functional pricing system.

In brief, while functional discounts granted to wholesalers on goods which are not sold in competition with retailers do not violate Section 2(a), such discounts often involve related legal considerations. These may be summarized as:

a. The Split-Function Problem
b. The "Leakage" Problem
c. The Classification Problem
SPLIT-FUNCTION PROBLEM. A split-function wholesaler or, as he is commonly called, a semi-jobber, is one who sells at retail as well as at wholesale. A split-function retailer, similarly, is one who is primarily engaged in a retail business, but who also undertakes wholesale transactions. Buyers of a split-function nature invariably present problems to a seller granting functional discounts.

The original Patman Bill, as reported out by the Judiciary Committee, stated:

...Nothing herein contained shall prevent or require differentials as between purchasers depending solely upon whether they purchase for resale to wholesalers, to retailers, or to consumers, or for use in further manufacture;...any purchaser who... does both a wholesale and retail business shall, irrespective of quantity purchased, be classified (1) as a wholesaler on purchases for sale to retail dealers only... and (2) as a retailer on purchases for sale to consumers.2

---


Although this classification proviso was not enacted, the "price-by-use" test which it sought to declare mandatory was voluntarily adopted by the Federal Trade Commission. Thus, in Urbana Laboratories, where the respondent classified its customers as consumers, retailers, and jobbers, without taking into account split-function purchasers, the Commission prohibited respondent from granting jobber prices to farm bureaus on all of their purchases, since most of these bureaus sold at retail as well as at wholesale. Recognizing that these organizations performed "mixed functions," the Commission added: "Where, in fact, jobbing services are rendered...nothing herein contained shall preclude jobber prices on that portion which is jobbed." The split-function problem was treated in a similar manner in the Nitragin Company case, where the Commission prohibited the granting of discounts only "as to that portion" of the inoculants as would be resold to consumers.

---

3See Chapter VII, supra.

4The practice of granting functional discounts on only those purchases which are to be resold at wholesale, while denying such discounts on purchases which are to be resold at retail, is commonly called "pricing by use." Cf. "Functional Discounts Under the Robinson-Patman Act: The Standard Oil Litigation," Harvard Law Review, LXVII (December 1953), 294, 304.

5In the Matter of Albert and Lucille D. Whiting, Trading as the Urbana Laboratories, 26 F.T.C. 312 (1938).

6Ibid., p. 317. (Emphasis supplied.)

7In the Matter of Nitragin Company, 26 F.T.C. 320, 326 (1938).
In Standard Oil, the Commission prohibited the granting of discounts "to any dealer, jobber, or wholesaler on gasoline sold by such dealer, jobber, or wholesaler at retail," without limiting such discounts on gasoline resold at wholesale. Although this decision was subsequently reversed on other grounds, it still serves as a sound precedent for what former Commissioner Mason termed, in his dissenting opinion, pricing "depending on what they use the stuff for." The principle is, therefore, well established that the dominance of either retail or wholesale activities in the operations of a purchaser does not permit him to be treated as a retailer or wholesaler, respectively, on all goods purchased. A mixed-function purchaser is entitled to functional discounts only on those goods resold at wholesale. This means that a seller granting such discounts

---

8In the Matter of Standard Oil Company, 41 F.T.C. 263, 284 (1945); order modified, 173 Fed 2(d) 210 (1949); reversed on other grounds, 340 U.S. 231 (1951).

9Dissenting Opinion of Commissioner Lowell B. Mason, In the Matter of Standard Oil Company, Docket No. 4389 (October 9, 1945).

10In one recent case, the cease and desist order was so drafted as to prohibit the granting of any functional discounts to a split-function purchaser. Holding that the seller's classification of customers was arbitrary and did not follow real functional differences, the Commission enjoined the granting of functional discounts to wholesalers who, in fact, competed with retailers (in any transactions), rather than merely prohibiting the granting of functional discounts on goods to be resold in competition with

(over)
must adopt a "price-by-use" test in order to avoid violating Section 2(a).

Responsibility for insuring that purchasers receive functional discounts only on goods resold at wholesale, and not on those resold at retail, belongs to the seller, according to the decision in the Sherwin-Williams case, and this responsibility is strictly interpreted. In the latter case, the Commission disapproved of the practice, undertaken by Lowe Bros. and Lucas, two subsidiaries of Sherwin-Williams, of granting functional discounts on the basis of the unverified representations of purchasers. The record indicated that both Lowe Bros. and Lucas allowed functional discounts to split-function customers on the face of the invoice, the amount being determined by the purchasers' estimates as to the percentage of these goods which would be resold at wholesale. The Commission admitted that "it was not...the policy or general practice of the manufacturers to grant or allow functional discounts on

retailers. The effect of this order was to deny all functional discounts to split-function wholesalers. This case, however, appears to represent an example of poor draftsmanship, rather than an intent to deprive split-function middlemen entirely of their functional discounts. In the Matter of Ruberoid Company, 46 F.T.C. 379 (1950); affirmed 189 Fed 2(d) 893 (1951); order amended on a different point, 191 Fed 2(d) 294 (1951); affirmed, 72 S Ct 800 (1952).

36 F.T.C. 25, 64 (1943).
paint products which were resold by distributors or dealers at retail. Evidence was introduced that some purchasers obtained functional discounts on goods which they resold to consumers, despite the sellers' policy to the contrary. The Commission held such discounts to violate Section 2(a), clearly implying that results rather than policies determined the legality of discounts granted in split-function cases. The Commission appeared to object to two aspects of the manner in which Lowe Bros. and Lucas handled the situation: first, that the discounts were granted on the face of the invoice, rather than after the goods were resold; and second, that the purchasers' representations were accepted without verification.

While disapproving of the manner in which Lowe Bros. and Lucas granted functional discounts to semi-jobbers, the Commission approved, by implication, the procedure adopted by the parent company for handling functional discounts given to split-function purchasers. The Sherwin-Williams parent company required "its dealers acting as distributors to submit statements after the end of each month showing the total sales at dealers list prices made to other dealers

12Functional discounts granted on the face of the invoice of a split-function purchaser must normally be based upon an estimate as to the percentage of such goods which will be resold at wholesale. Such an estimate is likely to be inaccurate, since the interests of the purchaser are to exaggerate this amount.
during the preceding month." The company issued credit memoranda for the discounts earned on such resales; these credit memoranda were applied to the dealers' invoices for that month. In addition, Sherwin-Williams required all statements claiming resales to other dealers to be certified as to accuracy.

Since the problem of the precautions a seller must undertake when granting functional discounts to semi-jobbers has not been at issue in any recent decision, the assumption is that the dictates of the Sherwin-Williams decision are still valid precedent. This means that normally a seller should not accord functional discounts to mixed-function wholesalers until after the goods for which such discounts are claimed have actually been resold at wholesale. Furthermore, a seller dealing with such wholesalers must either require a certification as to the accuracy of the statements made in order to receive functional discounts or he must establish a program or process whereby the truth of such statements can be verified.

The strictness of the responsibility imposed upon

---

the seller for insuring that goods on which functional discounts have been granted do not later compete with goods on which such discounts have not been granted is indicated in *The Matter of American Oil Company*. In July, 1937, the American Oil Company signed a contract with the General Finance Company agreeing to sell the latter gasoline at a price which was approximately 1 5/8 cents less than that charged to retail gasoline dealers in the same area, namely, Washington, D. C. This lower price was granted to General Finance on the express understanding that such gasoline was to be used in taxicabs owned or controlled by General Finance, and that none of it was to be resold to any other person, firm, or corporation. However, General Finance violated this informal agreement and sold some of the gasoline purchased at this favorable price to the general public through a service station owned and operated by it. In August of 1938 this fact became known to American Oil Company, which promptly required General Finance to execute a regular dealer's contract. Thereafter, American Oil charged General Finance the regular dealer tank-wagon

14 29 F.T.C. 857 (1939).
price for all gasoline purchased, crediting General Finance, at the end of each month, with the price differential applicable to the gasoline consumed by the taxicabs owned and controlled by General Finance. Despite the fact that American Oil Company required General Finance to sign a dealer's contract as soon as it learned of the latter's sales to the public, the Commission held American Oil guilty of price discrimination. The reasons justifying such a holding are not clear. American Oil originally insisted that General Finance agree not to resell the gasoline it bought. American Oil acted with dispatch upon learning that General Finance had violated its agreement. The record does not indicate that American Oil was derelict in any of its duties. The decision in the case would, therefore, seem to mean that a seller who grants a preferential price on the basis of a purchaser's agreement to put the products involved to a use which is not in competition with goods of "like grade and quality" bought from the seller at a higher price by other customers assumes responsibility for the buyer's subsequent conversion of the products to a use different from that agreed upon. If this represents

15The fact that American Oil Company relied upon an oral agreement by General Finance not to resell the gasoline can hardly be considered a "dereliction of duty." Generally speaking, an oral agreement is no less binding under American law than a formal written contract.
the holding in *American Oil*, and a contrary conclusion does not seem warranted, the principle is subject to serious question. Such a precedent would place liability upon a seller for acts undertaken by a buyer over which the seller had no control. This would be absolute liability, irrespective of fault, in the sense of *Rylands v. Fletcher*. The concept of absolute liability finds little favor in American or English common law. There are no reasons which argue for its application in price discrimination cases.

A few words should also be said about contracts between a seller and a buyer whereby the latter agrees not to resell the personal property he has bought from the seller, or where he agrees to refrain from reselling it to a certain class of purchasers. The legality of such contracts cannot always be assumed, since they undoubtedly constitute a restraint of trade. It is, of course, well settled that

---

*16* In *Rylands v. Fletcher*, the English House of Lords (in 1868) held that a person maintaining a reservoir on his property was chargeable for injury to another resulting from the "breaking away" of this water, although the injury was not due to either willful wrongdoing or negligence on the part of the person maintaining the reservoir on his property. This decision marks a notable exception to the general precept of modern common law that a person is liable to another only for such injury as he caused by his wrongful acts or omissions. *Rylands v. Fletcher*, 3 H. L. 330, 1 Eng Rul Cas 235.

not every restraint of trade will be deemed illegal, but only those which are "unreasonable." Consequently, whether an agreement restricting the right of alienation will be held to constitute an "unreasonable" restraint of trade depends upon the facts of the case. In Chicago Board of Trade, the Supreme Court said:

The true test of legality (of an agreement which restrains trade) is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied: its conditions before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences.20

The courts have indicated, on at least two occasions,


20Chicago Board of Trade v. United States, 246 U.S. 231, 238 (1918).
a willingness to consider an agreement by an industrial consumer not to resell goods purchased at a lower price than that quoted to distributors to be a "reasonable" restraint of trade. Thus, in *Fosburgh v. California and Hawaii Sugar Refining Company*, the court upheld the validity of an agreement whereby a buyer agreed to use the sugar bought from the seller for manufacturing purposes, and not to resell the same. The court, however, carefully limited its holding to the specific "circumstances" and "conditions" in the case. These were that sugar was scarce at the time (World War I) and was subject to governmental regulation. The restriction against resale was deemed to conform to existing allocation programs of the government. The court further held that there was no intent or purpose "to impinge upon the element of competition, or to interfere with regular course of trade." In *Chicago Sugar Company v. American Sugar Refining Company*, the court dropped some of the qualifying language of the *Fosburgh* decision, and upheld the validity of an agreement which forbade a buyer from reselling property it had bought, without basing the legality of the agreement in question

---

21291 Fed 29 (1923).

upon its conformance to a governmental allocation program. It, therefore, now appears that a covenant restricting a buyer's right to alienate goods he has purchased will not be held illegal where it can be shown that they were bought at a preferential price and that the purpose of the restriction is merely to prevent such goods from coming into competition with other goods of the same seller which were sold at a higher price.

It may be assumed, although there does not appear to be any decision in point, that a buyer may not only agree to refrain from reselling goods at all, but that he may obligate himself not to resell them to a particular classification of customers. Thus, it would seem that the courts would not strike down an agreement whereby a buyer agreed not to resell goods either to consumers, or to retailers, or to industrial users. However, while such a contract does not seem to be unlawful, the precedent established in American Oil indicates that it affords very little protection to a seller if the buyer should violate his obligation.

---

23 176 Fed 2(d) 1 (1948); certiorari denied, 338 U.S. 948 (1949).

In summary, the law as it stands today is that a seller serving a split-function customer is charged with the responsibility of insuring that such customer receives functional discounts on only those goods resold at wholesale. This responsibility can normally be fulfilled only by granting such discounts after the buyer has actually resold the goods. Furthermore, the Sherwin-Williams case would seem to indicate that the buyer cannot rely upon the unverified representations of the buyer in regard to the resale transactions. It seems that the seller must either require a certified statement, listing the goods resold at wholesale, or undertake to investigate the buyer's representations.

While the above requirements are not entirely unreasonable, the Commission went even further in the American Oil case. It is true that the American Oil principle has not been applied in any subsequent decision. But this is so because similar facts have not been litigated since American Oil, rather than because the Commission has reversed its earlier stand. The doctrine contained in American Oil affects many businesses; it is, therefore, to be hoped that the Commission will find an opportunity before long to reject the unfortunate precedent established in that decision.
THE "LEAKAGE" PROBLEM. A second problem connected with the granting of functional discounts is that which might be called "leakage." This occurs when a wholesale distributor receives functional discounts in excess of his costs of operations, including a reasonable net profit, with the result that he can pass on part of these discounts to his customers. The injury to competition arises from the fact that purchasers of the distributor pay a lower price than those buying directly from the original seller.

Only two cases have so far come before the Commission with this problem. In Standard Oil, one purchaser who was classified as a jobber and was quoted a price of about one-and-one-half cents per gallon less than direct-buying retail service stations, resold some of the gasoline so purchased to a string of retail stations at about one-

25 In the Sherwin-Williams case, several aspects of which have been previously discussed, the Commission also charged Sherwin-Williams and its subsidiaries with price discrimination, resulting from the fact that wholesalers of these respondents were selling to their retailer customers at a lower price than respondents were offering to direct-buying retailers. The Commission cited, among other specific examples, one wholesaler who received functional discounts of approximately 15% from Lowe Bros., and who resold to retail dealers at 4% less than Lowe Bros. charged to direct-buying retailers. The issue thus presented was not, however, resolved by the Commission, which dismissed the charges resulting from this "leakage" of functional discounts "without prejudice" to its right to proceed in the future. Loc. cit., pp. 74-75. The issue avoided in Sherwin-Williams became one of the bitterly-contested points of the Standard Oil litigation.
half cent above the jobber price, or at about one cent below Standard Oil's prevailing price to direct-buying service stations. The Commission found an adverse effect upon competition at the retail level and ordered Standard Oil to cease and desist from "selling...to any dealer, jobber, or wholesaler at a price lower than the price which respondent charges its retailer-customers...where such dealers, jobbers, or wholesalers resell such gasoline to any of its said retailer-customers at less than respondent's...price...."

Standard Oil appealed the order of the Commission, and the Court of Appeals modified it so that Standard Oil would be guilty of contempt only if it knew, or reasonably should have known, that a jobber resold or intended to re-sell to retailers at a price less than Standard Oil's price to direct-buying retail dealers. Judge Minton, speaking for the court, said:

The petitioner (Standard Oil) should be liable if it sells to a wholesaler it knows or ought to have known is engaged in or intends to engage in the competitive practices condemned by this proceeding (i.e., the passing on of functional discounts to retailers).... If the peti-

---

26 In the Matter of Standard Oil Company, 41 F.T.C. 263 (1945); order modified 173 Fed 2(d) 210 (1949); reversed on other grounds, 340 U.S. 231 (1951).

tioner is to be haled into court for a
violation of the Commission's order,
the petitioner must be guilty of knowing­
ly choosing a customer who is using or
intends to use its price advantage to
undersell the petitioner in its price
made to its retailers....28

The court, therefore, modified Paragraph 6 of the
cease and desist order to prohibit Standard Oil Company
from:
selling...to any jobber or wholesaler
at a price lower than the price at which
respondent charges its retailer-customers
...where such jobber or wholesaler, to
the knowledge of the respondent or under
circumstances as are reasonably calcu­
lated to impute knowledge to the respond­
ent, resells such gasoline or intends to
resell the same to any of its said re­
tailer-customers at less than respond­
ent's...price....29

Even as modified, the order is a disturbing factor
in the law applicable to functional discounts. Rather
than promote the objectives sought by the Robinson-Patman
Act and the other antitrust statutes, it actually subverts
the effectiveness of the competitive process. Standard
Oil, if it seeks to obey the order, has a choice of five
courses of action: (a) to control the prices charged by
jobbers; (b) to meet the prices charged by jobbers when­
ever they undercut Standard Oil's regular price to retail

28173 Fed 2(d) 210, 217.
29Ibid.
service stations; (c) to refuse to sell to either jobbers or direct-buying retailers; (d) to sell to all customers at the same price; or (e) to vary the price charged to jobber customers depending upon their individual costs of operation.

With regard to the first possible course of action, Standard Oil might seek to induce jobbers to maintain the announced list price to retail dealers by refusing to sell to non-cooperating jobbers, relying on United States v. Colgate. However, the precedent established in Colgate has been seriously curtailed in subsequent decisions, with the result that a refusal to sell under these circumstances might subject Standard Oil to further litigation. Similar hazards would probably be undertaken if Standard Oil sought to negotiate resale price maintenance agreements with its jobbers. Neither the Miller-Tydings Act, which was then in force, nor the present McGuire Act, sanctions

30250 U.S. 300 (1919).


32Act of August 17, 1937; United States Code, Title 15, Section 1.

33Act of July 14, 1952; United States Code, Title 15, Section 45.
resale price maintenance which brings about horizontal price fixing. Since Standard Oil and its jobbers both sell to service stations in the same area, they are in competition with each other. Standard Oil would, therefore, violate the law if it undertook to enforce price maintenance agreements against its jobbers.

The second course of action open to Standard Oil has no more to commend itself than the one just discussed. The record in the Standard Oil case indicated that in 1940 less than 20% of Standard Oil's total sales in the Detroit market were accounted for by jobbers. A company which finds that sales directly to retailers constitute by far its most important channel of distribution cannot permit jobbers to dictate its pricing policies. It is, therefore, unreasonable to require Standard Oil to conform its prices to those of its wholesale distributors at the risk of being in contempt of court.

The third possible course of action which Standard Oil might pursue is also subject to grave objections. The company could avoid contravening the order issued against it by restricting its sales either entirely to retailers

---


35 Transcript of the Official Record, p. 51
or entirely to jobbers. Such action would probably not be unlawful, since it would be a bona fide selection of customers. However, such action would not serve the purposes for which the Patman Bill was enacted. If faced with a choice of selling either to wholesalers or to retailers, there is little doubt that Standard Oil would choose the latter. This would be an unfortunate result, jeopardizing the very existence of many wholesalers. The Robinson-Patman Act was passed in order to help the "independent" businessmen; the order in the Standard Oil case is likely to have just the opposite effect.

The fourth alternative open to Standard Oil would be to sell to all customers at the same price. The effect of such a decision would, however, be similar to an affirmative resolve to eliminate jobbers from the company's channels of distribution. Petroleum jobbers, no less than

36Section 2(a) explicitly specifies: "...Nothing herein contained shall prevent persons engaged in selling goods, wares or merchandise in commerce from selecting their own customers in bona fide transactions and not in restraint of trade...." For a further discussion of the relevant legal principles, see Cyrus Austin, Price Discrimination (Philadelphia: Committee for Continuing Legal Education, 1954), pp.

37In fact, according to a recent decision, the protection of the wholesaler was one of the specific purposes of the Robinson-Patman Act. Henry Krug et al v. International Telephone and Telegraph Corporation et al., 1956 Trade Cases 38, 387 (1956).
other middlemen, must recover in their selling prices the expenses they incur as a result of maintaining bulk storage facilities and delivery equipment and as a result of performing services for their accounts. Should Standard Oil Company, therefore, offer to sell to all retailers at the same price as to jobbers, the latter would probably find it impossible to compete.

Finally, Standard Oil could seek to prevent "leakage" by charging different prices to different jobbers, varying its prices with the costs of operation incurred by individual jobbers. Aside from the administrative and managerial problems involved in such a discriminatory pricing system, it is unlikely that the courts would permit it, with its susceptibility of error and resulting injury to customers.

Since Standard Oil's legal staff would not permit the company to enforce resale price maintenance against jobbers nor to discriminate in price between different jobbers, and since Standard Oil's management would not permit the company to be put into a position of being compelled to adopt the same price to retail service stations as that charged by its jobbers, the effect of the order in the case is primarily to hurt the jobbers of the company. Such a result is entirely contrary to the purposes of the Robinson-Patman Act, and should have been avoided by the
The handling of the "leakage" problem in the Standard Oil case becomes all the more objectionable when it is realized that a much better solution was possible. Functional discounts granted to wholesale distributors are not likely to be passed on to retail customers as long as they do not exceed the approximate costs of performing the functions undertaken by these distributors. In general, there is a possibility of "leakage" only where: (a) the size of functional discounts is greater than the cost of performing the functions assumed by the wholesalers to whom they are granted; (b) a particular wholesaler is more efficient than his competitors; or (c) a particular wholesaler is satisfied with a lower per unit net profit than that included in the functional discounts granted to him.

The second and third of these three possible causes of "leakage" should certainly be encouraged rather than impeded. Greater efficiency is, after all, one of the ultimate objectives of a free enterprise economy.

---

38 As noted on a number of previous occasions, the size of functional discounts should generally be determined by the estimated costs which are likely to be incurred by wholesale distributors in handling the line in question, plus a "reasonable profit." Businessmen, however, do not always agree what constitutes a "reasonable" profit. What may be "reasonable" to one may be inadequate to another and excessive to a third. A wholesaler who seeks large volume and is satisfied with low per unit profit may, consequently, be willing and able to pass on a portion of his functional discounts to his retailer accounts.
"Leakage" brought about by the lower operating costs of wholesale distributors is, therefore, to be desired. Similarly, "leakage" caused by the fact that distributors are satisfied with lower, but still "reasonable," profits is a sign of healthy competition. The Federal Trade Commission should do nothing which prevents the occurrence of "leakage" resulting from these two causes.

The Commission need not even be unduly concerned about "leakage" resulting from functional discounts which exceed the cost and profit requirements of wholesale distributors. Competitive forces tend to prevent such "leakage," at least over a period of time. If a primary seller, Standard Oil in this case, charges direct-buying retailers a higher price than jobbers do to their retailer accounts, retailers purchasing from the primary seller are likely to shift their patronage to the lower-priced jobbers until the two prices are in equilibrium. The presence of imperfections in the market, such as those discussed in Chapter III, may perhaps temporarily retard the shifting of patronage from the higher-priced primary seller to the lower-priced jobbers. However, in the absence of a situation which might be described as one of monopoly or "near-monopoly," the shifting is bound to happen. If it does not occur, the causes preventing it should be examined with a view towards corrective action. The existence of
the "leakage" problem may, therefore, be indicative of a much more serious competitive situation. Any legal action decided upon should be directed against these causes, not against their symptoms.

In the Standard Oil case, the undercutting of Standard Oil's regular dealer price by one of its jobbers could not have continued long. Retailers purchasing directly from Standard Oil, upon learning that some of their competitors were buying at a lower price, would probably have demanded the same treatment from Standard Oil and, if refused, would have been likely to shift their business to this jobber. Standard Oil could prevent this loss of sales by cutting its own retail prices, raising its prices to jobbers (and thereby preventing the occurrence of this "leakage"), or ceasing to sell to jobbers. In any event, the "leakage" problem would have been one of relatively short duration.

It is, of course, true that the shifting of patronage from the higher-priced primary seller to the lower-priced jobber may not occur immediately after the "leakage" becomes known in the trade. This fact was demonstrated in the Standard Oil case. The retailers who purchased from Standard Oil were prevented by contracts and by short-term

leases from purchasing gasoline from anyone else. Such restrictions were, however, limited in duration, and retailers were free either to renew or cancel such obligations at their expiration. Ample opportunity was, therefore, afforded for the shifting of patronage within a reasonable amount of time.

Furthermore, since the success of Standard Oil depends, in a great measure, upon the cooperation of its retail affiliates in the operation of Standard Oil's selling programs, the company could not afford to jeopardize the good-will of its retailers. Consequently, even though some service stations were legally obligated to purchase from Standard Oil, once knowledge of the "leakage" became widespread, Standard Oil would have been forced either to meet the jobber's lower price or to take action to prevent the jobber from undercutting Standard Oil's price.

The Standard Oil case has been the only one which has so far attempted to deal with the "leakage" problem. The Court of Appeals affirmed the Commission's decision, but modified the order issued against Standard Oil. The


41173 Fed 2(d) 210 (1949).
Supreme Court reversed the Commission and the Court of Appeals, ruling that the discriminations in price with which Standard Oil had been charged were undertaken by the company in an attempt to meet competition in good faith. The Court held this to be a "complete defense," regardless of its effect on competition. Since the Commission's decision was reversed on grounds other than its holding with regard to the passing on of functional discounts, the law dealing with "leakage" is still far from settled.

It should be noted in this connection that there are only two methods by which "leakage" can be prevented completely. One of these is to establish the prices at which middlemen must resell the product. The other is by requiring primary sellers to vary their prices to middlemen depending on the individual marketing costs incurred by each merchant. Unless one of these two alternatives is adopted, some "leakage" is bound to occur, at least on a temporary basis. Since neither of these alternatives is practical, it is fortunate that not every "leakage," even under the highly questionable decision of the Federal Trade Commission in the Standard Oil litigation, violates the Robinson-Patman Act. Section 2(a) of that Act requires "substantial" injury to competition for a discrimination in

price to be unlawful. Minor differences in the prices charged to retailers as between jobbers and the primary sellers from whom the jobbers buy do not, consequently, contravene the Act.

To summarize, while "leakage" may sometimes constitute a problem, a wise course of action for the Commission, and for the courts, would be to permit competitive forces to correct this situation whenever it should arise. If competitive forces fail in this regard, the Commission and the courts should look to the causes of such failure, and treat such causes rather than their symptoms.

43 See Chapter VII, supra.
CHAPTER X
CLASSIFICATION OF CUSTOMERS

CLASSIFICATION OF SINGLE-FUNCTION PURCHASERS. The legality of functional discounts depends ultimately upon the correctness with which customers are classified for the purpose of determining their eligibility to receive such discounts. Price differentials are not rendered lawful by the fact that they may be called functional discounts by the seller granting them. The legitimacy of functional discounts does not rest upon the label which is attached to them. The indispensable requirement is that they must be made available to all purchasers entitled to receive them, on the basis of a proper functional classification, and to no others.

Single-function middlemen present no problem of classification, since they buy as well as sell in one distributive role. As early as 1915 the federal judiciary promulgated a test by which to identify wholesalers. In the often-cited A & P case, the United States Circuit Court of Appeals (Second Circuit) stated that whether a purchaser is a wholesaler or retailer is determined by the
"character of his selling." Several years later, the same court said:

Whether a buyer is a wholesaler or not does not depend upon the quantity he buys. It is not the character of his buying but the character of his selling which marks him as a wholesaler.2

Neither case, unfortunately, disclosed the specific factors in a purchaser's "character of selling" which are to be considered in classifying him. Subsequent decisions have, however, rectified this omission. A substantial number of decisions, all of them rendered subsequent to the passage of the Robinson-Patman Act, have clearly indicated that the "character of selling" of a purchaser refers to the nature of the persons or firms to whom the purchaser resells. A middleman who resells to retailers or to others for business purposes is a wholesaler. A middleman who resells to ultimate consumers is a retailer.

---


4In the Matter of Nitragin Company, 26 F.T.C. 320 (1938); In the Matter of Hansen Inoculator Company, 26 F.T.C. 303 (1938); In the Matter of Agricultural Laboratories, Inc., 26 F.T.C. 296 (1938).
This means that a department store or mail order house, although it may perform both wholesaling and retailing functions, is considered to be a retail establishment by virtue of the fact that it deals with ultimate consumers. Despite some of the obvious limitations of the "character of selling" test, there is widespread agreement today that it represents a reasonably satisfactory criterion by which to identify merchants who sell to a single class of customers.

CLASSIFICATION OF SPLIT-FUNCTION PURCHASERS. While there is little controversy with respect to the classification of single-function merchants, there is some division of opinion in regard to the classification of mixed-function middlemen. In recent years marketing functions have been shifted back and forth among manufacturers, wholesalers and retailers in a continuing effort to achieve more efficient means of distribution. Many manufacturers have assumed wholesaling functions, frequently by establishing their own wholesale outlets. Similarly, many retailers have undertaken wholesaling activities, often by

5Beckman and Engle, op. cit., pp. 17-18.

means of wholly- or cooperatively-owned warehouses. Whole-
salers themselves have been in a state of flux. Some have
curtailed their traditional services in order to reduce
operating expenses; others have found it propitious to
increase them. As a result of all of these conditions,
the number of mixed-function wholesalers has steadily in-
creased, and the problem of classifying them for purposes
of granting functional discounts has become ever more com-
plex.

Despite the inherent difficulties involved in classi-
fying split-function purchasers, the Commission has been
consistent in its treatment of such purchasers. The
Federal Trade Commission has steadfastly refrained from
designating split-function merchants as either wholesalers
or retailers, regardless of the predominance of either
wholesale or retail activities. The Commission has uni-
formly insisted on considering each transaction separately.

---

7Malcolm P. McNair, "Marketing Functions and Costs
and the Robinson-Patman Act," Business and the Robinson-
Patman Act, Benjamin Werne, ed. (New York: Oxford

8Melvin T. Copeland, "The Present Status of Whole-
sale Trade," Harvard Business Review, VI (April 1928)
257, 257-259.

9In the Matter of Albert and Lucille Whiting, 26
F.T.C. 312 (1938); In the Matter of Sherwin-Williams
Company et al., 36 F.T.C. 25 (1943).
Split-function wholesalers are, consequently, entitled to functional discounts only on goods actually resold at wholesale. This has been discussed previously in Chapter IX.

THE DOUBLEDAY DECISION. The "character of selling" test, as applied to split-function wholesalers, has been criticized in only one majority opinion of the Commission. This was in the Doubleday and Company case, decided in 1955. Former Commission Chairman Edward H. Howrey argued that relating functional discounts solely to the method of resale of a purchaser, without recognition of his buying functions, "thwarts competition and efficiency, and inevitably leads to higher consumer prices." Chairman Howrey suggested that the law should permit the classification of purchasers, and the granting of functional discounts, with due consideration to all functions performed by a buyer. He said:

> It is possible...for a seller to shift to customers a number of distributional functions which the seller himself ordinarily performs. Such functions should, in our opinion, be recognized and reimbursed. Where a businessman performs

---

11. Ibid.
various wholesaling functions, such as providing storage, traveling salesmen and distribution of catalogues, the law should not forbid his supplier from compensating him for such services.\textsuperscript{12}

The adoption by the Commission of the view expressed by its former Chairman in the \textit{Doubleday} opinion would have far-reaching effect not only with respect to split-function purchasers, but also in regard to single-function purchasers. Many chains and department stores and other integrated retailers, which have not heretofore been entitled to functional discounts, would undoubtedly qualify for such discounts under the Howrey ruling.

Theoretically, the ideas suggested by Chairman Howrey in \textit{Doubleday} have considerable merit. Manufacturers do frequently find it desirable, and even necessary, to rely upon middlemen to perform marketing functions in their behalf. Many times the only way, and almost always the most effective way, to induce middlemen to undertake these functions is by providing them with compensation for their activities. The granting of functional discounts is, therefore, a logical concomitant to the shifting of functions from manufacturers to middlemen. It also accords with sound economic principles to argue that such discounts should be related to all of the functions performed by middlemen,

\textsuperscript{12}\textit{Ibid.}
rather than to base them exclusively upon the nature of the customers which the middlemen serve.

From a practical viewpoint, however, application of the Howrey concept of functional discounts is likely to cause more mischief than good. The acceptance of the principle that an integrated merchant is entitled to functional discounts on the basis of all wholesale services undertaken will quickly lead to the assumption by many businessmen of new or additional wholesale functions, without regard to ability to perform them, but with the single purpose of qualifying for functional discounts, or for larger functional discounts. Equally important, adherence by the Commission to the Howrey opinion in the Doubleday case will inevitably kindle endless wrangling and litigation. Chairman Howrey suggested not only that functional discounts should be granted for the performance of all functions "shifted" by manufacturers to middlemen, but he added: "The amount of the discount should be reasonably

\[13\] A middleman who undertakes new or additional wholesale services will, of course, increase his operating expenses. However, this fact will not always deter middlemen from performing new or additional functions. Most marketing organizations lack adequate cost data, many are burdened with high overhead costs, with the result that they may be deceived as to the costs actually involved in adding activities.
related to the expenses assumed by the buyer."  

Since the number of different "bundles of services" which merchants may undertake in behalf of their manufacturers is almost limitless, the granting of functional discounts on the basis suggested by Chairman Howrey would be exceedingly burdensome. Who could possibly judge, with any degree of precision, the proper size of such discounts? It could hardly be the primary seller, who cannot be expected to know the costs that individual purchasers incur in their operations. He is fortunate, indeed, if he possesses reliable cost information about his own operations. It could certainly not be the buyer himself. At the current stage of development of the business sciences, it is quite impossible for a seller to grant merchants handling his line discounts "reasonably related" to the operating expenses incurred by them in carrying and promoting his line.

It has been suggested that a manufacturer could establish a scale of uniform discounts for specific wholesale functions performed, regardless of the expenses incurred by individual merchants. Professor Converse once

14Doubleday, loc. cit., p. 35, 678.

15The size of the functional discount given for each specific wholesale activity should, of course, be related to the costs incurred by the "typical" or "average" or the majority of merchants eligible to receive such discount.
proposed the following scale: a 6% discount for buying, warehousing, dividing and packing goods (i.e., "breaking bulk"); a 3% discount for extending credit to retailers; a 1% discount for delivering to retail outlets; a 5% discount for employing an outside sales force, etc. Such a plan is, obviously, unworkable. The cost of performing a particular function varies not only from trade to trade, but also from community to community and from firm to firm within the same community. Consequently, a 3% discount for the performance of delivery services may provide a substantial profit to a wholesaler who happens to be located in the center of a densely populated market, while the same discount may be entirely inadequate to compensate another wholesaler who happens to service a widely scattered rural area. The use of a discount scale based on wholesale activities assumed would cause merchants to undertake functions with little or no regard to the needs of their customers. Encouragement would be offered to merchants to perform as many wholesale services as possible, even if only in a perfunctory manner. The result would be economic chaos, with middlemen paying more attention to contriving ways to "beat the system" than to the problems of their day-to-day operations.

Several other considerations argue against the soundness of the Howrey opinion in the Doubleday case. Permitting a seller to grant functional discounts for all wholesale activities assumed by middlemen would lead to widespread avoidance of the Robinson-Patman Act. While it is true that the Act suffers from many deficiencies, there is nevertheless substantial sentiment among antitrust lawyers that the Act has served a useful purpose in the past and that it should not now be weakened or abandoned.

Under the Howrey doctrine it would be exceedingly difficult to determine which functions performed by middlemen could be compensated for by manufacturers. For example, would a department store buying directly from the manufacturer be entitled to functional discounts to cover all costs incurred in storing the manufacturer's line, or only for those incurred while the goods were stored in a reserve stock area? Would a small chain of two stores, possessing no central warehouse, qualify for functional discounts for the performance of its purchasing activities? Even if decisions could be reached on these points, there would still be the almost impossible task of assigning a proper value to these functions. As Commissioner Secrest

A service where the benefits inure exclusively to the seller is one thing. It is quite another where the service helps the buyer, even though such service may benefit the seller by resulting in larger purchases from him. Enforcement of the law would be extremely difficult if not impossible if, in each 2(a) case, the Commission were required to divide a common service which may benefit both the buyer and seller. Each case would require an operation as delicate and difficult as the separation of Siamese twins.18

As a practical matter, therefore, the Howrey view of trade discounts would seriously inhibit enforcement of the Robinson-Patman Act. It is not surprising, consequently, that it has been championed by groups anxious to 19 debilitate the Act.

Finally, and possibly most important, there is nothing in the provisions of the Robinson-Patman Act, or in its legislative history, that can be said to authorize the granting of trade discounts on the basis of the Howrey doctrine. As stated by the Hearing Examiner in the Doubleday proceedings:

...prices cannot under the present law be varyinglly fixed on the basis of what a customer does with his own merchandise in an effort to resell it. Pricing by


customer service inevitably means pricing by customer, the very result the law was obviously intended to prevent.20

Thus, neither the terms nor the spirit of the Robinson-Patman Act permit the approach to trade discounts which former Chairman Howrey sought to have the Commission follow. It is fortunate, therefore, that there is no evidence to indicate that the Commission is ready to adopt the trade discount views expounded by its former Chairman. Although the Howrey opinion represented that of the majority, the observations regarding discounts constituted nothing more than the reflections of a single individual, who is now no longer a member of the Commission. Commissioners Gwynne, Mead and Secrest concurred "in the result" of the Howrey opinion, but two of these gentlemen felt obliged to write separate opinions. Former Commissioner Mason wrote a dissenting opinion, and was not concerned with the issue of trade discounts.

The weight of Chairman Howrey's remarks as Commission precedent is further diminished by the fact that they were in the nature of obiter dicta. The Chairman's observations were directed to the issue whether the Hearing Examiner should have permitted the introduction of evidence by the Doubleday Book Company to show that certain

of its price differentials, which the Commission charged to be unlawful, were actually payments to favored customers for services and facilities furnished. The Hearing Examiner refused to admit such evidence, ruling that the asserted defense was unavailable on the ground that "the character of the selling of the purchaser and not the buying determines functional classification." Chairman Howrey's statements on the subject were dicta because, while holding the examiner's ruling to be incorrect, he conceded that the respondent "was not prejudiced" by the error. The Chairman ruled that the records and transcripts before the Commission indicated that the lower prices granted to the favored customers were not, in fact, designed to compensate customers for their services or facilities.

Furthermore, disagreement with the Howrey views was expressly stated by two members of the Commission. Commissioner Secrest said:

Functional classification of customers for discount purposes should be conditioned on their character as sellers, not on the performance of any services to their supplier. To hold otherwise would lead to pricing by individual customers which would undoubtedly give the larger buyer a price advantage in the resale of the seller's goods. 23

23Ibid.
Commissioner Mead stated:

Under (the Robinson-Patman) Act, a price discrimination, as described, unless justified in the manner therein set forth, is unlawful if the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly or to injure, destroy or prevent competition. This, of course, applies to discriminatory discounts based on distributional functions performed by the buyer as well as to any and all other price differentials. To hold otherwise is to not only read into the law a provision which is not there, but is to also completely disregard express provisions which are there. 24

CLASSIFICATION OF WHOLESALERS FINANCIALLY AFFILIATED WITH RETAILERS. The Commission has experienced a great deal of difficulty in the past in classifying wholesalers who possess a proprietary interest in retail establishments. In Sherwin-Williams, the Commission held functional discounts granted to wholesalers on goods resold through wholly-owned retail stores to be unlawful. 25 The Commission disregarded the fact that these retail stores were separately incorporated and that they therefore enjoyed distinct legal personalities. While it is true that the fiction of corporate personality may be "pierced,"

24Ibid., p. 35, 680.

25In the Matter of Sherwin-Williams et al., 36 F.T.C. 25 (1943).
this should not be done without adequate legal reason. There must first be a showing that the corporate personality has been used to defeat public convenience, to protect fraud, or, at the very least, to produce unjust or undesirable consequences. It is to be doubted that the granting of functional discounts to wholesalers who happen to possess a proprietary interest in retail stores is likely to produce any of these results.

The stores owned by the wholesalers in Sherwin-Williams were, for the most part, not only separately incorporated, but they were also separately managed. They operated in a manner similar to their independent competitors, incurring costs probably no less than those of their competitors, and expected to earn profits approximating those of their competitors. The wholesalers who owned these stores, consequently, would find it advisable to deal with them almost as if they were independently owned and operated. If such wholesalers were to sell or transfer to their retail affiliates goods at prices in excess, or at less than, the amount at which such goods could be purchased in the open market, they would, in the phraseology of that old cliche, merely "rob Peter to pay Paul";

that is to say, they would artificially raise the revenue earned either by the wholesale establishment or by the retail stores, while artificially reducing the revenue earned by the other. Such bookkeeping legerdemain cannot alter the basic facts. These are that wholesalers, whether they sell to independent retailers or to wholly-owned retail affiliates, must receive for their goods prices which cover their expenses and, in the long run, permit them a reasonable profit. For purposes of granting functional discounts, a distinction between bona fide wholesalers who resell to independently-owned retailers and those who resell to fully-owned (but separately operated) retail establishments is not justified.

While the Commission refused to sanction functional discounts allowed on goods resold through wholly-owned retail stores in the Sherwin-Williams case, the Commission applied a different rule to partly-owned retail affiliates. Functional discounts on goods resold through partly-owned retail outlets were not prohibited. Thus, the record discloses that one individual, by the name of Roy Harpester, was the sole proprietor of a wholesale paint establishment and that he also owned a 1/3 to 2/3 financial interest in five hardware stores. These retail establishments

27 Sherwin-Williams, loc. cit., p. 45.
were independently operated, although they bought their paint supplies from Harpester's wholesale firm. The Commission did not prohibit the functional discounts granted to Harpester's wholesale firm on goods resold to these partly-owned retail stores, but implied that a cease and desist order might have been issued if Harpester had been the sole owner of these retail stores. Such a distinction is completely unwarranted. The economic consequences of functional discounts are the same whether Harpester had a 100% or a 50% or a 30% financial interest in these retail stores. A legal distinction in the antitrust field, without concomitant economic differences justifying such a distinction, would seem to be unwise. It is suggested, therefore, that the right of a bona fide wholesaler to receive functional discounts should not be affected by the fact that he may have a partial, or even a complete, financial interest in retail stores selling the goods in question, assuming that the retail and wholesale operations are conducted in separate establishments.

Functional discounts granted to bona fide wholesalers who have wholly- or partially-owned retail subsidiaries, which are separately organized and managed, do not have the adverse effect upon competition required to constitute a violation of Section 2(a). Total operating costs of wholesalers are not necessarily decreased by the
fact that they sell to retail outlets in which they have a financial interest. Selling expenses may perhaps be reduced, but this decrease, if any, is likely to be more than offset by the greater administrative and supervisory costs which invariably arise when one person or firm operates several separate businesses. As a consequence, functional discounts granted to bona fide wholesalers on goods resold through wholly- or partly-owned retail establishments do not give these wholesalers or their retail affiliates competitive advantages over their independent rivals. It may be true that independent wholesalers will not find customers in the retail stores owned or controlled by their competitors. However, this is not injury to competition; this is competition, that constant quest for the most profitable and efficient arrangement of economic units.

What has been said so far about wholesalers who maintain a financial interest in retail establishments applies equally to retailers that cooperatively own wholesale establishments. There is no reason which justifies the denial of functional discounts to bona fide retailer-sponsored cooperatives on an equal basis with independent wholesalers. The important qualification is, of course, that such cooperatives must be bona fide wholesale supply houses. This means they must operate in a manner sub-
stantially similar to independent wholesalers. "Letterhead wholesalers," whose only claim to wholesale status rests on their own proclamations, would not meet the "bona fide" requirement. Neither would an office or warehouse established merely for the purpose of placing orders for its own retail stores. Generally, a bona fide wholesaler might be expected to sell to accounts other than its retail affiliates, unless these retail stores themselves account for a volume of purchases from the wholesale warehouse which an independent wholesaler, operating in the same market, would be likely to find profitable. A lesser volume of sales than this, without any attempt to cultivate non-affiliated retailers, leads to the presumption that the wholesale establishment is operated for the purpose of earning functional discounts on the goods purchased, rather than to conduct a successful wholesale business. Furthermore, in order to prevent widespread circumvention of the Robinson-Patman Act, it would be advisable to establish the principle that goods resold by a wholesaler to wholly- or partially-owned retail stores should qualify for functional discounts only when the wholesale operations are performed in a wholesale establishment, as this term is used in the Censuses of Retail Trade and Wholesale Trade of the U.S. Bureau of Census.

The law as it stands today does not permit the granting of functional discounts to merchants on goods resold, either directly or through wholly-owned retail affiliates, to ultimate consumers. It is suggested here that this rule should be relaxed so that such discounts may be granted to purchasers who perform wholesale and retail functions in separate establishments. For the reasons discussed in the section dealing with the Howrey views in the <b>Doubleday</b> case, the further relaxation of the present law to permit the granting of functional discounts for all wholesale functions performed by a retailer is not recommended. Adoption of the Howrey rule would, in effect, constitute a repeal of the Robinson-Patman Act, since enforcement of the Act would be rendered almost impossible. This is a result which few objective students of American antitrust law consider desirable.

Although functional discounts may not be allowed for functions undertaken by retail merchants who resell to ultimate consumers, this does not mean that retailers can never be rewarded for activities of a wholesaling nature which they may perform. The Robinson-Patman Act permits discounts on the basis of cost savings accruing to the
seller; retailers who discharge services in behalf of a manufacturer of a product may, therefore, be granted discounts which reflect the savings to the manufacturer resulting from the shifting of these functions to the retailers. The cost-savings clause of the Robinson-Patman Act is, to be sure, not an entirely satisfactory provision by which to compensate retailers for such activities. For one thing, the Act does not permit the seller to include in his discounts to purchasers an amount calculated to provide them with a profit on their performance of the functions assumed. The cost-savings clause has, furthermore, been so strictly construed by the Commission and the courts that discounts based on it are exceedingly burdensome to prove. All of these factors argue for a new approach to the whole problem of cost savings under the Act. Such a review of the law is long overdue. The fact

---

29 The first proviso in Section 2(a) reads: "Provided, That nothing herein contained shall prevent differentials which make only due allowances for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered."

30 H. Thomas Austern has gone so far as to say that discounts based on cost savings should be granted only by "the wealthy, the resourceful and the tireless." H. Thomas Austern, "Tabula Naufragio—Administrative Style, Some Observations on the Robinson-Patman Act," Antitrust Law Symposium 1953 (Chicago: Commerce Clearing House, 1953), p. 105, 115.
remains, however, that a method does exist by which retailers may be compensated for wholesale functions which they perform.

SUMMARY OF CLASSIFICATION PRINCIPLES. In brief, there is no entirely satisfactory solution to the problem of classifying customers for the purpose of allowing functional discounts. The answer to the problem appears to lie in an uneasy compromise between the theoretically sound and the operationally convenient. Single-function middlemen are the easiest of all purchasers to classify. Those who resell to ultimate consumers are retailers; those who resell to buyers for a business purpose are wholesalers. Complications occur with regard to split-function middlemen. The law is well settled, however, that such buyers should not be classified as either wholesalers or retailers, but that each transaction should be treated individually. Functional discounts to such split-function merchants are allowed only on goods actually resold at wholesale. Former Commissioner Howrey has suggested the application of a different principle. This has not, however, found favor among a majority of the members of the Commission.

The Commission has, in the past, prohibited the granting of functional discounts to wholesalers on goods
resold through wholly-owned retail stores, even though such stores were independently organized and operated. It is suggested in this study that the legality of functional discounts should not be affected by the fact that there may be some community of financial interests between the wholesale and retail establishments through which the goods move, provided these establishments operate separately and independently. This would mean that a bona fide retailer-cooperative should be entitled to functional discounts on the same basis as independent wholesalers. The law, as it now stands, is unclear on this last point. There is, unfortunately, some precedent to indicate that the Commission does not deem retailer-cooperatives to be entitled to functional discounts. The relevant cases are, however, by no means conclusive. It is a matter of common knowledge that most cooperatives do, in fact, receive functional discounts on their purchases.

It is well established that retailers who sell exclusively to ultimate consumers are not entitled to functional discounts, even though they may also perform functions of a wholesale nature. This principle may be justified on the simple premise that no other would be

---

practical. Permitting sellers to grant functional dis-
counts on the basis suggested by Commissioner Howrey would
create endless confusion and interminable litigation.

"MEETING COMPETITION" THEORY OF FUNCTIONAL DISCOUNTS.
The Commission and the courts have consistently predicated
the legality of functional discounts on the fact that such
discounts do not have the adverse effect on competition
required by Section 2(a) of the Robinson-Patman Act. In
recent years the Commission has been urged by a number of
respondents summoned to appear before it to recognize
that the legality of functional discounts can also be
sustained on a second and different legal theory. In
several cases, it has been argued that the practice of
granting functional discounts has become so well established
in many lines of trade that an individual seller must do
likewise in order to meet competition. The Robinson-
Patman Act specifically states that a price discrimina-
tion undertaken in an attempt to meet competition in good
faith does not violate Section 2(a). The Commission has,

5770 (April 29, 1955), pp. 9-10; In the Matter of Whitaker

33Section 2 (b) of the Robinson-Patman Act states,
in part: "...Provided, however, That nothing herein con-
tained shall prevent a seller rebutting the prima-facie
case thus made by showing that his lower price or the
furnishing of services or facilities to any purchaser or
purchasers was made in good faith to meet an equally low
price of a competitor, or the services or facilities
furnished by a competitor."
however, repeatedly declined to approve this "meeting competition" explanation of functional discounts. This does not mean that the legality of such discounts has in any way been curtailed. It does mean that functional discounts must be justified strictly on the basis that they do injure competition, as previously discussed.

In rejecting the "meeting competition" argument in favor of functional discounts, the Commission stated that the "meeting competition" proviso of the Robinson-Patman Act contemplates an attempt by a seller to match a competitor's price in a specific transaction, rather than the adjustment of an entire pricing structure to that of competitors in the industry. In Edelman and Company, the Commission said:

...respondent's (functional) pricing system is a continuing one related not to existing competition but to future competition. It is not geared to individual competitive offers or localized price cutting, but instead represents a nationwide system designed to come close enough to its principal competitors' (functional) pricing systems to allow it to retain most of its customers and gain perhaps a few more. The exemption provided under Section 2(b) places emphasis, however, on individual competitive situations rather than upon a general system of competition.35

34 See cases cited in footnote 32, supra.
36 Loc. cit., p. 9.
LEGALITY OF THE "ONE-PRICE." Legal writers and commentators are generally agreed that while the Robinson-Patman Act permits functional discounts, it does not require that such discounts be granted. Representative Patman has, however, consistently taken issue with this view.

Within less than a year after the passage of the Robinson-Patman Act, the Commission issued a complaint against Bird and Son, Inc., a manufacturer of linoleum rugs, charging the firm with selling at discriminatory prices in favor of Montgomery Ward, a large mail order house. Evidence introduced in the proceedings showed that immediately following the issuance of this complaint Bird and Son discontinued selling to all retailers, except to Montgomery Ward. The company limited its sales thereafter to wholesalers, who resold to retailers, and to

---


39Montgomery Ward was named as a co-respondent, charged with "knowingly" receiving a discriminatory price in violation of Section 2(f). In the Matter of Bird and Son, et al., 25 F.T.C. 548 (1937).
Wholesalers and Montgomery Ward were given the same price, with the result that retailers purchasing through Bird and Son's wholesalers paid a higher price than Montgomery Ward. The complaint charged that this injured competition at the second and third levels. The Commission dismissed the complaint in a memorandum decision in which it said:

Not until there is a discrimination in price among those chosen (as customers) does Section 2(a) of the act have any application. There is no suggestion that the selection of customers here involved was the result of any combination in restraint of trade.... The courts have consistently upheld the right of individual traders to select their customers in the absence of such combination.\(^4\)

\(^{40}\) At the time of the new policy, sales to all retailers combined, except for those to Montgomery Ward, accounted for less than 1% of Bird and Son's total sales volume. \textit{Ibid.}, p. 552.

\(^{41}\) \textit{Ibid.}, p. 553. In a 1937 Report to Congress on the disposition made by the Federal Trade Commission of sixty-four cases investigated under the new Robinson-Patman Act, the Chairman of the Commission, William A. Ayres, referred to one involving a manufacturer of radio tubes who was charged with selling to certain retail dealers at "distributors' price." The investigation disclosed that the manufacturer sold to all customers at the same price, and that there were ten retailers among its numerous customers. Chairman Ayres stated simply: "There being no price discrimination the file was closed." Letter from the Hon. W. A. Ayres to Representative Wright Patman, reprinted at \textit{Congressional Record}, Volume 81, p. 2336, 2339. This reaffirmed the holding in \textit{Bird and Son}. 

---

\(^{4}\) Section 2(a) of the Robinson-Patman Act. 

---

\(^{40}\) At the time of the new policy, sales to all retailers combined, except for those to Montgomery Ward, accounted for less than 1% of Bird and Son's total sales volume. \textit{Ibid.}, p. 552.

\(^{41}\) \textit{Ibid.}, p. 553. In a 1937 Report to Congress on the disposition made by the Federal Trade Commission of sixty-four cases investigated under the new Robinson-Patman Act, the Chairman of the Commission, William A. Ayres, referred to one involving a manufacturer of radio tubes who was charged with selling to certain retail dealers at "distributors' price." The investigation disclosed that the manufacturer sold to all customers at the same price, and that there were ten retailers among its numerous customers. Chairman Ayres stated simply: "There being no price discrimination the file was closed." Letter from the Hon. W. A. Ayres to Representative Wright Patman, reprinted at \textit{Congressional Record}, Volume 81, p. 2336, 2339. This reaffirmed the holding in \textit{Bird and Son}. 

---
Thus, one of the early decisions under the Robinson-Patman Act recognized the irreproachability of a one-price policy, regardless of its effect upon retailers buying from the wholesaler. However, a decision rendered on the same day as that in Bird and Son appears to have limited the latitude of the principle established in the latter case. In The Matter of Kraft-Phenix Cheese Corporation, the respondent and its subsidiaries, manufacturers of processed cheeses and salad dressing, were charged with granting quantity discounts not justified by cost savings. The complaint was dismissed by the Commission, largely on the basis of the de minimis rule. However, a question arose in that case which is of importance to the discussion at hand, viz., whether certain retailers who bought from jobbers could be considered "purchasers" of the Kraft-Phenix Cheese Corporation, the manufacturer. The record indicates that Kraft-Phenix's salesmen frequently solicited orders directly from retailers, that these salesmen sometimes made deliveries to retailers, that Kraft-Phenix executives established the prices at which retailers were to be resold, and that Kraft-Phenix otherwise "controlled"

42 F.T.C. 537 (1937).
44 The Federal Trade Commission seemed to feel that such a holding was necessary to bring the transactions of the respondent into interstate commerce and within the jurisdiction of the Robinson-Patman Act.
the distribution of its products. However, the retailers were billed by the jobbers operating in their territory, who normally took possession and title to the goods before they were resold to the retailers. On the basis of these facts, the Commission held that such retailers were "purchasers" of the Kraft-Phenix Company, within the meaning of Section 2(a) of the Robinson-Patman Act.

The significance of this highly questionable holding lies in its effect on the legality of a one-price policy. If a manufacturer sells to wholesalers and direct-buying retailers at the same price, retailers purchasing through the wholesalers would naturally have to pay a higher price than their direct-buying competitors. Wholesalers incur expenses in the performance of their functions; these are defrayed by adding an appropriate mark-up to the goods they sell. As a result, where retailers buying from wholesalers are considered to be "purchasers" of the manufacturer under Section 2(a) of the Robinson-Patman Act, the manufacturer may be held guilty of discrimination in

price, since he sells to direct-buying retailers at a lower price than do his jobbers to their retailer accounts.

Although the soundness of the Kraft-Phenix decision is very doubtful, the holding in the case has been reaffirmed on several occasions since 1937. In The Matter of Luxor, Ltd., the respondent, a manufacturer of toilet articles and cosmetics, employed salesmen to solicit the patronage of drug wholesalers in every state of the Union. These salesmen were instructed to secure orders for Luxor products from retail druggists; orders received were turned over for delivery to local wholesalers handling the Luxor line. The respondent enforced a resale price maintenance policy on all of its products. The Commission held that, under these circumstances, retailers whose business was solicited by salesmen of the Luxor Company were purchasers of the latter, within the meaning of Section 2(e) of the Robinson-Patman Act, even though the orders were delivered by wholesalers who had title to

46 However, if the difference between the price charged by the manufacturer to the direct-buying retailers and the price charged by wholesalers to their retailer customers is no greater than the additional costs incurred by the integrated retailers on the performance of the wholesaling functions they have assumed, there would be no effect on competition and, consequently, no violation of Section 2(a).

47 31 F.T.C. 658 (1940).
the goods and to whom payment was made.

The Commission came to a similar conclusion in The Matter of Dentists' Supply Company, where the sales representatives of the respondent, a manufacturer of artificial teeth, solicited dental laboratories, generally turning over orders received to local dental supply houses which bought from the respondent. In addition, these sales representatives undertook to encourage dental laboratories to sign "bonus contract agreements" with the respondent, whereby these laboratories received from the Dentists' Supply Company certificates entitling them to "free" or "bonus" teeth, the amount thereof depending upon the laboratory's annual purchase of artificial teeth manufactured by the respondent. The Commission held that the dental laboratories whose business was obtained by salesmen of the respondent were its "purchasers," in the sense of

48 Section 2(e) of the Robinson-Patman Act prohibits the furnishing of any service or facility connected with the processing, handling, sale, or offering for sale of any commodity purchased which is not made available to all purchasers on "proportionally equal terms." See Cyrus Austin, Price Discrimination (Philadelphia: Committee on Continuing Legal Education, 1954), pp. 110-141.

49 37 F.T.C. 345 (1943). Dental supply houses are considered wholesalers in this industry; they service dental laboratories, which work closely together with dentists.
that term under Section 2(a). The Commission made such a finding despite the fact that the orders received from dental laboratories were normally filled by local dental supply houses, rather than directly by the Dentists' Supply Company.

The fact that customers of a wholesaler buying from a manufacturer may become "purchasers" of that manufacturer, within the meaning of Section 2(a), has been reaffirmed in two recent decisions of the Commission. It appears from these decisions that such a result is achieved whenever a manufacturer exercises a substantial degree of control over the sales policies of the person or firm buying from him, and particularly when he determines the specific customers whose business shall be solicited, or when he participates actively, through his representatives,

50 The bonus system of the Dentists' Supply Company resulted in a lower unit price being paid for teeth by "respondent's purchaser customers" (i.e., the dental laboratories), who were able to take advantage of this bonus system by purchasing in the required annual volume. The Commission found this bonus system not justified by cost savings, and that it violated Section 2(a). Since the respondent sold to all dental supply houses at the same price, the Commission, in reaching its decision, must have held the customers of the dental supply houses to be "purchasers" of the respondent. The Commission was not specific on this point; no other interpretation is logical, however.

in securing orders for this person or firm.

A recent court decision has also given implied sanction to this broad conception of the term "purchaser." The soundness of these various holdings is, however, very doubtful. They reflect a naivete about American marketing policies and practices which should not be expected from an agency claiming expert status in trade regulation matters, nor from a federal judge who has presumably been exposed to the facts of American business life. It is not unusual, nor sinister, for a manufacturer to take an active interest in the distribution of his products after they have been sold to merchant middlemen. Such an interest, far from being exceptional, is the normal attitude of modern manufacturers. Missionary salesmen may, consequently, be

---

52 Matter of Whitaker Cable, loc. cit.

53 In Philip Klein v. Lionel Corporation et al., 138 Fed Supp 560 (1956), the court cited the Commission's decisions in Kraft-Phenix and Dentists' Supply and, although holding them inapplicable in the instant case, indicated that they were valid authorities for cases where the manufacturer "had either a direct actual relationship with the retailer" or "exercised a control over the relations between the jobber and the retailer." (p. 564.) The fact that the court went to the trouble of distinguishing the instant case from the prior Commission rulings shows that such holdings find some favor with the court. A federal district court is, after all, not bound by the precedents established by the Commission.

found in almost every line of trade in the United States. If retailers become "purchasers" of manufacturers as soon as the latter actively assist their jobbers to promote their lines, manufacturers who sell directly to retailers as well as to wholesalers cannot safely adopt a one-price policy. They will actually be required to grant functional discounts to wholesalers to avoid violating the Robinson-Patman Act. Such a result is inconsistent with the Commission's apparent predilection for a one-price policy.

The full impact of the Kraft-Phenix principle upon functional discounts has never been fully appreciated in either marketing or legal literature. If the Commission and the courts ever undertook to apply this principle to every manufacturer who sells both to retailers and to wholesalers, and who at the same time exercises substantial control over the resale policies of his distributors, the practical consequence would be to compel such manuf-


56 The exception to this statement would be where the difference between the price charged by manufacturers to direct-buying retailers and that charged by jobbers to their customers would be equal to the costs incurred by the direct-buying retailers in performing the wholesale functions they have assumed. In such a case, the manufacturers would not be required to grant functional discounts. See footnote 46, supra.

57 The Commission has indicated on a number of occasions its approbation of the practice of charging the same price to all buyers. See *In the Matter of Standard Oil Company*, 41 F.T.C. 263 (1945); order modified, 173 Fed 2(d) 210 (1949); reversed, 340 U.S. 231 (1951).
facturers to grant functional discounts to their wholesalers. In the past the Commission has resorted to the Kraft-Phenix principle in less than one-half dozen cases. There is little doubt that the Commission has not called upon the unsound precedent of Kraft-Phenix in all cases where application of the precedent was possible. While such self-restraint is to be commended under the circumstances, law should be a matter of right, not indulgence. It would be desirable, therefore, for the Commission to indicate clearly the extent to which it deems the Bird and Son decision to be limited by Kraft-Phenix. Until such a statement is on the books, the Kraft-Phenix principle stands as a source of major uncertainty in the determination of marketing policies.
Conclusions on many specific points were drawn at various places throughout this study, and especially in the summary sections of Chapters IV, VI, VII and X. It seems unnecessary to repeat these conclusions here. Suffice it to state, therefore, that there need be no doubt about the legality of functional discounts which are granted on goods resold at wholesale and which are available to all competitors of a purchaser receiving such discounts.

The discussion in the preceding chapters has dealt with many of the intricate marketing and legal problems which are frequently encountered in the process of granting functional discounts. The typical businessman cannot be expected to be familiar with all of these fine points and technicalities. The typical sales executive must necessarily rely on simple and clear-cut rules to chart his actions. He requires neat and affirmative maxims to facilitate his decision-making. He seeks straightforward conclusions and unequivocal instructions. In order to satisfy this need for unambiguous rules concerning functional discounts, the following
guides are offered to the busy executive to assist him with respect to his day-to-day price decisions:

1. A seller is not required to grant functional discounts. Functional discounts are permitted by the Robinson-Patman Act. They are not required by the Act.

2. For the purpose of qualifying for functional discounts, single-function purchasers must be classified on the basis of the type of customers to whom they resell. All purchasers selling or seeking to sell to the same customers must be included in the same classification. The fact that they may perform different functions is immaterial. Thus, a desk jobber and a full-service wholesaler, both buying from the same manufacturer and reselling to retailers in the same market, must be equally eligible for functional discounts granted by the manufacturer. Functional discounts may not be accorded to one purchaser and denied to another simply because they operate in different ways.

It is frequently possible to have several differ-

---

1This statement admits to only one major exception. This is where the functional discounts allowed to a high-cost merchant are no more than the difference between his operating costs and those of competing middlemen who are denied these discounts. Under such circumstances, the functional discounts offered to the high-cost merchant do not injure competition.
ent wholesaler classifications, the members of each classification selling to different customers. In the automotive parts industry, for example, some purchasers may be identified as super-jobbers or distributors, while others may be termed jobbers or wholesalers. The distributors sell to jobbers and the latter sell to retailers. Distributors and jobbers are not in competition with each other, and may therefore be assigned different classifications. In the grocery industry, to cite another example, some wholesalers may be classified as institutional distributors and others may be designated as regular wholesalers. The institutional distributors resell to hospitals, restaurants, schools and industrial cafeterias. The regular wholesalers resell to retailers. Since these two wholesalers serve different customers, they may be given different classifications and granted different functional discounts.

3. If a particular classification includes different types of marketing institutions, the size of functional discounts to these different types of middlemen may vary with the costs incurred by each of them in handling and selling the product in question. As noted in Rule 2, a manufacturer selling to both a drop shipper and full-service wholesaler in the same market cannot deny functional discounts to the drop shipper while offering such
discounts to the full-service merchant, assuming that both resell to the same customers. However, he can vary the size of the functional discounts he grants to each of these two types of middlemen with the average costs each is likely to incur in handling and selling the particular product. He may, therefore, usually allow a larger discount to the full-service wholesaler than to the drop shipper, since the former is likely to have higher operating costs than the drop shipper.

4. For the purpose of qualifying for functional discounts, split-function purchasers may not be classified as either wholesalers or retailers, irrespective of the predominance of either wholesale or retail activities. Such purchasers may receive functional discounts only on goods actually resold at wholesale. Each transaction must, therefore, be treated separately. Responsibility for assuring that no functional discounts are granted on goods resold at retail rests on the seller.

5. The size of functional discounts should be related to the average costs incurred by each type of wholesaler handling and selling the particular product. Since it is impossible to vary functional discounts with the exact expenses sustained by individual middlemen, it is sufficient if such discounts do not significantly exceed the costs incurred by the "average" merchant of
the type to which the purchaser belongs. This means that a seller may not grant functional discounts which are so large that he knows or has adequate reason to believe that the recipient will pass them on, in the form of price reductions, to his own customers.

These five rules do not provide guidance on all questions which may arise in the course of establishing and administering a functional discount policy. These rules, to be sure, oversimplify a highly complex subject. However, in oversimplifying intricate legal precedents, they provide a useful tool to the executive uninitiated in the esoteric idiom of the legal profession. Within their admitted limitations, the above rules will serve to guide the executive along the path of legality.

RECOMMENDATIONS. The marketing and legal implications of functional discounts were discussed in the preceding ten chapters. The conclusion repeatedly reaffirmed was that functional discounts constitute an essential and useful institution in American business. Such discounts provide middlemen with compensation for their performance of indispensable marketing functions. They permit manufacturers to obtain wide market distribution. Under certain circumstances, they may even cause form-utility production costs to be reduced, with
the result that lower prices may be established in the retail markets. In view of the economic desirability of functional discounts, the fact that such discounts are permitted by the Robinson-Patman Act is to be commended. The existing law regarding functional discounts is, however, unclear on many specific issues. Clarification of these points will not only curtail unnecessary litigation, but, more important, will permit businessmen to make pricing decisions with greater confidence and resoluteness.

It is suggested, therefore, that the legality of functional discounts be specifically authorized in an amendment to the Robinson-Patman Act. Such an amendment could, to a large extent, merely restate the current law. It would serve a useful purpose, nevertheless, by eliminating the doubt and confusion which has been unintentionally fostered by several legal and marketing writers. This amendment to the Robinson-Patman Act could read as follows:

Nothing contained in any section of this Act shall prevent or require differentials as between purchasers depending solely upon the character of their selling, provided that any purchaser who resells in more than one capacity shall, irrespective of quantity purchased, be classified on the basis of the proportion of goods, products and/or commodities resold to each type of customer. Provided further, that a bona fide wholesale establishment shall
not be denied recognition of its wholesale character by reason of the fact that it may be owned or controlled by one or more retail establishments or by reason of the fact that it may own or control one or more retail establishments.

A second recommendation is that the injury-to-competition requirement of Section 2(a) of the Robinson-Patman Act be interpreted more realistically, with greater regard to economic and marketing principles. In the past, the Commission and the courts have relied too much on presumptions of injury, on verbal standards which cannot be converted into meaningful tests, and on vague conclusions of injury which are unsupported by evidence presented in the proceedings. In effect, the injury-to-competition requirement has been almost read out of the statute.

Further emasculation of the injury-to-competition requirement of Section 2(a) of the Robinson-Patman Act could endanger the legal status of functional discounts, at least in the absence of some specific statutory provision authorizing such discounts. According to existing legal precedents, functional discounts do not violate the antitrust laws because they do not adversely affect competition. Should the need to show injury to competition ever be completely waived, the lawfulness of functional discounts might become doubtful.

The Federal Trade Commission can justify its
existence as an expert agency only by applying the business information and economic knowledge which it is assumed to possess. This means that the Commission should rely less on presumptions, inferences and arbitrary rules in coming to a finding of injury to competition, and depend more upon field investigations and studies to substantiate a conclusion of competitive injury.

As a third recommendation, it is urged that the Commission overrule its unfortunate decision in the Kraft-Phenix case, where it was held that retailers buying merchandise from a wholesaler may also become "purchasers" of the manufacturer of that merchandise should he send missionary salesmen to service these accounts. As discussed in Chapter X, this decision has the effect of calling into question the legality of a "one-price" system. Since there is almost universal agreement, with Representative Wright Patman being a notable but lonely exception, that it would be imprudent to require sellers to grant functional discounts to wholesalers, reversal or explanation of the Kraft-Phenix decision is long overdue.

It is further recommended that the Commission

---

clarify its 1939 decision in the American Oil Company case, where a seller was held responsible for a buyer's sale of goods in contravention of an agreement with the seller. Liability without fault is not favored by either English or American legal theory. The doctrine of absolute liability certainly should not be applied in the field of antitrust regulation. Consequently, a seller should not be held liable if a purchaser violates his agreement not to resell goods purchased from the seller at a preferential price in competition with goods sold by the same seller at a higher price, provided, of course, the seller did not consent to or encourage this violation of contract. This principle is so manifestly fair that it seems unnecessary to adjure the Commission to adopt it. Unfortunately, however, the Commission embraced a different view in the American Oil Company case. It is hoped that the Commission will soon find an opportunity to overrule or limit its decision in that early case.

Finally, it is recommended that functional discounts should be made equally available to all wholesale establishments, operated and organized separately, regard-

---

less of ownership. The fact that a retailer or several retailers may have a major financial interest in a wholesale concern should not affect that concern's right to functional discounts, provided the wholesale operations are conducted in a bona fide establishment, separately operated and managed. Similarly, the fact that a wholesale firm may possess a substantial financial interest in retail affiliates should not affect the firm's eligibility for functional discounts. The Commission has never taken a clear-cut position on these issues.

Several decisions of the Commission, however, indicate an unexplainable eagerness to consider wholesalers financially related to retail outlets as retailers. The Commission even seems willing to disregard the separate corporate personalities which these wholesale and retail establishments may possess in order to deny them the right to receive functional discounts. These apparent views of the Commission are not justified by either economic or marketing considerations. It is hoped, therefore, that they will be modified in line with the suggestions contained in Chapter X of this study.

FINAL CONCLUSION. The Robinson-Patman Act, with all of its deficiencies and shortcomings, is a salutary and useful enactment. In the haste of its passage,
however, certain important provisions were given inadequate attention. One of these concerned the legality of functional discounts under the Act. The Commission and the courts have been compelled to fill this vacuum left by Congress. They have done so, slowly and hesitatingly. It is now clear that such discounts are permitted under the Robinson-Patman Act. Some confusion exists, nevertheless. It would be desirable, therefore, for Congress to speak on the subject, even at this late date. The voice of Congress should be conclusive and unmistakable. Functional discounts, which are so widely prevalent in the American business community, should be given a precise and categorical mandate of legality. An amendment to the Robinson-Patman Act could best accomplish this purpose.
PUBLICATIONS CITED


Codes of Fair Competition, Nos. 196–244, Volume V. Wash­

Codes of Fair Competition, Nos. 1–57, Volume I. Wash­

Converse, Paul D. and Huegy, Harvey W. The Elements of

Cooke, Frederick H. Law of Combinations, Monopolies and

Chicago: Callaghan and Company, 1930.


Copeland, Morris. "Social Appraisal of Differential

Cost Behavior and Price Policy. New York: National Bureau
of Economic Research, 1943.

Cowan, Donald R. G. "Differential Selling Costs in Re­


Crowley, J. B. "Equal Price Treatment Under the Robinson-

Davisson, Charles N. The Marketing of Automotive Parts.

Dean, Joel. "Competition—Inside and Out," Harvard Busi­

--------. "Research Approach to Pricing," American Market­
ing Association Marketing Series, No. 67, p. 4.

--------. "How Much to Spend on Advertising?" Harvard Busi­
ness Review, XXIX (January, 1951), 65.
---


Hearing Before Sub-committee of Senate Committee on Interstate and Foreign Commerce, Senate Resolution No. 248, 80th Congress, 2nd Session, 1948.

House of Representatives Report, No. 627, 63rd Congress, 2nd Session, 1914.


House of Representatives Resolution No. 232.


Kirsh, Benjamin S. *Trade Associations, the Legal Aspects*. New York: Central Book Co., 1928.


"Legislative and Judicial Developments," *Journal of Marketing*, XXI, 114.


"Recent Decisions," Columbia Law Review, XXIII (June, 1923), 596.


Senate Resolution 224, 70th Congress, 1st Session, 1928.


"What is the Law As to Trade Discounts?" *Printers' Ink*, March 30, 1922, p. 13.


LEGAL PROCEEDINGS CITED


Bain and Blank Inc. v. Vim Television and Appliance Stores, 1956 Trade Cases § 208, 088.


Matter of Champion Spark Plug Co., Docket No. 3977 (1939); dismissed by Commission on July 10, 1953.

Chicago Board of Trade v. United States, 246 U.S. 231 (1918).


Eastern States Retail Lumber Dealers' Association v. United States, 234 U.S. 600, 609 (1914).
Great Atlantic and Pacific Tea Company v. Cream of Wheat Co.,
227 Fed 46 (1915).

Matter of Hansen Inoculator, 26 F.T.C. 303 (1938).

T. B. Henry IV, F. 47, Pl. 21 (1410), The Schoolmasters' Case.

Indiana Quartered Oak Co. v. Federal Trade Commission, 26
Fed 2(d) 340 (1928).

International Shoe Company v. Federal Trade Commission,
280 U.S. 291 (1930).


Phillip Klein v. Lionel Corporation et al., 138 Fed Supp
560 (1956).


Matter of Kraft-Phenix Cheese Corporation, 25 F.T.C. 537
(1937).

S.S. Kresge v. Champion Spark Plug Company, 3 Fed 2(d) 415
(1925).

Henry Krug et al., v. International Telephone and Telegraph
Company et al., 1956 Trade Cases 68, 387.

Ladoga Canning Company v. American Can Company, 44 Fed 2(d)
765 (1930); certiorari denied, 282 U.S. 899 (1931).


456 (1948).

Manhattan Properties, Inc. v. Irving Trust Co., 291 U.S.
320, 336 (1934).

Mead's Fine Bread Company v. Moore, 208 Fed 2(d) 777 (1953);


Munn v. Illinois, 94 U.S. 113 (1877).


Matter of Ruberoid Company, 46 F.T.C. 379 (1950); affirmed, 189 Fed 2(d) 893 (1951); order amended, 191 Fed 2(d) 294 (1951); affirmed, 72 S. Ct. 800 (1952).


Matter of Standard Oil Co., 41 F.T.C. 263 (1945); order modified, 43 F.T.C. 56 (1946); further modified and affirmed, 173 Fed 2(d) 210 (1949); reversed on other grounds, 340 U.S. 231 (1951).

Standard Oil Company of New Jersey v. United States, 221 U.S. 1 (1911).

Sullivan v. Minneapolis Railway Company, 142 NW 3 (1913).


United States v. E. C. Knight Co., 156 U.S. 1, 9 (1895).


United States v. Twentieth Century Fox Film Corporation et al., 137 Fed Supp 78 (1956).


Matter of Albert Whiting and Lucille D. Whiting, Trading As the Urbana Laboratories, 26 F.T.C. 312 (1938).


I, Henry D. Ostberg, was born in Bocholt, Germany, on July 21, 1928. My family and I arrived in the United States on April 5, 1939. After attending grammar school in New York City for three years, I was admitted to Forest Hills High School and later to Brooklyn College. Upon the completion of my pre-law training, I transferred to New York Law School, from which institution I received my baccalaureate of law degree in 1950. After graduating from New York Law School, I passed my state bar examination and, subsequently, enrolled in several courses at Columbia University and at the New York Graduate School of Business. Late in 1950 I enlisted in the United States Air Force and was commissioned a second lieutenant in June of 1951. While on military duty at Wright-Patterson, I participated in a graduate training program sponsored jointly by the Ohio State University and the Air Force. I was awarded the master of business administration degree by Ohio State University in December, 1952. I continued attending the Twilight Session of the University until the Autumn Quarter of 1953, at which time I was discharged from active duty with the Air Force. Upon my return to civilian status, I was appointed a "University Scholar" at Ohio State and pursued a program leading to the doctorate degree, with specialization in marketing. In August of 1954, I was appointed an instructor.
in the Department of Business Organization of Ohio State University. Since August of 1955, I have been assistant professor of marketing at New York University.
doubtedly an overstatement, but it did reflect the general significance of such discounts in the economy at the time. Accurate quantitative measurements showing the extent to which functional discounts are granted in different industries have, unfortunately, rarely been collected. As more and more retailers assumed wholesaling functions during the second and third decades of the current century, the economic soundness of granting functional discounts to independent wholesalers, and denying them to

7 The only published information available to indicate how many manufacturers allow functional discounts to their wholesale accounts is contained in "trade directories" compiled by different wholesaler trade associations. Some of these directories rate manufacturers on the basis of their selling policies, i.e., to what types of accounts they sell, whether they grant price differentials to wholesalers, etc. A directory of the ladies' hosiery industry, prepared by the Wholesale Dry Goods Institute, indicates that as of December 1, 1935, thirty of the 197 manufacturers listed in the directory granted a "satisfactory" price differential to wholesalers. This type of rating activity by trade associations has been curtailed since 1941, at which time the Federal Trade Commission ordered the Wholesale Dry Goods Institute to cease and desist from "preparing, maintaining, and circulating any list of manufacturers or their agents classified or rated in a manner which designates those whose sales policies are considered satisfactory to respondents and those whose sales policies are less satisfactory or not satisfactory to respondents...." In the Matter of the Wholesale Dry Goods Institute, 34 F.T.C. 177, 209 (1941); affirmed, 139 Fed 2(d) 230 (1943); certiorari denied, 321 U.S. 770 (1944).