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ROBINSON-PATMAN ACT—VALIDITY OF FUNCTIONAL DISCOUNTS—
In the traditional marketing system, as it existed around the turn of the century, discounts to the trade were of the essence. As a matter of custom, manufacturers and producers, in projecting their goods into the market, granted preferential prices to certain classes of buyers. The quotation to any particular buyer depended on the position he occupied in the marketing pyramid. Dealers who bought from the manufacturer for the purpose of resale to retailers were classified as wholesalers, or jobbers. In conformity with the "trade status" thus established, they were granted the wholesaler's discount. A manufacturer's customer who sold directly to the consuming public received the somewhat lower retailer's discount.¹

Against the background of the simple marketing structure of an earlier day, the functional discount created no problems of price discrimination. In the evolution of recent years, however, the marketing

¹ For economic background of the functional discount, see ZORN AND FELDMAN, BUSINESS UNDER THE NEW PRICE LAWS 3 (1937).

pattern has experienced widespread change. As part of the broader picture of the breakdown of traditional channels of distribution, many dealers have assumed functions of a mixed character.² Frequently, a single dealer will sell to other distributors and to the consumer as well. Furthermore, in the operation of his business he may perform a number of distributive services which, according to classical notions, make it extremely difficult to decide whether he should be treated as a wholesaler or a retailer.³ As a consequence, the categories of classification increased, and some manufacturers began quoting almost as many prices as they had customers. The fierce competition of the depression years fostered an awareness that many subtle discriminations could pass under the guise of a functional discount.⁴

The Robinson-Patman Act⁵ was an effort by Congress to rid the business community of unfair pricing practices. Since the act did not expressly refer to functional discounts,⁶ the continuing legality of their usage was an open question. It is the purpose of this comment to measure the extent to which the trade discount has been affected by the act as interpreted by the Federal Trade Commission and the courts.

A. *Theory of the Functional Discount*

Functional discounts are not considered to be rewards for quantity purchase.⁷ A retailer is not given the same discount accorded to a wholesaler even though the retailer buys from the manufacturer in quantities fully as large as does the wholesaler. The discount to the wholesaler is founded on a recognition that dealers of his class, in relieving the manufacturer of burdens in the distribution of goods, become entitled to special consideration.⁸ Originally, the quantum of discount was closely related to the manufacturer's savings. In time,

² *Id.* at 167.

³ McAllister, "Price Control by Law in the United States: A Survey," 4 *LAW AND CONTEMP. PROB.* 273 at 292 (1937).

⁴ McNair, "Marketing Functions and Costs and the Robinson-Patman Act," 4 *LAW AND CONTEMP. PROB.* 334 at 348 (1937); ZORN AND FELDMAN, *BUSINESS UNDER THE NEW PRICE LAWS* 26 (1937).

⁵ 49 Stat. L. 1526 (1936), 15 U. S. C. (1946) §13.

⁶ A clause deleted from the act before passage had provided: "That 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. . . ." H. R. Rep. No. 2287, p. 1, 74th Cong., 2d sess. (1936). The simple fact of deletion cannot be taken as persuasive evidence of a Congressional intent to outlaw the functional discount.

⁷ McNair, "Marketing Functions and Costs and the Robinson-Patman Act," 4 *LAW AND CONTEMP. PROB.* 334 at 346 (1937).

⁸ ZORN AND FELDMAN, *BUSINESS UNDER THE NEW PRICE LAWS* 167 (1937).

however, the costs of the wholesaler became the determinant.⁹ A manufacturer was willing to do business on that basis because he felt a genuine need for the wholesaler's services.

This comment will examine the status of those functional or trade discounts which cannot be justified by cost savings to the seller, either because he has never computed his savings¹⁰ and, therefore, is not prepared to offer substantiating data, or because the discount, if computed, is not commensurate with cost savings.

B. *Provisions of the Robinson-Patman Act*

The Robinson-Patman Act of 1936 was passed to amend section 2 of the Clayton Act.¹¹ Section 1 provides, in part, as follows:

"That it shall be unlawful for any person engaged in commerce . . . to discriminate in price between purchasers of commodities of like grade and quality . . . 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: *Provided*, that nothing herein contained shall prevent differentials which make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered."

The act posed questions of fundamental importance to the functional discount.¹² Unlike the Clayton Act, the new law applied to every transaction in interstate commerce, for no longer was it essential to show that a practice might "substantially lessen competition or tend to create a monopoly";¹³ it was enough that a single sale might prevent competition in some measure. Thus, the scope of regulation was expanded to include the activities of small business units as well as large. In addition, by referring to customers of either party to the transaction, Congress clearly manifested a purpose to search for and prevent ad-

⁹ McNair, "Marketing Functions and Costs and the Robinson-Patman Act," 4 *LAW AND CONTEMP. PROB.* 334 at 347 (1937).

¹⁰ *Id.* at 347-8, for factors which tend to deter the businessman from computing his cost savings.

¹¹ 38 Stat. L. 730 (1914), 15 U. S. C. (1946) § 12.

¹² See Thorp & George, "Check List of Possible Effects of the Robinson-Patman Act," 44 *DUN & BRADSTREET* 2 at 17 (1936) for an excellent early analysis of the potential effect of the act on functional discounts.

¹³ Clayton Act, 38 Stat. L. 730 (1914), 15 U. S. C. (1946) §2.

verse effects on three levels of distribution. Inasmuch as the impact of the functional discount was usually felt on levels below that of the seller, this provision of the act was highly significant.

On the other hand, the old section 2 of the Clayton Act had not disturbed the granting of functional discounts;¹⁴ therefore, argument could quite properly be made that Congress, by not expressly outlawing the practice, had adopted a policy of non-interference. There was doubt whether the courts would proscribe a firmly established marketing custom unless the mandate from the legislature was clear and unequivocal.

C. *Application of the Robinson-Patman Act*

1. *The Early Cases*

The few early proceedings before the Federal Trade Commission involving trade discounts were reported mainly in terms of the results, leaving to conjecture the specific grounds on which the decisions were based. Nevertheless, certain conclusions as to commission policy can be drawn from a survey of the cases.

In considering *Matter of Hansen Inoculator Co.*,¹⁵ the commission condemned a practice where "salesmen sell at varying prices which are not related to savings in cost of production, sale, or delivery or functions performed by the buyer in the resale of goods."¹⁶ Because the Robinson-Patman Act allows a differential which makes "due allowance for differences in the cost of manufacture, sale, or delivery," there was reason to believe that the commission had here indicated a willingness to add *function* as another legitimate basis for price differentials, although not expressly recognized in the statute.¹⁷ But the language of the commission could also be construed as limiting all discounts to demonstrable cost savings.

¹⁴ The cease and desist order directed to the Mennen Co., 4 F. T. C. 258 (1922), exemplified the Federal Trade Commission's contention that the functional discount conflicted with the Clayton Act. The order was set aside, however, in *Mennen Co. v. Federal Trade Commission*, (2d Cir. 1923) 288 F. 774, cert. den. 262 U.S. 759, 43 S.Ct. 705 (1923), the court interpreting the Clayton Act as requiring a showing of injury on the seller's level. This interpretation, as a practical matter precluding a close scrutiny of the functional discount, was overruled in *George Van Camp & Sons Co. v. American Can Co.*, 278 U.S. 245, 49 S.Ct. 112 (1929), a case not involving the functional discount. Notwithstanding the implications of the Van Camp decision, discounts to the trade continued unchallenged.

¹⁵ 26 F.T.C. 303 (1938).

¹⁶ *Id.* at 309 (Emphasis added).

¹⁷ In effect, this would be a reading into the act of the deleted portion quoted *supra* note 6.

The cease and desist order entered against the *Urbana Laboratories*¹⁸ threw considerable light on the ambiguity in the *Hansen* case. The respondent had sold goods of like grade and quality at various prices depending on his classification of customers. It appeared that certain dealers enjoying the wholesale discount were reselling at retail in competition with retailers supplied directly by the respondent at a higher price. The commission stated: "Where, in fact, jobbing services are rendered . . . nothing herein contained shall preclude jobber prices on that portion which is jobbed."¹⁹ Here the commission had conceded the legality of a price differential based solely on function. Apparently, a cost accounting justification was not required. Protection to competition would follow if customers were carefully classified on the basis of their further disposition of the goods.²⁰

Was the Robinson-Patman Act designed to affect the functional discount only to the extent of eliminating the abuses brought about by careless classification? The answer from the Federal Trade Commission seemed to be in the affirmative. The commission was fully aware that to require a cost justification would virtually spell the elimination of trade discounts because of the difficulty from an accounting standpoint of computing the savings, and because any saving that could be demonstrated would not be a true index of the wholesaler's usefulness.

The *Sherwin-Williams* case²¹ in 1943 lent support to the proposition that functional discounts were lawful without an examination of cost savings. *Sherwin-Williams* dealers frequently sold both to consumers and to other dealers. To determine the portion of goods on which the wholesale price was to be allowed, the company required monthly reports from its dealers showing total sales made by the dealers to other distributors. The commission did not disapprove this system.

However, subsidiaries of *Sherwin-Williams* were content to accept from their dealers a percentage estimate of the amount of their total sales which had been made to other distributors. Discounts were awarded on the basis of these representations. The commission showed

¹⁸ In the Matter of Albert L. Whiting and Lucille D. Whiting, Trading as the Urbana Laboratories, 26 F.T.C. 312 (1938).

¹⁹ Id. at 317.

²⁰ The use to which the buyer puts the goods was the test of function adopted in *Bird & Son, Inc., Bird Floor Covering Sales Corporation, Montgomery Ward & Company, Inc.*, 25 F.T.C. 548 (1937). Congressman Patman favored a test predicated on the services performed by the buyer. PATMAN, *THE ROBINSON-PATMAN ACT* 165 (1938).

²¹ *The Sherwin-Williams Co., The Lowe Brothers Co., and John Lucas & Co., Inc.*, 36 F.T.C. 25 (1943).

that the wholesale discount had been given on large quantities of goods which were sold directly at retail by the dealers. The loose system of awarding functional discounts, as used by the subsidiaries, was struck down by the commission.

The lesson taught by the *Sherwin-Williams* case was that a wholesaler's functional discount will not be disturbed if awarded according to a system reasonably calculated to insure that a dealer will not receive the wholesaler's discount on goods he sells at retail. The commission did not indicate any desire to probe into the value of the wholesale service.

2. *The Standard Oil Case*

The recent case of *Standard Oil Co. v. Federal Trade Commission*²² reveals that the earlier cases had not fully rounded out the law of functional discounts and price discrimination.

Standard Oil Company sold gasoline directly to service station dealers at a "tank wagon" price. It also sold large quantities of gasoline in the same area at a lower "tank car" price to customers whom it classified as jobbers. To qualify for the jobber price, a dealer was required to own and operate his own bulk plant, maintain a certain high volume of business, have proper financial standing, and be equipped to handle tank car deliveries. Citrin was one of three jobbers who sold both to retailers and to the public. In its sales to retailers, Citrin granted a price lower than the tank wagon price which Standard charged retailers to whom it sold directly. In effect, Citrin was passing on to its retailers part of the jobber discount. A fourth jobber sold exclusively at retail through its own service stations. Because of the price differential, which Standard was not able to justify on the basis of cost savings,²³ the jobbers and those dealers supplied by Citrin were able to sell at retail at lower prices than the retailers who bought directly from Standard.

It was not surprising, in view of the earlier cases, that Standard was ordered to revamp its pricing system so that wholesaler discounts would be given only on gasoline resold to retail dealers. But the order

²² (7th Cir. 1949) 173 F. (2d) 210 affirming *Matter of Standard Oil Co.*, 41 F.T.C. 263 (1945) and 43 F.T.C. 56 (1946). At the time of this writing, the case is before the Supreme Court on appeal, the major issue being whether §2(b) of the Robinson-Patman amendment provides a seller with a substantive defense when his lower price to a purchaser is made in good faith to meet the equally low price of a competitor.

²³ It is difficult to believe that Standard realized no cost savings by dealing with the jobbers, but the company was not able to adduce accounting data to establish satisfactorily any cost justification.

of the commission, as modified by the court of appeals, went further. Standard was forbidden to grant discounts to bona fide wholesalers where there was reason to believe that part of the discount would be passed on to retailers.²⁴

The earlier cases had assumed that competition would be protected if the wholesale discount was scrupulously restricted to goods which were later sold to retailers. The *Standard Oil* case delved into the fundamentals; injury to competition was an overriding test. If injury was likely to continue despite future careful classification, then the commission would insist that functional discounts be limited to those wholesalers who were willing to sell the goods to retail dealers at the same price which the producer charged its own retailer customers.²⁵

The *Standard Oil* case can hardly be taken as a departure from previous commission interpretations of the Robinson-Patman Act with respect to the functional discount. The earlier cases applied the test of proper classification only as a means to the ultimate end—prevention of injury to competition.²⁶ The cases did not hold that proper classification of itself would insure the legality of a functional discount.

The unprecedented order restraining Standard from selling at discount to wholesalers who might be expected to pass on the discount to retailers is an effort to achieve the purpose of the Robinson-Patman Act in an area where the economics of competition would seem to require a strict regulation of the producer's pricing policy. The volume of gasoline consumption in a given area is static, since it is governed

²⁴ By paragraph 6 of the order, as modified by the court, Standard was ordered to cease and desist from discriminating in price: "By selling such gasoline to any jobber or wholesaler at a price lower than the price which respondent charges its retailer-customers who in fact compete in the sale and distribution of such gasoline with the retailer-customers of such jobbers or wholesalers, where such jobber or wholesaler, to the knowledge of the respondent or under such circumstances as are reasonably calculated to impute knowledge to the respondent, resells such gasoline or intends to resell the same to any of its said retailer-customers at less than respondent's posted tank-wagon price. . . ." Page 217 of the report.

Consider in this connection Congressman Patman's opinion in answer to a hypothetical case similar to the *Standard Oil* case: "A manufacturer may establish functional discounts without direct reference to costs, but there is attached to that freedom the moral and legal responsibility to see that competition is preserved at the retail point of sale." PATMAN, *THE ROBINSON-PATMAN ACT* 169 (1938).

²⁵ The court was satisfied that Standard would be able to comply with this aspect of the order through exercise of its right to choose its customers. Page 217 of the report. Standard is now urging that the order requires it to establish price maintenance programs of questionable legality. *Standard Oil Co. Petition for Writ of Certiorari*, p. 10.

²⁶ The proper classification test rests on the theory that a difference in the prices quoted to wholesaler and retailer, though cognizable under the Robinson-Patman Act, is not prohibited thereunder because no deleterious effect on competition can result, since the wholesaler and retailer do not compete for the same customers.

by the number of automobiles in operation.²⁷ A dealer who can acquire the same brand of gasoline at a price below that of his competitors is given the means of increasing his own volume of sales. An increase of business to the favored dealer means a corresponding decrease to others. A small reduction in the retail selling price of gasoline by one dealer will attract considerable trade to his station, but it will not effect an increase in consumer use. In addition to the static nature of the demand, gasoline selling was considered to be a business where price is far more potent in attracting the consumer than any of the usual techniques of salesmanship. These somewhat unique considerations prompted the Federal Trade Commission in its refusal to apply proper classification as a sole test in the *Standard Oil* case.²⁸

Conclusion

Ordinarily, the Robinson-Patman Act will not invalidate functional discounts which are awarded according to a careful classification of customers on the basis of their further disposition of the goods. However, this rule has application only to those cases where competitive injury can be eliminated, or rendered negligible, through careful classification. The degree of injury to competition proscribed by the act will still exist, despite careful classification, in businesses where the consumer demand is static and a lower price to a favored retailer has the effect of giving him an insurmountable competitive advantage. In such a case, a producer who sells to both wholesalers and retailers will be required to take note of the price at which his wholesalers sell to

²⁷ See page 21 of the Federal Trade Commission's brief in the U.S. Court of Appeals for the Seventh Circuit. For a study of factors which shape the pricing policies of large gasoline distributors in a semi-integrated company, selling to dealers as a jobber and to consumers as a retailer, see Learned, "Pricing of Gasoline: A Case Study," 26 *HARV. BUS. REV.* 723 (1948).

²⁸ The *Standard Oil* case suggests ramifications affecting other marketing situations. For example, where a producer, dealing exclusively with wholesalers, desires to quote a lower price to one of his wholesaler customers in order to meet competition for that wholesaler's patronage, the legality of the producer's action may depend on whether the favored wholesaler can be expected to choose to enjoy a larger margin of profit, in preference to reducing the price to his retailer customers. If the favored wholesaler prefers to expand his volume of sales by passing on the benefit of his lower buying price, the stage will be set for a finding of injury to competition on both the wholesale and retail levels traceable to the sale by the producer.

The *Standard Oil* case is an apt illustration of the economic postulates on which the Robinson-Patman Act is based. Pure competition is deemed to be undesirable because it is self-destructive. Some degree of restraint on the freedom of competition is considered necessary to achieve a maximum public benefit. The immediate benefit accruing to the public when a jobber discount is passed on to the retailer must be balanced against the public interest in preserving the existence of competing retailers.

their retailers who compete with the producer's own retailer customers. If the wholesaler is passing on to his retailers part of the wholesaler's discount, then the producer must stop granting the functional discount to the wholesaler.²⁹

Charles Myneder, S.Ed.

²⁹ For further reading on the subject of functional discounts, see Bayly, "Four Years under the Robinson-Patman Act," 25 MINN. L. REV. 131 at 156 (1941); Shniderman, "The Tyranny of Labels—A Study of Functional Discounts under the Robinson-Patman Act," 60 HARV. L. REV. 571 (1947); Bartenstein, "Functional Discounts under the Robinson-Patman Act," 4 WASH. AND LEE L. REV. 121 (1947).
