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TRADING STAMPS: UNFAIR COMPETITION?

The inherent conflict between monopoly and a system of fair competition is found at the core of many economic questions. Recently this has been demonstrated by the increase in litigation concerning the question of whether the giving of trading stamps violates minimum price level provisions of state fair trade acts and state unfair practices acts.¹

State fair trade acts provide that when a manufacturer and a retailer enter into a resale price contract establishing a minimum price below which the retailer cannot sell, all other retailers in the state who have notice of this contract are prohibited from selling below this price.² State unfair practices acts, also known as sale below cost acts,

¹ The giving of trading stamps is a common practice in commercial transactions. This practice has grown in recent years until it has become a lucrative business, giving rise to several large stamp companies. It is used extensively in many large chain stores, and has become as popular with merchants as it has with housewives. It also has become popular with the courts. The Pennsylvania Law Review, which quoted the Wall Street Journal, summed it up this way, "Assailed by some as a costly device that raises family food bills and hotly defended by others as a perfectly legal promotional tool, trading stamps have become a center of controversy in the merchandising field. Though stamp plans have enjoyed a rapid upsurge since World War II, the idea itself is over fifty years old." Note, 105 U. Pa. L. Rev. 242 (1956).

The economic advantages of offering trading stamps are as hotly debated as their legality. Those arguing for trading stamps point out that the stamps result in an increase in business for the retailer; that, therefore, the retailer has a lower unit cost with rising profits, and can more than adequately cover the cost of the stamp plan; that the consumer can obtain a wide choice of merchandise without having to make a cash outlay; and that because trading stamps create a large demand, manufacturers and eventually the entire economy will benefit. Those arguing against trading stamps point out that while the first retailer in an area may enjoy a temporary increase in business, soon most other retailers in that area adopt stamps, and after the demand eventually returns to normal these retailers must continue using stamps to maintain business they formerly had; that stamps are therefore just another item of cost which results in lower profits to the retailer or higher prices to the consumer; and that the consumer does not get a large choice of merchandise because the goods are usually things he doesn't need or want. According to most surveys taken, those stores which offer stamps have the same retail prices as those stores which do not offer them. This is partially explained by the idea that many retailers purchase stamps with funds already earmarked for advertising. Charvat, *The Economics of Trading Stamps*, 7 J. Pub. L. 450 (1958).

² State legislative sanction, known as fair trade legislation, was first given to resale price maintenance agreements in California in 1931. Cal. Stat. ch. 260 (1933), as amended, Cal. Bus. & Prof. Code §§16900-05. These acts were upheld by the United States Supreme Court in 1936 in so far as the goods were strictly in intrastate commerce. *Old Dearborn Distrib. Co. v. Seagram Distillers Corp.*, 229 U.S. 183 (1936). By 1941 all but four states had enacted fair trade statutes based on the California model. 1 Trade Reg. Rep. §3075 (1960). These resale price contracts can be enforced against retailers who are not a party to the contract because nonsigner provisions were included in most state fair trade laws. Typical of these nonsigner provisions is Ohio Rev. Code §1333.07 (1953), which provides that "whoever knowingly and wilfully advertises, offers for sale or sells any commodity at less than the minimum price stipulated in any contract entered into under section 1333.06 of the Revised Code, whether such person is or is

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provide that no person engaged in business shall sell, offer for sale or advertise for sale any product at less than cost for the purpose of injuring a competitor and destroying competition.³ While unfair practices acts apply to all goods traded freely on the open market, fair trade acts apply only to those goods bearing the trade mark of the manufacturer.⁴ These two types of acts have one common provision; they establish a minimum price below which a product cannot be sold. The basic issue⁵ involved in trading stamp litigation is: Does the giving of trading stamps with merchandise sold at a minimum level result in a sale below the minimum established by a resale price contract in violation of fair trade acts, or result in a sale below cost in violation of unfair practices acts?

Since most goods are sold at a profit, the giving of trading stamps with merchandise priced at a minimum level is not a frequent com-

(Footnote continued from preceding page)

not a party to such a contract, is engaging in unfair competition and unfair trade practices and is liable to any person damaged thereby." A number of states, however, have held these nonsigner provisions unconstitutional. *E.g.*, *Arkansas—Union Carbide & Carbon Corp. v. White River Distrib.*, 224 Ark. 558, 275 S.W.2d 455 (1955); *Florida—Liquor Store, Inc. v. Continental Distilling Corp.*, 40 So. 2d 371 (Fla. 1949); *Michigan—Shakespeare Co. v. Lippman's Tool Shop Sporting Goods Co.*, 334 Mich. 109, 54 N.W.2d 268 (1952).

Since 1911, resale price maintenance contracts on goods traveling in interstate commerce were illegal. *Miles Medical Co. v. Park & Sons*, 220 U.S. 373 (1911). But in 1937 Congress passed the Miller-Tydings Act, which enabled states to apply their resale price maintenance laws to products resold within the state's borders after moving in interstate commerce. 50 Stat. 693 (1937), 15 U.S.C. §1 (1952), amending the Sherman Act, 26 Stat. 209 (1890), 15 U.S.C. §§1-7 (1952). To overcome some difficulty remaining in operating fair trade laws on interstate commerce, Congress later passed the McGuire Act, which specifically exempts the nonsigner provisions from the operation of federal anti-trust laws and declares that fair trade laws are not a burden on interstate commerce. 66 Stat. 632 (1952), 15 U.S.C. §45(3) (1952).

³ For example, Ky. Rev. Stat. 365.030, provides that "no person engaged in business within this state shall sell, offer for sale or advertise for sale any article or product, or service or output of a service trade, at less than the cost thereof to such vendor, or give, offer to give or advertise the intent to give away any article or product, or service or output of a service trade, for the purpose of injuring competitors and destroying competition."

⁴ In 1947, Eastman Kodak Company had resale price contracts on its color film, but since Eastman Kodak was the only producer of such film, it was held that the film was not in "fair and open competition" with other products and the contracts were invalidated. Phillips and Duncan, *Marketing: Principles and Methods* 678 n.29 (1951).

⁵ There is another question of equal importance concerning the practice of giving trading stamps: Are those statutes which directly and unequivocally prohibit the giving of trading stamps unconstitutional? Some states, including Kentucky, have held such statutes unconstitutional, because no authority exists upon which they can be passed. They bear no relation to the general welfare because there is no concern for health, safety or morals, nor do they bear any relation to the prevention of fraud or deceit because the trading stamp practice is familiar to all. *Lawton v. Stewart Dry Goods Co.*, 197 Ky. 394, 247 S.W. 14 (1923); *Sperry & Hutchinson Co. v. McBride*, 307 Mass. 408, 30 N.E.2d 269 (1940). Wisconsin, however, has held that such a statute is a valid and reasonable exercise of the police power and not discriminatory, and therefore constitutional. *Schuster & Co. v. Steffes*, 238 Wis. 41, 295 N.W. 737 (1941).

mercial practice. This practice however, if upheld by the courts, can be used effectively by retailers who wish to lower prices to entice customers, and yet continue to comply with the minimum price levels established by these two acts. If this practice is not upheld and an injunction is issued, the restraint does not prohibit the giving of trading stamps except with a sale at a minimum price. While this affects only a small proportion of the trading stamp program, it deprives retailers of a very useful competitive practice.

JUDICIAL APPROACHES TO THE PROBLEM

Five states have based decisions on fair trade acts, three of which have ruled that the giving of trading stamps does not result in a sale below the minimum resale price.⁶ Three states have based decisions on unfair practices acts, unanimously ruling that the giving of trading stamps does not result in a sale below cost.⁷ These decisions turn on the solution of three main questions: (1) whether the practice of giving trading stamps should be treated as a cash discount, which according to standard accounting procedure does not result in a reduction in the purchase price; (2) whether the practice of giving trading stamps is a promotional device which does not result in a reduction in price; and (3) whether the practice of giving trading stamps results in a discount of such significance as to require judicial recognition.

The Cash Discount

Long before fair trade acts or unfair practices acts were adopted, the practice of giving trading stamps was held to be a cash discount.⁸ Now, as then, a cash discount is treated in standard accounting practice as a reward for prompt payment in cash which does not result in a

⁶ That the giving of trading stamps does not result in a sale below the minimum resale price level: *California*—Weco Prods. Co. v. Mid-City Cut Rate Drugs, 55 Cal. 2d 684, 131 P.2d 856 (1942); *New Hampshire*—Corning Glass Works v. Max Dichter Co., 161 A.2d 569 (N.H. 1960); *Pennsylvania*—Grever v. American Stores Co., 387 Pa. 206, 127 A.2d 694 (1956); *Bristol-Myers Co. v. Lit Bros.* 336 Pa. 81, 6 A.2d 843 (1939). That the giving of trading stamps does result in a sale below the minimum resale price level: *Massachusetts*—Colgate Palmolive Co. v. Elm Farm Foods Co., 148 N.E.2d 861 (Mass. 1958); *New York*—Bristol-Myers Co. v. Picker, 302 N.Y. 61, 96 N.E.2d 177 (1950).

⁷ *California*—Food & Grocery Bureau v. Garfield, 20 Cal. 2d 228, 125 P.2d 3 (1942); *New Jersey*—Sperry & Hutchinson Co. v. Margettes, 15 N.J. 203, 104 A.2d 310 (1954); *Oklahoma*—Safeway Stores v. Oklahoma-Retail Grocers Ass'n, 322 P.2d 179 (Okla. 1957). *Utah*—Utah Code, Commerce and Trade 13-5-9 amended Utah's Unfair Practices Act to make trading stamps a reduction of the selling price by the amount of such cash discount. Before this amendment, Utah courts consistently held that the giving of trading stamps with a sale at the minimum price was not violative of the Unfair Practices Act. *Trade Comm'n v. Bush*, 123 Utah 302, 259 P.2d 304 (1953); *State v. Holtgreve*, 58 Utah 563, 200 Pac. 894 (1921).

⁸ *Ex parte Hutchinson*, 137 Fed. 949 (C.C.N.D. Wash. 1904); *Winston v. Beeson*, 135 N.C. 271, 47 S.E. 457 (1904).

price reduction.⁹ In *Sperry & Hutchinson Co. v. Margettes*, a New Jersey court held that the giving of trading stamps results in a cash discount, which is "a term of payment merely, not a price adjustment; it is a mode of financing, not a reduction in the price."¹⁰ Similarly, in *Safeway Stores v. Oklahoma Retail Grocers Ass'n*, the court held that the giving of trading stamps is a cash discount, and based its decision on a rule of long standing that cash discounts are a cost of selling rather than a reduction in purchase price.¹¹

The treatment of trading stamps as a cash discount was attacked in *Colgate Palmolive Co. v. Max Dichter & Sons*.¹² The court pointed out that the giving of trading stamps operates as a trade discount as well as a cash discount. Trade discounts include quantity and quota discounts. While not defined by this court, a trade discount is usually described as a reduction in price given to a certain class of buyers for performing marketing functions.¹³ Thus a manufacturer may give a wholesaler a reduction in the list price because the manufacturer is spared the expense of making numerous small sales to retailers. A quantity discount is described as a reduction in price given to any buyer who purchases in large quantities. Because a trade discount or quantity discount is given to induce buyers to purchase in large quantities, the price is reduced before the sale is effected. This discount appears in the books as a reduction in the purchase price. In addition to trade and quantity discounts, the court mentioned the quota discount, which is usually described as a reduction in price given to any buyer who agrees to purchase a certain amount during a stated period. The price is reduced retroactively when purchases reach the agreed amount within the time period. Combining the features of the quantity and quota discounts, and labeling the combination a trade discount, the court was able to conclude that the giving of trading stamps results in a reduction in the purchase price. The court recognized in the trading stamp program features of the quantity discount, because a customer cannot redeem his stamps book for merchandise until it is filled with stamps, and to accomplish this the holder must make numerous small or several large purchases. The court also recognized in the program features of the quota discount, because the customer receives his discount retroactively, only when he has collected the requisite number of stamps.¹⁴ This holding is weak, however, because the court went

⁹ Montgomery, *Auditing Theory and Practice* 499-500 (2d ed. 1918).

¹⁰ 15 N.J. 203, 104 A.2d 310, 312 (1954).

¹¹ 322 P.2d 179 (Okla. 1957).

¹² 142 F. Supp. 545 (D. Mass. 1956).

¹³ Phillips & Duncan, *op. cit. supra* note 4, at 669.

¹⁴ *Colgate Palmolive Co. v. Max Dichter & Sons*, 142 F. Supp. 545 (D. Mass. 1956).

beyond the usual definition of quantity discount. This type of discount is usually restricted to transactions involving large purchases of one particular article. Because trading stamps are given on many articles at the same time, the label, quantity discount, is inaccurately applied.

By debating whether the giving of trading stamps is a cash discount which may result in a reduction in the purchase price, courts have become unduly involved with accounting procedure. This is unfortunate because accounting procedure has the primary purpose of obtaining uniformity in the recording of business transactions, and this purpose bears no relation to the question of whether the giving of trading stamps results in a reduction below a minimum price level. By looking to accounting procedure, courts ultimately decide the trading stamp issue solely upon the bookkeeping methods used by the business issuing stamps. For example, if a stamp worth one cent is given with a one-dollar purchase the seller can enter the sale at one dollar and show the offset of one cent under expenses, which would not be a reduction in price. Another seller can enter the sale at ninety-nine cents, which would be a reduction in price. Labelling the stamps a "cash discount" or a "trade discount" should not be the basis of decision, for the result in each case would depend entirely upon how the seller keeps his books.

The Promotional Device

The use of trading stamps has been justified as a promotional device designed to attract customers. One court¹⁵ compared the trading stamp program to such commonly employed devices as free parking and free delivery service. These devices do not violate fair trade and unfair practices acts even though they result in a monetary benefit to the consumer. Trading stamps, like free parking and delivery service, are given on a lump sum basis for all articles purchased and bear no relation to the value of a particular article. But trading stamps do differ from free parking and free delivery service. Actually, a closer analogy can be drawn to "loss leader" selling, which is an illegal promotional device. This is the sale of an article below the minimum resale price or below cost to attract customers who while purchasing that article may purchase others. Trading stamps are issued on a percentage basis, thereby establishing a direct relationship between the value of the stamps and the cost of an article. Similarly, in a loss leader sale the price of an article is directly reduced. A direct relationship exists between the value of the discount the customer receives and the cost of the article.

¹⁵ *Weco Prods. Co. v. Mid-City Cut Rate Drug Stores*, 55 Cal. 2d 684, 131 P.2d 856 (1942).

The De Minimus Argument

Pennsylvania courts¹⁶ have held that trading stamps do not violate minimum price levels because of the insignificance of the discount. The court recognized that a trading stamp usually results in a discount of no more than one cent on a dollar. The decision was based on the maxim, *de minimus non curat lex*, that courts do not consider insignificant matters. But in view of the magnitude of the trading stamp business, the *de minimus* argument is nothing more than a fiction employed to evade the issues involved. If the value of a stamp or the value of the merchandise received for the stamp should increase, when would the discount become significant?

LEGISLATIVE INTENT

Unfortunately most courts decided the trading stamp issue without looking to the intent of the legislature in passing these two acts.¹⁷

The reason given for adopting the fair trade acts is to protect the good name of the manufacturer.¹⁸ If trade-marked products are sold at a very low price, the consumer will infer that these products are inferior. It is doubtful, however, that any sale at a reduced level will destroy the good name of the manufacturer, and more doubtful that the nominal reduction in price effected by the giving of a stamp will similarly discredit the product.

Although the stated purpose of these acts is to protect the good name of the manufacturer, the real purpose is to allow manufacturers or retailers to set prices and control retail competition.¹⁹ The fair trade acts began to appear as a result of lobbying by one main pressure group.²⁰ The National Association of Retail Druggists mobilized political opinion and pushed fair trade acts through most state legislatures before organized resistance could develop.²¹ Anti-trust legislation

¹⁶ *Gever v. American Stores Co.*, 387 Pa. 206, 127 A.2d 694 (1956); *Bristol-Myers v. Lit Bros.*, 336 Pa. 81, 6 A.2d 843 (1939).

¹⁷ One court did look to the legislative intent. *Bristol-Myers Co. v. Picker*, 302 N.Y. 61, 96 N.E.2d 177 (1950). Although the dissenting judge in the *Safeway* case stated that he was concerned with the meaning of the Oklahoma Unfair Practices Act as intended by the legislature, he based his dissent upon the literal wording of the act, pointing out that the act in no way authorizes discounts for cash in retail sales. *Safeway Stores v. Oklahoma Retail Grocers Ass'n*, 322 P.2d 179, 187 (Okla. 1957).

¹⁸ Lynch, *The Concentration of Economic Power* 144 (1946).

¹⁹ *Ibid.*

²⁰ *Ibid.*

²¹ Federal legislation was also obtained in this same manner. The Miller-Tydings Act was passed as a rider to the District of Columbia appropriation bill. At this time, President Roosevelt indicated that he would have vetoed it had it been a separate bill. This Miller-Tydings Act repealed part of the Sherman Anti-Trust Act. Until passage of the state fair trade acts all price fixing agreements

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prohibits retailers from entering into price-fixing agreements among themselves. This is known as horizontal price-fixing. After fair trade acts were adopted, a retailer could accomplish the same result by entering into an agreement with a manufacturer who could enforce the agreement on all other retailers in the state. This practice is known as vertical price-fixing. Thus the fair trade acts give retailers legislative warrant to do vertically what is forbidden horizontally.²²

The unfair practices acts developed contemporaneously with the fair trade acts.²³ The reason given for adopting the unfair practices acts is to protect merchants from cut-throat competition. Passed during the depression of the 1930's, these acts were designed to protect merchants from being "squeezed out" by large retailers.²⁴ Most of these acts require an intent to injure competitors and destroy competition.²⁵ Specifically, the acts are intended to prevent the "loss leader" type of sale.²⁶ Trading stamps, however, do not fall within the classification of "cut-throat" competitive practices; they are not offered with an intent to injure competitors and destroy competition. Although these acts have the stated purpose of prohibiting cut-throat competition, their effect is to restrict all low-level competitive pricing by requiring all businesses to observe a price minimum on any article.

The purpose of the above discussion is not to launch an attack on these two acts, but to demonstrate that they are designed to discourage, rather than encourage competition. To limit competition further by prohibiting trading stamps only compounds this error. It seems obvious that the small businesses that have instigated trading stamp litigation are hiding behind these two acts to escape competition. Faced with the ever increasing popularity of trading stamps, these merchants fear the loss of customers and the profits that accompany them. While these merchants should be protected, they should not be given immunity from all business competition. Competition is the life of the trade. No statute should be interpreted to outlaw it; no public policy is sound which stifles it.

The Kentucky Court of Appeals recently had the opportunity to debate the merits of certain provisions of our fair trade act.²⁷ It did not have the opportunity to decide this particular trading stamp issue.

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were illegal. With passage of this amendment all retailers and manufacturers who entered into resale price maintenance contracts under authority of state fair trade acts were exempt from prosecution. Lynch, *op. cit. supra* note 18, at 149.

²² Lynch, *op. cit. supra* note 18, at 145.

²³ Grether, *Price Control Under Fair Trade Legislation* 36 (1939).

²⁴ Phillips and Duncan, *op. cit. supra* note 13, at 683.

²⁵ See, e.g., Ky. Rev. Stat. 365.030.

²⁶ Grether, *op. cit. supra* note 23, at 32-33.

²⁷ General Elec. Co. v. American Buyers Coop., 316 S.W.2d 354 (Ky. 1958).

When this opportunity is presented, the court should weigh fully the basic policy conflict involved, monopoly versus a system of fair competition, and reconsider a statement recently made by the court in discussing another aspect of the fair trade act:

Our Bill of rights declares as one of "the great and essential principles of liberty and free government" and as "inherent and inalienable the right of acquiring and protecting property." This is free enterprise. Our economic system is founded upon competition—the "life of trade." It is an established principle that the constitutional guaranty of the right of property protects it not only from confiscation by legislative edicts and from the physical taking for public or private use, but also from any unjustifiable impairment or abridgement of this right, such as depriving the owner of any of its essential attributes or such as restricts or interrupts its common, necessary or profitable use.²⁸

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²⁸ *Id.* at 360.