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RESALE PRICE MAINTENANCE – A THREAT TO FREE COMPETITION

By Robert M. Ague, Jr.*

WITH increasing alarm I have observed the proponents of a so-called Federal "fair trade" bill gain strength and the support of many of our legislators. Since such measures would be extremely unpopular if the public were aware of their true ramifications, recent bills proposed to curb price competition have been given little publicity outside Washington. However, several of these bills were introduced at the last session of Congress and one was favorably reported out of Committee.[1] Since the author has been informally advised that a revised version of the favorably reported bill will be introduced at the next session of Congress (and, incidentally, is said to have a very good chance of passage), a critical analysis of it will be attempted in this paper. A brief review of the history of resale price maintenance or the so-called "fair trade" concept will also be presented.

The term "fair trade" is a misnomer. No thinking individual is in favor of "unfair trade", and any consumer who understands that a "fair trade" bill will mean higher prices for the commodities he purchases would not favor "fair trade" either. It has been suggested that the term be retired and the term "Dealer Security Program" be substituted for it.[2] An analysis of the features of resale price maintenance or "fair trade" laws will demonstrate that this is a more accurate term, since they are designed to prevent dealers who are able, because of sound business practices, to pass on savings to the consumer through lower prices, from doing so.

The salient provisions of a "fair trade" bill are: [3]

1. They apply only to goods sold under a brand name and in competition with other goods of the same general class.
2. They authorize agreements not to resell "at less than the price stipulated," or "except at the price stipulated." The stipulated price is usually a minimum price, but may be either a maximum or a minimum.

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[1] H.R. 10527, 85th Congress, 2d Session, entitled a bill "To Amend The Federal Trade Commission Act, as amended, so as to equalize rights in the distribution of identified merchandise."

[2] H. M. Myers, *Let's Get Tough on Fair Trade,* Photo Dealer, December, 1955.

[3] Alexander, Ralph S.; Surface, Frank M.; and Alderson, Wroe; MARKETING, p. 662 (1953).

3. They legalize contracts whereby (a) a producer or distributor may require a retailer to resell at a stipulated retail price; (b) a producer or primary distributor may require a wholesaler to maintain a fixed wholesale price and to sell only to retailers who agree to resell at the designated retail price; (c) a wholesaler may require a retailer to maintain a stipulated retail price.
4. When the manufacturer of an article has fixed its price by a contract or contracts such as above described, any dealer who having been notified of such action, sells it at less than the designated price is guilty of unfair trading, whether or not he is a party to such agreement. This means that retailers who refuse to sign such contracts must, nevertheless, sell at stipulated prices.
5. Transactions involving certain types of goods or executed under certain conditions are exempted from the provisions of the law, such as the disposal of damaged goods, *bona fide* closing-out sales, and sales under court order.

Resale price maintenance laws have been a part of the American marketing scene since the depression days of the 1930's. However, extension of the old common law doctrines on restraint of trade to include contracts providing for maintenance of resale prices at a stipulated level was a development of law which had its beginning long before the enactment of state "fair trade" laws in the 1930's. Certain contracts attempting to stipulate prices had been held valid under the common law, while still others had been held invalid. Consideration of selected leading Supreme Court decisions provides a background against which to consider the proposed legislation.

The question of price maintenance appears to have arisen first in 1889 in the case of *Fowle v. Park.*[4] In that case the inventor of a certain remedy contracted with two different parties permitting them to manufacture the remedy under his secret formula and to sell it in certain territories. The contracts contained a stipulated minimum price below which the remedy was not to be sold. Plaintiff brought an action for breach of the territory and price provisions of the contract.

The Supreme Court held that in cases of this kind the public welfare was to be considered first. If the public welfare was not involved and the restraint upon one party was not greater than protection of the other required, the contract might be sustained. The question, the Court said, was whether or not the contract was reasonable. In this case the Court held that it was, saying:

> Relating as these contracts did to a compound involving a secret in its preparation; based as they were upon a valuable consideration, and limited as to space within which, though unlimited as to time for which, the restraint was to operate, we are unable to perceive how they could be regarded as so unreasonable as to justify the court in declining to enforce them. The vendors were

[4] 131 U.S. 88 (1889).

> entitled to sell to the best advantage, and in so doing to exercise the right to preclude themselves from entering into competition with those who purchased, and to prevent competition between purchasers; and the purchasers were entitled to such protection as was reasonably necessary for their benefit. . . . The policy of the law is to encourage useful discoveries by securing their fruits to those who make them. . . .

Three years later the problem of price maintenance involving a patented article was passed upon by the Supreme Court in the case of *Bemont v. National Harrow Co.*[5] The owner of a patented soil cultivating implement licensed certain manufacturers to use the patent under certain restrictions, which included an agreement not to sell the article at a lower price or on more favorable terms than prescribed by the licensor. The Court was called upon to determine the validity of certain contract provisions when the defendant violated the conditions. The action was sustained and the price restriction explicitly approved.

The Court said:

> The very object of these [patent] laws is monopoly, and the rule is, with few exceptions, that any conditions which are not in their very nature illegal with regard to this kind of property, imposed by the patentee and agreed to by the licensee for the right to manufacture or use or sell the article, will be upheld by the courts. The fact that the conditions in the contracts keep up the monopoly or fix prices does not render them illegal.

and again:

> The owner of a patented article can, of course, charge such price as he may choose, and the owner of a patent may assign it or sell the right to manufacture and sell the article patented upon the condition that the assignee shall charge a certain amount for such article.

It is important to note here that these cases involved the sale or lease of the intangible secret formula or patent right, not just of the tangible article itself.

After a series of cases propounding varying aspects of the problem, the Supreme Court decided the case of *Dr. Miles Medical Co. v. Park & Sons Co.*[6] In this case the complainant, Dr. Miles Medical Co., manufacturers of proprietary medicines under secret formulae, sought to maintain minimum prices, both wholesale and retail, upon all sales of medicines. To accomplish this Dr. Miles entered into so-called "Consignment Contracts—Wholesale" with over 400 jobbers and wholesale dealers, and into so-called "Retail Agency Contracts" with 25,000 retail dealers in the United States. The circumstances dif-

[5] 186 U.S. 70 (1892).
[6] 220 U.S. 373 (1911).

fered here in that Dr. Miles' system purported to make the wholesale and retail distributors its agents. In addition, the questions concerned not the sale of the secret process or patent information, but the sale of the manufactured product solely.

In the *Miles* case, the defendant, Park & Sons Co., a wholesale drug concern that had refused to enter into the contract the Miles Company required, was charged with inducing Miles' dealers to violate their contracts and sell the preparations to defendant. The principal question for decision by the United States Supreme Court, according to the opinion rendered, concerned the validity of the restrictive agreements or contracts.

With respect to the so-called retail agency contracts, the Court held that they were clearly agreements looking to sale and not to agency; that the so-called retail agents were not really agents, but were contemplated purchasers who bought from the Miles' system to sell again as retail dealers. The contracts, which constituted a system of interlocking restrictions by which Miles sought to control, not merely the prices at which its agents might sell its products, but, the prices for all sales by all dealers, wholesale and retail, whether purchasers or sub-purchasers, thus eliminating competition, were held to be in restraint of both interstate and intrastate trade. The Court rejected Miles' contention that the contract restrictions were neither invalid at common law nor under the Sherman Act [7] because they related to proprietary medicines manufactured under a secret process. The Court said that, while the process-owner was "entitled to be protected against invasion of its right in the process by fraud or by breach of trust or contract" and while the "secret process [might] be the subject of confidential communication and of sale or license to use with restrictions as to territory and prices. . .," [8] such circumstances related to the process of manufacture and not to the manufactured product as in this case.

The Court went on to hold that general restraints upon alienation are invalid as obnoxious to public policy; a manufacturer cannot, "by rule and notice, in the absence of contract or statutory right, even though the restriction be known to purchasers, fix prices for future sales." The first consideration remains the public interest, said the Court, and restraints are sustained only if found reasonable, both with respect to the public and to the parties, and only if limited to what is fairly necessary for the protection of the covenantee, in the circumstances of the particular case.[9]

[7] 15 U.S. Code 1 (1890).
[8] Dr. Miles Medical Co. v. Park & Sons Co., *supra,* p. 402.
[9] *Id.* at 406.

Shortly after the Supreme Court's decision in the *Miles* case, demand arose from certain quarters for the passage of a Federal Act legalizing resale price maintenance contracts covering articles sold in interstate commerce. From this time until 1933 when the National Recovery Act was passed advocates of resale price maintenance exerted pressure on Congress for the passage of such legislation. Because under the National Recovery Act retail codes established resale prices, no further concerted attempts were made for passage of this type of Act until the National Recovery Act was declared unconstitutional by the Supreme Court on May 27, 1935.[10]

Again the clamor arose from some self-serving groups for a Federal Act legalizing resale price maintenance contracts. During the hearings on the bills introduced, several members of Congress suggested that the best way to curb price competition might be through State Fair Trade laws. State laws were passed, and after the United States Supreme Court decided the *Old Dearborn* case,[11] there was no question that these laws legalized resale price maintenance contracts between producers and distributors when the goods in question were produced and sold within the same State. But these laws could not be given extra-territorial effect, and a producer who desired to have an interstate operation either had to risk Federal prosecution or assume the expense of incorporating a selling company in each of the respective States.

This was the state of the law in 1937 when the Seventy-fifth Congress was in session. Attempts to pass a Federal Act had been thwarted when President Roosevelt requested that consideration of such legislation be postponed until the matter could be more fully explored. Toward the close of the session H. R. 7472, providing for revenue for the District of Columbia, passed the House and was sent to committee in the Senate. The committee favorably reported the bill, but attached as an unrelated "rider" clause an amendment to the Sherman Act legalizing resale price maintenance contracts providing the State in which the goods were resold had legalized this type of contract. The Act was specifically made applicable to the Federal Trade Commission Act. The bill, after conference amendment to the "rider", passed both the House and the Senate. Since the date was August 17, six weeks after the beginning of the fiscal year, and the appropriation for the District of Columbia was badly needed, President Roosevelt signed the bill. However, when he did he issued a statement denouncing the practice of attaching extraneous "rider" clauses to bills, and expressing fear that the bill would lead

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[10] A.L.A. Schechter Poultry Corp. v. United States, 295 U.S. 495 (1935).

[11] Old Dearborn Distributing Co. v. Seagram-Distillers Corp., 299 U.S. 183 (1936).

to higher prices for consumers. In this way the Miller-Tydings Act [12] became the law of the land.

In 1945 the Federal Trade Commission completed an exhaustive study on resale price maintenance and submitted to Congress an 872 page report. The conclusions reached are far too long and detailed to discuss here, but, speaking quite generally, the Commission found that resale price maintenance was unsound economically, tended to destroy competition, and, at least in certain areas, favored the large concerns. In addition, the report was critical of the Miller-Tydings Act.

That brings us to the next step in our consideration. It should be noted that the Miller-Tydings Act is only an exemption law, and has no effect unless the described contract is legal as applied to intrastate transactions under any statute, law or public policy in effect in any State, territory or the District of Columbia. Moreover, the Act encompasses only those who are parties to the resale price maintenance contracts.

Until May 21, 1951, however, the exercise of the right granted by State fair trade laws to enforce fair trade prices against persons who had not signed the contracts, where interstate commerce was involved, had not been thoroughly reviewed by the courts. On that date in the case of *Schwegmann Bros., et al. v. Calvert Distillers Corp.*,[13] the Supreme Court held that the exemption in the Miller-Tydings Act extended only to the making of fair trade contracts and did not legalize the efforts of persons fair trading commodities to impose their prices on persons not party to the contracts. The Court said, therefore, that the exercise of this right, when interstate commerce was involved, was not protected by the exemption in the act.

It was primarily this leading decision by the Supreme Court that led to the enactment of the Federal Fair Trade or McGuire Act [14] on July 14, 1952. Although the McGuire Act, which amends the Federal Trade Commission Act, is in many respects similar to the Miller-Tydings Act, the McGuire Act is much broader in scope. Its exemptions extend to any of the antitrust acts, while the Miller-Tydings Act exempts only those transactions arising out of the Sherman Act or the Federal Trade Commission Act. In addition, the McGuire Act relates to contracts prescribing both minimum and stipulated prices, whereas the Miller-Tydings bill only relates to minimum prices. Moreover, to overcome the *Schwegmann* decision, the McGuire Act declares that it is not unlawful to exercise or enforce the unfair competition provision of any

[12] 15 U.S. Code 1 (1937).
[13] 341 U.S. 384 (1951).
[14] 15 U.S. Code 45 (1952).

State or local "fair trade" law, thereby making it lawful under the Federal antitrust laws to compel non-contracting parties, by an action under State fair trade laws, to abide by fair trade prices established in the State.

When President Truman signed the McGuire bill into law he issued a statement which, in part, said:

> . . . I believe the "fair trade" laws do remove some competitive forces which should be retained in our progressive free enterprise economy.
>
> Accordingly, I believe we have not yet found the best solution for the problem this legislation is intended to solve, and I urge the Congress to make a thorough investigation of this field, including not only the "fair trade" laws, but the related problems of price discrimination and antitrust policy.

What has happened in the courts since the passage of the McGuire Act? The constitutionality of the Act has never been tested in the United States Supreme Court.[15] However, the highest courts in no fewer than fourteen states have held that their "fair trade" acts, as applied to non-signers, are unconstitutional. In four more states there are lower court decisions to the same effect, making a total of eighteen states where the non-signer aspect has been declared unconstitutional. Since three states and the District of Columbia have no fair trade laws, and in nine more states the laws have not been tested by the courts, these figures become even more significant. Moreover, courts in four states have declared their "fair trade" acts in general unconstitutional.

The reason given by most State Supreme Courts for holding "fair trade" law, as applied to non-signers, unconstitutional was that it violated the due process clause of the State constitution. Among other reasons given for its unconstitutionality were that it was an unlawful delegation of legislative power to private persons, and granted to a certain class of citizens privileges which did not equally belong to all citizens. These are valid grounds; and since the due process clauses contained in most state constitutions are identical to, or modeled after, the due process clause in the United States Constitution, grave doubts arise as to the constitutionality of such a bill when tested by the Supreme Court.

The "seesaw game" between Congress and the Supreme Court is continued even now with Congress attempting to curb price competition and the Supreme Court attempting to preserve this aspect of our free competitive economy. The most recent "fair trade" bill proposed (and favorably reported

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[15] However, certiorari was denied by the Supreme Court in Schwegmann Brothers Giant Super Market v. Eli Lilly & Co., 205 F.2d 758 (1953); *cert. den.*, 346 U.S. 856 (1953).

out of Committee) was H. R. 10527. This measure is a "hodge-podge" of loose and confusing terms, so poorly drafted that, indeed, it is doubtful if it would accomplish its announced purpose of providing a Federal "fair trade" law. One section,[16] in pertinent part, provides as follows:

> It shall be lawful for a proprietor to establish and control by actual notice to his distributors stipulated or minimum resale prices of his merchandise in commerce which is in free and open competition with articles of the same general class produced by others. He may so establish schedules of resale prices differentiated with reference to any criteria not otherwise unlawful.

This language would appear to legalize the establishment of stipulated or minimum resale prices by means of a Federal statute without respect to State law. However, Section 5 (a) (2), in pertient part, provides:

> Nothing contained in this Act or in any of the Antitrust Acts shall render unlawful any notices provided in paragraph 5 of this subsection or any contracts or agreements prescribing minimum or stipulated prices, . . . for the resale of a commodity . . . *when notices, contracts or agreements of that description are lawful or effective as applied in intrastate transactions under any statute, law, or public policy now or hereafter in effect in any State, Territory, or the District of Columbia in which such resale is to be made or to which the commodity is to be transported for such resale.* (Emphasis supplied)

This is substantially identical to the language of 5 (a) (2) of the McGuire Amendments to the Federal Trade Commission Act. That subsection, presently in effect, provides, in substance, that agreements or contracts providing for minimum or stipulated prices for the resale of identified merchandise will not be unlawful under the Antitrust Acts when the State where the merchandise is to be resold or transported for such resale has a State "fair trade" law. It is difficult to see how the first quoted paragraph can be reconciled with the second. It cannot be determined whether the bill provides for a Federal "fair trade" law, is still dependent upon whether the State has such a law, or is designed to be effective only in those States where all or part of the State "fair trade" law has been held unconstitutional. Another subsection [17] is the same as the so-called "non-signer" paragraph of the McGuire Amendments. As previously pointed out, the non-signer aspect has been declared unconstitutional in the courts of some eighteen States. Moreover, the proposed bill requires no contract at all. The only interpretation the author can place on H. R. 10527 is that everybody is a "non-signer".

One section [18] of the proposed bill provides, in part, that a proprietor may establish and control the resale price of his identified products for his

[16] Section 5(a)(5).
[17] Section 5(a)(3).
[18] Section 5(a)(5).

distributors, "even though he sells in competition with them, so long as he sells at the applicable prices he has established for his distributors making comparable sales." It can only be assumed that this language is designed to overcome the objections of the United States Supreme Court to such practices as expressed in the *McKesson & Robbins* case,[19] and, in fact, to overrule it and a long line of Supreme Court decisions.[20]

Section 1 of the Sherman Act provides:

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with Foreign nations, is hereby declared to be illegal. . . .

As the Supreme Court said in the *McKesson & Robbins* case, "It has been held too often to require elaboration now that price fixing is contrary to the policy of competition underlying the Sherman Act. . ." The author firmly believes that to reverse the trend of antitrust decisions, as well as to render partially ineffective Section 1 of the Sherman Act (as the proposed bill does), is not in the public interest.

One subsection [21] of the proposed bill states that a proprietor may establish and control the resale prices of his identified merchandise when he has given his distributor "actual notice" of the stipulated price. "Actual notice" is defined in the same subsection as including

> "notice imparted by mail, or through advertising, or through notice attached to merchandise, or containers, packages or dispensers thereof, or imparted orally. Deposit in the United States mail, with postage prepaid of a letter properly addressed to a distributor and specifying resale prices established by a proprietor *shall constitute prima facie evidence of actual notice* of such prices. The acquisition of or dealing in merchandise clearly marked, or enclosed in containers, packages or dispensers clearly marked, with resale prices established by a proprietor *shall be conclusive evidence of actual notice* of such prices." (Emphasis supplied)

The author believes this to be a revolutionary concept of "actual notice", and that it would be impractical and unfair to attempt to hold distributors to such a stringent test as set forth above. Moreover, the small manufacturers that this bill is supposed to protect might soon find they had no distributors to market their merchandise.

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[19] U.S. v. McKesson & Robbins, 351 U.S. 305 (1956).

[20] E.G., United States v. Trenton Potteries Co., 273 U.S. 392 (1927); Ethyl Gasoline Corp. v. United States, 309 U. S. 436 (1940); Schwegmann Bros. v. Calvert Corp., 341 U.S. 384 (1951). See also Standard Oil Co. v. United States, 221 U.S. 1 (1911).

[21] Section 5(a)(5).

The drafters of the proposed bill, as well as its Congressional protagonists, believe that the Federal Trade Commission has been vested with jurisdiction to administer its provisions. However, no provision can be found in the Act which grants that agency such authority. On the contrary, it appears that a form of private relief has been granted in Section 5 (a) (6) which, in pertinent part, provides:

> Any person suffering or reasonably anticipating damage by reason of anything forbidden in paragraph 5 may sue in any State or Federal court of competent jurisdiction without respect to the amount in controversy and shall be entitled to recover the amount of damages sustained, plus the costs of suit, including a reasonable attorney's fee and to obtain injunctive relief and recover such costs and fee, whether or not specific monetary damages are established: . . .

Consequently, it is not believed that the Federal Trade Commission has been granted any authority under the terms of the bill. Moreover, without regard to the prohibitively monumental policing task involved, it is doubted that that Commission would want any such authority. Legislation of this type would change this agency from one protecting the public from the evils of price fixing to one enforcing such fixed prices. In addition, this bill would require the enforcement body to proceed against respondents for selling at *lower* prices which gives rise to grave public interest considerations. In evaluating this subsection, it should be mentioned that to vest concurrent jurisdiction in both Sate and Federal courts, would have the tendency to lead to a multiplicity of suits and confusion in the law.

Another section[22] defines "commerce" as it is to be applied in the proposed bill. It states that a *substantial* portion of the merchandise upon which a proprietor has established a price must cross State lines before the Act applies, and that the Act will not apply to the merchandise of proprietors *no substantial* part of whose merchandise crosses State lines, at any stage of distribution. This is apparently a new definition of "commerce", and does not coincide with the definition contained in Section 4 of the Federal Trade Commission Act. It is not believed that having one definition of "commerce" for some purposes and another for other purposes in the same Act will conduce to continuity in any definitive statements of the law. Moreover, the standard provided, "substantial", is loose and difficult of definition, and seems out of phase with established decisions of the Supreme Court of the United States.[23]

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[22] Section 5(a)(7).

[23] See Socony-Vacuum Oil Co. v. United States, 310 U.S. 150 (1940), 221-224, where the Court held, *inter alia,* that it makes no difference whether the amount of interstate commerce affected was large or small.

Still another section [24] begins by prohibiting so-called "horizontal" price fixing contracts. But the end of this subsection permits such horizontal price fixing agreements when they are made between the proprietor and any or *all of his distributors* who are distributing the same product. When distributors of the same products, performing the same economic function, can get together to fix prices (whether the proprietor is also a party or not) this constitutes horizontal price fixing. Were this language enacted into law, it is believed that it would repeal or effectively emasculate the Sherman Act which prohibits such practices.

As previously stated, in spite of the confusion of terms and contradictory language contained in H. R. 10527, the bill, with some amendments, was given a favorable report by the House subcommittee to which it was assigned for hearings. In the next session of Congress this bill or a revised version, will once again be introduced. Constituting at least a contributing factor in its failure to pass in the 85th Congress was the poor draftsmanship described above. Should some of the more obvious ambiguities and inadequacies be written out, the American public may soon be confronted with a Federal "fair trade" law. One of the principal reasons such legislation has the probability of passage is the dearth of organized opposition.[25] The public is largely unaware that Congress is considering a resale price maintenance bill and even if they were, would probably not comprehend its manifold effects. Consumer groups, in the main, are dissident having widely diverse interests. As a result, the vast majority of the materials Congress has to study in making the final determination on resale price maintenance will have been supplied by the well organized and integrated proponents of the legislation.

It is submitted that the so-called "fair trade" theory contravenes the traditional concepts of free, competitive enterprise which form the foundation of our American economy.

Such a law would mean the demise of the "discount house", fast becoming an institution. Moreover, we all may be constrained to pay higher, fixed prices for many of our everyday commodities. If this thought appalls you, as it does me—to use a hackneyed but appropriate phrase—"Write Your Congressman or Senator"!

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[24] Section 5(a)(9).

[25] However, the recent formation of the National Anti-Price Fixing Association whose function is to oppose the enactment of a national "fair trade" law, is certainly a step in the right direction. Under the leadership of its Executive Secretary and Washington Counsel, Judge Alex Akerman, Jr., the Association rallied last minute opposition to H.R. 10527.