TRADE REGULATION: COURT OF APPEALS REJECTS INDEPENDENT STATUS FOR FUNCTIONAL DISCOUNT UNDER ROBINSON-PATMAN ACT

THE PRINCIPAL thrust of the Robinson-Patman amendment to section 2 of the Clayton Act is to eliminate discrimination in price by buttressing the Clayton Act where it had proved most vulnerable. Section 2 (a) makes it unlawful to discriminate in price among purchasers of commodities of like grade and quality unless the discriminations fall within one of the dispensations found in sections 2 (a) and (b).[1] Discriminations that stem from legitimate marketing efficiencies are saved by the section 2 (a) proviso which permits differentials based on a seller's lower cost of manufacture or distribution because of his dealing with the favored buyer.[2] Price discriminations among buyers are likewise placed beyond the grasp of section 2 (a) by section 2 (b) if the discrimination is made for the purpose of meeting in good faith an equally low price of a competitor.[3] By construction, those price differentials that fail to substantially lessen competition are also beyond the ban of 2 (a).[4]

Under the Clayton Act, it had been assumed that a seller could

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[1] 49 Stat. 1526 (1936), 15 U.S.C. §§ 13 (a), (b) (1958).

[2] The "cost justification" defense reads as follows: "*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...." 49 Stat. 1526 (1936), 15 U.S.C. § 13 (a) (1958). Each customer must bear his proportionate share of overhead costs and for this reason marginal cost savings cannot be attributed to just one customer in order to secure his business. See Murray, *Cost Justification Under the Robinson-Patman Act: Impossibility Revisited*, 1960 WIS. L. REV. 227, 229-30; S. REP. No. 1502, 74th Cong., 2d Sess. (1936).

[3] Section 2 (b) of the Robinson-Patman Act, 49 Stat. 1526 (1936), 15 U.S.C. § 13 (b) (1958), provides that when a discrimination in price has been proved, the burden of rebutting the prima facie case falls on the grantor of the discrimination to show "justification." The defenses found in § 2 (a) are absolute on their face and because of the holding in Standard Oil Co. v. FTC, 340 U.S. 231 (1951), the "good faith meeting of competition" defense is accorded the same status.

[4] Samuel H. Moss, Inc. v. FTC, 148 F.2d 378 (2d Cir. 1945), held that the necessary competitive injury need not be part of the prima facie case under § 2 (b) and that the party showing justification of the differential had the burden of showing that no competitive injury resulted. However, in Automatic Canteen Co. of America v. FTC, 346 U.S. 61 (1953), the Supreme Court indicated an unwillingness to so construe § 2 (b), and the prevailing view to date is that the moving party must show the likelihood of substantial competitive injury to establish the prima facie case.

discriminate in price among buyers merely on the basis that they occupied different positions in the distributive system since these price differentials could not harm those who did not compete at the same level. This concept of pricing, known as the functional or trade discount,[5] was definitively treated and validated under the Clayton Act in *Mennen Co. v. FTC*.[6] *Mennen* interpreted the Clayton Act as being directed only at competitive injury at the primary or seller's level and further held that the Clayton Act's unlimited quantity discount placed a functional discount beyond the reach of section 2.[7]

Robinson-Patman explicitly demolishes the unlimited quantity discount and places on the seller the burden of showing that price differentials stem from manufacturing or distributive cost savings peculiar to the favored customer.[8] Cost accounting studies used to substantiate the cost justification defense present an onerous financial burden that is further complicated by the fact that the FTC often rejects such studies for failure to conform to its concepts of cost accounting.[9] In a further attempt to curtail indirect benefits

[5] The definition of a functional discount that best serves the present analysis is "the differential in price extended by a seller to a buyer who, because of the buyer's performance of distributive 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." Kelley, *Functional Discounts Under the Robinson-Patman Act*, 40 CALIF. L. REV. 526 (1952).

[6] 288 Fed. 774 (2d Cir.), *cert. denied*, 262 U.S. 759 (1923).

[7] The Supreme Court later gave the Clayton Act a broader construction in George Van Camp & Sons Co. v. American Can Co., 278 U.S. 245 (1929), which permitted the application of § 2 to injury on the secondary level. While this holding eliminated one of the supports functional discounting had received from *Mennen*, the system as such still relied upon Clayton's unlimited quantity discount. "*Provided*, That nothing herein contained shall prevent discrimination in price between purchasers of commodities on account of differences in the grade, quality, or quantity of the commodity sold...." Clayton Act ch. 323, § 2, 38 Stat. 730 (1914). Because sales to wholesalers possessing a high degree of bargaining power were usually made in large amounts, the seller had only to invoke this dispensation to avoid the application of § 2. As a result of this provision, functional or trade discounts remained free from the price discrimination laws until the 1936 amendments.

[8] See statute quoted note 2 *supra*.

[9] Through 1957, only seven successful cost defenses were raised. Stedman, *Twenty-Four Years of the Robinson-Patman Act*, 1960 WIS. L. REV. 197, 203. For a discussion that does not attack the principals of the cost defense but rather the difficulty of the use of cost accounting in regard to distributive costs, see Murray, *supra* note 2, at 230-38. The cost justification defense is broadly treated in Rowe, *Cost Justification of Price Differentials Under the Robinson-Patman Act*, 59 COLUM. L. REV. 584 (1959).

The difficulty of sustaining the validity of cost accounting studies in support of cost justification defenses prompted appointment of a committee to study the FTC's treatment of accounting systems and to make recommendations. See Shniderman, *Cost Justification Under the Robinson-Patman Act—The FTC Advisory Committee's Report*, 25 U. CINC. L. REV. 389 (1956).

conferred by a seller on an economically powerful buyer, section 2 (d)[10] makes it unlawful for a seller to compensate a customer for services performed in selling a commodity unless such compensation is available on proportionally equal terms to other customers. To avoid the burden of cost justification of price differentials given to defray the cost of added functions and the necessity of making this form of compensation available on proportionally equal terms, it has been urged that the functional discount should be allowed an independent status under Robinson-Patman.[11] The Robinson-Patman Act further vitiated the *Mennen* decision by rendering unlawful price discriminations that adversely affect competition, not only at the primary level but at any level of distribution.[12] This severe circumscription of price differentials raised considerable doubt concerning the use of functional discounts as a tool for avoiding the price discrimination provisions.[13]

[10] 49 Stat. 1527 (1936), 15 U.S.C. § 13 (d) (1958). Section 2 (d) was applied in Lever Bros., 50 F.T.C. 494 (1953); Procter & Gamble Distrib. Co., 50 F.T.C. 513 (1953); Colgate-Palmolive-Peet Co., 50 F.T.C. 525 (1953).

[11] The term "independent status" is used herein as a shorthand method for stating the view that a functional discount stands independent of the various prohibitions of § 2 because the section is not intended to reach differentials granted to those at non-competitive distribution levels. Of course, to so state the proposition admits of only one answer and ignores the more fundamental question—that of determining just what distribution level the recipient of the differential does in fact occupy.

[12] Section 2 (a) provides, in its langnage regarding the competitive effect necessary to have a violation of the section, that the effect of such discrimination may be to lessen, 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...." 49 Stat. 1526 (1936), 15 U.S.C. § 13 (a) (1958). This langnage permits the effect of a price discrimination to be traced from the primary level through the secondary or buyer's level and finally to the tertiary level. See Haslett, *Price Discriminations and Their Justifications Under the Robinson-Patman Act of 1936,* 46 MICH. L. REV. 450, 454-64 (1948); Shniderman, *"The Tyranny of Labels"—A Study of Functional Discounts Under the Robinson-Patman Act,* 60 HARV. L. REV. 571, 581 (1947).

[13] Inasmuch as the two provisions through which functional discounting had escaped illegality in the past (unlimited quantity discount and narrow inquiry into competitive injury) were narrowed or destroyed, see notes 2 and 12 *supra,* the degree to which such a discount was still beyond the reach of the statute was of obvious importance. The case that potentially could have done the most to settle the questions surrounding functional discounting was the celebrated *Standard Oil* case. Standard marketed its gasoline products through jobbers and also directly to some retailers. Those jobbers who bought in tank car lots were granted discounts and they in turn sold to other retailers and retailed some gasoline as well. Some of these jobbers either cut their own retail prices or passed on enough of the discount to their retail buyers so as to undercut the price at which Standard's own retailers were selling. The effect of the Commission's order in this case was to strike down the price cut to those who sold at retail or to force those who sold to other retailers to sell at the same price as Standard. A further impact of the FTC's opinion would have been to force Standard to police the distribution system to guard against illegal price

In *Mueller Co. v. FTC*,[14] the Seventh Circuit Court of Appeals recently upheld an FTC order that confined the legality of functional discounting to the express terms of section 2 and refused to accord it such independent status. The case arose when Mueller's system of discounting was challenged under section 2 of the act. The company produced pipe and pipe fittings for use in municipal water and gas systems. It sold much of its product directly to municipalities and marketed the remainder through two types of jobbers. Regular jobbers solicited orders, sent them to the company for direct shipment, and received a fifteen per cent discount for their services. The limit jobber, who also received the fifteen per cent discount for sales services, was given an additional ten per cent discount for storing a supply of Mueller products and shipping them directly to customers. This additional discount was attacked under section 2 as a discrimination in price among Mueller's jobbers. The hearing examiner dismissed the complaint, but the Commission reversed, finding a violation of 2 (a) and 2 (d).[15]

A divided court upheld the Commission, finding sufficient evidence for the decision and endorsing without extensive analysis the Commission's attempt to define the position of functional discounting in the Robinson-Patman scheme. The evidence relied upon upholding the finding of a 2 (a) violation showed Mueller had granted the additional discount to limit jobbers who were in actual competition with regular jobbers. Moreover, there was evidence that, in some instances, the limit jobbers who received the additional ten per cent discount never actually provided the warehousing service, thereby negating the functional nature of the discount.[16] In support of its decision sustaining the findings of discriminatory payments for services violative of 2 (d), the court pointed to evidence that showed Mueller's desire to protect those already in the limit jobber category and the lack of objective criteria to guide those who sought to enter the limit jobber status.[17]

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cutting. The Supreme Court never reached the merits of this aspect of the case, however, as it overruled the decision on the good faith meeting of competition defense. Standard Oil Co., 41 F.T.C. 263 (1945), *modified*, 43 F.T.C. 56 (1946), *modified and enforced*, 173 F.2d 210 (7th Cir. 1949), *rev'd and remanded*, 340 U.S. 231 (1951). See also Note, *Functional Discounts Under the Robinson-Patman Act: The Standard Oil Litigation*, 67 HARV. L. REV. 294 (1953).

[14] 323 F.2d 44 (7th Cir. 1963).

[15] Mueller Co., TRADE REG. REP. (1962 Trade Cas.) ¶ 15686 (FTC Jan. 12, 1962).

[16] 323 F.2d at 46-47. The requisite competitive injury was found by virtue of the impact of a 10% discount in an area of extremely low profit margin. *Id.* at 46.

[17] 323 F.2d at 46.

The majority of the court evidently assumed that the FTC had correctly interpreted the legal status of functional discounting under 2 (a) and 2 (d). Only on that basis could the case have been disposed of on appeal by analysis of the sufficiency of the evidence.[18] This adoption by the court of the Commission's interpretation of the role of functional discounting under Robinson-Patman would seem to indicate acceptance of the view that functional discounting is not to be accorded an independent status under the act.[19]

The distribution system utilized by Mueller indicates how troublesome the concept of functional discounting has become in light of modern marketing methods. When a supplier sells directly to some consumers, directly to some retailers, and also through wholesalers or jobbers who in turn perform some distributive service, the entire basis for functional discounting is jeopardized. The functional discount system depends upon neat categorization of components in the distributive chain and Robinson-Patman problems arise when the various elements overlap in the performance of distributive services.[20]

Both the House and Senate versions of the bill that eventually became the Robinson-Patman Act contained provisions of varying detail establishing standards for functional discounts. Both proposals relating to functional discounts failed of adoption, however, and the present enactment is entirely silent as to functional discounting.[21] It has been suggested that this silence implies either

[18] 52 Stat. 112-13 (1938), 15 U.S.C. § 45 (c) (1958).

[19] The Commission's express position, evidently accepted by the court, would certainly negate any idea of special consideration for a functional discount. "[I]t appears that the hearing examiner interpreted [an earlier decision] as either holding that a price differential granted as compensation for services performed by a purchaser for the seller will not result in injury to competition or as holding that a price differential granted for this purpose is permissible regardless of injury to competition. There is nothing in the amended Clayton Act or in the applicable case law, however, to support *either* of these propositions." Mueller Co., TRADE REG. REP. (1962 Trade Cas.) ¶ 15686, at 20519 (FTC Jan. 12, 1962) (Emphasis added.)

[20] The nature of the problem that arises under a distributive system which defies neat categorization is indicated by the following: "The easy assumption that a functional class—wholesalers, fabricators, primary distributors—may receive special or discriminatory price treatment because of an historical practice of the trade, or because of the magic of the functional label, is as erroneous as most simple answers to complex problems." Shniderman, *supra* note 12, at 571. See also Rowe, *Price Discrimination, Competition, and Confusion: Another Look at Robinson-Patman*, 60 YALE L.J. 929, 934 (1951).

[21] The Senate version had an express authorization of functional discounts. S. REP. No. 1502, 74th Cong., 2d Sess. 5 (1936). The House bill had such a provision also based on the idea that the act assumed equal treatment within a given classification and that the various classes did not compete. The House, however, added a

the absolute legality or illegality of such discounts, but neither of these positions seems warranted. The more cogent position is that failure to expressly deal with this subject implies that the permissibility of functional discounting is to be considered in individual cases in light of the express prohibitions and defenses of section 2.[22]

There are few cases in which a functional discount has been urged as an independent defense. *Doubleday & Co.*[23] was heavily relied upon by Mueller in the instant case as apparent authority for the separate status of functional discounting. The Commission in that case dealt with varying price discounts to jobbers who performed warehousing and promotional services. The Commission agreed with the Government that the simple categorization of purchasers was not feasible in light of modern multi-function distributors and that the dual function of this purchaser made it more likely that an anti-competitive effect would ensue. Nevertheless, in support of its holding that the discount was not violative of section 2 (a), the Commission reasoned that a purchaser's "buying function" could be taken into consideration and that a buyer could be given a discount on products upon which he actually performed an additional service, if the discount were reasonably related to the costs involved in performing the given function.[24]

The Commission in the instant case chose to rely on its later holding in *General Foods, Inc.*[25] There the seller gave an additional ten per cent discount on purchases to wholesalers who sold to institutions that was not accorded to those engaged in the general wholesale business. The additional function of the institutional whole-

provision that a distributor's classification be determined by the way he sold. H.R. REP. No. 2287, 74th Cong., 2d Sess. 1-2 (1936). The farm block felt this latter addition endangered the status of farm buying co-ops and its opposition killed any attempt to deal expressly with the problem. EDWARDS, THE PRICE DISCRIMINATION LAW—A REVIEW OF EXPERIENCE 42-44 (1959); Shniderman, *supra* note 12, at 585.

[22] Shniderman, *supra* note 12, at 587 & n.58.

[23] 52 F.T.C. 169 (1955).

[24] "In our view, to relate functional discounts solely to the purchaser's method of resale without recognition of his buying function thwarts competition and efficiency in marketing, and inevitably leads to higher consumer prices.... Such functions should, in our opinion, be recognized and reimbursed." 52 F.T.C. at 209. The Commission's approach in *Mueller*, affirmed by the Court of Appeals, is the exact opposite of the above in that the concern was with the level at which the limit jobbers sold. The limit jobbers were found to have sold at the same point in the distribution scheme as the regnlar jobbers, such finding giving them the same "selling function." With such a finding in hand the Commission deemed analysis of the limit jobber's buying function to be immaterial.

[25] 52 F.T.C. 798 (1956).

salers consisted of promotional activities, maintenance of large inventories, and an extensive delivery service. The Commission stressed that Robinson-Patman was written against the background of the distributive scheme then existing and that there was no indication that functional discounting was to be viewed as illegal per se. However, it was equally clear to the Commission that functional discounting could not be utilized when a proscribed competitive injury would be the result and that the seller could not compensate a wholesaler for doing his own work on his own products.[26] Furthermore, the Commission declared that such a discount system must be offered to all on proportionally equal terms and failure to do so constituted a 2 (d) violation.[27] At the core of the holding was the fact that those who received the discount based on the performance of an additional service were in competition with those who did not receive such discounts.

Foreshadowing the holding in *Mueller* is the early *Sherwin-Williams* decision[28] which also involved the use of discounts to dual function buyers. Sherwin-Williams kept elaborate records of the amounts of paint each of its buyers sold at wholesale and retail and granted discounts only on that sold at wholesale. The discounts were upheld without regard to cost justification. Sherwin-Williams subsidiaries, however, had used only estimates of the amounts sold at wholesale and retail and discounts based on these approximations were struck down under 2 (a). Clearly the central inquiry was the avoidance of competitive injury that would result from granting the

[26] The evidence here showed that General Foods had sold institutional food products to those exclusively in the institutional foods market and to those in the general wholesale trade competing for regular grocery and institutional business. Even among those in the institutional market alone, General Foods had created a special category for those who were to use extraordinary services to enlarge General's share of the institutional foods market. This special category received the additional 10% discount. The Commission's view was that the special institutional wholesaler was performing many extra functions but that the purpose of these functions was to expand the wholesaler's own busiuess and that his increased costs would have to be recovered out of increased volume and customer good will. 52 F.T.C. at 809.

[27] Iu this connection, it is important to notice that the Commission had previously found the requisite competitive injury. Based on this finding, the Commission reasoned that labeling these price differentials as payment for services did not call § 2 (d) into play to operate as a defense and to insulate the party from a 2 (a) violation. 52 F.T.C. at 825. This analysis leads to the conclusion that the 2 (d) considerations arise only after the discount has passed the scrutiny of § 2 (a). The reasoning of the *Mueller* decision would then indicate that the system as a whole must be available to all on proportionately equal terms. For a similar earlier holding in regard to promotional distributors, see American Art Clay Co., 38 F.T.C. 463 (1944).

[28] Sherwin-Williams Co., 36 F.T.C. 25 (1943).

discount on a retail item and the Commission would not accept approximations of which items were sold at wholesale and retail.

An analysis quite in keeping with the decision in the instant case indicates that whatever may be drawn from the legislative history of Robinson-Patman, functional discounting was given no status in and of itself and that its legality in a given case depends upon the availability of one of the standard defenses under section 2. Inasmuch as the act was concerned with narrowing these very defenses, there can be no doubt that those conferring discounts must show that a differential is justified by cost savings or that it has no injurious competitive effect at any of the three levels covered by Robinson-Patman.[29]

The most vehement attack upon the limitations thus imposed on functional discounting is premised upon the inhibitions that are placed upon cost saving vertical integration.[30] When dual function buyers in fact warehouse all of the goods and then sell them either at wholesale or retail, it has been submitted that no reason exists for forcing a split discount system on them since the functions performed seldom vary according to what is done with the product.[31] Robinson-Patman's reliance on cost as the determinant of price has also been viewed with disfavor. The "market function" of price is strenuously urged to have as much or more to do with price than cost. The functions performed at different levels of the distributive system and the degree to which they can be shifted from one member to another give rise to widely varied degrees of buyer bargaining power leading to divergent price concessions. The presence of dual or triple function buyers and suppliers who themselves straddle all phases of the distributive system is said to make reliance on cost

[29] Shniderman, *supra* note 12, at 583, 586, 600. For instances in which general jobbers who sold both at retail and wholesale in competition with other single function distributors had their discounts invalidated see Hansen Inoculator Co., 26 F.T.C. 303 (1938); Nitragin Co., 26 F.T.C. 320 (1938).

[30] Kelley, *supra* note 5, at 527-28. The author here relies heavily on the outlay of capital necessary in order to take on added distributive functions. The potential for great efficiency by vertical integration is said to lose its appeal because the distributor cannot be compensated for his expanded effort unless it grows out of cost savings to the seller which are not likely to be equal in amount or as easily provable. A more pertinent cost saving is suggested to be the costs saved over the distributive system and not the costs of the seller.

[31] "Requiring a wholesaler-retailer, who performs wholesale functions...on all purchases and retail functions...on some purchases to pay retail prices on that portion of the product sold directly to consumers is itself economic price discrimination." Kelley, *supra* note 5, at 541-42. For a view that current authority demands precisely what is objected to here, see text accompanying note 28 *supra*.

alone an unrealistic approach.[32] This analysis casts considerable doubt on the economic wisdom of those decisions that seem on their face to stand in the path of efficient cost saving marketing. It is submitted, nevertheless, that the *Mueller* decision, in light of the statutory mandate, is correct in severely limiting the role of functional discounting. The broad language used by the Commission in defining the legal status of functional discounting might have caused those that use a form of functional discount to fear that their system had been invalidated.[33] Such is not necessarily the case. However, the decision does make it clear that a functional discount is not a peculiar form of price differential beyond the pale of section 2. The price differential accorded is simply tested to ascertain whether or not it gives rise to a lessening of competition at any distributive level. If such injury is found the discount is illegal until its grantor takes steps to see that it is granted only on those items that do not in fact compete with items upon which no discount has been given. Such treatment of course takes into account only the manner in which a given distributor sells and not the number or the cost of functions performed before sale. If the arguments that functional discounts should be accorded special status are to prevail, they must do so through an amendment to the act which would recognize the buying function of certain distributors and depart to some degree from Robinson-Patman's sole reliance on cost as the determinant of price.[34]

[32] McNair, *Marketing Functions and Costs and the Robinson-Patman Act,* 4 LAW & CONTEMP. PROB. 334, 337 (1937). The writer asserts that reliance on cost is "bad economics and impossible accounting." A quite forceful argument is made that while a uniform price at the retail level is workable, it is particularly unsuited to the wholesale level, owing to the varying degree of buyer bargaining power. Because this is so, no institutional view can be supported. Rather than permitting this fact to negate the validity of a functional discount, McNair suggests that a close analysis of how a distributor buys would yield a fair result that reliance on cost cannot bring about. *Id.* at 337-43. A similar outlook is found in ATT'Y GEN. NAT'L COMM. ANTITRUST REP. 207 (1955), and this is precisely the point upon which the dissent in *Mueller* is based. The dissenting judge finds an error of law in the Commission's analysis of § 2(a) and strongly urges that the buying function be recognized as in the *Doubleday* decision. 323 F.2d at 48-49.

[33] The sweeping langnage of the Commission quoted note 19 *supra* could easily cause such apprehension.

[34] The most ardent supporters of the validity of the functional discount as a continuing tool tacitly recognize this point by advocating amendments to § 2 to recognize various buying functions. See Kelley, *supra* note 5, at 557; McNair, *supra* note 32, at 352.