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## FUNCTIONAL DISCOUNTS UNDER THE ROBINSON-PATMAN ACT

TERRY CALVANI\*

### INTRODUCTION

Functional discounts are basic to a significant part of business pricing practices. A functional discount occurs where a buyer is permitted to purchase a product at a lower price per unit than another buyer, because of the advantageous marketing function which the favored buyer performs for the seller. The practice is thus justified by well-settled business norms: the buyer renders services to the seller and receives a price discount in return. The legality of the practice, however, is less than clear, since functional discounts often present both buyers and sellers with many legal problems under the Robinson-Patman Act [the Act].<sup>1</sup>

This article will disclose and discuss some of the legal difficulties which presently confront those who incorporate functional discounts into their pricing policy. In the first half of the article, the validity of such discounts under section 2(a)<sup>2</sup> of the Act will be examined. The legality of functional discounts under the so-called "per se" sections—sections 2(c), 2(d) and 2(e)<sup>3</sup>—will be the subject of the second half of the article; special emphasis will be given to the "services rendered" exception of section 2(c)<sup>4</sup> and to the marketing practices of (1) brokers' transactions on their own account, and (2) cooperative purchasing ventures. The purpose of this article is to demonstrate that the uncertain status of functional discounting is primarily due to

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\*Assistant Professor of Law, Vanderbilt University. This article is a result of the author's participation in the ABA Antitrust Section Robinson-Patman Committee Study on Functional Discounts. The opinions expressed in the article are those of the author and not necessarily those of the Study Group or any of its other members. The author wishes to acknowledge the support of the Vanderbilt University Research Council which enabled his participation in this project.

<sup>1</sup> 15 U.S.C. §§ 13, 13a, 13b, 21a (1970).

<sup>2</sup> 15 U.S.C. § 13(a) (1970).

<sup>3</sup> 15 U.S.C. §§ 13(c)-(e) (1970).

<sup>4</sup> The text of § 2(c) is quoted at note 58 *infra*.

the failure of Congress, the Federal Trade Commission, and the courts to give explicit and independent recognition to the practice, and to define with any modicum of specificity its permissible contours. The result of this failure of recognition has been a lack of focus upon the validity of the functional discount which, in turn, has left the law in a state of confusion, causing often legitimate practices to be condemned.

## I. EARLY OBSTACLES TO FTC REGULATION UNDER THE ACT

With the passage of the Act in 1936,<sup>5</sup> the subject of functional discounts and dual distribution became an important, controversial and extensively litigated segment of trade regulation.<sup>6</sup> Although the Federal Trade Commission (the FTC) had attempted to challenge functional differential pricing practices<sup>7</sup> prior to the passage of the Act, effective regulation was precluded by two significant obstacles. First, early decisions by the lower federal courts limited the pricing proscriptions of the Clayton Act<sup>8</sup> to primary line discrimination, thereby effectively ending for several years both administrative and

<sup>5</sup> Act of June 19, 1936, ch. 592, § 3, 49 Stat. 1526.

<sup>6</sup> The topic has often secured the attention of Congress. See, e.g., *Hearings Before the Special Subcomm. on Small Business and the Robinson-Patman Act of the House Select Comm. on Small Business*, 91st Cong., 1st Sess. 291-334 (1969) (Small Business and the Robinson-Patman Act); *THE IMPACT UPON SMALL BUSINESS OF DUAL DISTRIBUTION AND RELATED VERTICAL INTEGRATION*, REPORT OF SUBCOMMITTEE NO. 4 OF HOUSE SELECT COMMITTEE ON SMALL BUSINESS, H.R. REP. NO. 1943, 88th Cong., 2d Sess. 5-20 (1964); *Hearings on the Impact Upon Small Business of Dual Distribution and Related Vertical Integration Before Subcomm. No. 4 of House Select Comm. on Small Business*, 88th Cong., 1st Sess. 1923-28 (1964); *Hearings on Dual Distribution in the Automotive Tire Industry Before a Subcommittee of the Senate Select Committee on Small Business*, 86th Cong., 1st Sess., pt. 1, at 131-38 (1959); *Hearings on Functional Discounts Before the Antitrust Subcomm. of the House Comm. on the Judiciary*, 85th Cong., 2d Sess. 1-164 (1958).

Although the functional discount is an important and controversial topic, it has not secured a great deal of attention in the journals. The literature includes: Law, *The Performance of Distribution Functions as Legal Justifications for Price Differentials under the Robinson-Patman Act*, 69 DICK. L. REV. 39 (1964); Lofton, *Dual Distribution and Vertical Integration under the Robinson-Patman Act*, 41 IND. L.J. 4 (1965); Note, *Effective Regulation of Dual Distribution: A Robinson-Patman Approach*, 1967 DUKE L.J. 996. See also Jones, *Marketing Strategy and Governmental Regulation in Dual Distribution Practices*, 34 GEO. WASH. L. REV. 456 (1966); Jordan, *Robinson-Patman Act Aspects of Dual Distribution by Brand of Consumer Goods*, 50 CORNELL L.Q. 394 (1965); Schneiderman, *The Tyranny of Labels—A Study of Functional Discounts under the Robinson-Patman Act*, 60 HARV. L. REV. 571 (1947).

<sup>7</sup> See, e.g., *South Bend Bait Co.*, 4 F.T.C. 355 (1922); *Mennen Co.*, 4 F.T.C. 258 (1922), *rev'd*, 288 F. 774 (2d Cir.), *cert. denied*, 262 U.S. 759 (1923). In *South Bend*, the FTC challenged the respondent's policy of classifying its customers as jobbers, wholesalers, retailers, and consumers, to whom it provided discounts of 50%, 40%, 33 1/3% and 0% respectively. The Commission entered a cease and desist order precluding respondent's practice of utilizing a functional classification. 4 F.T.C. at 362. A similar result followed in *Mennen Co.* In that case, however, the decision of the Commission was appealed and reversed, the Second Circuit reasoning that the Clayton Act had no application to secondary line discriminations. 288 F. at 779.

<sup>8</sup> Act of Oct. 15, 1914, ch. 323, § 2, 38 Stat. 730.

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judicial scrutiny of functional discounts.<sup>9</sup> Even after the Supreme Court's decision in *Van Camp & Sons Co. v. American Can Co.*,<sup>10</sup> where the Court clearly indicated that the price discrimination provisions of the Clayton Act extend to secondary line activities,<sup>11</sup> effective regulation of functional discounts was still precluded by a second obstacle; namely, the provision in the Clayton Act exempting quantity differences from the price discrimination provisions.<sup>12</sup> That provision was removed with the passage of the Robinson-Patman Act.<sup>13</sup> While the Act does not specifically address the legality of functional discounts and dual distribution, the elimination of the quantity discount exemption and the clear application of the law to secondary line discrimination did remove the earlier obstacles to administrative and judicial scrutiny.<sup>14</sup>

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<sup>9</sup> See, e.g., *Mennen Co. v. FTC*, 288 F. 774 (2d Cir.), cert. denied, 262 U.S. 759 (1923); cf. *National Biscuit Co. v. FTC*, 299 F. 733 (2d Cir.), cert. denied, 266 U.S. 613 (1924). See also *S.S. Kresge Co. v. Champion Spark Plug Co.*, 3 F.2d 415 (6th Cir. 1925); *Baran v. Goodyear Tire & Rubber Co.*, 256 F. 571 (S.D.N.Y. 1919).

It is perhaps best at the outset to insure a common understanding of terms. The terms "primary line" and "secondary line" as used herein denote their respective conventional meanings of seller level and buyer level discrimination. With respect to a proper understanding of functional discounts it is important to note that the amount of a particular functional discount is dependent in part on the buyer's distributive function. Thus a supplier may sell to the ultimate consumer as \$1.00 per unit, a retailer for \$.90, a jobber for \$.80, and a wholesaler for \$.70 in a four tier distributive scheme. In return for performing their respective functions the retailer receives a discount of \$.10, the jobber a discount of \$.20, and the wholesaler a discount of \$.30.

Some commentators have distinguished between the terms "functional discount" and "trade discount." A "trade discount" is based on the supplier's classification of the buyers at particular levels of the distribution scheme. Alternatively, a "functional discount" is extended by the supplier according to the distributive functions actually performed by each buyer. The importance of such definitional distinctions has diminished; the legality of these discounts has been determined according to their effect on competition in each case. The Commission has previously advised that actual competition in resale operations is decisive, rather than nomenclature. FTC Advisory Opinion No. 202, 73 F.T.C. 1314 (March 14, 1968). The case law is replete with Commission enforcement of this principle. See, e.g., *DL Prods. Inc.*, 62 F.T.C. 35 (1963); *Wesco Prods. Co.*, 60 F.T.C. 1664 (1962). See also *FTC v. Ruberoid Co.*, 343 U.S. 470 (1952). For convenience in this discussion, only the term "functional discounts" will be used.

<sup>10</sup> 278 U.S. 245 (1929).

<sup>11</sup> *Id.* at 253.

<sup>12</sup> That statute provided: "[N]othing 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 . . ." Act of Oct. 15, 1914, ch. 323 § 2, 38 Stat. 730 (emphasis added). Thus, a seller could legally charge \$1 per widget for 10 widgets and \$.10 per widget for 20 widgets, notwithstanding the absence of any cost savings, because of the quantity-sold exception in the statute. See *Goodyear Tire & Rubber Co. v. FTC*, 101 F.2d 620, 624 (6th Cir. 1939).

<sup>13</sup> See Act of June 19, 1936, ch. 592, § 3, 49 Stat. 1526.

<sup>14</sup> Drafts of what emerged as the Robinson-Patman Act in both the House and Senate contained specific provisions with reference to functional pricing. REPORT OF THE ATTORNEY GENERAL'S COMMITTEE TO STUDY THE ANTI-TRUST LAWS 203 (1955) [hereinafter cited as ATTORNEY GENERAL'S REPORT]. Indeed, the ATTORNEY GENERAL'S REPORT concluded that functional discounts were "principal objects of Congressional concern." *Id.* In both houses, drafts expressly preserved functional discounts from il-

## II. FUNCTIONAL DISCOUNTS UNDER SECTION 2(a) OF THE ACT

Section 2(a) of the Act prohibits a seller from discriminating in price between different purchasers of commodities of like grade and quality where an anticompetitive effect may result.<sup>15</sup> Since Congress elected not to expressly regulate functional discounts, the legitimacy of the practice under section 2(a) depends on the absence of an anti-competitive effect or the presence of a conventional defense. One such defense is cost justification, under which the seller must show that the disparity in prices is attributable to differences in the cost of dealing with two buyers.<sup>16</sup> Obviously, there will be many instances where functional discounts cannot be cost justified, either because

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legality and contained a classification scheme for determining function. S. 3154, S. REP. NO. 1502, 74th Cong., 2d Sess. 1-2 (1936); H.R. 8442, H.R. REP. NO. 2287, 74th Cong., 2d Sess. 1-3 (1936). However, lobbying efforts by farm groups caused the scheme to be excised. ATTORNEY GENERAL'S REPORT, *supra*, at 203-04. See also C. EDWARDS, THE PRICE DISCRIMINATION LAW 286 (1959).

It has been suggested that the Act by its silence sanctioned functional discounts. Functional discounts were a well-established practice at the inception of the Robinson-Patman Act, and it has frequently been argued that a "substantial upheaval of accepted business practice" could not be achieved so casually—especially by silence. See, e.g., Schneiderman, *supra* note 6, at 575-76. While there is no specific support for this thesis in the legislative history, there is earlier language in a House Judiciary Report indicating that Congress did not intend to create unwarranted disturbance of existing habits of trade. H.R. REP. NO. 2287, 74th Cong., 2d Sess. 10-11 (1936). On the other hand the report prepared by the Senate Judiciary Committee suggests that a specific exemption for functional discounts was necessary in order to maintain their legality. See S. REP. NO. 1502, 74th Cong., 2d Sess. 5 (1936). Thus, the elimination of the specific exemption may also be read as legislative disapproval of functional discounts.

<sup>15</sup> The relevant statutory language provides:

It shall be unlawful for any person . . . to discriminate in price between different purchasers of commodities of like grade and quality, where either or any of the purchases involved in such discrimination are in commerce . . . 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 inure, 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 . . .

15 U.S.C. § 13(a) (1970).

<sup>16</sup> It is important that functional discounts be distinguished from the cost justification defense of § 2(a). See 15 U.S.C. § 13(a) (1970). As has been held on numerous occasions, the cost justification defense protects only bona fide savings in cost. See, e.g., *United States v. Borden Co.*, 370 U.S. 460, 468 (1962). For example, a manufacturer sells its widget at retail for \$1.00, the cost of production and distribution of which is 80 cents. He is making a profit of 20 cents, or 25%. If that manufacturer could save 20 cents by allowing an independent retailer to assume the function of retail distribution, sales by the manufacturer to the retailer at 80 cents would be cost justified. The functional discount is distinguishable in that it permits not only cost savings, but also allows the person or entity assuming the distributive function a reasonable profit margin. Thus, the above manufacturer might sell to the retailer at 75 cents, thereby passing on not only its direct cost savings of 20 cents, but also the 25% profit attributable to that 20 cent saving in the cost of distribution. Note, however, that in this instance the manufacturer still retains its 25% profit margin as his cost becomes 60 cents and his profit 15 cents.

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some retailers may buy in larger quantities than some wholesalers, or because of other insufficient economies of scale.<sup>17</sup> In such instances the appropriate inquiry is whether injury to competition results.<sup>18</sup>

A proper understanding of the requirement of injury to competition under the Robinson-Patman Act can only be accomplished through a consideration of the general purposes of the Act. One of the most significant reasons for the controversy that has surrounded the Act and its construction by the courts is a failure to appreciate that the Act is *not* generally concerned with the promotion of competition and the efficient allocation of economic resources. The Robinson-Patman Act is not an "antitrust act."<sup>19</sup> The conventional concern for efficiencies in production, distribution and marketing that underlies the antitrust laws in general have no paramount significance in this Act.<sup>20</sup> Rather, the Act is committed to the preservation of a

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<sup>17</sup> Moreover, it should be noted that while the functional discount can be justified by a showing of a relationship to cost in section 2(a) and 2(f) cases, as a practical matter, that defense is rarely effective. The Commission has generally required that data be produced in sufficient detail to document the "passed on" economies. Demonstrations predicated on buyer classification groupings have not fared well. *See, e.g., United States v. Borden Co.*, 370 U.S. 460, 469 (1962).

<sup>18</sup> The nature of this inquiry is significant. Illustrative is the Commission's willingness to permit the award of a greater discount to one group of resellers when that group is composed of new entrants, even though the resellers compete for the same customers and the new entrants do not provide the supplier with any cost savings. While there is obviously a discrimination in price between purchasers at the same functional level, the Commission reasons that competition would not be injured as a result of a "one-shot" discount to new entrants—especially in view of the start-up costs that new entrants are likely to experience. 16 C.F.R. § 15.384 (1975).

Of course, the established firm has at one time experienced start-up costs. The Commission's position seems to be that such discounts make it easier for new firms to enter, which either enhances present competition or revives competition in markets tending toward economic concentration.

<sup>19</sup> It is interesting to note that the Supreme Court has held that § 3 of the Act, 15 U.S.C. § 13a (1970), (the Borah-Van Nuys Amendment), is not an antitrust law as that term is used in section 4 of the Clayton Act, 15 U.S.C. § 15 (1970). *Nashville Milk Co. v. Carnation Co.*, 355 U.S. 373, 375-76 (1968).

<sup>20</sup> The language of the Act has often been the subject of criticism. *See note 22 infra.* Though the Act may lack clarity, a review of the legislative history of the Robinson and Patman bills clearly evidences that the intent of the draftsmen, congressional supporters, and interest groups that shepherded the proposals through Congress was never open to question. The Robinson-Patman Act was adopted as protective legislation following the inability of the cooperative movement, *see Rowe, The Evolution of the Robinson-Patman Act: A Twenty Year Perspective*, 57 COLUM. L. REV. 1059 (1957), the state multiple location and chain store tax acts, *see Feldman, Legislative Opposition to Chain Stores and its Minimization*, 8 LAW & CONTEMP. PROB. 334 (1941), and the National Industrial Recovery Act, ch. 90, §§ 1-10, 48 Stat. 195 (1933), to sufficiently bolster the status of independent businesses in the face of the success and growth of the large volume, multiple location and often vertically integrated reseller. H.R. REP. NO. 2287, 74th Cong., 2d. Sess. 3 (1936). It was specifically intended to impede the growth and success of the chains and to bolster the position of the independent retailer and its suppliers. *Id.* at 4-5. Thus, while its sister "antitrust acts" are generally thought to protect competition, the Robinson-Patman Act was drafted and enacted to protect a certain group of competitors.

specific segment of economic activity—small business<sup>21</sup>—and to trade diversion.<sup>22</sup>

<sup>21</sup> The Supreme Court has acknowledged this to be the case. See, e.g., *FTC v. Morton Salt Co.*, 334 U.S. 37, 49 (1948). See also *FTC v. Fred Meyer, Inc.*, 390 U.S. 341, 349, 359 (1968).

The history of the Act is both interesting and colorful, and seems clearly to indicate that the Act was drafted and enacted in a concerted effort to retain the small retailer and its supplier on the American commercial landscape. Historians have recorded the preeminent role of the National Association of Retail Grocers and similar organizations in the drafting and passage of the law. See, e.g., Fulda, *Food Distribution in the United States, the Struggle Between Independents and Chains*, 99 U. PA. L. REV. 1051 (1951).

<sup>22</sup> *Foerster Mfg. Co. v. FTC*, 335 F.2d 47, 56 (1st Cir. 1964). This lack of emphasis on the promotion of competition does not necessarily mean that the Act was ill-conceived. However, many scholars have so stated. Adelman, *The Consistency of the Robinson-Patman Act*, 6 STAN. L. REV. 3 (1953), where the author suggests that the Act does not prohibit price discrimination, but rather fosters it. Adelman reasons that the Act makes it both legally dangerous and administratively costly to pass on to subsequent buyers the fruits of efficiencies. *Id.* at 11. Thus, some buyers are forced to pay unnecessarily high prices. Recently one economist has written that "Section 2 was designed to restrict and punish free market competition." D. ARMENTANO, *THE MYTHS OF ANTITRUST* 170 (1972). See generally REPORT OF THE TASK FORCE ON PRODUCTIVITY AND COMPETITION, reprinted in, 2 J. ANTITRUST LAW AND ECON. 13 (1969); McGee, *Some Economic Issues in Robinson-Patman Land*, 30 LAW & CONTEMP. PROB. 520 (1965); Anon., *Eine Kleine Juristische Schlümmgeschichte*, 79 HARV. L. REV. 921 (1966).

Others have suggested radical revision of the Act. See, e.g., ATTORNEY GENERAL'S REPORT, *supra* note 14, at 191-92; REPORT OF THE WHITE HOUSE TASK FORCE ON ANTITRUST POLICY, reprinted in, 2 J. ANTITRUST LAW & ECON. 11 (1969); C. KAYSER & D. TURNER, *ANTITRUST POLICY: AN ECONOMIC AND LEGAL ANALYSIS* 179-88 (1959); C. WILCOX, *PUBLIC POLICIES TOWARD BUSINESS* 196-214 (4th ed. 1971); Friendly, *The Gap in Lawmaking—Judges Who Can't and Legislators Who Won't*, 63 COLUM. L. REV. 787, 793-94 (1963); Oppenheim, *Small and Big Business: Orientation of Antitrust Points and Counterpoints*, 39 U. DET. L.J. 155, 164 (1961); Schneiderman, *The Impact of the Robinson-Patman Act on Pricing Flexibility*, 57 NW. U.L. REV. 173 (1963). See also *FTC v. Fred Meyer, Inc.*, 390 U.S. 341, 362 (1968) (Harlan, J., dissenting).

Other courts have been much less critical. For example, in *American Oil Co. v. FTC*, 325 F.2d 101, 104 (7th Cir. 1963), *cert. denied*, 377 U.S. 954 (1964), the court stated: "The protection intended to be afforded by the statute is directed to the preservation of competition. The statute's concern with the individual competitor is but incidental."

Three general categories of reasons can be tendered in support of the Act; two of these are premised on the virtues of economic atomization. First, it may be argued that political power follows economic power, and thus that economic atomization is necessary in order to preclude—or at least retard—concentrations of political power. Second, in an era of expanding asphalt and "bigger and better shopping centers," it can be argued that aesthetic considerations justify the preservation, to the extent possible, of more traditional methods of distribution. A third possible argument would stress that there are practices that are improper in a moral sense without regard to their particular competitive impact. One might argue that it is only proper to sell to customers at the same price. Thus, the law is viewed as a mechanism for the enforcement of a particular business ethical standard.

The Supreme Court has remarked on more than one occasion that the Robinson-Patman Act does not exemplify the highest quality of lucid legislative draftsmanship. See, e.g., *Automatic Canteen Co. v. FTC*, 346 U.S. 61, 65 (1953) (Frankfurter, J.). Other commentators have been much less charitable. In Murray, *Injury to Competition under the Robinson-Patman Act: Futility Revisited*, 29 U. PITT. L. REV. 623 (1968), the author refers to "the incredibly inept draftsmanship exhibited by the Act."

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Several methods of pricing have been the subject of scrutiny under the Act. One typical pricing policy is that of selling products to resellers at a lower price than the same products are sold to ultimate users. In such a case the seller is clearly selling commodities of like grade and quality to different purchasers at different prices. In *FTC v. Anheuser Busch, Inc.*,<sup>23</sup> the Supreme Court held that such a practice is price discrimination within the meaning of the Act.<sup>24</sup> This result has been criticized by both commentators and some lower courts. At least one commentator has noted: "All this is common trade practice, and nobody is surprised that a wholesaler buys goods more cheaply than a retailer and a retailer more cheaply than a housewife."<sup>25</sup> Since the respective purchasers are on different levels of the chain of distribution, and thus do not compete with each other, it is argued—and generally held—that in this situation there is no competitive injury.<sup>26</sup>

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*Id.* See also Austern, *The Robinson-Patman Act—Isn't Thirty Years Enough?*, 30 ANTITRUST L.J. 18, 20 (1966).

While the wisdom of the Act may be an appropriate object of criticism, it is perhaps a bit unfair to criticize the case law as anticompetitive if the maintenance of competition was not in fact the purpose of the Act. See D. ARMENTANO, *THE MYTHS OF ANTITRUST 196-97* (1972), where the author writes: "The nightmare that is Robinson-Patman is working out *exactly* as it was designed. . . . The law, when enforced, can make genuine price competition almost impossible and that is exactly what Congress intended it to do." *Id.* (emphasis supplied).

<sup>23</sup> 363 U.S. 536 (1960).

<sup>24</sup> *Id.* at 550.

<sup>25</sup> A. NEALE, *THE ANTITRUST LAWS OF THE U.S.A.* 251 (2d ed. 1970).

<sup>26</sup> *Chicago Sugar Co. v. American Sugar Ref. Co.*, 176 F.2d 1, 10 (7th Cir. 1949), *cert. denied*, 338 U.S. 948 (1950). This development based on conventional trade practice is purposely qualified, however. Perhaps the most important caveat focuses on the situation where the seller sells to both resellers and consumers and the resellers pass on to their customers all or part of the wholesaling functional discount. Under these facts, the reseller's customers will enjoy a lower purchase price than will the direct purchasers, and a resultant competitive advantage will accrue to the reseller. The Federal Trade Commission's position has been that the Act is violated under these facts, *The Sherman-Williams Co.*, 36 F.T.C. 25, 70 (1943), and this position has secured some judicial approval. See *Standard Oil Co. v. FTC*, 173 F.2d 210 (7th Cir. 1949), *rev'd on other grounds*, 340 U.S. 231 (1951). *But cf.* *Klein v. Lionel Corp.*, 237 F.2d 13 (3d Cir. 1956).

This construction of the Act obviously places the seller in a rather curious position. The seller may continue the practice and risk suit under the Robinson-Patman Act. Or, it may predetermine its customer-reseller's price structure by contract. Such conduct would most assuredly constitute vertical price fixing under section 1 of the Sherman Act, 15 U.S.C. § 1 (1970). *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911). This situation is all the more curious in view of the Commission's historical and continued opposition to fair trade legislation. See, e.g., *Pepsodent Co. v. Krauss Co.*, 56 F. Supp. 922 (E.D. La. 1944). The seller may also attempt to police its customer's pricing policies by suggesting a retail price and by refusing to deal with those who fail to adhere to this suggestion. *United States v. Colgate & Co.*, 250 U.S. 300 (1919). Yet this course of conduct also raises very serious Sherman Act problems. See *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960).

Another course of action open to the discriminating seller is to discontinue sales to either reseller or retailer groups. The economic costs associated with this alternative would undoubtedly encourage internal absorption of the entire reselling function by the seller, and thus bring about additional integration. Such internal absorption may be construed as an attempt to monopolize under section 2 of the Sherman Act, 15 U.S.C. §



The argument that no injury can be found where purchasers occupy different distribution levels is, nonetheless, qualified. For example, in *Krug v. International Telephone & Telegraph Co.*,<sup>27</sup> the district court found the defendant's pricing policy unlawful notwithstanding the fact that the "favored" buyer did not compete on the same distribution level with the plaintiff.<sup>28</sup> In *Krug*, the defendant sold to retail dealers at prices lower than those charged to wholesalers. Despite the absence of direct competition between the purchasers, the court held that "there can be no doubt that a violation of section 2(a) may occur when a manufacturer sells his products to a retailer at a lower price than that charged to a wholesaler whose customers compete with the retailers."<sup>29</sup> Thus, the Act has not been construed to mean that the requisite competitive injury can never be found where the customers are on different competitive levels. Rather, the present interpretation of the Act has been that there is no competitive injury where the discounts are granted equally on each competitive level and the greater discounts are given at lower levels. Presumably, the rationale for prohibiting the inverted discount is that the wholesaler is forced to resell at higher prices to its customer-retailers, thereby putting them at a competitive disadvantage compared to direct-buying retailers.

This construction of the Act raises the question of whether the Act *compels* a seller, who would otherwise sell to all purchasers at the same price regardless of functional identity, to inaugurate a functional discount system where the purchasers occupy various positions on the distribution chain. Without such a policy, the intermediate wholesaler may be forced to sell at a higher price to its retailer-customers, thus resulting in a competitive disadvantage vis-à-vis direct-buying retailers. This result has not influenced judicial reasoning, however, as the lower federal courts have consistently held that the practice of selling to all purchasers at a uniform price is legal regardless of the specific circumstances involved.<sup>30</sup> Although in economic terms a policy of sell-

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2 (1970), and could also raise significant problems under section 7 of the Clayton Act, 15 U.S.C. § 18 (1970). Thus, the proscriptions of the antitrust acts, coupled with the Commission's and courts' interpretation of the price discrimination provision of section 2(a) have placed the seller in an unenviable position where he attempts to sell to both consumers and resellers who pass the discount on to their customers.

<sup>27</sup> 142 F. Supp. 230 (D.N.J. 1956).

<sup>28</sup> *Id.* at 236.

<sup>29</sup> *Id.* at 235. Other cases support this view. *Universal-Rundle Corp. v. FTC*, 352 F.2d 831 (7th Cir. 1965), *rev'd on other grounds*, 387 U.S. 244 (1967); *Allen v. Smith, Inc.*, 54 F.T.C. 967 (1958); *C. F. Sauer Co.*, 33 F.T.C. 812 (1941); *cf. Curtiss Candy Co.*, 44 F.T.C. 237 (1947). *But see Secatore's Inc. v. Esso Standard Oil Co.*, 171 F. Supp. 665 (D. Mass. 1959).

<sup>30</sup> *See Sano Petroleum Corp. v. American Oil Co.*, 187 F. Supp. 345 (E.D.N.Y. 1960) where the court held that "equality in price charged to different purchasers by the same seller is without the ban of section 2(a) and an injury to competition caused by such equality cannot serve to bring the conduct within the section." *Id.* at 353-54. *See also Klein v. Lionel Corp.*, 237 F.2d 13 (3d Cir. 1956); *Krug v. International Tel & Tel Co.*, 142 F. Supp. 230 (D.N.J. 1956).

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ing to all at the same price may be discriminatory, the Act fails to reach such conduct.

A somewhat different situation is presented where a product is sold to different purchasers who resell the product by different means. The question which arises in this context is whether such differing means of resale should be taken into account for purposes of awarding functional discounts. The state of the law on this issue is less than clear. The Federal Trade Commission has ruled that the allowance of a greater functional discount to a mail-order seller of paperback books than that accorded conventional retail booksellers is impermissible under section 2(a).<sup>31</sup> The Commission's rationale is that the favored seller and the conventional retailers compete for the same customers, and that trade would be diverted from the latter to the former if the favored seller paid less than the conventional retailer.<sup>32</sup> However, the Commission has also ruled that a publisher may grant an "extra discount" to "premium jobbers" who sell books to institutional customers for promotional use.<sup>33</sup> Thus, sales at a favored price to a savings bank for use in conjunction with new-account promotions or branch openings are permissible. Yet, here too, trade is diverted from the conventional retailer to the favored customer.

The above cases might be distinguishable, since the favored institutional customer is not generally regarded as a competitor of the conventional retailer; but for the favored treatment, the institutional purchasers would not have purchased the goods. Thus the conventional sellers have lost no sales. This argument, however, is not completely persuasive. While the institutional customers would not ordinarily have purchased the promotional goods from the conventional seller, the ultimate recipients of the goods might very well have purchased the goods from the conventional seller. The attempt to distinguish the two cases by concluding that in the former there was some pre-existing competition for sales while in the latter there was not thus rings hollow; the question is not whether the disfavored purchaser would have competed for sales, but whether it would have attempted to compete in the absence of the discriminatory price. Moreover, it has traditionally been the position of the Commission that actual pre-existing competition is irrelevant.<sup>34</sup> If the underlying

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Moreover, at an early date the Commission took the position that a seller may sell to all its customers at the same price without regard to their functional characterization and notwithstanding the fact that the ultimate customers of the seller's customer-resellers would be at a competitive disadvantage vis-à-vis the seller's direct-buying customers. See, e.g., *Bird & Son, Inc.*, 25 F.T.C. 548 (1937). The rationale of the Commission was apparently the jurisdictional absence of a discriminatory price, i.e., a price difference. *Id.* at 557.

<sup>31</sup> 16 C.F.R. § 15.41 (1975). See also *General Foods Corp.*, 52 F.T.C. 798 (1956); 16 C.F.R. § 15.111 (1975).

<sup>32</sup> 16 C.F.R. § 15.41 (1975).

<sup>33</sup> Advisory Opinion No. 67, 69 F.T.C. 1238 (1966). See also *Thompson Prods. Inc.*, 55 F.T.C. 1252 (1959); *Champion Spark Plug Co.*, 50 F.T.C. 30 (1953); *Curtis Candy Co.*, 44 F.T.C. 237 (1947).

<sup>34</sup> See, e.g., *Thomas Y. Crowell Co.*, 52 F.T.C. 919 (1956).

purpose of the Act is the protection of conventional non-integrated retailers and their suppliers,<sup>35</sup> then the allowance of a trade diversion from the conventional retailer to the favored purchaser seems ill-considered.

The pricing practices depicted above are characterized by relatively simple factual situations confronted by a seller. Consideration should now be given to the complicating factors of vertical integration and dual distribution. A frequent question relative to the application of section 2(a) of the Act to a functional discount scheme is whether an integrated entity's distribution level should be determined by its buying or its selling function. For example, is a retail chain that has acquired its own wholesaler to be accorded a wholesale or retail discount by an independent seller? Does it matter whether the purchasing entity is a separate corporate entity or a division of a larger corporation?

The integrated enterprise will undoubtedly argue that it performs the same functions as the conventional wholesaler. The large retail chain—or more accurately its wholly owned wholesaler—will perform wholesaling functions and will likely purchase in wholesale, not retail quantities. Moreover, to the extent that there are costs associated with the wholesale function of the integrated entity, those costs will not be compensated unless the enterprise is awarded a wholesale discount. Therefore, if such an entity is not accorded the wholesale discount, it may complain that *it* is the object of discrimination. On the other hand, if the identity of the integrated entity is based on its retail function, the non-integrated retailer and its independent wholesale supplier would argue that the integrated entity could still reap any supplier discounts that are cost-justified. Thus, any provisions for *other* than a conventional cost-justified discount would place the integrated enterprise at a competitive advantage over the non-integrated concern. Though meritorious, this argument is not completely persuasive since cost-justification under the Act is measured exclusively by the *supplier's* cost savings, and takes no cognizance of internal savings achieved by the integrated organization.<sup>36</sup> Thus, economies in operation secured by the *integrated concern* are not compensable by the supplier and therefore the savings attributable to those economies cannot be fully extended from the integrated concern to its customers.

The FTC, in *Doubleday and Co.*,<sup>37</sup> had originally taken the posi-

<sup>35</sup> See note 20 *supra*.

<sup>36</sup> See *United States v. Borden Co.*, 370 U.S. 460, 467-71 (1962).

<sup>37</sup> 52 F.T.C. 169, 209 (1955). The Commission reversed a hearing examiner's refusal to consider evidence tendered by respondent demonstrating that the discounts allowed by it to favored jobbers and wholesalers (which were integrated concerns) were legitimate compensation for furnished services. The Commission held that a customer's status as a buyer was relevant in determining whether an allowance of a functional discount is permissible. *Id.*

In our view, to relate functional discounts solely to the purchaser's method of resale without recognition of his buying function thwarts com-

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tion that functional discounts were to be judged in terms of the purchaser's function both as a buyer and as a reseller. However, since 1963, when the Commission decided *Mueller Co.*,<sup>38</sup> it generally has been held that the position of a purchaser in the chain of distribution is determined by the capacity in which it *resells*, rather than buys, the product.<sup>39</sup> Thus, the integrated retailer has no claim to the wholesale functional discount and the presence of a separate purchasing entity, albeit owned or controlled by the purchasing reseller, is irrelevant.<sup>40</sup> Even the performance of valuable services for the seller in conjunction with the purchase of goods has been declared unimportant in determining the propriety of according a functional discount to an integrated concern,<sup>41</sup> although there is some indication of a possible change in the Commission's position.<sup>42</sup>

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petition and efficiency in marketing, and inevitably leads to higher consumer prices. It is possible, for example, for a seller to shift to customers a number of distributional functions which the seller himself ordinarily performs. Such functions should, in our opinion, be recognized and reimbursed. Where a businessman performs various wholesale functions, such as providing storage, traveling salesmen and distribution of catalogues, the law should not forbid his supplier from compensating him for such services. Such a legal disqualification might compel him to render these functions free of charge. The value of the service would then be pocketed by the seller who did not earn it. Such a rule, incorrectly, we think, proclaims as a matter of law that the integrated wholesaler cannot possibly perform the wholesaling function; it forbids the matter to be put to proof.

*Id.*

<sup>38</sup> 60 F.T.C. 120 (1962), *aff'd*, 323 F.2d 44 (7th Cir. 1963), *cert. denied*, 377 U.S. 923 (1964). In *Mueller*, the FTC questioned the propriety under the Act of respondent's practice of providing a greater functional discount to its "stocking" jobbers who not only submitted orders to respondent to be filled, but unlike respondent's ordinary jobbers, provided warehousing services to respondent. Relying on *Doubleday*, the trial examiner dismissed the FTC complaint. 60 F.T.C. at 127. The Commission thereafter reversed, holding that the principle articulated by *Doubleday* was no longer good law, having been overruled *sub silentio* in *General Foods Corp.*, 52 F.T.C. 798 (1956). 60 F.T.C. at 127-28.

<sup>39</sup> *Knoll Associates, Inc.*, 70 F.T.C. 311 (1966), *rev'd on other grounds*, 397 F.2d 530 (7th Cir. 1968).

<sup>40</sup> See 16 C.F.R. § 15.23 (1975).

<sup>41</sup> See *Knoll Associates, Inc.*, 70 F.T.C. 311 (1966), *rev'd on other grounds*, 397 F.2d 530 (7th Cir. 1968), where an additional discount to those customer-resellers who displayed, stocked and advertised respondent's goods was held impermissible. 70 F.T.C. at 410. See also 16 C.F.R. § 15.263-64 (1975). This had been the position of the Commission even prior to judicial affirmation of the principle in *Mueller Co. v. FTC*, 323 F.2d 44 (7th Cir. 1963). See *Gojer, Inc.*, 57 F.T.C. 1228 (1960).

<sup>42</sup> It should be noted that the "actual"—as distinguished from "theoretical"—availability of such an additional discount to all has been held to be a defense in a *Mueller*-type action. Such a defense is clearly an invocation of the principles underlying § 2(d) of the Act. A discount is evidently only theoretically available to all where the supplier considers the buyer's credit record, ability to perform and warehousing capacity in determining whether to confer the additional discount, whereas it is actually available to all where no such requirements are imposed. *Mueller Co. v. FTC*, 323 F.2d 44, 46 (1963), *cert. denied*, 377 U.S. 923 (1964); *cf. FTC v. Morton Salt Co.*, 334 U.S. 37, 42 (1948).

The Commission later amplified its position in Advisory Opinion No. 263, 74 F.T.C. 1649 (1968). There the inquiring party, in seeking FTC clearance of its plan to

Moreover, as a result of *Mueller*, the FTC and the courts have carefully scrutinized distributive relationships to determine whether a supplier is in fact the alter ego or sham creation of the buyer.<sup>43</sup> For example, it has become quite common in recent years for sellers within certain industries to form groups for the purpose of making purchases at prices lower than those which would be legally available if the members purchased individually. Typically, these "cooperatives" are attempts by smaller independents to secure some of the advantages of quantity purchases available to their larger integrated competitors.<sup>44</sup> Because it is the selling level, rather than the purchasing level, that determines an entity's functional identity, it is important that the cooperative enterprise which purchases the goods be viewed as a separate legal entity from its member purchasers, in order that it be able to qualify for receipt of a functional discount from its suppliers. This has not been the case, however. The Commission has

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give a higher functional discount to "stocking dealers" than to "non-stocking dealers," noted that its stocking dealers experience higher costs because of their warehousing, and were thus—absent a higher discount—at a competitive disadvantage, vis-à-vis the non-stocking dealers. The inquiring party also noted that such a price differential would stimulate the purchase of inventory by the stocking dealers. *Id.* The Commission concluded that it would not give its approval to such a plan, but indicated that a plan to compensate sellers for assuming functions of distribution is permissible if available to all customers on equal terms. Thus, the Commission seemed to conclude that the allowance of a functional discount is permissible only when made available on equal terms to all.

This conclusion provoked strong dissents from Commissioners Elman and Nicholson. *Id.* at 1650-53. Commissioner Elman commented:

The Commission here imposes an unreasonable and impossible burden on suppliers in meeting the requirement of "availability." It declares that compensation may be given only for services or facilities which all competing customers can provide. In other words, if some of a supplier's customers cannot—for any reason, including their own inefficiency—provide services or facilities which a supplier needs to promote more economical distribution, he is barred from compensating other customers who are ready, willing, and able to furnish such services or facilities. . . . Here again . . . through administrative interpretation, the Robinson-Patman Act is converted into an anticompetition, antiefficiency, anticonsumer statute.

*Id.* at 1651-52. See also Advisory Opinion No. 264, 74 F.T.C. 1653 (1968).

The defense of actual availability has been legitimized, at least in the Commission's view, only recently. In Advisory Opinion No. 147, 72 F.T.C. 1050 (1967), the Commission, Commissioner Elman not concurring, held that the granting by a manufacturer of a "backhaul" allowance from its delivered price to customers who desired to pick up the products from the manufacturer's warehouse would probably violate § 2(a) of the Act notwithstanding the nondiscriminatory availability of this option. *Id.* See 16 C.F.R. § 15.147 (1975). On January 7, 1974 the Commission, after reconsidering its advisory opinion relative to "backhaul allowances," announced that questions would not likely arise under the laws it administers if sellers using valid delivered price systems offered a backhaul allowance on a nondiscriminatory basis to all customers. 16 C.F.R. § 15.483 (1975). Thus, the Commission may be indicating an acceptance of a defense of "theoretical" availability, which would make significant headway toward validating functional discounts for services rendered by an integrated concern.

<sup>43</sup> See cases cited in note 45 *infra*.

<sup>44</sup> *Cf.* United States v. Topco Associates, Inc., 405 U.S. 596, 599 n.3 (1972).

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generally invalidated the grant of functional discounts to such cooperatives by invoking a variation of the indirect-purchaser doctrine.<sup>45</sup>

The problems caused by the *Doubleday—Mueller* evolution are difficult to resolve. The Act does not expressly address the issue of integrated and closely related entities, and the legislative history is vague. A solution to the controversy can thus be attempted only in the context of the general purpose of the Act. Nonetheless, such a solution fails under current case law. If one accepts the notion that the Robinson-Patman Act is essentially protectionist legislation, tailored for the small independent retailer and its independent supplier,<sup>46</sup> then the *Mueller* solution—focusing on the reselling function—appears appropriate. Under the *Mueller* approach, the large integrated retailer would not be fully compensated for its wholesaling function, thereby losing a competitive advantage over the small independent retailer.<sup>47</sup> On the other hand, the emergence of cooperative purchasing ventures raises doubts about the validity of the *Mueller* rationale. The application of a solution supporting the general purpose of the Act to cooperative purchasing ventures by small independents suggests that small businesses might be better protected if an entity's *buying* function were determinative.

The purchaser who resells in more than one capacity and thus performs multiple functions also poses an interesting problem of characterization. The desire of such an enterprise to receive a wholesaling discount has given rise to two sales techniques. First, a multi-function buyer can designate the functional identity of those to whom it will resell, in order to receive the appropriate discount from its own supplier. Alternatively, the buyer may attempt to attain the discount after the resale is made and its customer can be identified. Neither technique is without problems.

For example, in *Sherman-Williams Co.*,<sup>48</sup> respondent's subsidiary,

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<sup>45</sup> The "indirect purchaser" doctrine was first enunciated in *Kraft Phenix Cheese Corp.*, 25 F.T.C. 537 (1937). There the Commission found that the respondent exercised control over the distribution channels (jobbers and wholesalers) through which the products moved until they reached the retailers. "A retailer," said the Commission, "is nonetheless a purchaser because he buys indirectly, if, as here, the manufacturer deals with him directly in promoting the sale of his products and exercises control over the terms upon which he buys." *Id.* at 546. See also *American News Co. v. FTC*, 300 F.2d 104 (2d Cir.), *cert. denied*, 371 U.S. 824 (1962); *Checker Motors Corp. v. Chrysler Corp.*, 283 F. Supp. 876 (S.D.N.Y. 1968), *aff'd*, 405 F.2d 319 (2d Cir.), *cert. denied*, 394 U.S. 999 (1969); *Joseph A. Kaplan & Sons, Inc.*, 63 F.T.C. 1308 (1963); *Champion Spark Plug Co.*, 50 F.T.C. 30 (1953); *Elizabeth Arden, Inc.*, 39 F.T.C. 288 (1944), *aff'd*, 156 F.2d 132 (2d Cir. 1946), *cert. denied*, 331 U.S. 806 (1947); *Luxor Ltd.*, 31 F.T.C. 658 (1940). *But cf.* *Klein v. Lionel Corp.*, 237 F.2d 13 (3d Cir. 1956). Since many of the cooperative purchasing cases arise within the context of brokerage payments, further discussion of this problem is postponed until the brokerage provisions of the Act have been initially explored. See text at notes 90-107 *infra*.

<sup>46</sup> See note 20 *supra*.

<sup>47</sup> See text at notes 35-36 *supra*.

<sup>48</sup> 36 F.T.C. 25 (1943).

Low Bros. Co., accepted its customers' pre-sale estimates as to that segment of their business that was wholesale, and granted a discount accordingly.<sup>49</sup> The Commission successfully challenged the practice and established that wholesale discounts were actually granted more often than warranted.<sup>50</sup> Another of respondent's subsidiaries, John Lucas and Co., attempted to persuade its customers to submit certified statements of ultimate product destinations, but accepted unverified statements from customers who refused to do so.<sup>51</sup> The Commission also successfully challenged this practice as unacceptable.<sup>52</sup> The Ruberoid Company is reported to have scrapped such a certification plan as unworkable because it was not adopted by its competitors, was resented by its customers, and resulted in falsehood and inaccuracy.<sup>53</sup> In view of the difficulties attributable to proving bona fide multi-function buyer status under the foregoing cases, one might question whether in such circumstances the Act permits the functional discount at all.

The foregoing analysis discloses that the treatment accorded functional discounts under section 2(a) has created great problems for those who seek to utilize them. First, the test for a discrimination in price has not always been applied with a view to economic reality, thereby creating uncertainty in the seller's pricing policy. Second, the occasional practice of awarding functional discounts according to the means by which purchasers distribute their products tends to obfuscate the real issue of whether such purchasers compete for the same customers. Third, reference to the buyer's resale identity for purposes of granting a functional discount fails to acknowledge the valuable functions often performed in connection with the purchase of goods, and may ultimately tend to injure the small businesses which the Act was intended to protect. Finally, the practice of granting functional discounts to the multi-function buyer is dangerous because of the difficulties in proving the buyer's functional status. In short, the seller must be aware of a host of problems under section 2(a) which may invalidate *economically* sound functional discounting practices.

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<sup>49</sup> *Id.* at 65.

<sup>50</sup> *Id.* at 68.

<sup>51</sup> *Id.* at 66.

<sup>52</sup> *Id.* at 73. See also *Shell Oil Co.*, 54 F.T.C. 1274 (1958); *Libbey-Owens Ford Glass Co.*, 53 F.T.C. 1038 (1957); *Pittsburgh Plate Glass Co.*, 52 F.T.C. 902 (1957); *American Oil Co.*, 29 F.T.C. 857 (1939); *Nitragin Co.*, 26 F.T.C. 320 (1938).

<sup>53</sup> See C. EDWARDS, *THE PRICE DISCRIMINATION LAW* 337 (1959).

The role that functional discounts play under § 2(f) of the Act is, of course, quite similar to that under § 2(a). Section 2(f) provides essentially that it is illegal to knowingly induce or accept a discriminatory price prohibited under § 2(a). 15 U.S.C. § 13(f) (1970). Section 2(f) imposes two requirements in addition to those of § 2(a). First, the challenged buyer must also be "in commerce" and the illicitly received concession must occur "in the course of such commerce." Second, the buyer must accept the favored treatment with the knowledge that the price concession is illegal. *Id.* See also *Automatic Canteen Co. v. FTC*, 346 U.S. 61, 71 (1953).

Most of the § 2(f) cases have arisen within the context of cooperative purchasing endeavors and will be discussed in the text at notes 135-221 *infra*.

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### III. THE PER SE PROVISIONS OF THE ACT AND COOPERATIVE PURCHASING ENDEAVORS

Functional discounts generally have been examined by the FTC and the courts under section 2(a) of the Robinson-Patman Act. However, from time to time they also have been considered in proceedings under the other proscriptive subsections of section 2.<sup>54</sup> An examination of three of the subsections, 2(c), 2(d) and 2(e), is particularly interesting because the courts have held that most of the conventional defenses in a price discrimination action are not available to defendants under these sections.<sup>55</sup> For example, a defendant in a section 2(c) action may not allege as defenses the establishment of cost-justification, the necessity to meet competition, or the absence of an anticompetitive effect.<sup>56</sup> For this reason, the proscriptions contained in these sections have sometimes been referred to as the "per se" offenses of the Act.<sup>57</sup>

#### A. Section 2(c)

Under section 2(c) a seller is prohibited from paying a brokerage commission or allowance to a buyer, unless the commission or allowance is "for services rendered."<sup>58</sup> It is generally agreed that the thrust of this section is to prohibit the exaction by buyers from sellers of "dummy" allowances which produce the same anticompetitive effects as unlawful price discrimination.<sup>59</sup> Therefore, a frequently presented

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<sup>54</sup> These are subsections 2(c), 2(d), 2(e), and 2(f). 15 U.S.C. §§ 13(c)-(f) (1970). Subsection 2(b) is not proscriptive; rather, it is the statutory exposition of the "meeting competition" defense. See 15 U.S.C. § 13(b) (1970).

<sup>55</sup> See, e.g., *Oliver Bros., Inc. v. FTC*, 102 F.2d 763, 767 (4th Cir. 1939). Section 2(f) is the exception. Since that section incorporates the elements of § 2(a) within the cause of action, the defenses in a 2(a) action have been held to apply. *Automatic Canteen Co. v. FTC*, 346 U.S. 61, 70-71 (1953).

<sup>56</sup> *FTC v. Henry Broch & Co.*, 363 U.S. 166, 170-71 (1960); accord, *Oliver Bros., Inc. v. FTC*, 102 F.2d 763, 767 (4th Cir. 1939).

<sup>57</sup> See, e.g., Fulda, *The Per Se Provisions of the Robinson-Patman Act*, 49 TEX. L. REV. 961 (1971).

<sup>58</sup> Section 2(c) provides:

It shall be unlawful for any person engaged in commerce, in the course of such commerce, to pay or grant, or to receive or accept, anything of value as a commission, brokerage, or other compensation, or any allowance or discount in lieu thereof, except for services rendered in connection with the sale or purchase of goods, wares, or merchandise, either to the other party to such transaction or to an agent, representative, or other intermediary therein where such intermediary is acting in fact for or in behalf, or is subject to the direct or indirect control, of any party to such transaction other than the person by whom such compensation is so granted or paid.

15 U.S.C. § 13(c) (1970).

<sup>59</sup> The sponsors of section 2(c) successfully argued before Congress that the independent broker would be eliminated by chain store brokerage practices unless the "unearned" brokerage proscription was adopted. See Fulda, *supra* note 57, at 963. For an excellent legislative history of the Act, see Fulda, *Food Distribution in the United States*,



question in section 2(c) litigation is whether a specific allowance granted to a buyer is a lawful functional discount or a prohibited unearned brokerage allowance.

### 1. The "Services Rendered" Exception

Prior to the passage of the Act, Congressman Emanuel Celler admonished his colleagues: "The bill finally agreed upon [in conference] . . . contains many inconsistencies, and the courts will have the devil's own job to unravel the tangle."<sup>60</sup> His prediction was certainly fulfilled by the treatment accorded the "except for services rendered" language of section 2(c). The Commission nearly emasculated the services rendered exception in *Biddle Purchasing Co. v. FTC*,<sup>61</sup> and again in *Great Atlantic & Pacific Tea Co.*<sup>62</sup> In *Biddle*, respondent provided a market information and purchasing service for its customers. In purchasing products from the manufacturers on behalf of its customers, Biddle obtained a commission which, in turn, would be passed on to its customers.<sup>63</sup> In some instances, the commission passed on to the customers would exceed the monthly charge paid by them to Biddle.<sup>64</sup> The Federal Trade Commission charged that this practice constituted a receipt of illegal brokerage payments under section 2(c). The Commission's theory was that under the agreement with its customers, Biddle was reduced to an agent.<sup>65</sup> Thus, payment of a commission to Biddle by the manufacturers was a *prima facie* violation of section 2(c).

The court accepted the Commission's characterization of Biddle<sup>66</sup> as an agent of its subscribing purchasers, and then noted: "[I]t is clear that the statute prohibits payment of brokerage by the seller to the buyer or his agent . . . except for services rendered."<sup>67</sup> Rather obviously it can be argued that the broker provided services

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*the Struggle Between Independents and Chains*, 99 U. PA. L. REV. 1051 (1951).

Professor Fulda has noted that the principal target of the provision was the Great Atlantic and Pacific Tea Co., (A&P), which had for several years exacted, through its "brokers," significant fees from suppliers to the competitive disadvantage of its competitors. These purchasing agencies were able to collect substantial brokerage fees or allowances because they provided substantial services to the sellers, *e.g.*, providing market information, advice about product quality, and traffic and routing information. Fulda, *supra* note 57, at 963-65. A&P's brokerage practices were subsequently successfully challenged by the FTC. *Great Atl. & Pac. Tea Co. v. FTC*, 106 F.2d 667 (3d Cir. 1939), *cert. denied*, 308 U.S. 625 (1940).

<sup>60</sup> 80 CONG. REC. 9419 (1936).

<sup>61</sup> 96 F.2d 687 (2d Cir.), *cert. denied*, 305 U.S. 634 (1938).

<sup>62</sup> 26 F.T.C. 486 (1938), *aff'd*, 106 F.2d 667 (3d Cir. 1939), *cert. denied*, 308 U.S. 625 (1940).

<sup>63</sup> 96 F.2d at 689.

<sup>64</sup> *Id.*

<sup>65</sup> *Id.* at 691.

<sup>66</sup> *Id.*

<sup>67</sup> *Id.*

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for its sellers; this posed a significant problem for the court.<sup>68</sup> Nevertheless, in considering the exception, the court looked to the legislative history of section 2(c), and concluded that "Congress must have intended that payments by sellers should not be made to buyers through any one acting as agent for the buyer. . . . If buyers' agents . . . are excepted for services rendered, so too are the buyers themselves."<sup>69</sup> Thus, it would appear that the court held that an agent of a buyer can never receive a brokerage payment. The same legislative history relied upon by the court to reach that conclusion, however, contained a statement that section 2(c) "permits the payment of compensation by a seller to his broker or agent for services actually rendered . . . but it prohibits the . . . indirect payment of brokerage *except* for such services rendered."<sup>70</sup> Thus, there was apparently authority that even indirect brokerage could be paid in return for services rendered.<sup>71</sup>

A result similar to *Biddle* was reached in *Great Atlantic & Pacific Tea Co., (A & P)*<sup>72</sup> where both the Third Circuit and the Commission acknowledged that buyers are included within the "for services rendered" exception, but that an agent of the buyer cannot as a matter of law render compensable services within the meaning of the statute.<sup>73</sup> With the *Biddle* and *A & P* holdings, and the subsequent decisions of the First and Fifth Circuits in *Quality Bakers of America v. FTC*,<sup>74</sup> and *Webb Crawford Co. v. FTC*,<sup>75</sup> respectively, it was well established that the "for services rendered" exception provided little comfort to brokers who were considered by the courts to be agents of the buyers.

The case law relative to the services rendered exception remained static until the Supreme Court's decision in 1960 in *FTC v. Henry Broch & Co.*<sup>76</sup> There the Court held that respondent, an independent sales broker, had violated the Act by reducing its customary commission to allow a seller to reduce its prices to a tough bargaining buyer. The Court, acknowledging that the proscriptions of the Act apply equally to brokers acting as sellers' agents, determined that respondent should have lowered its commission on all sales to all buyers in order to avoid entanglement with the statute.<sup>77</sup> Particularly relevant

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<sup>68</sup> *Id.* Indeed, the dissent concluded that the exception was operational in this case. *Id.* at 693 (dissenting opinion).

<sup>69</sup> *Id.* at 691.

<sup>70</sup> H.R. REP. NO. 2951, 74th Cong., 2d Sess. 7 (1936).

<sup>71</sup> The court recognized the dilemma, but concluded that the statutory language "may be given effect by a construction that will harmonize with the remainder of that section." 96 F.2d at 691.

<sup>72</sup> 26 F.T.C. 486 (1938), *aff'd*, 106 F.2d 667 (3d Cir. 1939), *cert. denied*, 308 U.S. 625 (1940).

<sup>73</sup> 106 F.2d at 674; 26 F.T.C. at 512.

<sup>74</sup> 114 F.2d 393 (1st Cir. 1940).

<sup>75</sup> 109 F.2d 268 (5th Cir.), *cert. denied*, 310 U.S. 638 (1940).

<sup>76</sup> 363 U.S. 166 (1960).

<sup>77</sup> *Id.* at 176. The decision has been widely criticized. See, e.g., F. ROWE, PRICE DISCRIMINATION UNDER THE ROBINSON PATMAN ACT § 12.7 at 361 (1962); Fulda, *supra* note 57, at 968.

to the instant discussion is a footnote intimating that the "for services rendered" exception is not necessarily rendered nugatory with regard to brokers. The Court stated:

We need not view this administrative practice as laying down an absolute rule that § 2(c) is violated by the passing on of savings in broker's commissions to direct buyers, for here . . . the "savings" in brokerage were passed on to a single buyer who was not shown in any way to have deserved favored treatment.<sup>78</sup>

The Court's statement seemed to imply that a buyer might "deserve" an allowance in a proper case. This implication was buttressed where, after acknowledging criticism of the *A & P* decision, the Court stated:

There is no evidence that the buyer rendered any services to the seller or to the respondent nor that anything in its method of dealing justified its getting a discriminatory price by means of a reduced brokerage charge. We would have quite a different case if there were such evidence and we need not explore the applicability of § 2(c) to such circumstances.<sup>79</sup>

The import of these comments seems to be that in some cases services might be rendered by brokers in such a manner as to be compensable under the subsection.<sup>80</sup>

Subsequently, in *Thomasville Chair Co. v. FTC*,<sup>81</sup> the Fifth Circuit permitted a manufacturer to assert a limited cost justification defense under the services rendered exception.<sup>82</sup> There the respondent manufacturer had charged its jobber purchasers a lower price than its car-load purchasers because respondent's salesmen received a smaller commission on sales to the jobbers.<sup>83</sup> The difference in commissions resulted from a difference in time and effort necessary to make sales to each group. The practice was challenged by the Commission, which subsequently found that respondent had passed on to its jobber customers a discount in lieu of brokerage.<sup>84</sup> The Fifth Circuit reversed the Commission, holding that the amount of commissions saved in consummating sales to different purchasers is relevant in determining whether there has been discrimination.<sup>85</sup> Since the Commission had thus applied an erroneous standard, the court remanded the case for further proceedings consistent with the proper standard.<sup>86</sup> On re-

<sup>78</sup> 363 U.S. at 177 n.19.

<sup>79</sup> *Id.* at 173.

<sup>80</sup> See Note, *Beleaguered Brokers: The Evisceration of Section 2(c) of the Robinson-Patman Act*, 77 HARV. L. REV. 1308 (1964).

<sup>81</sup> 306 F.2d 541 (5th Cir. 1962).

<sup>82</sup> *Id.* at 545-46.

<sup>83</sup> *Id.* at 543.

<sup>84</sup> *Thomasville Chair Co.*, 58 F.T.C. 441, 443 (1961).

<sup>85</sup> 306 F.2d at 542.

<sup>86</sup> *Id.* at 546.

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mand the Commission dutifully dismissed the complaint, but expressly stated its disagreement with the standard established by the court.<sup>87</sup> Although in a subsequent case Commissioner Elman appeared to adopt the court's interpretation and conclusion,<sup>88</sup> it is still unclear whether the Commission has changed its position on this issue.

It would appear that the holding in *Thomasville* does no harm to section 2(c)'s purpose of preventing dummy discounts. The statute specifically permits brokerage payments for services rendered. Thus, the court seems to have indirectly resurrected the "except for services rendered" language of the Act by allowing a defendant to argue that there has been no discrimination—essentially a cost-justification defense. While the effect of the *Thomasville* decision is to remove a measure of the protection formerly accorded small businesses under the Act, it is salutary from the perspective of free competition. The seller is now able to pass on to the buyer economies resulting from the buyer's efficient mode of purchasing. Ultimately, some of these savings should accrue to consumers.<sup>89</sup>

### 2. Brokers' Transactions on Their Own Accounts

Brokerage houses sometimes complete transactions for their own accounts; that is, the brokerage house purchases goods from sellers, holds the goods until market conditions are favorable, and then sells the goods to subsequent purchasers. This practice gives rise to possible violations of section 2(c) if the brokerage house accepts allowances or other payments from the original seller.

In *Southgate Brokerage Co. v. FTC*,<sup>90</sup> the Commission ordered a seller to stop granting such discounts to a brokerage house purchasing for its own account. On appeal to the Fourth Circuit, the brokerage house advanced several arguments to justify the discounts. First, it argued that it performed certain functions, specifically warehousing, which justified the discounts.<sup>91</sup> The court concluded that the Commis-

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<sup>87</sup> 63 F.T.C. 1048, 1049 (1963).

<sup>88</sup> *Tillie Lewis Foods, Inc.*, 65 F.T.C. 1099, 1150-51 (1964) (concurring opinion).

<sup>89</sup> One might argue that the facts of *Thomasville* are distinguishable from those of *Broch*, to the extent that the Fifth Circuit erred in its reliance on the 1960 Supreme Court decision. In *Broch* the questioned reduction was made in order to consummate a single sale to a single customer, 363 U.S. at 168, whereas the questioned sale in *Thomasville* was merely part of the respondent's ongoing business of selling manufactured products. 306 F.2d at 543. Also, the defendant in *Broch* was a middle person, 363 U.S. at 167, while the defendant in *Thomasville* was a seller. 306 F.2d at 542. In *Broch*, the middle person was an independent broker, 363 U.S. at 167-68, while in *Thomasville* the recipients of the reduced commissions were the defendant's employees. 306 F.2d at 543. Nevertheless, these factual differences are not sufficient to distinguish the two cases. The *Broch* case intimated that brokerage payments for services rendered may be permissible. See text at note 79-80 *supra*. *Thomasville* simply brought this aspect of *Broch* to fruition.

<sup>90</sup> 39 F.T.C. 166, *aff'd*, 150 F.2d 607 (4th Cir. 1945).

<sup>91</sup> 150 F.2d at 608. Appellant Southgate made purchases from its suppliers both as a broker and on its own account. In the later instance, the merchandise was stored

sion had properly excluded evidence on this matter since such evidence, while germane to a cost justification defense under section 2(a), is irrelevant in an action under section 2(c).<sup>92</sup> Respondent then sought to justify the discount by noting that sales from its own account were made to wholesalers who would have paid the same price regardless of whether the wholesalers purchased from a brokerage house transacting on its own account or from a brokerage house acting merely as a broker. The court also found this evidence irrelevant, reasoning that the receipt of a brokerage allowance by a broker who never performed a broker's function is illegal "without regard to [competitive] effect in a particular case."<sup>93</sup> Respondent finally argued that the allowances received by it in lieu of brokerage were compensation for services performed by it and thus protected by the "services rendered" clause within the statute.<sup>94</sup> The court rather summarily rejected this defense. The court then held that the discounts were unlawful and that the Commission's order prohibiting the practice should be enforced.<sup>95</sup>

Quite obviously the "broker" in the *Southgate* case had elected to take a functional discount, which would be lawful under the price-discrimination provisions of the Act if taken by an ordinary buyer. The Commission's position, upheld by the Fourth Circuit, seemed to be that a broker, by virtue of its *status* as a broker, cannot accept an otherwise lawful functional discount. This narrow approach has justifiably prompted one writer to comment that such cases "artificially confine independent brokerage concerns exclusively to agency operations . . . ."<sup>96</sup>

Some 18 years later, the case of *Hruby Distributing Co.*<sup>97</sup> presented the Commission with another opportunity to consider its position. There the Commission had challenged respondent's acceptance of an allowance labeled "brokerage" on goods purchased by respondent for its own account. Respondent, as in *Southgate*, took title to the goods, set its own retail price, and assumed the risks of collection and loss with reference to the goods it handled.<sup>98</sup> Respondent's position on the distribution chain placed it between producers and

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by appellant in its own warehouses, insured under its own name, and taxed to appellant. Additionally, appellant bore the risk of loss in case of accident, and assumed the risk of credit loss; moreover, appellant sold the merchandise at such prices and upon such terms as it, in its sold discretion, determined. In such cases its profit or loss depended on a market advance or decline. *Id.*

<sup>92</sup> *Id.* at 608-09.

<sup>93</sup> *Id.* at 610, quoting *Oliver Bros. v. FTC*, 102 F.2d 763, 767 (4th Cir. 1939).

<sup>94</sup> 150 F.2d at 610.

<sup>95</sup> *Id.* at 611-12.

<sup>96</sup> F. ROWE, PRICE DISCRIMINATION UNDER THE ROBINSON-PATMAN ACT § 12.7, at 359 (1962).

<sup>97</sup> 61 F.T.C. 1437 (1962).

<sup>98</sup> *Id.* at 1446. Goods handled by respondent accounted for approximately 50% of the goods sold; the remaining goods were dropshipped directly to its customers. *Id.*

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wholesalers who sold to retail grocers.<sup>99</sup> The question thus presented was whether the allowance was an illegal brokerage payment or a permissible functional discount. The trial examiner, in concluding that *Hruby* was "on all fours"<sup>100</sup> with *Southgate*, took cognizance of the fact that many of the sales documents referred to the discounts as "brokerage"<sup>101</sup> but that the respondent was purchasing on its own account.<sup>102</sup> The examiner thus determined that respondent's acts and practices were in violation of section 2(c), and entered a cease and desist order.<sup>103</sup> On appeal, the Commission reversed, holding that the payments, despite their label, were legal functional discounts and not illegal brokerage.<sup>104</sup> The Commission reasoned that the purpose of section 2(c) is to prohibit "dummy" allowances, and clearly respondent was not the alter ego of, or otherwise controlled by, its customers.<sup>105</sup>

When *Southgate* is juxtaposed with *Hruby*, three conclusions are possible. First, the cases can be harmonized. In *Hruby* respondent was not a broker; in *Southgate* respondent was admittedly a broker, but a broker who on occasion purchased on its own account. Thus the two cases may be read as holding that a broker may not on occasion purchase on its own account and legally receive a functional discount. In short, brokers must always be brokers. Second, one may read *Hruby* as inconsistent with *Southgate* and thus evidencing a change in the Commission's position. This seems to be the view taken by Commissioner MacIntyre in his dissent in *Hruby*.<sup>106</sup> A third reading of the case is that the court's decision in *Southgate* was limited to a construction of the "for services rendered" exception to section 2(c), and that the court in *Southgate* did not address the question—apparently conceded—of whether the discount was in lieu of brokerage.<sup>107</sup>

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<sup>99</sup> *Id.* The Commission noted that respondent's position on the distribution chain placed it in the same position as food brokers, and "that in order to remain in business, [respondent] must be able to offer and sell to wholesalers at a price competitive with that offered to wholesalers by producers selling through food brokers." *Id.* The Commission also noted that respondent provided warehousing, credit and small lot deliveries to its customers—services not commonly offered by brokers. *Id.*

<sup>100</sup> *Id.* at 1444.

<sup>101</sup> *Id.* at 1441.

<sup>102</sup> *Id.* at 1442.

<sup>103</sup> *Id.* at 1445.

<sup>104</sup> *Id.* at 1449.

<sup>105</sup> *Id.* at 1447-48.

<sup>106</sup> *Id.* at 1449. In response to respondent's contention that the allowances represented a functional discount and not a brokerage payment, Commissioner MacIntyre argued that *Southgate* had disposed of this defense. *Id.* at 1453. More interestingly, Commissioner MacIntyre seemed to question the basic propriety of functional discounts. *Id.*

<sup>107</sup> This is the position taken by Judge Moore in his dissent to the panel's decision in *Empire Rayon Yarn Co. v. American Viscose Corp.*, 354 F.2d 182 (2d Cir. 1965):

[A]s Judge Weinfeld noted in his opinion on the first motion in this case, in *Southgate* the applicability of Section 2(c) to the discounts granted was not in issue, i.e., there was no dispute as to whether they constituted an allowance in lieu of brokerage, as the situation is here. *Empire Rayon*

Perhaps the lesson to be learned from a comparison of *Southgate* and *Hruby* is that the label attached to a particular discount—functional discount or discount in lieu of brokerage—might be determinative of the validity of the transaction. This would appear to be the case, since, in the author's view, the roles performed by *Southgate* and *Hruby* appear strikingly similar. It is submitted that where a concern clearly acts in two capacities—as buyer and broker—it should be permitted to receive a functional discount for those services performed in its buying capacity. To reason otherwise would be to place form over substance.

### 3. The Allocation of Superior Functions Among Dual Function Customers: The Relationship Between Sections 2(a) and 2(d)

The Act expressly provides that nothing within it shall prevent a seller from selecting its own customers.<sup>108</sup> Once a seller selects its customers, however, section 2(d) requires that services or facilities made available to one customer must be made available in proportionally equal terms to all other customers competing with the favored customer in the distribution of the products or commodities involved.<sup>109</sup> Section 2(d) can create problems for sellers where their customers are engaged in dual distribution, because the question arises whether a seller may be selective in the allocation of superior functional status<sup>110</sup> to its customers or, alternatively, whether it must make those positions available to all on a non-discriminatory basis.

*Empire Rayon Yarn Co. v. American Viscose Corp.*<sup>111</sup> provides some guidance on this issue. Plaintiff purchaser was engaged in the dual distribution of yarn which it purchased from manufacturers. Some of the yarn was processed and sold as a finished product, while the rest was sold in the original package to other processors. American Viscose Corporation, a manufacturer of yarn, had provided two of plaintiff's competitors with a price discount in lieu of brokerage while denying plaintiff's request for similar treatment.<sup>112</sup> Alleging a violation of section 2(c), plaintiff filed a suit against the manufacturer and plaintiff's competitors.

*Yarn Co. v. American Viscose Corp.*, 160 F. Supp. 334, 336 n.5 (S.D.N.Y. 1958). The sole issue in *Southgate* was whether the payments were made "in return for services rendered" to the seller and, thus, excepted from Section 2(c).

354 F.2d at 188.

<sup>108</sup> 15 U.S.C. § 13(a) (1970). See also *United States v. Colgate & Co.*, 250 U.S. 300 (1919).

<sup>109</sup> 15 U.S.C. § 13(d) (1970).

<sup>110</sup> For purposes of this article, a customer with "superior functional status" is one who occupies a relatively high level on the distribution chain, e.g., wholesaler, thereby entitling that customer to a relatively high discount in accordance with the superior function performed.

<sup>111</sup> 238 F. Supp. 556 (S.D.N.Y.), *rev'd*, 354 F.2d 182 (2d Cir. 1965), *rev'd en banc*, 364 F.2d 491 (2d Cir. 1966).

<sup>112</sup> 238 F. Supp. at 557.

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The evidence demonstrated that plaintiff's competitors were transacting on their own account.<sup>113</sup> Nevertheless, the court assumed that the competitors performed the function of brokers, which placed defendants' conduct within the purview of the statute in that the manufacturer had given and the competitors had received discounts in price in lieu of brokerage commissions.<sup>114</sup> The court then determined, however, that defendants' conduct was insulated by the "for services rendered" exception.<sup>115</sup>

On appeal before the Second Circuit, a panel reversed the district court, basing its reversal on a determination that defendant had not performed any brokerage function:

[Plaintiff's competitors] bought goods from [defendant], kept on hand a stock of these goods, and sold them to the purchasers they found ready to buy. In reselling the goods which they bought from [defendant] they were no more acting as brokers than are retailers who buy goods from wholesalers and sell them to consumers.<sup>116</sup>

Anticipating the argument that if there was no brokerage section 2(c) had no application, the court responded that "[t]he prohibition of the statute is not confined to brokerage but extends also to . . . 'other compensation, or any allowance of discount in lieu thereof.'"<sup>117</sup> Unsupported by any brokerage services rendered, the discount was held to be unlawful.<sup>118</sup>

On en banc rehearing the court vacated the earlier opinion of the panel.<sup>119</sup> The FTC, as amicus curiae on rehearing, argued that the discount there in question "bears all the characteristics of a functional discount, the validity of which should be judged under Section 2(a)."<sup>120</sup> Relying heavily on the opinion of the Commission, the court agreed, concluding that the plaintiff's claim should be based on section 2(a), not section 2(c).<sup>121</sup> Unfortunately, the decision of the full court is singularly cryptic and, like the panel's opinion, provides little assistance in delineating the extent to which a seller must make the superior functional status available to all other customers. The decision is nevertheless significant in that the respondent was not required to make the status available on an equal basis.

This result seems inconsistent with that reached in *Mueller Co. v.*

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<sup>113</sup> *Id.* at 559.

<sup>114</sup> *Id.*

<sup>115</sup> *Id.* at 560.

<sup>116</sup> 354 F.2d at 186.

<sup>117</sup> *Id.* at 187, quoting from 15 U.S.C. § 13(c) (1970).

<sup>118</sup> "A 'functional discount' which is paid, like commissions and brokerage, in connection with such a sale, may be used to mask price discrimination in violation of the legislative purpose of Section 2(c)." 354 F.2d at 187.

<sup>119</sup> See 364 F.2d at 492.

<sup>120</sup> *Id.*

<sup>121</sup> *Id.* at 493.



FTC<sup>122</sup> where the Seventh Circuit held that a manufacturer's failure to extend a special functional discount to all purchasers of its products constitutes a violation of section 2(a).<sup>123</sup> In *Mueller*, the Commission challenged a manufacturer's practice of allowing a special category of jobbers a greater functional discount than that permitted ordinary jobbers. Although the action was brought under section 2(a), the Commission argued before the court of appeals "that [the manufacturer] had failed to establish the section 2(d) 'defense' " of availability to all purchasers on proportionately equal terms.<sup>124</sup> The court noted initially that there was substantial evidence that status as a special category jobber was theoretically available to all jobbers.<sup>125</sup> However, the manufacturer's decision of whether to actually extend the status to a particular jobber was influenced both by practical considerations, such as whether it already had adequate distribution in that geographic area, and by its concern for the protection of established jobbers.<sup>126</sup> Therefore the court held that section 2(a) of the Act had been violated because the premium functional discount was not actually available to all purchasers as required by section 2(d) of the Act.<sup>127</sup> Unfortunately, the import of the court's discussion of section 2(d) within the context of section 2(a) is somewhat clouded because resolution of this question was unnecessary to the resolution of the case.<sup>128</sup>

The decision of the Ninth Circuit in *Alhambra Motor Parts v. FTC*<sup>129</sup> is similarly noteworthy. Respondent, a cooperative purchasing entity whose membership was composed of automotive parts jobbers, was accorded a greater functional discount on its purchases than that given to jobbers purchasing independently. The Commission argued that the practice violated section 2(f) in that the respondent had induced or received a discriminatory price prohibited by section 2(a).<sup>130</sup> Respondent contended in defense that the discount was justified by cost differences, and was thus lawful under the proviso to section

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<sup>122</sup> 323 F.2d 44 (7th Cir. 1963), *cert. denied*, 377 U.S. 923 (1964), *affirming* 60 F.T.C. 120 (1962).

<sup>123</sup> 323 F.2d at 46.

<sup>124</sup> *Id.* at 46-47.

<sup>125</sup> *Id.* at 46.

<sup>126</sup> *Id.*

<sup>127</sup> *Id.* See 15 U.S.C. § 13(d) (1970).

<sup>128</sup> The actual holding—or at least alternative holding—of the case results from the court's finding that on many occasions "stocking" jobbers received the added discount on goods purchased after having received orders from their customers. 323 F.2d at 47. On these occasions there was no showing that the stocking jobbers performed additional or different functions than did the ordinary jobbers and yet they received the favored discount. The court, in finding that respondent was in violation of the price discrimination provisions of the Act, concluded that the actual function performed, and not the label attributed to the jobber, determined the propriety of the discount. *Id.*

<sup>129</sup> 309 F.2d 213 (9th Cir. 1962).

<sup>130</sup> *Id.* at 216. For a discussion of the provisions of § 2(f) of the Act see note 53 *supra*.

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2(a).<sup>131</sup> Specifically, respondent noted that it provided its suppliers with centralized ordering, financial responsibility for payment, warehousing and transportation. The court held that the cost-justification defense had not been appropriately considered by the Commission and remanded the case.<sup>132</sup> The court stated, however, that the defense should be denied if it was found that the special discount was not available on proportionately equal terms to independent jobbers competing with the jobber members.<sup>133</sup>

*Mueller*, and more particularly *Alhambra Motor Parts*, seem to suggest that availability of the favored status to all purchasers constitutes a defense to a charge of discrimination. While there is certainly authority for a general defense of equal availability under the Act,<sup>134</sup> such a defense would provide little insulation to the defendant in *Empire Rayon Yarn*, who failed to make such a favored status available to all of its customers.

There does not appear to be any definitive answer to this problem. What is clear, however, is that section 2(d), if read too broadly, has the capacity to practically eliminate functional discounts. An "actual availability to all" requirement might create a reluctance in suppliers to compensate customers for their ability to furnish needed services to the supplier.

### B. Cooperative Purchasing Ventures

Cooperative purchasing ventures have also provided fertile soil for litigation. As indicated above,<sup>135</sup> the distributive position of a reseller for purposes of functional discounting is determined by the capacity in which it resells rather than that in which it buys. Obviously, this rule has the effect of minimizing the amount of the discount. In efforts to avoid this rule and thus to secure the maximum discounts possible, cooperatives have sought classification as separate legal entities wholly distinct from their member owners.

The Commission and the courts have generally been unwilling to recognize the cooperative as being separable from its members, just as they have been generally unwilling to treat the purchasing arm of the vertically integrated chain, though a separate corporate entity, as being entitled to functional discounts in accordance with its purchaser

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<sup>131</sup> *Id.* at 217.

<sup>132</sup> *Id.* at 219.

<sup>133</sup> *Id.* at 216.

<sup>134</sup> See *Borden Co. v. FTC*, 381 F.2d 175 (5th Cir. 1967), where the court held that while sales of branded and private label milk at two different prices might constitute price discrimination, *id.* at 177, no injury was established where the branded and private label milks were available to all. *Id.* at 180-81. *Accord*, *Tri-Valley Packing Association*, 70 F.T.C. 223 (1966), *aff'd*, 411 F.2d 985 (9th Cir. 1969).

<sup>135</sup> See text at notes 37-42 *supra*.

status.<sup>136</sup> *Quality Bakers of America v. FTC.*,<sup>137</sup> an early group-purchasing case, reflects the treatment accorded cooperative purchasing ventures by the courts. Quality Bakers was a cooperative association of seventy bakery companies that collected brokerage from sellers on purchases made through the association by its members. After subtracting operating expenses, the association credited this brokerage to its respective members' accounts in proportion to their purchase.<sup>138</sup> The Commission challenged the practice under section 2(c), alleging that the association was receiving and paying to its members illegal brokerage or allowances.<sup>139</sup> Quality Bakers responded that it provided its suppliers with valuable services, and was thus entitled to brokerage in the same manner as an independent brokerage house under the exception "for services rendered."<sup>140</sup>

The First Circuit initially acknowledged some validity in the association's argument:

Undoubtedly the sellers received valuable benefits and advantages from the business given them by the Service Company, other than the ordinary profits on the sales. For instance, they were saved the expense incident to obtaining the business and dealing separately with numerous customers taking a large amount of merchandise. . . . For these benefits the sellers were willing to pay and did pay . . . .<sup>141</sup>

Nevertheless, the court found that the association was the "agent for the purchasers" and as such was not entitled to brokerage.<sup>142</sup> This finding compelled the conclusion that the association could not invoke the "for services rendered" exception of the statute and that the receipt and payment of brokerage was therefore unlawful.<sup>143</sup>

The next significant case to review the status of cooperative pur-

<sup>136</sup> *Webb-Crawford Co. v. FTC.*, 109 F.2d 268 (5th Cir.), cert. denied, 310 U.S. 638 (1940), illustrates the extent to which the courts and the Commission have gone in precluding purchasing entities owned, controlled by, or otherwise associated with resellers from obtaining a supplier's functional discount. In *Webb-Crawford*, the allowance of such a discount was held impermissible where the brokerage company and the company it supplied were owned by essentially the same people. 109 F.2d at 270. The case is weaker than the more common parent-subsidiary fact situation, in that the ownership of one company was not vested in the other. See also *North American Philips Co.*, 55 F.T.C. 682 (1958); *Thomas Page Mill Co.*, 33 F.T.C. 1437 (1941); *Mississippi Sales Co.*, 30 F.T.C. 1282 (1940).

<sup>137</sup> 114 F.2d 393 (1st Cir. 1940).

<sup>138</sup> *Id.* at 396-97.

<sup>139</sup> *Quality Bakers of America*, 29 F.T.C. 1328, 1334 (1939).

<sup>140</sup> 114 F.2d at 398.

<sup>141</sup> *Id.* at 398.

<sup>142</sup> *Id.* at 399.

<sup>143</sup> *Id.* Similar results were reached in three other early group purchasing cases. *Associated Merchandising Corp.*, 40 F.T.C. 578 (1945); *Caradine Hat Co.*, 39 F.T.C. 86 (1944); *United Buyers Corp.*, 34 F.T.C. 87 (1941). Two minor differences should be noted. *Associated* was a § 2(f) proceeding brought against the organization's members. 40 F.T.C. at 579. In *Caradine* it was the supplier of the cooperative and not the cooperative or its members, whose practices were being challenged. 39 F.T.C. at 87-88.

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chasing ventures was *Modern Marketing Service, Inc. v. FTC*.<sup>144</sup> *Modern Marketing* is significant because it illustrates the extent to which the courts have been able to apply agency principles to invalidate group purchase efforts to secure functional discounts. Respondent independent grocery companies had originally purchased through their cooperative venture, Red and White Corporation. However, the grocery companies ceased making purchases from Red and White and instead began to purchase from respondent Modern Marketing—a company in which neither the purchasing grocery companies nor Red and White had any interest.<sup>145</sup> Because Modern Marketing was owned by employees of Red and White, however, the Seventh Circuit found that the independent grocery companies controlled Modern Marketing through their ownership of Red and White.<sup>146</sup> Respondent Modern Marketing nevertheless argued that it had rendered bona fide services to its suppliers and was thus entitled to its earned brokerage under the “for services rendered” exception. As in *Quality Bakers*, the court rejected the proffered justification: “[W]e think the proof shows, that such services were genuine and of benefit to such sellers. . . . [W]here such [agency] relationship exists [, however,] it is immaterial whether the services rendered the seller were genuine or fictitious . . . .”<sup>147</sup> Thus, the cooperative scheme was held to be violative of section 2(c) of the Act.<sup>148</sup>

In *National Retailer-Owner Grocers, Inc.*,<sup>149</sup> the issue of the distinction between the payment of an illegal brokerage allowance and a functional discount to a cooperative arose again. Thirty-five retailer-owned wholesale grocery houses formed the respondent cooperative to provide a central purchasing organization that could achieve economies through bulk purchases. The cooperative’s negotiations with its suppliers were based upon estimates of merchandise needs furnished by members at the beginning of each season.<sup>150</sup> When a member required supplies, it would order from the cooperative which, in turn, would order the goods from its supplier. The goods were shipped directly to the member, while the bill was sent to the cooperative which paid the supplier and billed the member—the bill reflecting not only the cooperative’s cost but also an additional

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<sup>144</sup> 149 F.2d 970 (7th Cir. 1945).

<sup>145</sup> See *id.* at 976-77.

<sup>146</sup> *Id.* at 978.

<sup>147</sup> *Id.* See *Quality Bakers*, 114 F.2d at 399.

<sup>148</sup> *Id.* at 979. As a result of the Commission’s order, Modern Marketing went out of business. C. EDWARDS, *THE PRICE DISCRIMINATION LAW* 121 (1969). The Commission subsequently directed itself to similar practices employed by International Grocery Alliance (IGA), where it found the allowance of brokerage to respondent IGA for sales made to IGA affiliated grocery concerns illegal. *Independent Grocers Alliance Dist. Co. v. FTC*, 203 F.2d 941, 946 (7th Cir. 1953). As would be expected, the court placed reliance on its earlier decision in *Modern Marketing Service, Inc.* at 945.

<sup>149</sup> 60 F.T.C. 1208 (1962), *rev’d sub nom.* *Central Retailer-Owned Grocers, Inc. v. FTC*, 319 F.2d 410 (7th Cir. 1963).

<sup>150</sup> 60 F.T.C. at 1234.

amount to absorb its operating expenses.<sup>151</sup> The FTC issued a cease and desist order, concluding that the arrangement violated section 2(c) of the Act.<sup>152</sup>

On appeal, under the name *Central Retailer-Owner Grocers, Inc. v. FTC*,<sup>153</sup> the Seventh Circuit reversed, relying heavily on the cooperative's argument that it performed legitimate distribution functions that should be compensated: its suppliers received advance commitments assuring the suppliers of a definite volume of business, it absorbed the billing function, and the arrangement reduced the supplier's credit risk.<sup>154</sup> The court also reasoned that the survival of small firms, particularly in those industries characterized by the growth of giant chains, may be dependent on cooperative purchasing schemes,<sup>155</sup> since this method of combination enables independent purchasers to counter the buying advantages of the corporate chains.<sup>156</sup>

Unfortunately, as seems the rule in functional discount cases, the holding of the Seventh Circuit is somewhat unclear. Understandably, the Commission placed significant reliance on the Seventh Circuit's earlier decision in *Modern Marketing*.<sup>157</sup> Although the court distinguished *Modern Marketing* rather summarily,<sup>158</sup> it also declared that the evidence "lends no support to the inference drawn by the Commission to the effect that [the cooperative] received or accepted price

<sup>151</sup> *Id.* at 1220.

<sup>152</sup> *Id.* at 1241.

<sup>153</sup> 319 F.2d 410 (7th Cir. 1963).

<sup>154</sup> *Id.* at 414.

<sup>155</sup> Interestingly, the court placed significant reliance on a speech by Commissioner Dixon, who wrote the opinion of the Commission which the court reversed.

[C]ombination in one form or another by small firms may be essential to their survival, particularly in those industries characterized by massive aggregates of corporate power. The growth of the giant food chains, for example, revolutionized the behavior of the small independent grocery stores. They were quickly faced with the alternative of constructing cooperative buying arrangements or extermination. Certainly many independent food stores long ago would have withered before the competitive threat of large chains had they not formed retailer-owned cooperative wholesalers; stores with combined retail sales of over \$7 billion are now affiliated with such jointly-owned wholesalers.

*Id.* at 415, quoting Address of Commissioner Paul Rand Dixon Before the Economic Club of Detroit, March 12, 1963.

<sup>156</sup> Cooperatives can match the advantages inhering in the chains in four ways. First, brokerage receipts can be passed on to members in money or savings, or alternatively, be used to provide services to members, e.g., managerial training. Second, quantity discounts become available to what would otherwise be small purchasers. Third, members can market "their own" private label products. Fourth, the group purchasing power may be used to entice sellers to grant special discounts in order to enjoy the custom of the association. See C. EDWARDS, *supra* note 148, at 118.

<sup>157</sup> 60 F.T.C. at 1237, 1239. See 149 F.2d 970 (7th Cir. 1945). The Commission also relied on Independent Grocers Alliance Dist. Co. v. FTC, 203 F.2d 941 (7th Cir. 1953). 60 F.T.C. at 1239.

<sup>158</sup> 319 F.2d at 415 n.5. Independent Grocers Alliance Dist. Co. v. FTC, 203 F.2d 941 (7th Cir. 1953) was similarly distinguished.

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concessions 'in lieu of brokerage.'"<sup>159</sup> This statement raises the question of whether *Central Retailer* is distinguishable from *Modern Marketing* in that the existence of a brokerage payment was admitted in *Modern Marketing* but contested and found non-existent in *Central Retailer*. At least one commentator has suggested that *Central Retailer* stands only for the proposition that the FTC must do more than compare the amount of the price discount received by the cooperative with the commissions normally received by brokers in similar sales.<sup>160</sup> Moreover, it should be noted that in recent years the Commission has reaffirmed its position in *Modern Marketing*<sup>161</sup> and that the Seventh Circuit itself has cast doubt on the continuing validity of the *Central Retailer* decision.<sup>162</sup>

Cooperative ventures among automobile parts jobbers, like those in the food industry, have also caused much litigation. *American Motor*

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<sup>159</sup> 319 F.2d at 415.

<sup>160</sup> See Note, 15 SYR. L. REV. 612, 613 (1964); cf. Note, 32 GEO. WASH. L. REV. 663 (1963).

<sup>161</sup> See *Modern Marketing Service, Inc.* [1967-1970 Transfer Binder] CCH TRADE REG. REP. ¶ 17,945, at 20,318 (FTC 1967).

<sup>162</sup> *Monroe Auto Equip. Co. v. FTC*, 347 F.2d 401, 404 (7th Cir. 1965), cert. denied, 382 U.S. 1009 (1966). In *Monroe Auto Equipment Co.*, the FTC successfully invoked the indirect purchaser doctrine to enjoin respondent's practice of allowing warehouse distributors a greater functional discount than that accorded jobbers on the next lower distributional tier, where those distributors were affiliated with certain of their jobber-customers and where those jobbers received the benefit of their supplier-warehouse distributor allowance. 347 F.2d at 402. Respondent invoked *Central Retailer* in defense, *id.* at 404, but the court disagreed, stating that "in *Central*, the Commission . . . took the position that the sums *Central* received and accepted from certain of its suppliers constituted [impermissible] brokerage or allowances in lieu of brokerage . . . . It was upon that theory alone that the case was submitted to and decided by us. No such theory has been asserted in the case at bar; our holding in *Central* is inapposite here." *Id.*

See also *Purolator Prods. Inc.*, 65 F.T.C. 8 (1964), *aff'd*, 352 F.2d 874 (7th Cir. 1965), cert. denied, 389 U.S. 1045 (1968). The *Purolator* case presented a complex distribution and functional discount system. *Purolator* manufactured automotive filters and restricted its sales to warehouse distributors. The warehouse distributors were classified into two groups—those who had single locations and those who had branches or affiliated jobbers. The greatest discounts were given to those warehouse distributors who sold to affiliated jobbers. 352 F.2d at 878. The Commission claimed that the extra, or increased, discount injured competition between distributors by subsidizing the internal operation of those distributors with affiliated jobbers. The Commission rejected *Purolator's* claim that such discounts merely recognized additional functions performed by the distributor and were granted to cover the additional costs associated with those additional functions. 65 F.T.C. at 37. The Commission also claimed that the different prices charged the jobbers injured competition between jobbers. *Purolator's* claim that since it did not sell to jobbers it was not responsible for the cost differences was rejected by the Commission. The Commission relied on the "indirect purchaser" doctrine and found that, since *Purolator* exercised control over the sales from the distributors to the jobbers, *Purolator* was responsible for the discrimination in price charged the different jobbers. *Id.* at 36. The Commission appeared to emphasize only the buyer's reselling function in analyzing the distribution process; complex distribution plans, such as *Purolator's*, were thus unlikely to receive Commission approval. Commissioner Elman, in a separate opinion, was more willing to tolerate additional discounts for the performance of additional functions. *Id.* at 45.

*Specialties Co. v. FTC*<sup>163</sup> was the first fully litigated case of this series.<sup>164</sup> Seventeen jobbers of automotive parts formed a cooperative purchasing entity. This entity received a greater functional discount, in the form of rebates, than that available to independent jobbers, because the cooperative occupied an elevated status on the chain of distribution, although the goods were drop shipped by suppliers directly to jobber members. The discount was ultimately passed on to its members in proportion to their respective purchases.<sup>165</sup> The Commission issued a cease and desist order, concluding that the cooperative violated section 2(f) by inducing or receiving a prohibited discrimination in price.<sup>166</sup>

On appeal, the Second Circuit upheld the Commission's order.<sup>167</sup> Respondents had argued that the banding together of the "small men" was necessary in the face of strong integrated competition that was able to purchase in larger quantities. Indeed, petitioners candidly admitted that "the members sought to associate themselves together in a collective activity for the purpose of achieving the economies and price advantages of larger scale buyers."<sup>168</sup> The court rejected this argument, however, and held the purchasing scheme violative of section 2(f).<sup>169</sup>

<sup>163</sup> 278 F.2d 225 (2d Cir. 1960).

<sup>164</sup> *E. Edelmann & Co. v. FTC*, 239 F.2d 152 (7th Cir. 1956), was actually the first automotive parts case to be litigated in the courts, but the cooperative purchasing aspect of the case received only minor attention, and the opinion focused on other issues. *See id.* at 154-55. That same year the FTC had successfully challenged the payment of functional discounts to group purchasing entities in *Moog Indus. Inc. v. FTC*, 51 F.T.C. 931 (1955), 238 F.2d 43 (8th Cir. 1956), *aff'd*, 355 U.S. 411 (1958). Although the FTC found that the cooperative ventures were "in reality a bookkeeping device for the collection of rebates," 51 F.T.C. at 935, and intimated its disapproval of the practice, *id.* at 938, the decision of the Eighth Circuit turned not on the cooperative purchasing aspects of the case, but on the payment by respondent, at the end of each annual period, of a retroactive volume rebate consisting of a flat, *graded*, percentage of the customer's purchases during the relevant period. 238 F.2d at 49-50. It should be noted that the FTC had earlier challenged cooperative purchasing endeavors in the parts business and had secured numerous consent decrees and victories before the Commission. *See, e.g.*, *D & N Auto Parts Co.*, 55 F.T.C. 1279 (1959), *aff'd sub nom. Mid-South Distribs. v. FTC*, 287 F.2d 512 (5th Cir.), *cert. denied*, 368 U.S. 838 (1961); *Albright's*, 55 F.T.C. 1556 (1959); *Hunt-Marquardt, Inc.*, 55 F.T.C. 910 (1958); *Midwest Warehouse Distribs. Inc.*, 55 F.T.C. 414 (1958); *Warehouse Distribs. Inc.*, 55 F.T.C. 188 (1958).

<sup>165</sup> 278 F.2d at 227.

<sup>166</sup> *American Motor Specialties Co.*, 55 F.T.C. 1430, 1439-41 (1959).

<sup>167</sup> 278 F.2d at 229.

<sup>168</sup> *Id.* at 227.

<sup>169</sup> Respondents also argued that section 4 of the Act afforded them a defense. *Id.* at 229. That section provides:

Nothing in . . . this title shall prevent a cooperative association from returning to its members, producers, or consumers the whole, or any part of, the net earnings or surplus resulting from its trading operations, in proportion to their purchases or sales from, to, or through the association.

15 U.S.C. § 13b (1970). The court summarily rejected the argument, stating that that section "only protects a cooperative association from charges of violating the Act premised upon the association's method of distributing earnings." 278 F.2d at 229.

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*Mid-South Distributors v. FTC*,<sup>170</sup> the second case of import in the series, is similar to *American Motor Specialties*. In *Mid-South Distributors*, petitioners were two purchasing cooperatives and their member jobbers, who organized to take advantage of volume rebates and graduated price schedules.<sup>171</sup> The Commission held that petitioners' buying policy constituted a violation of section 2(f).<sup>172</sup> On review of the Commission's cease and desist order, petitioners frankly argued "that they . . . formed the cooperative associations . . . for the purpose of achieving a measure of competition with their larger, more aggressive rivals . . .,"<sup>173</sup> and that such concerted action was necessary to combat the "enormous bargaining leverage of those integrated distributive organizations."<sup>174</sup> Although the argument was rejected, the Fifth Circuit's rationale was significantly more detailed than the Second Circuit's had been in *American Motor Specialties*. The court reasoned that respondents' focus on their larger competitors was a bit myopic, in that respondents competed not only against the large integrated chains, but also against the other non-member independent jobbers. Therefore the preferential treatment accorded respondents via their cooperative would likely cause injury to the less favored independent non-member jobbers.<sup>175</sup>

*Alhambra Motor Parts v. FTC*<sup>176</sup> is the next major auto parts cooperative decision. The *Alhambra Motor Parts* petitioners were job-

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<sup>170</sup> 287 F.2d 512 (2d Cir.), cert. denied, 368 U.S. 838 (1961). During the interlude between *American Motor Specialties* and *Mid-South Distrib.*, the Commission considered *American Ball Bearings Co.*, 57 F.T.C. 1259 (1960), where it apparently concluded that a similar cooperative venture was illegal under section 2(a). Unfortunately, the Order is sufficiently cryptic to be of little guidance. See *id.* at 1264-65. See also *Borg-Warner Corp.*, 58 F.T.C. 629 (1961).

<sup>171</sup> 287 F.2d at 514-15.

<sup>172</sup> *D & N Auto Parts Co.*, 55 F.T.C. 1279, 1302-03 (1959), *aff'd sub nom.* *Mid-South Distrib. v. FTC*, 287 F.2d 512 (2d Cir.), cert. denied, 368 U.S. 838 (1961).

<sup>173</sup> 287 F.2d at 514.

<sup>174</sup> *Id.* at 515. Petitioners continued:

Petitioners are neither judges, antitrust lawyers, nor soothsayers; they are simply local businessmen operating in a fiercely competitive industry dominated by far larger integrated competitors . . . . Petitioners joined in these cooperatives for the sole purpose of achieving some measure of competitive parity with these rivals.

*Id.* <sup>175</sup> *Id.* at 517. Respondents again argued that section 4 of the Act absolved the questioned conduct, and that the cooperative had an unrestricted right to return to its members " . . . the net earnings . . . resulting from its trading operations, in proportion to their purchases or sales from, to, or through the association." *Id.* at 516. As in *American Motor Specialties* the court rejected the defense, and concluded:

We purposely leave to a future day the problem of delineating the activities which may rightfully come within the congressional purpose of leaving cooperatives "free to seek through cooperative endeavor . . ." and assure to them "any real economies and savings to which mass operations entitle them . . ."

*Id.*, quoting Congressman Utterback, chairman of the House Conferees, 80 CONG. REC. 9415-19 (1936). The court clearly avoided the issue squarely before it.

<sup>176</sup> 309 F.2d 213 (9th Cir. 1962).



bers engaged in the purchase and resale of automotive parts, accessories and supplies. They formed a corporation for the purpose of receiving lower and more favorable prices by manufacturers and sellers of auto parts.<sup>177</sup> The FTC brought an action against petitioners alleging that the receipt of income by the jobbers as a result of the corporation's brokerage<sup>178</sup> and wholesaling<sup>179</sup> operations was illegal under sections 2(a) and 2(f). The Commission found against respondents on both counts and entered a cease and desist order.<sup>180</sup>

On appeal, the FTC argued that *American Motor Specialties* was "fully dispositive of all the issues in the present proceeding . . ."<sup>181</sup> The court affirmed the order with respect to petitioner's brokerage operation, but set aside the order with respect to petitioner's wholesaling operation.<sup>182</sup> The case was remanded to the Commission for an examination of the availability of the cost justification defense relative to the wholesaling operation.<sup>183</sup> In closing, the court intimated that notwithstanding the ultimate resolution of that issue, petitioners might be entitled to the discount anyway.<sup>184</sup> Although the indirect purchaser doctrine was not specifically mentioned, the court stated that the issue was whether the discount was, as a matter of law, paid to the cooperative or whether the cooperative entity would be ignored and the jobber-members deemed the actual recipients.<sup>185</sup> While it did not resolve the issue, the court seemed to suggest that payment of the discount was proper. The court also emphasized several times that the instant case was distinguishable from earlier cases in that the respondent performed valuable bona fide warehousing services.<sup>186</sup>

*Alhambra Motor Parts* is significant because it raises the possibility that a purchasing cooperative might be entitled to a functional discount if it warehouses the goods. By implication, wherever a purchasing entity performs any meaningful function the vitality of the indirect purchaser doctrine may become subject to question. It should be noted, however, that on remand the Commission found that the

<sup>177</sup> *Alhambra Motor Parts*, 57 F.T.C. at 1014.

<sup>178</sup> In its brokerage operations, member-jobbers would sometimes directly order goods from suppliers on cooperative order blanks; on other occasions the cooperative would pool the orders of its members to a supplier and make one order. The suppliers would in turn either dropship the goods, or allow the cooperative's delivery service to make the deliveries. The suppliers would bill and accept payment from the cooperative and accord it a brokerage fee. 309 F.2d at 214.

<sup>179</sup> Respondent cooperative would select particular brands of merchandise and stock in quantity those goods in anticipation of member-jobber orders. *See id.* at 214-15.

<sup>180</sup> 57 F.T.C. at 1024.

<sup>181</sup> 309 F.2d at 221 n.16.

<sup>182</sup> 309 F.2d at 221.

<sup>183</sup> *Id.*

<sup>184</sup> *Id.* at 219.

<sup>185</sup> *Id.*

<sup>186</sup> *Id.* at 219, 221. Respondent ordered in its own name commodities from manufacturers, accepted financial responsibility for payments, took title, and warehoused and transported the goods. *Id.* at 218. In essence, it performed all the functions of a warehouse distributor.

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cooperative was not a bona fide buyer separate from its members and that the cooperative scheme thus violated section 2(f).<sup>187</sup> Moreover, during the same period there were several other cases where the initial decision of the Commission was not disturbed.<sup>188</sup> Indeed, in one later case, strikingly similar to *Alhambra*, the Seventh Circuit seemed to reject the approach of the Ninth Circuit and held that the performance of warehouse functions affords cooperatives little comfort in section 2(f) proceedings.<sup>189</sup>

The cooperative purchasing cases are interesting for yet another reason: the statute designed to succor small businesses and to deter the growth of the large, integrated-chain organizations has apparently produced the opposite result in this area. As one commentator has noted in his examination of the effects of the cooperative purchasing cases, "the brokerage cases appear to have reduced the size and effectiveness of voluntary groups."<sup>190</sup> To have applied the Act in any other manner, however, the Commission and courts would have had to have treated the "joint venture" integration secured by small independents in a manner different than the vertical integration of the larger chains. While consistent with the general purposes of the Act, such obvious discrimination in favor of the independents leaves doubt as to whether Congress intended this result under the Act.

### C. Sections 2(d) and 2(e)

Sections 2(d) and 2(e) are important enforcement weapons in the FTC's general efforts to eliminate unlawful price discrimination. After examining FTC records, the late professor Carl Fulda indicated that as of 1969 at least one-half of that agency's enforcement efforts were based on these two sections.<sup>191</sup> Section 2(d) generally prohibits a seller from making any payment to, or for the benefit of, a customer for any services or facilities furnished by or through the customer to the seller.<sup>192</sup> An important proviso to section 2(d) permits such payment if it is "available on proportionally equal terms to all other customers competing in the distribution of such products or commodities."<sup>193</sup>

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<sup>187</sup> 68 F.T.C. 1039 (1965).

<sup>188</sup> *E.g.*, *Automotive Jobbers, Inc.*, 60 F.T.C. 19 (1962), where the facts closely resembled those in *Alhambra*.

<sup>189</sup> *General Auto Supplies, Inc. v. FTC*, 346 F.2d 311 (7th Cir.), *cert. dismissed*, 382 U.S. 923 (1965), *aff'g* *National Parts Warehouse*, 63 F.T.C. 1692 (1963). In *National Parts Warehouse* approximately 80% of respondent's sales were warehoused, and only 20% dropshipped. Nevertheless, the court was unimpressed. 63 F.T.C. at 1719.

<sup>190</sup> C. EDWARDS, *supra* note 148, at 130.

<sup>191</sup> See Fulda, *The Per Se Provisions of the Robinson-Patman Act*, 49 TEX. L. REV. 961, 972 (1971).

<sup>192</sup> See 15 U.S.C. § 13(d) (1970).

<sup>193</sup> *Id.* It is noteworthy that § 2(d) makes reference to "customers," while §§ 2(a) and 2(e) use the term "purchaser." 15 U.S.C. §§ 13(a), (e) (1970). This difference in terminology was mooted in *American News Co. v. FTC*, 300 F.2d 104 (10th Cir.), *cert. denied*, 371 U.S. 824 (1962), where the court held that the terms should be given the same meaning. 300 F.2d at 109. *Accord*, *Brewer v. Uniroyal, Inc.*, 498 F.2d 973, 977 (6th Cir. 1974).

Section 2(e) generally prohibits a seller from discriminating between purchasers by furnishing services or facilities to such purchasers on proportionally unequal terms.<sup>194</sup> While sections 2(d) and 2(e) are often characterized as "per se" offenses,<sup>195</sup> they differ somewhat from section 2(c), the "pure" per se offense provision, in that under those sections, meeting competition is a legitimate defense.<sup>196</sup>

Although sections 2(d) and 2(e) are not of central importance in regulating functional discounts, issues concerning such discounts occasionally arise in proceedings under the two sections.<sup>197</sup> *Tri-Valley Packing Association v. FTC*<sup>198</sup> and *FTC v. Fred Meyer Inc.*,<sup>199</sup> two cases arising out of the same fact situation, illustrate the occasional concurrence of functional discounts and section 2(d) issues.<sup>200</sup> These related cases began when the FTC brought suit against Tri-Valley.<sup>201</sup> The impetus for the FTC's action was an arrangement between Tri-Valley and Meyer, under which Tri-Valley financed Meyer's trading coupon program by paying a fee to participate<sup>202</sup> and by reimbursing Meyer for the discount offered to consumers by Meyer on sales of certain Tri-Valley products.<sup>203</sup> The FTC argued that because of this practice Tri-Valley had granted an allowance to Meyer without making such allowance available on proportionally equal terms to those customers

<sup>194</sup> 15 U.S.C. § 13(e) (1970).

<sup>195</sup> See, e.g., A. NEALE, *THE ANTI-TRUST LAWS OF THE U.S.A.* 260 (2d ed. 1970).

<sup>196</sup> *FTC v. Simplicity Pattern Co.*, 360 U.S. 55, 67 (1959); *Exquisite Form Brasiere, Inc. v. FTC*, 301 F.2d 499, 506 (D.C. Cir. 1961), *cert. denied*, 369 U.S. 888 (1962).

<sup>197</sup> See Fulda, *supra* note 191, at 972.

<sup>198</sup> 60 F.T.C. 1134 (1962), *rev'd*, 329 F.2d 694 (9th Cir. 1964).

<sup>199</sup> 63 F.T.C. 1 (1963), *rev'd*, 359 F.2d 351 (9th Cir. 1966), *rev'd*, 390 U.S. 341 (1968).

<sup>200</sup> The Commission first had occasion to consider functional discounts within the context of § 2(d) in *General Foods Corp.*, 52 F.T.C. 798 (1956). The Commission challenged respondent's practice of providing a certain class of wholesalers with a discount that was unavailable to wholesalers in general. Specifically, in an effort to increase its institutional sales, respondent had provided a discount of 10% on its wholesale price lists to a certain group of institutional wholesalers who in turn provided respondent with additional services, e.g., arranging for distribution and use of display and promotional material. *Id.* at 802. Respondent's practice proved successful, since sales to this group of wholesalers increased dramatically during the relevant period, while its sales to others declined. With the two groups of wholesalers competing for many of the same customers, it was found that "[w]hen competition is keen [the favored wholesalers] take advantage of their ability to accept business at respondent's list prices and still make a satisfactory margin of profit." *Id.* at 811. The Commission rejected the functional discount defense proffered by General Foods because the favored "institutional" wholesalers were in direct competition with nonfavored wholesalers; thus, they could not lawfully be granted a functional discount. *Id.* at 812.

<sup>201</sup> Tri-Valley's arrangement with another buyer, Central Grocers, was also the subject of the FTC scrutiny in the instant case. *Tri-Valley Packing Ass'n*, 329 F.2d at 706-10.

<sup>202</sup> Meyer financed the endeavor by charging its participating suppliers an advertising fee. Some participants further underwrote the promotion by providing Meyer with "price reductions on its purchases of the featured items, by replacing at no cost a percentage of the promotional goods sold by Meyer during the campaign, or by redeeming the coupons in cash at an agreed rate." *Meyer*, 390 U.S. at 345.

<sup>203</sup> *Tri-Valley Packing Ass'n*, 329 F.2d at 707.

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competing with Meyer, in violation of section 2(d).<sup>204</sup> The Commission agreed, and ordered the practice to cease.<sup>205</sup>

On appeal to the Ninth Circuit, Tri-Valley argued first, that its payments to Meyer were not in consideration of any service to be rendered by Meyer, but were payments made to facilitate the original sale of Tri-Valley's goods to Meyer, and second, that there was no substantial evidence to support a finding that any of Tri-Valley's other customers who were not privy to such an arrangement actually competed with Meyer.<sup>206</sup> The court rejected Tri-Valley's first argument, but accepted the second argument, on the basis that no showing had been made that a customer in direct functional competition with Meyer had been denied the allowance.<sup>207</sup>

Soon thereafter, Meyer's coupon program again became the subject of scrutiny in *FTC v. Fred Meyer Inc.*<sup>208</sup> The FTC contended, and the Commission held,<sup>209</sup> that Meyer had knowingly induced its suppliers to grant promotional allowances, where such allowances were not available to all purchasers under the terms of section 2(d).<sup>210</sup> The Commission's holding was based on the view that section 2(d) prohibits the granting of promotional allowances from a supplier to a direct-buying retailer unless wholesalers who purchase from the supplier and resell to the direct-buying retailer's competitors also have access to the allowances.<sup>211</sup> On appeal to the Ninth Circuit, the FTC acknowledged that an affirmance of the Commission's holding would require a modification of the court's position in *Tri-Valley Packing Association*.<sup>212</sup> "[A]fter so short a time," the court decided against such a modification and refused to affirm the Commission's position.<sup>213</sup>

The Ninth Circuit's construction of section 2(d) posed an interesting dilemma because under its construction a retailer who made no direct purchases from a supplier, and instead purchased from a wholesaler, would have no recourse when a competing retailer, buying directly from the seller, received a promotional allowance. The Supreme Court granted certiorari to resolve the issue,<sup>214</sup> and rejected the reasoning of both the Court of Appeals and the Commission. The Court agreed with respondent—that "§ 2(d) reaches only discrimination between customers competing for resales at the same functional level and, therefore, does not mandate proportional equality between

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<sup>204</sup> *Tri-Valley Packing Ass'n*, 60 F.T.C. at 1173-74.

<sup>205</sup> *Id.* at 1174-75.

<sup>206</sup> 329 F.2d at 708.

<sup>207</sup> *Id.* at 710.

<sup>208</sup> 359 F.2d 351 (9th Cir. 1966), *rev'd*, 390 U.S. 341 (1968).

<sup>209</sup> *Fred Meyer, Inc.*, 63 F.T.C. 1, 39-40 (1963).

<sup>210</sup> This course of conduct was actually found to be a violation of section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45 (1970), but the elements of that offense were made out by reference to section 2(d). *Fred Meyer, Inc.*, 63 F.T.C. 1, 26 (1963).

<sup>211</sup> 63 F.T.C. at 83.

<sup>212</sup> 359 F.2d at 362-63.

<sup>213</sup> *Id.* at 363.

<sup>214</sup> 390 U.S. at 343.

Meyer and the two wholesalers."<sup>215</sup> The Court then went on to hold that retailers with whom Meyer competed were "customers" of the suppliers for purposes of the Act, and, therefore, entitled to its protection.<sup>216</sup> Thus, the rule seems to be that a supplier's payment of a promotional allowance to a direct-buying retailer is in violation of section 2(d), if a comparable allowance is not made available to other retailers who sell in direct competition with the direct-buying retailer.

Following the decision of the Court in *Fred Meyer*, the Commission promulgated "Guides for Advertising Allowances and other Merchandising Payments and Services."<sup>217</sup> The Guides define "customer" under section 2(d) and "purchaser" under section 2(e) to include "any buyer of the seller's product for resale who purchases from or through a wholesaler or other intermediate reseller."<sup>218</sup> According to the Guides, the seller can satisfy its duties under section 2(d) and 2(e) through the utilization of its wholesalers: "A seller may, in good faith, enter into written agreements with intermediaries . . . that such intermediaries will perform all or part of seller's obligations . . ." <sup>219</sup> To comply with the good faith requirement, the seller must periodically undertake "affirmative steps to verify that his customers are receiving the proportionally equal treatment to which they are entitled by making spot checks . . ." <sup>220</sup> Thus, the regulations spawned by the Supreme Court's decision in *Fred Meyer* require that a supplier make an active effort to police the prices charged by intermediaries. One might well question what violence is done to the spirit, if not the letter, of the Sherman Act by these requirements.<sup>221</sup>

## CONCLUSION

The Robinson-Patman Act has been the subject of much criticism. This criticism has focused upon, among other things, its rather confusing language, its potential for conflict with the antitrust laws, its failure to encompass a more economics-oriented view of pricing practices, and its protectionist approach. It is hoped that this article has demonstrated that the treatment of functional discounts under the Act raises an additional reason for which criticism of the Act may be justified. Though functional discounts represent a legitimate and important business practice, the case law to date indicates that the Act has raised significant obstacles which often preclude a seller from safely adopting the practice. The solution, it is suggested, lies either in an amendment to the Act or a specific sanction by the Commission

<sup>215</sup> *Id.* at 349.

<sup>216</sup> *Id.*

<sup>217</sup> 16 C.F.R. §§ 240.1-.17 (1974).

<sup>218</sup> *Id.* at § 240.3.

<sup>219</sup> *Id.* at § 240.13(a).

<sup>220</sup> *Id.* at § 240.13(b).

<sup>221</sup> See, e.g., *United States v. Parke, Davis & Co.*, 362 U.S. 29, 47 (1960) (prohibiting the practice of resale price maintenance which is arguably encouraged by the regulations).

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and the courts. It is only by such a clear demonstration of support for functional discounts that the present uncertain situation can be remedied.

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