The perverse effects of the Robinson-Patman Act

BY MARIUS SCHWARTZ*

I. Introduction

Passed in 1936 as a substantial amendment of section 2 of the Clayton Act, the Robinson-Patman Act is the key U.S. antitrust law against price discrimination. The act was originally intended to aid small food and drug retailers against the large chain stores by preventing the latter from obtaining discriminatory concessions from suppliers. Although enforced less vigorously in recent years, the act has long been controversial.

This article, however, is not intended as an overall appraisal of the Robinson-Patman Act, nor as an analysis of the broader issue of optimal policy toward price discrimination. Its purpose is to point out subtle and unintended perverse effects induced by the act, effects stemming largely from difficulties in obtaining the

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information necessary to implement the law efficiently. These perverse effects illustrate the inherent implementation difficulties associated with any statutory regulation of business behavior, whatever the merits of the policies underlying the law. Nuts-and-bolts problems involving data and measurement tend to be slighted in academic discussions of optimal legal systems. On the occasion of Robinson-Patman's fiftieth anniversary, a reminder of these neglected but important problems is appropriate.

It is difficult to estimate accurately the effects of the Robinson-Patman Act. There is no suitable benchmark against which to compare economic performance under the act since the act has been in effect in the entire U.S. since 1936. Moreover, many of the effects are unobservable and therefore particularly hard to estimate, for instance, the improvements in distribution and the increases in competition that may have been forgone because of the act. These conceptual problems are compounded by data problems. First, little is known about the degree of compliance with the act. Second, accurate information is frequently unavailable even on cases that have been brought, since those have predominantly involved small firms.

Understandably, therefore, the available evidence is largely qualitative and anecdotal. The most thorough study is by Edwards, who examined a sample of court cases.[1] The present

[1] C. Edwards, The Price Discrimination Law: A Review of Experience (1959). Edwards selected a sample of 84 of the 244 cases brought by the Federal Trade Commission prior to January 1, 1955. The 84 cases were those for which names of parties involved could be identified; most of the remaining cases offered little information. He conducted interviews with the parties and complemented the interview evidence with material from findings, orders, appellate decisions, and underlying public records in the 84 cases. He also used information from the other 160 cases decided by the FTC before January 1, 1955, and from 67 cases decided from January 1, 1955, to December 31, 1957, and appellate decisions rendered during this three-year period. Using this information, he analyzed the litigation and changes in business practices following this litigation. *Id.* at ix. Another useful source, which summarizes many studies and cases, is United States Department of Justice, Report on the Robinson-Patman Act (1977) [hereinafter cited as 1977 Report].

article draws on his work and supplements it with other material including subsequent cases, especially from the 1960s, and commentary by academics and the trade press. Section II of the article briefly describes the act's provisions and enforcement patterns. Sections III and IV discuss effects on competition and efficiency in distribution. Section V concludes.

II. The act and its enforcement

The relevant parts of the act are sections 2(a) through 2(f). Section 2(a) prohibits a seller from charging different prices to different buyers of goods of "like grade and quality" where the effect may be to weaken competition.[2] Section 2(b) puts the burden of rebutting a prima facie charge of discrimination on the defendant. Section 2(c) prohibits the payment of brokerage commissions in any form from sellers to buyers; brokerage payments can be made only to independent brokers. Sections 2(d) and 2(e), respectively, prohibit the seller from granting any allowance to a buyer for promotional services performed by the buyer or from providing those services himself, unless the allowance or provision is granted to all other buyers on "proportionally equal terms." Section 2(f) prohibits a buyer "knowingly to induce" discrimination. Sections 2(a), 2(b), and 2(f) have become known as the "price discrimination clauses"; section 2(c) as the "brokerage clause"; and sections 2(d) and 2(e) as the "proportionality clauses." The purpose of the brokerage and proportionality clauses was to prevent concealed price discounts.

A prima facie presumption of price discrimination is established once price differences have been shown. The defendant can either admit price discrimination and attempt to show that it did not weaken competition, or justify the price differences under

[2] The language of 2(a) articulates a weaker standard for establishing a violation than did the original section 2 of the Clayton Act, thereby bringing a broader class of practices under the scope of the act. Note that only discrimination involving commodities is covered by the act; services are excluded.

one of three defenses permitted in the act. The "distress defense" applies when sales were made under bankruptcy or other distress conditions. The "cost defense" maintains that price differences reflect differences in the cost of producing or delivering the goods to different buyers. The "meeting competition" defense is that a discriminatory concession was "made in good faith to meet an equally low price of a competitor." These defenses are available only in price discrimination cases; the brokerage and proportionality clauses have evolved into per se prohibitions.[3]

Enforcement of the act has been undertaken largely by the Federal Trade Commission, which can issue cease and desist orders. The FTC has concentrated on brokerage cases, followed by price discrimination cases against sellers. Proportionality cases became important in the 1950s. Cases against buyers have been rare despite Congress' original perception of them (especially A&P and the other chain stores) as the villains.[4] Some of the most important and diverse cases have been brought under section 2(a), challenging geographic price discrimination, quantity discounts, and functional discounts—discounts granted to different buyers for performing a different range of middleman functions. The issues addressed have included injury to competition versus injury to competitors, the degree of injury to competition required for Robinson-Patman action,[5] and the operational meaning of "like grade and quality" when branded and unbranded goods are involved. In terms of industries affected, enforcement has concentrated heavily on the food industry. Also affected were clothing, medical supplies, drugs, cosmetics, and other finished consumer goods, as well as industries with disorderly price structures, such as automotive supplies.

Much of the mischief caused by the act stems from the difficulty of diagnosing true price discrimination when there are different customer types and the costs of serving them differ. In such circumstances, equal treatment necessarily implies discrimination while unequal treatment need not. However, since differences in costs and in circumstances of sale are frequently difficult to ascertain, a permissive approach to price differences will allow much genuine discrimination. A restrictive approach, on the other hand, will disallow many legitimate business arrangements. In practice, the restrictive approach was adopted with the attendant consequences.

For example, numerous functional discounts have been attacked. Such attacks seem misplaced since a manufacturer should obviously offer a lower price to a wholesaler than to a retailer. But since middleman functions are often difficult to ascertain, if functional discounts were liberally permitted powerful buyers could merely allege that they were performing various middleman functions in order to rationalize preferential treatment accorded them.[6]

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3 Rowe, *Price Discrimination, Competition, and Confusion: Another Look at Robinson-Patman*, 60 YALE L.J. 957-61 (1951).

4 C. EDWARDS, *supra* note 1, at 68, 74, discusses the distribution of enforcement by type of violation and by industry. The paucity of cases against buyers was partly due to the stringent standard of proof demanded by the Supreme Court in a key case, Automatic Canteen Co. v. FTC, 346 U.S. 61 (1953). According to the Court, the phrase "knowingly to induce" discrimination requires proof not only that the buyer received illegal price concessions, but that it had good reason to believe the concessions were illegal. The concentration on brokerage cases may arise because brokerage payments became per se illegal and because the basic facts are rarely in dispute.

5 Injury to competition under section 2(a) can be shown at any one of three levels: (1) primary line, entailing injury to direct rivals of the seller; (2) secondary line, entailing injury to buyers competing with favored buyers; and (3) tertiary line, entailing injury to competitors of customers of favored buyers. The standards required to establish injury have been stricter in primary than in secondary line cases, probably reflecting Congress' desire to protect small buyers such as food and drug retailers.

6 A recent example is Boise Cascade Corp., 649 TRADE REG. REP. (CCH) ¶ 22,330 (Feb. 24, 1986). Boise, the largest distributor of office products in the U.S., sold sometimes as a wholesaler and other times as a retailer. Boise paid suppliers lower prices than did other retailers and argued that the discounts were justified by the additional wholesale functions it performed. The FTC, however, found that the discounts

While it is inevitable, therefore, that some legitimate price differences will be struck down in the attempt to prevent disguised discrimination, judicious interpretation of the cost defense of price differences might have limited such occurrences. Unfortunately, the cost defense has been virtually eliminated by rigid standards of proof imposed by the FTC and various court decisions.[7] As a leading commentator observed: "Under current interpretations a cost defense, as a practical matter, is impossible. . . . Only a uniform price policy is fully secure from Robinson-Patman proceedings and treble-damage claims."[8]

were not shown to reflect cost savings to suppliers from Boise's performance of wholesale functions, but rather, reflected Boise's greater bargaining power. It cited, inter alia, the fact that smaller retailers that performed a similar range of wholesale functions to Boise's did not receive a similar discount.

7 The ineffectiveness of the cost defense is discussed in F. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 578-79 (2d ed. 1980); 1977 REPORT, *supra* note 1, at 14, 19-22, 41-43; R. BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF 391-94 (1978); M. ADELMAN, A&P: A STUDY IN PRICE-COST BEHAVIOR AND PUBLIC POLICY 164-65, 172 (1959). Adelman explains the problems as follows: "The burden of proof of a cost differential is on the seller. Any cost differential is presumed to be 'unjustified' unless and until the Commission finds to the contrary. The procedural requirements are such that a cost differential must be disregarded unless it is certain and precise. But, since cost differentials are inherently uncertain and imprecise, most of them cannot exist in the contemplation of law."

Note that price differentials must be cost-justified precisely; if 90% of a price discount can be traced to cost savings but the remaining 10% cannot, the FTC rejects the entire defense. Moreover, the FTC has not put out accounting standards for implementing a cost defense. 1977 REPORT, *supra* note 1, at 19, 22. Partly because of these problems and partly because the defense is inapplicable in many cases (*e.g.*, for brokerage payments, which are per se illegal), only 11 attempts were made to employ the defense in cases contested before the FTC between 1936 and 1954. Of these, only 2 were fully successful. F. SCHERER, *supra*, at 578. Some estimates of the expense of cost studies necessary to attempt a cost defense, are discussed in Lynn, *Is the Cost Defense Workable?*, 29 J. MARKETING 37-42 (1965).

8 Rowe, *supra* note 3, at 963, 972. The fact that uniform prices are not challenged even when cost of service differs implies that much

In addition to condemning legitimate price differences, Robinson-Patman has struck down efficient business arrangements through its brokerage and proportionality clauses. The brokerage clause was intended to prevent "dummy commissions," discounts to large buyers granted under the guise of payments for having allegedly performed brokerage services (*e.g.*, for seeking out the seller rather than utilizing an independent broker who would have charged a fee to the seller). The per se prohibition of brokerage payments, however, has prevented discounts to buyers that did perform brokerage functions. Similarly, the proportionality clauses against promotional allowances or services were designed to prevent discriminatory concessions disguised in nonprice forms. But where retail outlets differ in size and scope it is only natural for a manufacturer to treat them differently in promotional assistance. The stringent enforcement of the proportionality clauses has turned them—like the brokerage clause—into per se prohibitions: either the same promotional assistance was granted to all buyers or it was deemed illegal. This has obviously stifled promotional activity.

It is ironic that brokerage and promotion concessions have been treated more harshly than outright price discounts, since the brokerage and proportionality clauses were intended only to prevent concealed price discounts. At best, these clauses were redundant since their intent could have been captured by proper interpretation of the discrimination clauses. In the event, the separate language of the brokerage and proportionality clauses has reached well beyond the prevention of concealed discounts.

Ambiguity and redundancy in the act itself together with unenlightened enforcement have thus produced perverse results, attacking legitimate distribution practices and encouraging anticompetitive behavior. The next two sections of the article attempt to spell out more systematically the effects on competition and on efficiency in distribution.

genuine discrimination slips through. This "Type II error" in the law is in addition to the "Type I error" mentioned earlier—the condemnation of legitimate price differences.

III. Effects on competition

A. *Insulating sellers from large-buyer pressure*

Where sellers possess market power, either individually or as a colluding group, an important force in lowering prices is the bargaining power of larger buyers. This is particularly true for a colluding group since chiseling can cause the collapse of the entire collusive agreement, and the temptation to chisel on the collusion is greatest when a large buyer comes along. By preventing selective discounts to large buyers, Robinson-Patman insulates sellers from the pressure of large buyers, thereby promoting cartel stability. Naturally, sellers are happy with this outcome. Indeed, the impetus for enforcement of the act often comes from colluding sellers.

The procompetitive role of unsystematic, sporadic concessions extracted by large buyers has been emphasized by many students of industrial organization. As Adelman vividly puts it:

> A strong, alert buyer, large enough so that the loss of his patronage is not a matter of indifference, constantly on the watch for a break which he can exploit by rolling up the whole price front, able to force concessions first from one and then from all, and followed by other buyers, can collapse a structure of control or keep it from ever coming into existence. . . . *Sporadic, unsystematic* discrimination is one of the most powerful forces of competition in modern industrial markets. Like a high wind, it seizes on small openings and crevices in an "orderly" price structure and tears it apart.[9]

There are numerous cases where large buyers forced down monopolistic or cartel prices yet the practice was attacked under Robinson-Patman. In *Morton Salt* the chain stores beat down the salt industry's collusive prices.[10] In *Automatic Canteen*, the sellers were firms such as Wrigley with substantial brand name and market power.[11] In *Staley*, the defendant selectively cut price after discovering that its fellow colluders in the glucose industry had chiseled.[12] In *Cabin Crafts*, carpet manufacturers used the FTC to discontinue volume discounts that threatened their cartel; the very same practice (prohibitions on volume discounts) had been found illegal in that industry under the Sherman Act some 20 years earlier.[13] In *Abby Kent*, garment manufacturers in New York City persuaded the FTC to prevent them from granting advertising concessions to large buyers.[14] More recently, in *Cotton*, one of several colluding bakeries convinced the FTC to discontinue discounts by bakeries cheating on the collusion.[15] That there was less price vigor and competition following FTC enforcement of Robinson-Patman is also confirmed in a recent survey of business executives.[16]

B. *Encouraging customer allocation and anticompetitive information exchange*

One defense of price differences provided under Robinson-Patman is "meeting competition in good faith." Various court

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9 Adelman, *Effective Competition and the Antitrust Laws*, 61 HARV. L. REV. 1300, 1331-33 (1948). Other references to the competitive importance of sporadic price-cutting appear in 1977 REPORT, *supra* note 1, at 47-58.

10 Morton Salt Co., 39 F.T.C. 35 (1944), *modified*, 40 F.T.C. 388 (1945), *set aside*, Morton Salt Co. v. FTC, 162 F.2d 949 (7th Cir. 1947), *rev'd and remanded*, 334 U.S. 37 (1948). The presence of collusion in the salt industry in 1943 is documented in Rowe, *supra* note 3, at 950.

11 Automatic Canteen Co. of America, 3 TRADE REG. REP. (CCH) ¶ 14,398 (1950); and Automatic Canteen Co. of America v. FTC, 346 U.S. 61 (1953).

12 Staley Mfg. Co., 34 F.T.C. 1362, 1369-70 (1942).

13 Respondent's Proposed Findings of Fact at 34, Cabin Crafts, Inc., No. 7812 (July 6, 1963); and United States v. Institute of Carpet Mfrs., 1940-43 Trade Cas. (CCH) ¶ 56,097 (S.D.N.Y. 1941).

14 Abby Kent Co., TRADE REG. REP. (CCH) ¶ 17,310 (Aug. 9, 1965).

15 United States v. Cotton Inc., Cr. 75-43 (M.D. La. Aug. 29, 1975).

16 1977 REPORT, *supra* note 1, at 57. One commentator said: "It is probable that the final furniture prices by suppliers affected by the FTC action . . . would have been lower by 10 to 20 percent without the FTC decision."

decisions have suggested that the meeting competition defense can be used only: (1) to retain old customers but not to acquire new ones;[17] (2) to meet but not beat a competitor's price;[18] and (3) to meet only a competing price that the defendant must verify is lawful.[19]

Regarding point (1), if sellers cannot compete for new customers the effect is identical to customer allocation among them—one of the most effective methods of cartelization. Regarding points (2) and (3), for a seller to comply with these he must collect information about rivals' prices, costs, etc. Such information exchange ordinarily would be suspicious under the Sherman Act.[20] Competitors, however, have exploited misguided interpretations of the meeting competition defense to justify the exchange of competitively sensitive information as necessary for Robinson-Patman compliance.[21] The former chief prosecutor in a price-fixing case in the gypsum industry observed: "[i]ntercommunication on competitive matters is also facilitated considerably by this facade, this sham, of alleged compliance with the Robinson-Patman Act."[22] Adelman expresses a similar assessment: "The fact of the matter is that the Robinson-Patman bill practically enacted the Sugar Institute code."[23]

A recent Supreme Court decision provides for a more sensible and pragmatic interpretation of the meeting competition defense.[24] The Court stated that the defense was applicable to efforts to obtain new customers (as well as retain old ones), that the defense did not hinge on the defendant setting price on a customer-by-customer basis (rather than setting area-wide prices as he did), and that it did not matter whether the discriminatory prices resulted from raising price to one buyer rather than lowering it to the other. It remains to be seen if the Court's decision will curb abuses of the meeting competition defense.

C. *Overprotecting competitors*

The Robinson-Patman Act has overprotected competitors by attacking vigorous price competition when such competition involved sporadic, unsystematic price discrimination. For example, in *Moss*,[25] a seller of rubber stamps charged varying prices to his accounts. He did not know his competitors' prices but merely "bid low enough to get the business." This practice, found the FTC, had a "tendency to induce purchase of [his] stamps by

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17 Sunshine Biscuits, Inc., TRADE REG. REP. (CCH) ¶ 15,469, *rev'd*, 306 F.2d 48 (7th Cir. 1962).

18 National Dairy Products Corp., 70 F.T.C. 79 (1966), *cert. denied*, 393 U.S. 977 (1968).

19 Forster v. FTC, 335 F.2d 47 (1st Cir. 1964), *cert. denied*, 380 U.S. 906 (1965).

20 The requirement that the price met must itself be lawful seems to have evolved from a court's incorrect analogy with an earlier decision. In FTC v. Staley Mfg. Co., 324 U.S. 746 (1945), where the argument first appeared, there was a conspiracy involving, among other things, geographic price discrimination via basing-point pricing. The court correctly dismissed a "meeting competition" defense, arguing that the defendant was adopting the discriminatory pricing *system* of its fellow colluders. In Standard Oil v. FTC, 340 U.S. 231 (1951), where the argument next appeared, there was no conspiracy. Standard unilaterally lowered the price selectively to gasoline jobbers to prevent their turning to competing gasoline suppliers. *See* Rowe, *supra* note 3, at 942.

21 Belliston v. Texaco, Inc., 455 F.2d 175 (10th Cir. 1972), *cert. denied*, 408 U.S. 928 (1972).

22 United States v. United States Gypsum Co., Cr. 73-347 (W.D. Pa. July 15, 1975). Testimony of John Fricano, *Hearings on the Robinson-Patman Act Before the Domestic Council Review Group on Regulatory Reform*, tr. 380 (1975) [hereinafter cited as *DCRG Hearings*].

23 Adelman, *supra* note 9, at 1334. Sugar Institute Inc. v. United States, 277 U.S. 553 (1936), is frequently cited as a classic cartel example.

24 Falls City Industries, Inc. v. Vanco Beverage, Inc., 460 U.S. 428 (1983).

25 Samuel H. Moss v. FTC, 148 F.2d 378 (2d Cir. 1945), *cert. denied*, 362 U.S. 734 (1945), *clarified*, 155 F.2d 1016 (2d Cir. 1946).

various users and to divert trade to [him] from his competitors." Unfortunately, this case was not an isolated event. Outside the food industry, the FTC has focused on industries such as rubber stamps and automobile supplies where the price structure is disorderly: transactions are typically small, there is no well-recognized market price, and prices are determined through haggling. In such industries, *unsystematic* price discrimination is common, reflecting "competitive maneuvering for position in which no sustained advantage for a favored group is clearly discernable."[26] Blanket condemnation of price differences in such markets is bound to stifle competition.

Another notorious attack on competition is the *Utah Pie* case.[27] The defendants, three national concerns, were convicted of geographic price discrimination when they lowered price selectively in the Utah market in response to aggressive pricing and consequent market share increases by Utah Pie, a small family-run firm. The defendants were accused to trying to drive out Utah Pie. Utah Pie, which enjoyed a significant transport cost advantage due to the location of its plant, survived the retaliation and continued to prosper during the period. Its market share, though reduced, remained the largest in the area.[28] Thus, under the Robinson-Patman Act vigorous competition was condemned because it gave rise to geographic price discrimination deemed to cause primary line injury. It is doubtful that such condemnation would have occurred had the case been appropriately brought as a predation case under section 2 of the Sherman Act.

Competition was also harmed by Robinson-Patman's restrictions on brokerage payments and functional discounts. These restrictions discouraged buyers from assuming various middleman functions, thereby protecting brokers and other classes of

26 C. EDWARDS, *supra* note 1, at 76.

27 Utah Pie Co. v. Continental Baking Co., 386 U.S. 685 (1967).

28 For a detailed description and critique of the case, *see* Bowman, *Restraint of Trade by the Supreme Court: The Utah Pie Case*, 77 YALE L.J. 70 (1977).

distributors. The brokerage prohibition was harshly condemned by the Attorney General's Committee to Study the Antitrust Laws: "In our opinion, the virtual legal monopoly conferred by Section 2(c) on one type of middleman [the independent broker] clogs competition in the channels of distribution and exacts tribute from the consumer for the benefit of a special business class."[29]

Attacks on functional discounts have also stifled competition, sometimes in rather exotic ways. The *Standard Oil* (Indiana) case, appealed twice to the Supreme Court, is illustrative.[30] Standard's controlled retailers took tank-wagon delivery while independent distributors, who had bulk storage, took large tank-car lots and were charged a lower price. The independents sold some gasoline through their own pumps and resold some to other independents. The FTC found two violations. One tank-car buyer resold to an independent below Standard's posted tank-wagon price and the independent then cut its prices and "diverted business" from others. Another tank-car customer cut prices to the public at his own pumps, which enabled him to "divert large amounts of business" to himself with "resultant injury" to other retailers. The FTC ordered Standard to prevent further injury by denying lower tank-car rates to buyers who resold to retailers below Standard's posted price, and by charging identical prices to nonintegrated retailers and integrated retailers—even though integrated retailers performed more functions than nonintegrated ones. The FTC also suggested that Standard police the resale prices of the dealers. On appeal before the Supreme Court, Standard argued that no seller "in his right mind" familiar with antitrust law would establish such a resale price maintenance system. The FTC responded that Standard could ensure distributor compliance by threatening to refuse to sell (which is legal under Robinson-Patman). The Supreme Court was understand-

29 REPORT OF THE ATTORNEY GENERAL'S NATIONAL COMMITTEE TO STUDY THE ANTITRUST LAWS (1955).

30 41 F.T.C. 263 (1945). The ensuing discussion of the case is based on Rowe, *supra* note 3, at 942, 965.

ably puzzled, wondering if the government was "trying to enforce two conflicting legislative policies."

D. Inducing uncertainty about the legality of competitive actions

The uncertainty generated by Robinson-Patman concerning the legality of various pricing moves creates a tendency to play it safe and avoid aggressive pricing. For instance, the meeting competition defense requires that the price met must itself be lawful. Barring information exchange, itself competitively suspicious, a seller is unlikely to know if a rival's price is lawful. As Rowe observes: "Meeting *lawful* prices, moreover, presupposes prophets not competitors. . . . If sellers must hurdle legal barriers of meeting only lawful prices in a state of metaphysical good faith, competition will not be very likely."[31]

There is also uncertainty about the legality of promotional and penetration prices used to enter new markets. Evidence from the trade press indicates that, since promotional pricing often generates price discrimination and cannot be justified with certainty under the meeting competition defense, entry and aggressive marketing are discouraged.[32]

The Supreme Court has recognized the tension between Robinson-Patman and other antitrust statutes and has attempted to limit the anticompetitive effects of Robinson-Patman. It has stated that compliance with the act neither justifies price-fixing[33]

[31] Rowe, *supra* note 3, at 969. A similar sentiment was expressed by the chairman of the ABA's Robinson-Patman Act Committee: ". . . a salesman is almost required to become a lawyer in order to know how he can meet competition and stay within the law." Testimony of Paul H. La Rue, *DCRG Hearings*, *supra* note 22, tr. 205-06.

[32] *Robinson-Patman: Dodo or Golden Rule?*, Bus. Wk., Nov. 12, 1966, at 65-72 [hereinafter cited as Bus. Wk.]. For similar themes, *see* Shniderman, *The Impact of the Robinson-Patman Act on Pricing Flexibility*, 57 Nw. U. L. Rev. 173 (1962).

[33] United States v. United States Gypsum Co., 438 U.S. 422 (1978).

nor requires abandoning vigorous price bargaining.[34] And it has reinterpreted the meeting competition defense to minimize its anticompetitive implications.[35] Nevertheless, some anticompetitive fallout is inevitable given the aims and language of Robinson-Patman.

IV. Effects on distribution efficiency

A. Discouraging buyer initiative

The prohibition on brokerage payments and the legal ambiguity of functional discounts have meant that buyers are not adequately compensated for distribution functions they may perform. This discourages buyer initiative and fosters inefficient distribution.

The brokerage clause, which has evolved into a per se prohibition, is particularly notorious.[36] It discourages big buyers from eliminating redundant middlemen and induces inefficient buying

[34] Great Atlantic & Pacific Tea Company, Inc. v. FTC, 440 U.S. 69 (1978).

[35] Falls City Industries, Inc. v. Vanco Beverage, Inc., 460 U.S. 428 (1983).

[36] Initially, brokerage cases were judged on the same standards as price discrimination cases. Unjustified price discounts masquerading as brokerage payments were challenged, while payments made for services provided by the buyer were eligible for the cost defense. In *A&P* (1938), *Biddle* (1938), and *Oliver* (1939), the defendants provided valuable services such as market information, advice on quality improvement, information on routing of shipments, etc., and courts were willing, at least in principle, to consider this as justification for brokerage payments. *See* C. Edwards, *supra* note 1, at 94. A series of subsequent decisions culminating in the *Southgate* decision (1945), established that the question of services was irrelevant. *Id.* at 95-97. The brokerage clause, as interpreted by the courts, became a complete bar to any payment of brokerage in any form by a party on one side of a transaction to a party on the other. *Id.* at 100. *See also* Rowe, *supra* note 3, at 957-98.

practices. An early example is the *A&P* case of 1938.[37] A&P's field buyers eliminated the need for brokers by sellers and A&P received the sellers' cost savings. Yet the practice was condemned under the brokerage clause. For a while, A&P obtained discounts in lieu of direct brokerage payments but when these practices were finally ended, after a 1949 decision against A&P, the company changed its buying practices dramatically. Among other things, it reduced inventory and started buying in smaller quantities and demanding immediate delivery. This placed the burden of larger inventory and delivery fleets on brokers and induced other inefficiencies. Rowe summarizes the effects of the brokerage prohibition:

> Obviously direct buyers relieve a seller from paying intermediaries to find market outlets. But these are not *legal* services—the buyer is "doing his own work" [as argued by the court in *Southgate*]. The market effects of the brokerage clause are, therefore, simple. Because a direct buyer is denied functional compensation, an unneeded broker picks up business or a seller pockets the value of the function. The clause thus grants a legal tollgate to the broker or a windfall to the seller. Ironically, small wholesalers' cooperative buying agencies are conspicuous victims of strict FTC "brokerage clause" enforcement.[38]

The last point merits elaboration. Small buyers have suffered disproportionately from brokerage cases for two reasons. First, many cases have targeted buyer cooperatives formed by small retailers, especially in the food industry.[39] Second, large corporate

37 The ensuing discussion of the case is based on C. Edwards, *supra* note 1, at 94-110.

38 Rowe, *supra* note 3, at 957-58. [Footnotes omitted.]

39 The FTC's enforcement policy in general has victimized small firms, both in terms of the number of cases brought and in the treatment accorded small versus large firms once cases are brought. This pattern is due partly to the case selection method used by the FTC (relying largely on public complaints, likely to come from small firms against other small firms); and partly to the ability and willingness of large firms to fight legal battles. On the subject of the FTC's enforcement bias in all cases, *see Small Business Before the Federal Trade*

chains have more strategic options to circumvent brokerage prohibitions than do loose cooperatives of independent retailers. According to Edwards: "The difficulties that the brokerage provision represents to independents appear to be more enduring, more general, and less readily avoided than those that it presents to the corporate chains."[40]

A particularly onerous inefficiency induced by the brokerage prohibition arises from restrictions on "backhaul allowances" in food and other industries. Many grocery chains and cooperative wholesalers operate large private truck fleets to serve their affiliated stores. In the course of their routes, these trucks often pass in the vicinity of a manufacturer's warehouse. It would save both fuel and money for these trucks to pick up goods from the manufacturer on the way back from delivery trips. However, the FTC's rulings against brokerage payments have prevented manufacturers from adequately compensating buyers for any extra expense involved in backhauling. Consequently, the trucks return empty.

The losses involved are not trivial. Estimates developed by the food industry advisory committees of both the National Commission on Productivity and the Federal Energy Administration indicate that if backhaul was fully utilized in the food industry, savings could reach up to 100 million gallons of fuel and an additional $300 million per year, in 1975 dollars.[41]

Commission, 75 Yale L.J. 487 (1966). On the enforcement of Robinson-Patman cases in particular, *see Recent Efforts to Amend or Repeal the Robinson-Patman Act: Hearings Before the Ad Hoc Subcomm. on Antitrust, the Robinson-Patman Act, and Related Matters of the House Comm. on Small Business*, pt. 2, 94th Cong., 1st Sess. (1976) [hereinafter cited as *Recent Efforts*].

40 C. Edwards, *supra* note 1, at 150.

41 Letter from Frank Zarb, then head of the Federal Energy Administration, to Lewis Engman, Chairman, FTC (dated Aug. 15, 1975); Letter from Albert Rees, then head of the Council on Wage and Stability, to Lewis Engman (dated Apr. 1, 1975); Testimony of Lewis Fox, *DCRG Hearings*, *supra* note 22, tr. 93.

Like the brokerage prohibition, the uncertain status of functional discounts also has hampered distribution efficiency. Functional discounts are vital to "dual distribution" systems in which sales are sometimes made directly to retailers and other times to middlemen, such as warehouses, who then resell to retailers. Functional discounts have been attacked as price discrimination despite the fact that they reflect differences in cost savings to the seller from being able to delegate varying distribution activities to different buyers. The FTC and the courts have considered only whether the buyer receiving a discount competed *at some level* of resale with a buyer who did not receive the discount, regardless of differing degrees of vertical integration by the different buyers. If he did compete, the competitive injury was usually inferred and the discount declared illegal.[42] Thus, the FTC has condemned functional discounts granted to special-function distributors but not to competing regular distributors,[43] and discounts granted to dual-function buyers, such as warehouse distributors with affiliated jobbers, but not to unaffiliated jobbers.[44]

Some of the worst Robinson-Patman cases have been functional discount cases brought in the automotive parts industry. Many of the absurdities are illustrated by *Alhambra Motor Parts, Inc.*[45] In *Alhambra*, a cooperative of small retailers bought large parts inventories of its own account, stored them at its ware-

42 If the true range of middleman functions performed by various buyers could be easily verified, differential discounts that reflected the degree of vertical integration of buyers would presumably be allowed. But it is often difficult to verify precisely the various functions alleged, hence powerful buyers could obtain discriminatory concessions under this guise. In principle, the cost defense should exonerate legitimate discounts, but in practice the cost defense has proved inadequate. *See supra* note 7.

43 *See* Mueller Co., 60 F.T.C. 120 (1962), *aff'd*, 323 F.2d 44 (7th Cir. 1963), *cert. denied*, 377 U.S. 923 (1964).

44 *See* Monroe Auto Equipment Co., 66 F.T.C. 276 (1964), *aff'd*, 347 F.2d 401 (7th Cir. 1965), *cert. denied*, 382 U.S. 1009 (1966).

45 Alhambra Motor Parts, Inc., 68 F.T.C. 1034 (1965).

house, and filled members' orders out of the cooperative's inventory. The FTC ruled that, since the retailers competed with other retailers not members of the cooperative, any discount to the warehousing cooperative would have to be justified by documenting cost savings from the warehousing function. After analysis, the FTC rejected the cost justification offered and struck down the discounts. Discounts granted to nonintegrated independent wholesalers were not challenged, because these wholesalers did not sell at retail and therefore were not in competition with retailers. The decision in effect subsidized independent wholesalers at the expense of the small retailers. Unable to get the same discounts as the independent wholesalers, the retailers were discouraged from establishing cooperative wholesale operations and cutting out independent wholesalers.

Aside from disproportionately harming small retailers, attacks on functional discounts have retarded experimentation with new distribution systems and denied the cost savings that such experimentation would yield. Though the magnitude of such benefits is difficult to quantify, it could be substantial.

B. Hampering promotional activities

The proportionality sections of Robinson-Patman hamper promotional activities. It is hard to know when buyers of widely different characteristics have been granted "proportionally equal" treatment as required by the proportionality clauses, since the term is nowhere defined. To obey the law, a manufacturer may scale down his overall promotion or devise schemes which only certain buyers will demand.[46] Like the brokerage prohibition, the proportionality clauses are per se prohibitions, requiring no showing of competitive injury and subject to no cost defense.

46 If no small buyer complains, the seller is presumably safe from Robinson-Patman. However, even if only a handful complain, the seller may be challenged by the FTC.

The *Elizabeth Arden* case is illustrative.[47] Elizabeth Arden, Inc., supplied cosmetic demonstrations to some department stores and specialty stores but not to other accounts. Rejecting Arden's arguments that demonstration service cannot be proportionalized, the FTC argued that Arden could simply avoid any service that could be supplied only on terms violating Robinson-Patman. A cease and desist order was affirmed, with the court emphasizing that a showing of competitive injury to other retailers was unneeded. Other cases have involved different merchandise being retailed through different outlets. In one FTC case,[48] junior-size packages of cosmetics were distributed only through limited-price variety stores (mostly chains) since there was insufficient demand from druggists and department stores. The FTC ordered that the packages be made generally available or discontinued. Ironically, the few druggists that had requested the junior-size packages later found them unprofitable.

Thus, in proportionality cases the law forbade differentiating channels of distribution by package sizes, merchandise sold, or service provided—even if the differentiation conformed to market realities and to the desires of most distributors, large and small.[49] As Edwards observes: "Under the standard of proportionality, concerns have either had to buy undesired advertising and provide services they regarded as valueless, on the one hand, or refrain from providing service or purchasing advertising they regard as desirable on the other."[50]

47 Elizabeth Arden, Inc., 39 F.T.C. 288 (1944), *aff'd*, Elizabeth Arden, Inc., v. FTC, 156 F.2d 132 (2d Cir. 1946), *cert. denied*, 331 U.S. 806 (1947).

48 Luxor, Ltd., Docket No. 3736, F.T.C. 731 (1940).

49 The drug and, especially, cosmetics industries have suffered. *See* Rowe, *supra* note 3, at 960-61.

50 C. Edwards, *supra* note 1, at 629.

C. Inducing adoption of substitute practices

Attacks under Robinson-Patman on conventional business practices have led buyers and sellers to substitute other practices for those being attacked. It is unclear whether these responses aggravate or mitigate the effect of Robinson-Patman's attacks. This depends on whether the practices attacked were performing socially efficient functions. It is nevertheless worth identifying some of the responses induced by Robinson-Patman, because the substitute practices adopted are sometimes themselves attacked on other antitrust grounds.[51]

Firms' responses to Robinson-Patman have included:[52] (1) selling exclusively to large buyers to avoid the emergence of "discriminatory" prices; (2) discontinuing certain outlets in dual distribution systems to avoid attacks on functional discounts; (3) artificially differentiating goods sold to large buyers and introducing private brands to prevent goods from being classified of "like grade and quality"; (4) altering promotion efforts so that only large buyers demand participation, to avoid the proportionality clauses; (5) large buyers avoiding sellers who use brokers; (6) large buyers purchasing in smaller quantities and insisting on faster delivery when dealing with brokers; and (7) increasing the degree of vertical integration.[53]

51 Since substitute practices are often available, vertical relations should be analyzed in a broad context with attention paid to the underlying motivation for rather than the form of a particular practice. This point has been emphasized by several recent authors, *e.g.*, F. Warren-Boulton, Vertical Control of Markets (1978); White, *Vertical Restraints in Antitrust Law: A Coherent Model*, 26 Antitrust Bull. 327 (1981); Schwartz & Eisenstadt, Vertical Restraints (U.S. Department of Justice, Antitrust Division, Economic Policy Office Discussion Paper 82-8, revised July 1983; Dixit, *Vertical Integration in a Monopoly Competitive Industry*, 1 Int'l J. Indus. Org. 63 (1983); Matthewson & Winter, *An Economic Theory of Vertical Restraints*, 15 Rand J. Econ. 27 (1984).

52 Some of the responses are discussed in C. Edwards, *supra* note 1, at 109-13.

53 An FTC report on the food industry showed the greatest vertical integration in products that also exhibited the most pervasive price

Vertical integration, exclusive dealing, product differentiation, and other practices above are frequently efficient. The preceding discussion does not suggest otherwise. However, the effect of Robinson-Patman is to induce these practices in market settings where they may otherwise not have occurred. This is ironic in two respects. First, practices such as exclusive dealing are sometimes attacked as restraints of trade, though they may be merely responses to the Robinson-Patman Act. Second, the above options are generally more readily available to large than to small firms. A large chain, for example, can integrate into manufacturing more easily than can a cooperative of small retailers. Consequently, the act may have weakened rather than strengthened the competitive position of many small buyers.[54]

discrimination. Local retail markets for products such as fluid milk, ice cream, and bakery products are highly concentrated. The large retailers in these sectors may possess local market power and might wish to integrate into food manufacturing in order to avoid distortions from monopoly pricing at successive stages. An alternative to vertical integration would be for the large retailers to secure low prices from suppliers under the threat of backward integration. By preventing sellers from granting selective discounts to large buyers, Robinson-Patman can thereby prompt vertical integration by the large retailers. FEDERAL TRADE COMMISSION, ECONOMIC REPORT ON THE STRUCTURE AND COMPETITIVE BEHAVIOR OF THE FOOD INDUSTRY (1966).

[54] *See* Testimony of F. Scherer, *Recent Efforts*, *supra* note 39, at 144, 150. On the broader question of whether overall the act has served its stated purpose of helping small business, the following should be noted. The act has benefited certain classes of small-to-medium middlemen, especially food brokers, and harmed the corporate chains. *See* Ross, *Winners and Losers Under the Robinson-Patman Act*, 37 J. L. & ECON. 243 (1984). However, some small businesses were harmed, notably cooperatives of small retailers. These retailers lost both to brokers and wholesalers and to corporate chains who could circumvent the act more easily (*i.e.*, the small retailers' vertical *and* horizontal position was weakened).

D. Creating uncertainty and rigidity

The Robinson-Patman Act is a poorly drafted statute. A sympathetic commentator has described it as "the most awkwardly drafted of all antitrust legislation . . . a roughly hewn, unfinished block of legislative phraseology."[55] The intrinsic ambiguity in the act and the complex case law have created considerable uncertainty about the legality of various business practices. Consequently, considerable legal costs are incurred in enforcing and complying with the act.[56] Despite these legal expenditures, considerable uncertainty persists about the legality of various pricing practices.[57] This uncertainty has created a tendency to play it safe which, in this context, has meant preserving the status quo. Businessmen have been deterred from selective price reductions which they would otherwise have undertaken in response to geographic changes in competitive pressures or in demand conditions.[58] Such rigidity has been particularly harmful in industries where pricing would otherwise be volatile, such as food and gasoline.[59] As Edwards observes: "There is a consensus

[55] J. VAN CISE, UNDERSTANDING THE ANTITRUST LAWS 43 (1963). Further colorful characterizations are cited in Anonymous, *Eine Kleine Juristische Schlummergeschichte*, 79 HARV. L. REV. 921 (1966). Some examples: "Its text baffles even one familiar with Gothic German." ". . . no statute better demonstrates the legislative folly of trying to define 'sin' in detail," and "practicing lawyers . . . call it 'crystal clear confusion,' requiring 'legal bifocals,' and compare their job in advising under it to the stability of a dog walking on his hind legs."

[56] Elzinga & Hogarty, *Utah Pie and the Consequences of Robinson-Patman*, 21 J. L. & ECON. 427 (1978), estimate the costs, exclusive of government lawyers' time, at $1.4 billion between 1936 and 1974. BUS. WK., *supra* note 32, at 66, gives some examples. See also the testimony of an RCA executive, Martin Bennett, *DCRG Hearings*, *supra* note 22, at 81-81a.

[57] *See* Shniderman, *supra* note 32, at 173.

[58] 1977 REPORT, *supra* note 1, at 23, 26.

[59] BUS. WK., *supra* note 32, at 67.

of opinion among both buyers and sellers that the result has been to diminish the flexibility of prices; indeed, many of the persons interviewed viewed this as the chief virtue of the statute."[60]

V. Conclusion

It is questionable whether, on balance, the Robinson-Patman Act has helped small business as intended; many of the gains to small firms came at the expense of other small firms. What is clear is that the act has produced numerous perverse results, as even sympathetic commentators concede: ". . . whatever its other failings, [the act] has at least given rise to plenty of cases. . . . There is a real danger that an account of the case law under the Robinson-Patman Act . . . will be met with frank unbelief."[61]

Many of the absurdities are attributable to unenlightened enforcement rather than to the act itself. The exotic cases under the meeting competition defense are a prime example. Better wording of the act itself also would have helped. A probable such improvement would have been to eliminate the brokerage and proportionality clauses and subsume their intent under the price discrimination clauses.

It is likely, however, that any effective law against price discrimination would have struck down numerous legitimate practices and induced considerable uncertainty. The issue addressed, price discrimination, might seem clear conceptually. But implementing a law against it is tricky when buyers differ in the functions they perform and where the cost of serving them differs. The approach adopted under Robinson-Patman has been to presume that any differential treatment reflects discrimination and to force defendants to provide cost justifications. An alternative might have been to place the burden of proof on plaintiffs to

[60] C. Edwards, *supra* note 1, at 630.

[61] A. Neale & D. Goyder, The Antitrust Laws of the U.S.A. 215, 245 (1980).

demonstrate that differential treatment is not cost-justified. But such an approach would have had its own drawbacks, since buyers cannot be expected to possess information about the cost to sellers of serving various third parties.

Given the inevitable implementation problems and that price discrimination is not unambiguously harmful to economic welfare, the case for a law against price discrimination is not clear-cut. The experience with the Robinson-Patman Act, however, dramatizes a broader lesson, that implementing legal rules can raise formidable problems even when the underlying principles are seemingly clear. This point should be borne in mind before embarking on any legislation that attempts to fine tune business behavior.