THE ECONOMIC AND LEGAL ASPECTS OF FAIR TRADE LEGISLATION

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OF FAIR TRADE LEGISLATION

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PREFACE

In the Congress of the United States bills have been introduced to legalize the practice of fair trade pricing in interstate commerce. This represents an attempt by advocates of this price system to strengthen its weakened position.

Fair trade should not be considered a superficial or momentary phenomenon. It has been an issue for seventy-five years or more in the United States and Great Britain. Further, it has become an important problem in post war public policy in several countries, including Sweden and Japan as well as the United States and Great Britain.

This manuscript represents a study of the operation of fair trade in the United States. The study attempts to analyze the operation of fair trade under the present state laws and under the proposed federal legislation.

I wish to express my appreciation to Dr. Joseph J. Klos of Department of Economics for his valuable guidance throughout the entire study for this thesis. Thanks are also due Dr. Rudolph W. Trenton of the Department of Economics for his helpful suggestions during the preparation and research.

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CHAPTER I

INTRODUCTION

Effective competition in the market place has long been accepted by economists, statesmen, and the judiciary as a necessary ingredient for the maintenance of a free enterprise economy. Recognizing the principle that competition must be "free" but not free in the sense of being "unbridled," state and federal governments have enacted legislation to restrain competition regarded as harmful to the public.

In this study we are concerned with a particular form of restraint to the competitive system: fair trade laws. Under the provisions of these laws a manufacturer is permitted to establish the minimum price at which his product may be resold.[1] On the one hand this system of pricing is characterized as an un-American restriction of free enterprise and private competition, and on the other as an enlightened restraint on predatory pricing policies of retailers who

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[1]Fair trade is not the only technique by which the proprietor of a trademark may exercise control over the resale price at which his goods are sold. Others include attempts by patent holders to incorporate resale price conditions in the licenses they grant to dealers. Another alternative is that the manufacturer can market his product through an agency system or on consignment, thus retaining title to his goods until sold to the ultimate consumer. Also the manufacturer can refuse to deal with wholesalers or retailers who do not follow his suggested retail prices. Another alternative may include selling directly to the consumer through his own retail outlets, door-to-door sales organization, or his own mail order system, giving the manufacturer an unchallenged legal right to fix resale price.

Although these alternatives are recognized, only limited reference will be made to them, since they are beyond the scope of this study.

desire to monopolize the market.

Over the years numerous public and private investigations have been made into this question. But in spite of the number of studies, including governmental reports, there has been no agreement concerning the desirability or the actual effects of fair trade legislation. No one has succeeded in arraying and interpreting the evidence to the satisfaction of objective investigators, to say nothing of the more ardent proponents and critics of the measure.

Since the last quarter of the nineteenth century retail druggists and other small retailers, led by the National Association of Retail Druggists and its Bureau of Education on Fair Trade, have waged a continuous fight to eliminate the alleged "unfair" practice of cutting prices on identified products through the enactment of so-called "fair trade" legislation. The legal and economic aspects of fair trade legislation make up the subject matter of this study.

Today in thirty states technically valid fair trade laws are in effect. Actually a total of forty-four states have fair trade laws on their statutes, but in fourteen of these states the state supreme court has declared the so-called non-signer clause invalid leaving these laws weak and unenforceable.

In addition, the advocates of fair trade find themselves on the defensive as fair trade becomes weaker. The cause for alarm on the part of the fair trader is five fold. First, discriminatory enforcement or complete lack of enforcement has characterized all state fair trade laws. Second, there have been a wave of state supreme court decisions which have either partially or completely invalidated fair trade in many states. Third, has been the growth of the discount

house and its acceptance by the consumer. Fourth, has been the recent reversals in the General Electric v. Marshall fair trade litigation which makes it possible for retailers in non-fair trade areas to sell in fair trade areas via the mail at below established minimum fair trade prices, and fifth, a number of large manufacturers, especially appliance manufacturers, have abandoned their efforts to fair trade their products.

Realizing that effective enforcement of fair trade prices is impossible under these conditions, advocates of this price system seek the solution to this problem of enforcement in federal legislation.

The culmination of these efforts is directed toward the passage of legislation presently under consideration in the House and Senate of the United States Congress. This legislation, commonly referred to as the National Fair Trade Bill[2] and the Quality Stabilization Bill,[3] would make it possible for the proprietor of a product identified by a trademark, brand or trade name to establish and control the resale price of such merchandise on a nationwide basis.

This most recent attempt by proponents of fair trade to force the passage of federal legislation afford the economist a new opportunity to examine the "facts" as presented by those sponsoring the bills and to determine who, if anyone, would benefit from their passage.

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[2]Harris Bill (H. R. 1253), 86th Cong., 1st Sess., and Humphrey-Proxmire Bill (S. 1083) 86th Cong., 1st Sess.

[3]Quality Stabilization Bill (H. R. 9692), 86th Cong., 2nd Sess.

Definition of Fair Trade

A common error in studies concerned with the fair trade controversy has been a misinterpretation and misuse of the terms "fair trade" and "resale price maintenance." Often these terms have been used interchangeably, as if they were synonymous, to denote a price system by which resale prices were regulated by the manufacturer. This is not the case, and a distinction must be clearly drawn in order that we may avoid confusion in their use and meaning.

Fair trade is in fact but the legalization of one method at the disposal of manufacturers by which they may regulate the price at which their goods are resold. Resale price maintenance is the broader term; "fair trade" is a technique included within resale price maintenance. In this discussion we will adhere to the following definition of fair trade.

Fair trade as now practiced in intrastate commerce in the United States, and in the interstate commerce between states is a system of pricing a trademarked, branded, or otherwise identified product for resale in which the manufacturer, producer, or his distributor prescribes the minimum price or the resale price at which such product may be resold. This is done by entering into contract with at least one distributor of such product and serving notice upon all other distributors who are thereupon obligated to maintain the minimum price or the resale price named in the contract.

Procedure of Study

In studying the proposed legislation the origin and development of the fair trade movement is first discussed so that we may become

familiar with those forces at work in society which brought forth the recognition of a "need" for such legislation. The economic aspects of fair trade are then considered, and the arguments and counter arguments are examined to try to determine the actual effect of fair trade on the competitive system.

The legislative history of fair trade is then traced, including state and federal legislation and important court decisions which have affected the development of this form of resale price maintenance.

Developments in the market place during the past ten years have reduced to a great degree the effectiveness of fair trade laws in those states where such laws are in operation. A study of these developments will show the reasons proponents of fair trade have attached such great importance to the passage of the National Fair Trade Bills and the Quality Stabilization Bill.

Finally we will consider the questions "Who will benefit from fair trade?" and "Are fair trade prices fair prices?"

In considering these basic issues of the fair trade controversy we shall adhere to the hypothesis that fair trade is inherently monopolistic in character, and that effective enforcement of such a policy can result only in an increase in retail margins, an increase in the number of low volume inefficient outlets, an increase in the cost of distribution, and a departure from the most efficient allocation of resources in our economic system.

CHAPTER II

ORIGIN AND DEVELOPMENT OF THE FAIR TRADE MOVEMENT

If we are to effectively evaluate the present controversy over Fair Trade it is necessary that we discover the conditions in our economy which brought about the desire for such legislation, and that we understand the motives and thinking of those forces that brought this legislation into being. The practice of resale price maintenance is not a new concept in the market place. In the last quarter of the nineteenth century the advent and extension of the practice of identifying a producer's product by his trademark and the evolution of mass production and mass distribution in the development of industry and commerce gave rise to efforts on the part of certain manufacturers to control the resale price of their products.[1]

Competition in the Nineteenth Century

Competition in the nineteenth century was enhanced first by the development of new types of retail establishments including department stores and mail order houses. Development was also seen in the growth of additional layers of exchange and production as intermediaries were introduced into the distribution system. Operations were expanded

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[1]Herman S. Waller, _Resale Price Maintenance on Identified Merchandise and the State Fair Trade Laws_, National Association of Retail Druggists (Chicago, 1958), p. 68.

steadily with the development of a national market. Secondly, the increase in branding or trademarking make it easier for the retailer to handle the merchandise. Mass consumer acceptance made it unnecessary for the retailers to have any special knowledge of the merchandise.[2]

With the growth of the popularity and acceptance of branded products, and the reliance by the consumer on the value and integrity of the product as represented by the price, came the growing recognition on the part of the retailer that cutting prices on these nationally known and accepted brands had great advertising appeal. The consumer took pride in purchasing a well known brand at below the established price.

After 1890, the "evils" of price cutting were the dominant theme of the retail trade journals of the period, reflecting the views of the ordinary or "legitimate" small scale retailers. It was frequently alleged that these price cutters were practicing what we today call "loss-leader" selling (which term appears to be of more recent origin). This was the practice of selling some well known, generally accepted merchandise at low prices in order to attract customers into the store. It should be noted that although this charge was directed against the new large scale retailing firms coming into existence, price cutting was also common among the small scale retailers.

In attempting to improve their own competitive position or to neutralize the competitive advantages of their rivals the hardpressed retailer tried a variety of schemes. Prominent at that time groups of small retailers banded together to combine their purchases and

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[2]B. S. Yamey, "The Origin of Resale Price Maintenance," Economic Journal, September, 1952, p. 523.

secure the better terms which their bulk-buying competitors enjoyed. These associations further made attempts to persuade manufacturers not to grant more favorable discounts to bulk-buyers than were granted to themselves. Local agreement seemed another promising method of maintaining profit margins as attempts were made to introduce minimum price lists and secure adherence to them. But not all dealers belonged to the sponsoring associations and as a rule the large firms refused to join. As a result it became increasingly hard for members of the association to honor the agreed prices when non-members were selling below them. Thus, since there were no effective measures for enforcement, this method fell into disuse.

Introduction of Resale Price Maintenance

As early attempts to reduce competition failed the late Sir William Glyn-Jones, one of the most influential figures in the early history of resale price maintenance, observed in 1896, ". . . the key to the situation lies in the manufacturers hands; he is the one who can control supplies, and without this control . . . it would be impossible to arrange matters by mutual consent of the traders."[3] To him resale price maintenance "was not only a question of ensuring a better profit on proprietory articles, but more important, to rob the cutter and stores of the advantage which followed their sale of these goods to the public."[4]

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[3]Sir William Glyn-Jones, The Grocer, October 10, 1896, Supplement, p. 40.

[4]Ibid.

Retailers who were anxious to end retail price competition perceived that a manufacturer who has the right to make and sell a good, by virtue of being the sole source of supply, had the means of withholding supplies from particular retailers; and that this power was not enjoyed by any one manufacturer of an unbranded line.

Resale price maintenance or protected prices, to use an earlier term, came to be regarded by large numbers of retailers as the most promising devise to eliminate price competition on branded goods. Not only did it enable the retailer to maintain his profits but even to raise them, and it robbed the large scale competitor of his most important method of attracting customers and building his trade.

Retailers who were in favor of resale price maintenance, had the job of convincing the manufacturer that the system of protected prices was in his own best interest as well as in the interest of the retail trade.

The realization that the arguments would not favorably impress the manufacturer unless backed up by impressive organized bodies representing large numbers of retailers was a factor in the development of strong trade associations. Though large numbers of "legitimate" small scale retailers were not and have never been members of these organizations, from the beginning these associations were formulating and pressing for demands on behalf of a considerably larger number of retailers than their membership rolls would indicate.

The Manufacturers' Hesitant Approach

The manufacturer when considering whether or not to yield to retailer demands to protect his prices, faced a difficult problem.

Some, but not all, retailers were in favor of eliminating price competition; the manufacturer had to judge the relative strengths of the two broad groups, supporters and opponents, as well as the relative severity of the damage each group was likely to inflict upon him if dissatisfied with his decision.[5]

The difficulty of the decision was reflected in the hesitant approach of manufacturers. Compromise was a common solution sought. Among the most prevalent compromises were: price maintenance applied to particular regions, often after consultation with local retail associations; price maintenance introduced at very low margins of retail profit, sometimes after having obtained the agreement of leading price-cutting firms; price maintenance introduced by the manufacturer for some but not all of his brands; adjustment of discount terms to be favorable for smaller retailers, without any price protection; special discount terms granted to retailers who would undertake to advertise and display the brand, without resale price maintenance being introduced; and price protection schemes without any effective enforcement and with numerous protestations of the difficulties. But the main type of compromise was for manufacturers to give patronage dividends not regarding them as a form of price cutting, despite the protests of the trade that such dividends were an injurious exception to the desired uniformity of retail prices.[6]

Except for the advantages flowing from the fact that some sections of the retail trade favored protected prices, there is

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[5]Yamey, p. 531.

[6]Ibid., p. 537-538.

little evidence that manufacturers believed they were deriving any other advantages from resale price maintenance.[7] As time went on, manufacturers lost interest in fixing the prices at which their goods could be resold as a substantial portion of their output came to be marketed, at cut prices, by mass distributors.

During the period 1885 to 1906 three general tendencies may be observed.

First, the initiative to introduce Resale Price Maintenance did not come from manufacturers, the great majority of whom were reluctant to move in the matter. Secondly, the pace at which the reluctance of manufacturers was overcome depended largely upon the strength of retail organization. Thirdly, the most effective resistence to the introduction of protected prices came from owners of well-established brands.[8]

Violation of the Sherman Anti-Trust Law

Legal resale price maintenance, by contractual relationship between producer and his distributors, existed in this country unmolested and to a great degree ineffective up to 1911. In this year the United States Supreme Court in the Miles Case, (Dr. Miles Medical Company v. J. D. Park and Sons Company, 220 U. S. 373) held that the words of the Sherman Act of 1890 prohibiting "conspiracies and agreements in restraint of trade" meant that unless specifically provided by statute, manufacturers could no longer enter into resale price agreements. This decision established the principle that resale price maintenance contracts involving interstate sales constitute unlawful restraints of trade at common law and accordingly are invalid and unenforcible.

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[7]Ibid., pp. 537-538.

[8]Ibid., p. 540.

Before the 1930's there were then but two methods of maintaining resale prices that the courts allowed: (1) Manufacturers could refuse to sell to price cutters. Freedom to do so was guaranteed by Section 2 of the Clayton Act, which gives to "persons engaged in selling goods, wares, or merchandise in commerce the right to select their own customers in bona fide transactions and not in restraint of trade." But refusal to sell could not be used to enforce an illegal agreement to maintain a resale price.[9] And it could not be carried to the extent of spying on distributors and threatening to withhold supplies.[10] (2) Producers were permitted to fix the prices at which their products could be sold by agents.[11] But agency could not be used as a mere subterfuge; the permission was limited to cases where an agent did not take title but acted solely on behalf of his principal.

Modern Fair Trade Laws

Largely due to the rapid growth of retail trade associations and the pressure brought to bear by them, in almost every session of Congress beginning in 1914 bills were introduced to legalize resale price maintenance as reflected by the Stephens and Capper-Kelly bills. In all these bills the same philosophy appeared, namely that the manufacturer's trademark, name, and goodwill must be protected from

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[9] U. S v. A. Schroeder's Sons, Inc., 252 U. S. 85 (1920).

[10] Beechnut Packing Company v. F. T. C., 247 U. S. 441 (1922).

[11] U. S. v. General Electric Company, 272 U. S. 476 (1926).

diminution in value of the use of such a brand-name product as a "loss leader" or in a cut-rate sale.

In the 1930's, however, a more persuasive argument was advanced as the result of and supported by the economic chaos of the depression years. Existing in those years along with retail failures and bankruptcies was the "unprecedented collapse of the price structure."[12] Generally efforts to ease the plight of manufacturers, and small, independent, as well as large retailers and to bolster the shattered price structures,[13] became the order of the day. The National Industrial Recovery Act and Agricultural Adjustment Act, and similar drastic measures were instituted in an effort to stabilize the economy. Therefore, in many states legislatures sought legal methods to stabilize and fix prices with the avowed purpose of preventing firms with large capital reserves from driving small competitors out of business through the practice of slashed prices and "loss leader" selling.

The state of California in 1931 enacted what is considered to be the first fair trade statute. (In 1914 New Jersey enacted a permissive Resale Price Maintenance law.) The California law exempted from the states' antitrust act any contract wherein the seller of a branded product bound the buyer, where reselling it to charge the price the former specified. The law proved ineffective because retailers who did not sign contracts undercut the prices charged by those who did.

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[12] U. S. Congress House Report No. 1516, Committee on the Judiciary, Amending the Sherman Act with Respect to Resale Price Maintenance, 82d Cong., 2d Sess. (Washington, 1952), p. 2.

[13] Ibid.

An amendment was therefore adopted in 1933, incorporating a provision known as the "non-signers" clause: "Willfully and knowingly advertising, offering for sale or selling any commodity at less than the price stipulated in any contract entered into pursuant to . . . the Act, whether the person so advertising, offering for sale or selling is or is not a party to such contract, is unfair competition and is actionable at the suit of any person damaged thereby."[14] Contracts maintaining resale prices were thus binding, not only on retailers who had signed them, but also on those who had refused to do so. The terms of a contract accepted by a single dealer might thereby be made to govern the prices charged by every dealer in the state. Fair trade laws which up to this point had been of little consequence now became a force to be contended with.

[14] California Statutes, 1933, Chapter 250.

CHAPTER III

COMPETITION AND FAIR TRADE

The fundamental issue, especially from the point of view of the economist, is the effect that fair trade may have upon the competitive system. Opponents of fair trade challenge the whole program as being suppressive of competition and as a serious weakening of our antitrust policy. Advocates of fair trade deny this charge and point to the way in which they feel competition is strengthened. This chapter takes up these arguments and counter arguments.

Accepting that effective competition is desirable over monopoly on the grounds of economic efficiency, and that practices which permit unfair competition tend towards the elimination of competition, legislation towards the goal of effective competition is desirable and warranted.

These questions remain: Is the practice of cutting prices on branded goods "unfair competition?" Is fair trade monopolistic in character?

The Case for Fair Trade

In presenting the case for fair trade, the advocates contend that fair trade does not mean the end of competition. Price competition, it is pointed out, is not the only kind of competition we have. Competition between retailers remains in other forms, such as

quality competition, competition in terms of advertising and promotion, service competition, and technological competition of research and development.

Free and Open Competition

It is also alleged that competition also may come from products carrying no brand at all. They emphasize that fair trade operates on a vertical basis rather than horizontal so that prices vary with each producer and respond fully to consumer preferences and the laws of supply and demand.

Attention is called to the provisions of the proposed federal fair trade laws which state, as do state fair trade acts, that the product must be in "free and open" competition with articles of the same general class produced by others. This is cited as a guarantee of free competition. To quote the National Association of Retail Druggists:

> The moment a branded product ceases to be in free and open competition with other products of the same use and general character, its manufacturer, under the Fair Trade laws, ceases to have the privilege to establish minimum resale prices. A fair trade product therefore must always remain a competitive product.
>
> Collusion between manufacturers of different brands to establish the same price and thereby to eliminate price competition with each other, is ruled out by our fair trade laws. It is also ruled out by the fact that when resale prices of national brands rise, private brands gain a competitive advantage.[1]

Fair Trade Purely Voluntary

Advocates of fair trade also stress that under the provisions of state fair trade acts and the proposed federal fair trade bills that price maintenance is entirely permissive. They permit the manufacturer

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[1]National Association of Retail Druggists, What About Fair Trade (Chicago), p. 17.

of a trademarked article to place his product on the fair trade list, but they do not compel him to do so. Price maintenance, they allege, is therefore purely voluntary.

Fair Trade a Deterrent to Monopoly

Not only are the advocates of fair trade convinced that fair trade is in harmony with competitive principles but also that in the long run it will be a strong deterrent to monopoly. This is based on the assumption that price cutting is discriminatory in effect and a powerful weapon for the suppression of competition. By preventing price cutting, fair trade is a strong barrier to price discrimination and hence monopoly as well. This argument has been stated by the Bureau of Education on Fair Trade as follows:

> The public has never hesitated to put curbs on competition which it regards as unfair and monopolistic. The anti-trust laws, the Robinson-Patman Act and many other statutes curb unfair competition in order to promote fair competition. So do fair trade laws. They are intended to curb bold, relentless, predatory commercial behavior. They restrain the unfair competition of retailers who engage in pricing practices that bedazzel the consumer without benefit to her pocketbook and lead, to the concentration of retailing in a few hands--to monopoly.
>
> Under fair trade, American consumers can shop with confidence in getting fair value in big and little stores, in villages as well as in great cities, in neighborhoods as well as on Main street. Without fair trade they lose their freedom to shop where they please, for most retailers in America cannot exist for long in a jungle of unrestrained price wars. Few people would care to argue that retail monopoly would be good for the buying public, or for the country.[2]

Help for the Small Business Man

Fair trade, it is claimed, further supports the competitive system by placing the independent retailer on a par with the mass

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[2]Bureau of Education on Fair Trade, A Dozen Reasons Why Your Congressmen Should Vote For Fair Trade (New York), pp. 2-3.

distributor in respect to his ability to compete. The Bureau of Education on Fair Trade presents the retailers point of view as follows:

> Fair trade is designed to give the small business man a chance to compete fairly on equal terms with large distributors, and thereby to preserve for small enterprises the field in which they can function most effectively--that of distribution.
>
> It is admitted that the mass-production manufacturing industries have become so big that no individual can command enough capital to engage in them successfully. But retail distribution is a business in which, government findings show, the little fellow is fully as efficient as his corporate competitor. Unless we are willing to make practically all men hired-men and to deny to all, but a few, the opportunity to engage in businesses of their own, we should outlaw every unfair practice that gives the strong an unfair advantage over the weak.
>
> One of those advantages is the ability of massed capital to drive out competitors by selling temporarily below cost in one community, and therefore to raise prices to the consumer and to use the profits so gained in carrying the process of extermination into other communities.[3]

With these arguments proponents of fair trade defend their position that the effect of fair trade is to strengthen competition.

Monopolistic Character of Fair Trade

The Department of Justice has opposed fair trade under both Democratic and Republican administrations. Such large retailers as R. H. Macy and Company, Inc., Julius Geitman and Company of Baltimore, Schwegmann Brothers of New Orleans, and more recently Masters Mail Order Company of Washington, D. C. have openly opposed fair trade. Also fighting it are such usually divergent publications as the St. Louis Post Dispatch and the Wall Street Journal.

These opponents of fair trade charge that the actual effects of

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[3] Bureau of Education on Fair Trade, undated release.

this practice are monopolistic in character. This same conclusion has been reached by most government agencies that have studied the problem. The Federal Trade Commission concludes its 1945 report on resale price maintenance with the following statement:

> Both the results of the Commission's present study of the operation of legalized resale price maintenance and information developed over a period of many years in connection with complaints strongly confirm these conclusions and point to the further conclusion that in the absence of effective government supervision in the public interest, resale price maintenance, legalized to correct abuses of extreme price competition, is subject to use as a means of effecting enhancement of prices by secret agreements and restraint of competition by coercive action on the part of interested cooperating trade groups of manufacturers, wholesalers and retailers in such ways and to such an extent as to make it economically unsound and undesirable in a competitive economy.[4]

A study made by the Temporary Economic Committee led to substantially the same conclusion. The report states:

> In summary, it is sufficient to point out that resale price maintenance is not a fair-trade measure but a price fixing, margin-setting measure that injures consumers, reduces flexibility of output, restricts progress in marketing, and contributes to monopolistic prices and monopolistic action.[5]

Among those conditions often cited by opponents of fair trade is the tendency for various manufacturers to make identical resale price agreements. The net effect of this is no different than if there was an actual horizontal price agreement. Economists are in virtually unanimous agreement that this is a valid contention, and that the

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[4] Federal Trade Commission, _Report of the Federal Trade Commission on Resale Price Maintenace_ (Washington, 1945), p. lxiv.

[5] U. S. Congress, Temporary National Economic Committee, "Problems of Small Business," _Investigation of Concentration of Economic Power_ (Washington, 1941), Monograph No. 17, p. 196.

primary purpose and effect of fair trade is to reduce price competition.[6]

Horizontal price agreement is essentially an agreement among those who are on the same level in the distributive process, be they manufacturers or distributors, not to compete. Vertical resale price maintenance takes place between a manufacturer and his distributors, who are not on the same level in the distributive process and thus, of course, are not competitors.

It is pointed out that when fair trade laws provide that the article must be in "free and open competition with other articles of the same class produced by others" this does not mean that there is anything approaching pure competition as the economists uses the term. Nor does it necessarily mean that the fair trade manufacturer and retailer are in the kind of free and open competition that most other manufacturers and retailers are in.

One principal characteristic of price-maintained products may be taken as given; that is that each case involves a distinctive, a trade named, or a branded product. Not only is this a legal requirement under the fair trade laws, but it is a practical requirement where legal rules are not a barrier to the establishment of resale price maintenance. It is not difficult to understand why this must be so.

An attempt by a farmer, for example, to maintain the price of his wheat or corn for subsequent resale would be preposterous. Neither he nor the subsequent buyers could know whether it was his

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[6] Ward S. Bowman, "Resale Price Maintenance-A Monopoly Problem," Journal of Business of the University of Chicago, July, 1952, p. 143.

product or somebody else's, the price of which was or was not being maintained. Moreover, even if he were to dye his wheat purple for the purpose of identification, unless he could convince customers that purple wheat was more desirable than plain wheat, his activity would be futile. If his maintained price were higher than the market price of wheat he would sell none. If it were lower, he would be giving away part of his product. In addition, of course, he would be wasting the cost of dying the wheat as well as the cost of supervising the price unless he considered this sort of activity as a sort of advertising expense to convince customers of the desirability of subsequently paying a premium price for this product. This, in turn, would depend not only upon whether he could convince customers that purple wheat was worth more than nonpurple wheat, but also, and equally important, upon the assurance that his competitors would not be able to dye wheat purple and secure a "free ride" on his advertising.[7]

The ability, therefore, even to be in a position to make an intelligent decision about whether to maintain resale prices depends upon the existence of a degree of effective monopoly power.

A legal test of free and open competition is incapable of effective administration for the simple reason, to quote the Temporary National Economic Committee report, "no adequate definition for 'free and open' exists."[8] The same is true of the phrase, "commodities of the same general class."

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[7]Ibid., pp. 143-144.

[8]U. S. Congress, Temporary National Economic Committee, "Problems of Small Business," Investigation of Concentration of Economic Power (Washington, 1941), Monograph No. 17, p. 196.

Competition, as it exists in fair traded products, is free and open only insofar as there are similar products of the same type. This is a quite loose and superficial designation so that competition need not be very close or great. Only one other competing article in the general class has been found sufficient to put the article in "free and open competition" under the fair trade law.[9]

Moreover, the power of institutional brand-name advertising and the required investment are often so great that some one commodity may corner the market, and even constitute a greater degree of monopoly than control over the entire supply of other commodities might afford.[10]

Of course other producers are still free to compete if they can make a better product in this particular price range or quality price field. But only an extremely large firm is able to advertise its private brand nationally against the name that has already become famous and been accepted as the standard. This obviously is not the small-man kind of competition, and freedom of opportunity that fair trade manufacturers are in the habit of referring to and praising in support of the system.[11]

Instead of considering the facts, fair trade proponents point out

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[9]S. C. Oppenheim, Unfair Trade Practices (St. Paul, 1950), p. 8.

[10]E. T. Grether, Price Control Under Fair Trade Legislation (New York, 1939), p. 379.

[11]It is interesting to note that this degree of monopoly power has been pointed to by proponents of fair trade as the judicially proper determining factor in granting the right of refusing to sell a distributor who will not maintain suggested or established prices. If the product dominates the market in its field such right should be withheld. Walter Adam, "Resale Price Maintenance; Fact and Fancy," Yale Law Journal, 1955, p. 983.

that only in the case of fair trade resale price maintenance does the law require the article to be in "free and open competition with articles of a similar class produced by others." They ignore the fact that if a producer maintains prices by these other, more indirect methods, and is not in free and open competition he is subject to prosecution for conspiracy in restraint of trade by the Anti-Trust Division of the Department of Justice. If the producer has developed such a monopolistic position that he has more or less cornered the market, he would be more open to investigation for trust restraint of competition than in the case of a similarly powerful fair-trader protected by law. Proponents of fair trade would thus seem to overlook the direct legal protection given resale price maintenance under fair trade.

Further evidence of the monopolistic character of fair trade is the fact that when competition becomes too keen manufacturers are inclined to abandon fair trade and battle it out on a price basis. Recent examples of this tendency, cited earlier, include the abandonment of fair trade in its appliance lines by General Electric and Sunbeam Corporations and also the experience of Esso Standard in North Carolina gasoline wars.

Advocates of fair trade have associated fair trade laws and the Robinson-Patman Act in the same category of measures designed to remove the general "evil" of price cutting. This view is in serious error.

Fair trade laws are directed against price <u>cutting</u> per se where as the Robinson-Patman Act is directed against price <u>discrimination</u>. Even though at times they may seem the same there is significant difference between the two targets. In the first place, the Robinson-

Patman Act affects the price the retailer pays. Fair trade laws affect the price he receives. Secondly, and perhaps the most important, fair trade stops all price cutting whether it is discriminatory or not. And thirdly, the fair trade laws are designed to promote uniformity in prices whereas the Robinson-Patman Act may in fact require variation in prices.

In the light of this evidence of horizontal collusion, and the inability to meaningfully define "free and open competition," we must conclude that fair trade is decidedly more a stimulate to monopoly than it is a deterrent.

"Unfair" Competition

To ask any American businessman today if he believes in competition is like asking if he believes in God and country. Of course he believes in competition. And he pays lip-service to the basic business freedoms--the freedom to enter or withdraw from any specific field or career, the freedom to set his own prices, yes, even the freedom to undersell somebody else and to take business away from him.[12]

But all too often when another competitor really acts like a competitor and does something which hurts him--cuts price, sells harder, improves quality--it becomes "unfair" competition, and he runs to his trade association or to the government for protection. Such has all too often been the case.[13]

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[12] Charles F Phillips, "Do We Still Believe in Competition," Vital Speeches of the Day, November 1, 1954, p. 802.

[13] Ibid.

Going back to the turn of the present century one finds that small country merchants were going through the mail order scare. Following the lead of Montromery Ward Company and Sears, Roebuck and Company, mail order firms were springing up in many parts of our country. To the small country retailer this newer form of retailing was "unfair."[14]

Along about the same time the "unfair" competition of the department store was also growing. As a matter of fact, by 1895 the department store had developed to such an extent that a group of retailers meeting in convention passed a resolution condemning this form of retailing as it would "result in oppression of the public by suppressing competition and causing the consumer in the end to pay higher prices and ultimately create a monopoly--and, further, that it (would) close to thousands of energetic young men who lack great capital the avenue of business which they should find open to them."[15] What these retailers were really opposed to was the fact that the department store was a formidable competitor.

Similar circumstances surrounding the advent of the chain store in the late twenties and early thirties give rise to the Robinson Patman Act and the fair trade laws.

Today picking up any trade paper you will discover that discount houses are a form of "unfair" competition.

It is not here contended that there is no such thing as "unfair" competition. When a competitor resorts to false and misleading adver-

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[14] Ibid.

[15] C. F. Phillips, Marketing (Boston, 1938), p. 308.

tising, engages in misbranding, and makes false statement against competitors of their products, he is engaging in practices which all would denounce.

What is here contended is that much which retailers refer to as "unfair" competition is in reality just keen competition. It is the kind of competition which is part and parcel of a free economic system. If retailers want to maintain the freedoms which our system gives us--to enter business of their own choice, to produce the merchandise they please, to set their own prices--then they must accept the kind of competition which is inevitable if the economy is actually free.

CHAPTER IV

LEGAL ASPECTS OF FAIR TRADE

There have been few matters whose constitutional basis have been more fully explored by the nation's judiciary than the subject of fair trade as a particular form of restraint to the competitive principle.

With the enactment of the California Fair Trade Law of 1931 and its significant amendment in 1933 began an era marked by an almost endless number of cases to test the validity of these enactments and those which were to follow.

State Fair Trade Laws

The California law and its "non-signer" clause was soon copied by other states. By 1936 a total of fourteen states had adopted similar legislation.

The validity of such enactments was upheld by the Supreme Court of the United States in 1936, in the case of Old Dearborn Distributing Company versus Seagrams Distillers Corporation. Justice Sutherland speaking for the court in regard to this case said:

> The manufacturer made a substantial investment in advertising his brand. The goodwill thus acquired was a species of property that belonged to him When he made a sale he parted with his product, but not his good will. When distributors cut his prices, they impaired his good will and thus inflicted damage on his property. Prevention of such damage was a proper subject for legislation.[1]

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[1] 299 United States, 183, 195 (1936).

Then in an effort to justify or defend its position, the court added:

> There is nothing in the Act to preclude the purchaser from removing the mark or brand from the commodity thus separating the physical property, which he owns, from the goodwill which is the property of another--and then selling the commodity at his own price . . .[2]

Thus the Supreme Court gave its stamp of approval to the argument that the manufacturer needed legislation to protect the goodwill embodied in his trademarked products. Actually, the organized drive for maintained prices came largely from independent retailers and wholesalers who were interested in restricting price competition at the retail level, not from manufacturers.

This decision stimulated the spread of price fixing legislation, and by 1941 all the states but Missouri, Texas and Vermont, a fourth exception being the District of Columbia, had enacted the same or similar laws as fundamental portions of the public policy of the several states. More than half of these laws followed the California Act, most of the others being based upon a model statute drafted by the National Association of Retail Druggists (hereinafter referred to as N. A. R. D.). These laws placed no limit on the level at which a seller may set a resale price. They made no reference to the costs of distribution or to the reasonableness of the margins that might be allowed. The contracts they authorized, however, were confined to those involving vertical agreements among manufacturers, wholesalers, and retailers. Horizontal agreements among manufacturers, wholesalers, and retailers continued to be forbidden.

The speed with which the statutes legalizing fair trade were

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[2]Ibid.

whipped through the legislatures is evidence of the strength of the retail trade associations in general and the N. A. R. D. in particular. There is no record of hearings being held in forty states.[3] There is no transcript of hearings available in any of the states.[4] "The N. A. R. D. held the hoop and cracked the whip. The legislators and the executives obediently jumped."[5]

High pressure tactics were also used in persuading manufacturers to enter into contracts, at prices providing margins that distributors desired. Committees of distributors visited the manufacturers, reviewed the contracts they proposed to issue, and discussed the adequacy of the margins allowed. Manufacturers, in turn, received assurance that the prices being set by other manufacturers of the same or similar products were equal or similar to their own. Normally, manufacturers did not join in horizontal agreements, but the effect was the same.

Retailers circulated white lists of manufacturers who signed contracts advising dealers to push displays, special advertising, and extra sales effort. They used black lists of those who failed to sign, for example, the makers of Pepsodent refused to sign such contracts, "Pepsodent went under the counter in practically every drugstore . . . and . . . clear across the country . . . Rapidly, other brands . . . forged ahead . . . Result: a few months later, Pepsodent

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[3]Clair Wilcox, Public Policies Toward Business (Revised Ed. Homewood, 1960), p. 381.

[4]Ibid.

[5]Ibid.

returned to the fold . . ."[6]

Federal Legislation Concerning Fair Trade

Prior to the enactment of the federal antitrust laws, the legality of resale price maintenance rested on common law and on state laws regulating monopoly and unfair trade practices. The question of legal status could normally arise therefore only in local, intrastate trade. In the few instances in which the courts were faced with price maintenance in sales involving interstate trade, they generally upheld the practice.

The Sherman Act of 1890 first brought price maintenance within the scope of federal law. The general rule under the Sherman Act is that contracts for maintaining prices are illegal restraints of trade subject to criminal and civil penalties. This rule was not applied to resale price maintenance until 1911 when in the case of *Dr. Miles Medical Company* versus *John D. Park and Sons Company* the Supreme Court established the principle that resale price maintenance contracts involving interstate sales constitute unlawful restraints of trade and accordingly are invalid and unenforceable.[7]

Therefore, fair trade contracts wherein both parties to the contract were in the same state were valid, but those contracts where parties were in different states were found to violate federal antitrust laws. And since the great bulk of branded goods sold at retail

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[6] *Business Week*, August 28, 1937, pp. 37, 44.

[7] 220 United States, 373, 31 S. Ct. 376.

moved across state lines, it was necessary to amend the federal laws if fair trade laws were to be effective.

Miller-Tydings Fair Trade Act

Proponents of fair trade legislation achieved their objective on August 17, 1937, with the passage of the Miller-Tydings Fair Trade Act as an amendment to Section 1 of the Sherman Antitrust Act.[8] This amendment exempted from the federal antitrust laws interstate contracts fixing prices within those states where intrastate contracts of this type have been legalized. The amendment further declared that the making of resale price contracts shall not be regarded as unfair competition.

The passage of the Miller-Tydings amendment was accomplished in 1937 by attaching a rider to the District of Columbia Appropriations Act, which was passed just before Congress adjourned. President Roosevelt was thus forced either to accept the rider or to deprive the District government of the revenues required to finance its activities. He, therefore, recorded his objection to the measure and to the manner of its enactment but signed it into law.

As a result of this amendment the Federal Trade Commission and the Department of Justice could still prosecute persons attempting to maintain resale prices in those states that did not have fair trade laws. By 1941 only three states, Missouri, Texas and Vermont, and the District of Columbia were without fair trade laws.

Wentling Loophole

In 1950, the Sunbeam Corporation versus Wentling Case weakened the

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[8] 50 Statutes, 693 (1937).

Miller-Tydings amendment.

Wentling, a mail-order dealer, and also a nonsigner, in Pennsylvania, had been making both interstate and intrastate sales of Sunbeam electric shavers at less than the price Sunbeam had stipulated. In the suit Sunbeam brought against Wentling, the Court of Appeals in its first decision said: "The Pennsylvania statutes cannot govern sales by Pennsylvania retailers to consumers in other states." Sunbeam was denied protection against Wentling in making interstate sales at less than the maintained resale price for Pennsylvania. In 1951, the Court of Appeals declared in a second decision in the Wentling case that a party not signing a price maintenance contract cannot be subjected to the nonsigners provision of a state law on sales made within a state where interstate trade is involved.[9]

The effect of the "Wentling loophole" was to give the nonsigning mail-order house in one state the legal right to sell and ship into another state at prices below the locally maintained prices.

Schwegmann Brothers versus Distillers Corporation

The validity of the Miller-Tydings amendment, and in effect the legality of the "nonsigners" clause, was not successfully tested until 1951 when the Supreme Court's decision on the Schwegmann Brothers versus Calvert Distillers Corporation was announced. It was held that the Miller-Tydings Act contained no reference to the non-signer's clauses in the state laws, and, therefore, did not permit control of the prices at which non-signers resold goods brought in from other

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[9]"Fair Trade: A Half-Hearted Comeback," Readings in Marketing ed. J. H. Westing (New York, 1953), pp. 287-290.

states. Justice Douglas stated: "Contracts or agreements convey the idea of a cooperative arrangement, not a program whereby recalcitrants are dragged in by the heels and compelled to submit a price." Such a program he said, "is not price fixing by contract or agreement; that is price fixing by compulsion. That is not following the path of consensual agreement; that is resort to coercion."[10]

McGuire-Keogh Act

The Schwegmann decision knocked the props from under the structure of fair trade and within weeks a major price war was under way. This price war afforded the proponents of fair trade a dramatic illustration of the "need" for Congressional action to undo the "damage" that the court had done.[11] Bills were introduced with the backing of the American Fair Trade Council, representing the manufacturers of branded goods, and the Bureau of Education on Fair Trade organized by the druggists to represent their interests. These bills were opposed in public hearings by Macy and Schwegmann, by the Department of Justice and the American Bar Association, by organized groups of labor, agriculture, and by many other groups.

The druggist had not forgotten how to get results. Congress was overwhelmed with letters, telegrams, phone calls, and delegations of visitors.

The McGuire-Keogh Fair Trade Enabling Act passed the House and Senate by large majorities and was signed on July 14, 1952 by President Truman.

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[10] Schwegmann v. Calvert, 341 U. S. 384, 390 (1951).

[11] Wilcox, p. 383.

The McGuire-Keogh Act, an amendment to Section 5 of the Federal Trade Commission Act, in effect tried to reverse the Schwegmann decision saying that merchants are legally bound to adhere to fair trade prices whether or not they have signed contracts.

The Act also declared that neither the authorized agreement nor the nonsigner agreements "shall constitute an unlawful burden or restraint upon, or interference with, interstate commerce." This clause was designed to remedy the mail-order loophole left by the Wentling decision.[12]

Schwegmann Brothers versus Eli Lilly and Company

After the enactment of the McGuire-Keogh Act, Eli Lilly and Company fixed a resale price of $2.83 on a bottle of insulin. Schwegmann sold it for $2.08. Eli Lilly and Company sued under the Louisiana law and was granted an injunction by the state court. Schwegmann appealed to the federal courts, contending that the nonsigners provisions in the state and federal laws were unconstitutional. He lost his case in the Court of Appeals and carried it to the Supreme Court of the United States. In October, 1953, this body refused him a hearing. A year later in October, 1954, the Court refused to review the decisions of the lower courts upholding the New York, New Jersey, and federal laws in cases appealed by Sam Giody, a dealer in phonograph records, and S. Klein, a department store operator in New York and Newark. Refusal to review, however, does not affirm the validity of a decision of a lower court, but it does permit it to stand.

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[12]"Use of Resale Price Maintenance by Integrated Manufacturers--A New Loophole for Abuse of Monopoly Power," Yale Law Journal (January, 1955), pp. 431-432.

Legal Status of Fair Trade Today

In 1957, the decision in the General Electric Company versus Masters Mail Order Company case reopened the so-called "Wentling loophole," named after the Pennsylvania mail-order operator who exploited the same weakness in the Miller-Tydings Act. The Masters case concerns the question of whether or not retail price fixing could be made to cover goods shipped in interstate trade from non-fair trade states.

In the General Electric Company versus Masters Mail Order Company case, the U. S. Circuit Court of Appeals, for the 4th District (N 3 N.Y.) in 1957, overruling a lower U. S. District Court, held:

> A mail order house located in the District of Columbia cannot be enjoined from advertising, offering for sale, or selling a fair trader's products in New York below fair trade prices established under the New York Fair Trade Act. Neither the McGuire Act nor the New York Fair Trade Act authorizes the enforcement of fair trade prices against a retailer making resales or located in a non-fair trade jurisdiction. The fact that the retailer's owner was located in New York was irrelevant, and the retailer will not be treated as a mere dummy corporation for its New York parent. Also, New York contracts of the retailer were irrelevant.[13]
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> In this 2 to 1 decision, one majority judge ruled that the McGuire Act and the New York Act were inapplicable since the resales of the fair traded products took place in the District of Columbia, a non-fair trade jurisdiction. The place of sale was considered to be the place where the title to the products passed. The other majority judge ruled that the retailer was located in the District of Columbia and therefore beyond the reach of the New York Fair Trade Act. The exemption provided in the McGuire Act can be availed of only by the state that the McGuire Act designated as the state of resale, that is, the state where the retailer is located.[14]

The decision in the Masters case and a like decision for Masters by the U. S. Circuit Court of Appeals in the Bissel Carpet Company

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[13]Waller, p. 55

[14]Ibid.

case, for the 2nd District (viz Maryland) made void the effectiveness of the state fair trade acts as they apply to interstate and intrastate commerce. These decisions make it possible for a retailer doing business in a fair trade state (as in this case, New York) to establish an office in a non-fair trade state (as in this case the District of Columbia) to solicit business in the fair trade state by advertising, offering for sale, and selling resale price restricted merchandise below prices established under the provisions of the state fair trade laws.

Another evident weakness in fair trade's present position is what might be termed "gaposis." Geographical gaps exist where no fair trade legislation was ever enacted or where in recent court decisions high state courts either partially or entirely invalidated their fair trade acts. The latter trend seems particularly significant.

The legal status of fair trade state laws, as of November 10, 1959, was as follows: Seventeen (17) state Supreme Courts have declared their fair trade acts constitutional, fully valid and enforceable.

Arizona	Maryland	Pennsylvania
California	Massachusetts	Rhode Island
Connecticut	Mississippi	South Dakota
Delaware	New Jersey	Tennessee
Hawaii	New York	Wisconsin
Illinois	North Carolina	

Thirteen (13) states have had no state Supreme Court decision with respect to the validity of their fair trade acts, thereby leaving these acts fully valid and enforceable:

Alabama	Montana	Ohio
Idaho	Nevada	Oklahoma
Iowa	New Hampshire	Virginia
Maine	North Dakota	Wyoming
Minnesota		

In the following fourteen (14) states the Supreme Court declared the so-called non-signers clause of the state's fair trade act invalid:

Arkansas	Kansas	Oregon
Colorado	Kentucky	South Carolina
Florida	Louisiana	Washington
Georgia	Michigan	West Virginia
Indiana	New Mexico	

In Nebraska and Utah the state Supreme Courts held invalid the entire fair trade act.

Alaska, Missouri, Texas and Vermont and the District of Columbia have never had a fair trade act.[15]

The obvious answer to these weaknesses, the "Wentling loophole," and "gaposis," according to the proponents of fair trade, is to legalize resale price maintenance on a national scale through federal legislation.

The Non-Signers Clause

The "non-signer" clause has been called the "heart" of fair trade. This is true for the very practical fact that without the non-signer provision systematic price maintenance is not effective. There are always some retailers who in the absence of compulsion will refuse to observe the manufacturer's minimum prices. The "discount house," whose primary appeal to the consumer is lower prices, naturally will not voluntarily sign a fair trade contract. Chains and other large distributors refuse to enter into agreements for the maintenance of resale prices as a matter of general policy.

Supporters of the non-signer clause agree that the number of

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[15]Bureau of Education on Fair Trade, Newsletter, November 10, 1959.

confirmed price cutters is small but claim that the presence of even a single price cutter in a market has a demoralizing effect on the entire price structure. If one retailer starts to cut prices, others must follow. This, according to the advocates of fair trade, will lead to full scale price war resulting in the price-cut article disappearing from the market.[16]

The proponents of fair trade believe that if one accepts the basic philosophy of fair trade, there is no logical reason for objecting to the non-signer clause. If it is good public policy to allow a manufacturer to stipulate the minimum resale prices of his products at all, it does not cease to be good merely because a few retailers do not desire to sell at that price. Once the principle of fair trade is accepted, the extension of the practice is a logical and practical necessity.

Following this line of reasoning the House Judiciary Committee reported its finding of its 1952 study of resale price maintenance. Dealing with the non-signer clause in the state fair trade acts the majority report states:

> . . . the committee is of the opinion that the non-signer clause is the keystone of such legislation and must therefore be sanctioned.
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> This is so even though the committee realized that the non-signers' clause has been the subject of much litigation and criticism throughout the years. Without such clause, Fair Trade contracts or agreements alone cannot provide for resale price maintenance, as experience has plainly shown in the Schwegmann and Wentling cases. The merchant who does not wish to sign a Fair Trade contract can easily demoralize and shatter the whole structure of resale price maintenance with the consequence of rendering any number of products subject to price cutting. The retailer who does not adhere to a trade policy as expressed in the declaration of public policy in state laws must effectively be bound lest all other merchants lose

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[16] Herman S. Waller, Resale Price Maintenance on Identified Merchandise and the State Fair Trade Laws, The National Association of Retail Druggists (Chicago, 1958), p. 61.

the protection afforded by such laws.[17]

We are also told that enforcement against non-signers is necessary for the protection of contract rights. To hold that fair trade contracts are good when voluntarily signed but that they cannot be protected against non-contract nullification "is to say that the body may live but the heart must die."[18]

To the advocates of fair trade the enforcement of fair trade with the non-signers clause is "fair," "democratic" and "the American way of doing things." It is merely the principle of majority rule applied to commercial practices. The retailer is not forced to sell articles subject to price maintenance. He can sell only "free" goods or can develop his own private brands. Or, as the courts have pointed out, he is not bound by fair trade minimum price if he removes the identifying trademark. The limitations apply only to identified products and only if a retailer elects to deal in fair trade goods and to retain their distinguishing trademarks, is he affected by the fair trade contract.

Objections to the Non-Signer Clause

In opposing the non-signer provision of the state fair trade acts those who object to fair trade as a matter of principle are joined by others who are willing to tolerate price maintenance on a voluntary basis, but cannot accept the coercive element inherent to the non-

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[17]Ibid , p. 64.

[18]U S. Congress, House, Committee on the Judiciary, Price, Resale Maintenance, Hearings, 75th Congr., 1st Sess. (Washington, 1937), p. 57.

signers clause.

Both groups believe that the non-signer clause is unfair, undemocratic and contrary to the public interest. To permit manufacturers or groups of retailers to force other retailers to conform to contracts which the latter have not signed and the terms of which they have not voluntarily accepted is coercive, and as such a violation of the principle of freedom of contract itself.

The contention that the non-signer clause is necessary to protect price maintenance contracts and to make fair trade effective is dismissed as merely begging of the question and an indication of the objectionable elements inherent in the whole program. As Fortune magazine has stated: "In a democracy it is simply not true that any means are justified to attain an end. Legitimate means can and ought to be found to protect the small retailer on a competitive basis."[19]

The "permissive" character of fair trade may be best described as largely imaginary, for a small retailer does not have a free choice in deciding whether or not to handle fair trade goods. Often the widespread consumer acceptance of one brand or trademark, achieved through nationwide advertising, forces the retailer to deal in controlled merchandise. In some lines, in fact, all competitive products are subject to control. A great majority of retailers have neither the market nor the resources to develop their own brands. And how, it has been asked, can a storekeeper remove the identifying trademark from an aspirin or a tube of toothpaste as the one court said he could? To argue that fair trade is not inherently compulsory in character is to

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[19]"The 'Fair' Trade Controversy," Fortune, April, 1949, p. 76.

dodge the whole issue presented by the non-signer clause.

The importance of this particular issue of the fair trade controversy, the non-signer clause, has been somewhat diminished by the introduction of the National Fair Trade Bills and the Quality Stabilization Bill. Under the provisions of the National Fair Trade Bill a manufacturers' established price on his trademarked product becomes enforceable through actual "notice" to his distributors thus eliminating the need for contracts, as well as the non-signer clause.

Even though the need for the non-signer clause itself will have been eliminated if such legislation is enacted the compulsory characteristic of fair trade remains. This characteristic of fair trade cannot be overlooked in evaluating the merits or short comings of the entire program.

CHAPTER V

NATIONAL FAIR TRADE BILL

The National Fair Trade Bill (or bills) frequently before the House and Senate is a result not only of an attempt to solve those legal problems discussed in the previous chapter but also an attempt to eliminate or minimize the effect of other weaknesses in the current status of fair trade.

Weakness in the Status of Fair Trade

These weaknesses include the lack of or discriminatory enforcement of fair trade prices, the popularity and growth of the "discount house," the controversy concerning the giving of trading stamps on fair traded products, and the abandonment, by once strong supporters, of the practice of fair trade pricing.

Discriminatory Enforcement of Fair Trade Prices

Enforcement of fair trade contracts was exempted from the operation of the federal antitrust laws by the Miller-Tydings and McGuire-Keogh Acts.[1] State laws typically provide that an action may be brough against violators by "any person damaged thereby."[2] Normally this action

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[1]50 Statutes 693 (1937), 15 U. S. C. 1 (1952).

[2]"Discriminatory Enforcement of Fair Trade Prices: The Problems and Remedies Under State and Federal Laws," Yale Law Journal, December, 1955, p. 235.

takes the form of suits for an injunction against retailers who have violated the fair trade laws, brought either by other retailers or by fair trading manufacturers. Criticism has focused on the infrequent and discriminatory enforcement practices of some manufacturers.[3]

This lack of enforcement by manufacturers is due to several reasons. First the enforcement of fair trade prices is very expensive for the manufacturer. Sheaffer Pen Company, for example, spent two million dollars over a two-year period and discontinued selling to some 700 dealers because of their discount practices.[4]

Many manufacturers think that the complaining retailers, largest source of complaints, often are price cutters themselves, and complain only to establish an excuse for their own prospective violations if the reported price cutting does not stop.[5]

Finally, the growth in number and popularity of the "discount house" as a means of distributing the manufacturers expanded output have left the manufacturer reluctant to rigidly enforce their fair trade prices.

Discount House

The discount houses started as small operations in the 1930's, catering to a small clientele who had to have special identification cards. Sometimes the discounts given were substantial; sometimes they were only nominal. But even when the discount was only nominal,

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[3]Ibid., pp. 235-236.

[4]"Retreat of the Fair-Trader " Time, December 19, 1955, p. 90.

[5]C. I. Kanter and Stanford G. Rosenblum, "The Operation of Fair Trade Programs," Harvard Law Review, December, 1955, p. 318.

people took pride in telling their neighbors that they had purchased a well known brand product at a discount. Eventually, virtually anyone could secure the required identification card so that the discount house in effect became only another retailer operating as a "discount house."

In 1954, the total number of discount houses was estimated at between 6,000 and 10,000.[6] In 1955, the sales of the nation's largest discount house, Polk Brothers of Chicago, were reported to be about $30 million a year.[7]

The discount house depends primarily on price appeal to obtain its customers. Many services normally made available to the customer, such as credit, free delivery, and repair service, are not furnished by these houses. High-rent locations and luxury fixtures are also sacrificed to cut overhead expense, thus enabling the discount house to sell at a lower price and still maintain its margin of profit.

The selling of well known fair traded products at less than the fair trade price is a natural drawing card for this type of retail outlet.

Trading Stamps

The question has been raised as to whether or not the giving of trading stamps constitute a price cut. The Massachusetts Supreme Court held, in March, 1958, that trading stamps given on fair traded

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[6]Hervert Breon "Discount Houses Stir Up a $5 Billion Fuss," Life, August 9, 1954, p. 52.

[7]Ralph S. Alexander and Richard M. Hill, "What to do About the Discount House," Harvard Business Review, January, 1955, p. 53.

items are a violation of the state's fair trade law.[8] In other states, however, trading stamps are being given with the purchase of products on which fair trade prices have been established.

Manufacturers Drop Fair Trade Pricing

A significant development in the current status of fair trade is the recent dropping of fair trade prices by once militant advocates of this form of resale price maintenance. In February, 1958, Sunbeam Corporation and General Electric Company dropped the minimum price system on many of their appliances.[9]

W. H. Sahloff, General Electric's vice president, cited these factors as contributing to G. E.'s decision to drop fair trade: recent adverse legal decisions; and the untenable competitive position that dealers complying with G. E. fair trade prices are faced with when located next to a non fair trade area or areas where it has become difficult to secure injunctions or adequate penalties to enforce them.[10]

More recently, in February, 1960, Esso Standard, after less than six months' trial of fixing statewide prices on petroleum products in North Carolina, announced discontinuance of the practice. Eight or nine other companies are expected to follow the Esso lead.[11]

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[8]"Fair Trade Gets a Two State Boost; Trading Stamps Get Slapped Down," Business Week, March 22, 1958, p. 78.

[9]"Sunbeam Joins GE in Dropping Fair Trade Prices in Most Items," Wall Street Journal, February 27, 1958, p. 2.

[10]Ibid.

[11]"Another Fair Trade Company Deserts the Sinking Ship," Temple (Texas) Daily Telegram, February 1, 1960, p. 4.

National Fair Trade Bill

In an attempt to strengthen the faltering position of fair trade an intensive, long-term program was launched in May, 1956, by the National Association of Retail Druggists and its Bureau of Education on Fair Trade. Various drafts of federal legislation to preserve the fair trade principle were developed by working panels of top legal experts from all parts of the country. These lawyers represented fair trading manufacturers in most of the fields in which fair trade is practiced, as well as wholesalers and retailers in these fields.[12]

Professor James A. MacLachlan of the Harvard Law School specialist in, among other fields, antitrust and trade regulations, was then retained by the N. A. R. D. "to examine the drafts already prepared and to develop such other drafts as, in his opinion, might more effectively meet the present situation."[13] Another participant was Dr. Walter Adams, professor of economics at Michigan State College, who was a member of the Attorney General's National Committee to Study the Antitrust Laws.[14]

February 7, 1958, Dr. John W. Dargavel, executive secretary of the N. A. R. D. and chairman of the Bureau of Education on Fair Trade, issued a mobilization call to proponents of fair trade to support the National Fair Trade Bill. He wrote:

Every important legal problem confronting fair trade which has

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[12]John W. Dargavel, Release, Bureau of Education on Fair Trade, February 7, 1958, p. 2.

[13]Ibid., p. 3.

[14]Ibid.

developed or could be foreseen was given full consideration in the evolution of the bill. It is the consensus of all the expert minds which have worked on the bill that it offers the most comprehensive and legally sound method for establishing the fair trade principle for the first time on a strong nationwide basis.[15]

House of Representatives 10527

The culmination of these efforts, H. R. 10527, an amendment to the Federal Trade Commission Act was introduced in the House February 5, 1958, by Representative Oren Harris (D) of Arkansas.

The pattern of the measure is as follows:

The manufacturers, through a federal act, are to be allowed to establish minimum resale prices on the commodities they produce. Then the manufacturers are to have the legal right to take action against the violators of the established minimum resale national in scope . . . .[16]

Basis for the proposed law is the alleged principle that the manufacturers are entitled to the right to protect the value of the trademarks they possess and the integrity and the goodwill attached to them.[17] The minimum resale price is to be effective and enforceable simply on notice to the distributor or retailer.

H. R. 10527 was referred to the House Committee on Interstate and Foreign Commerce. After exhaustive public hearings the Subcommittee on Commerce and Finance, headed by Representative Peter F. Mack, Jr. (D) of Illinois, concluded "that the Bill's demonstrable advantages to the general welfare outweighed the doctrinal objections that were

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[15]Ibid.

[16]Address by John W. Dargavel at the National Association of Retail Druggists Convention, Minneapolis, Minnesota, October, 1957.

[17]Ibid.

offered against its enactment."[18] However, this bill was never brought to a vote and thus died in committee.

House of Representatives 1253 and Senate 1083

January 7, 1959, the opening day of the 86th Congress, Representative Oren Harris (D) introduced in the House H. R. 1253. This bill is substantially the same as H. R. 10527 recommended by the Subcommittee on Commerce and Finance in the last session of the 85th Congress. It does incorporate revisions made in the light of questions raised in the course of consideration of H. R. 10527 in 1958. The objective remains to establish a national fair trade law.

While the Harris Bill, H. R. 1253, is being considered in the House of Representatives the identical bill is also under consideration in the Senate. In the Senate the bill is identified as the Humphrey-Proxmire Bill, S. 1083.

Provisions of H. R. 1253 and S. 1083

The National Fair Trade Bill, as stated in H. R. 1253 and S. 1083, is a bill "to amend the Federal Trade Commission Act, as amended, so as to equalize rights in the distribution of merchandise identified by a trademark, brand or trade name."[19]

The use of the word "equalize" in the Bill implies that certain trademark owners already enjoy "rights" which the Bill provides, while others do not. Supporters of the Bill point out that "rights" of the same nature are already available to, and utilized by, trademark owners

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[18] U. S. Congress, House, Committee on Interstate and Foreign Commerce, Fair Trade: 1959, Hearings, 86th Congress, 1st Sess. (Washington, 1959), p. 1.

[19] H. R. 1253, p. 1.

who employ specialized methods of distribution such as consignment selling, exclusive franchise arrangements and forward integration. Enactment of H. R. 1253 or S. 1083 would make the "rights" available on a national basis to trademark owners who use normal channels of distribution.

Under the provisions of the proposed meausre (paragraphs (5) through (10) of the reported bill) the proprietor of merchandise identified by a trademark, brand, or trade name would have the option to establish and control stipulated resale price for such merchandise. Such merchandise must, however, be in interstate commerce, or held for sale in any state, the District of Columbia, and territory of the United States after moving in interstate commerce. Such merchandise must also be "in free and open competition with merchandise of the same general class produced by others."[20]

H. R. 1253 and S. 1083 further provides that a manufacturer's established price on his trademarked product becomes enforceable through actual "notice" to his distributors thus eliminating the need for contracts, as well as the controversial non-signers clause.[21]

The proposed legislation permits not only suits for the recovery of damages or for injunctive relief but also the recovery of reasonable attorney's fees.[22]

Progress of H. R. 1253

The national fair trade bill, H. R. 1253, was the third piece of

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[20]Ibid., p. 6.

[21]Ibid.

[22]Ibid., p. 7.

legislation to be brought before the House Committee on Interstate and Foreign Commerce in the first session of the 86th Congress. Exhaustive public hearings were held, resulting in a voluminous record.

The committee report was filed in the House on June 9, 1959 (House Report 467, 86th Congress), and after some delay a hearing was held on August 3, 1959 before the Committee on Rules. This hearing could not be completed that day and the chairman of the Committee on Rules, Representative Howard W. Smith (D) of Virginia, announced that the hearing would be resumed at a later date, which appeared to mean sometime in 1960.[23] The measure again appears to be dead as far as the 86th Congress is concerned.

Quality Stabilization Bill (H. R. 9692)

In 1959, a once strong supporter of fair trade, the American Fair Trade Council, was dissolved. In its place, at the same addresses, was organized Quality Brands Associates of America, Inc. The President of the newly organized association is John W. Anderson, long time president of the American Fair Trade Council.

The objective of the association as printed on its letterhead reads as follows:

> Quality Brands Associates of America, inc. is the only organization of manufacturers, of diversified industries, devoted exclusively to educational activities relating to the value of voluntary price stabilization as a means of stabilizing product quality.

The Quality Stabilization Bill (H. R. 9692) sponsored by Quality Brands Associates represents a new approach to the control or elimination of the alleged unfair practice of offering well-known trade-

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[23] Oren Harris, "Call to Arms in Fight To Save Fair Trade," National Association of Retail Druggists Journal (October 19, 1959), p. 28.

marked or branded products at less than the price established under the provisions of state Fair Trade Acts.

The Quality Stabilization Bill provides that a manufacturer may protect his property rights in his trademark simply by revoking (by mail, if desired) the right of an offending reseller to make any further use of or reference to the trademark.[24]

Three grounds are set out in the bill to allow the owner of the brand to invoke this remedy: bait advertising, selling at other than the established price, and consumer deception.[25]

Those who utilize the brand or trademark for any of these purposes can, under the provisions of the proposed bill, be held to have forfeited the right to further use of the brand.

Not only does this bill attack the practice of price cutting on identified merchandise, but also emphasis has been given to the "unfair" acts of store traffic baiting and misrepresentation as to the size, capacity, quality, condition, model, or age of the goods.

The Quality Stabilization Bill also differs from the National Fair Trade Bills in that no reference is made to the method by which resale prices may be established. Nor are any provisions made for disposing of damaged, defaced or deteriorated merchandise.

The Quality Stabilization Bill was introduced in the House January 18, 1960 by Representative Ray J. Madden (D) of Indiana, and referred to the Committee on Interstate and Foreign Commerce.

Speaking in behalf on the bill, Representative Madded stated:

To avoid further misleading confusion of Quality Stabilization

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[24]Ray J. Madden, "Rep. Ray Madden Cited the Benefits of Bill to Labor and Consumer," Stabilizer, February, 1960, p. 1.

[25]Quality Brands Associates of America, Inc., The Quality Stabilization Story (1959), p. 9.

with so-called Fair Trade a separate hearing will be requested for the Quality Stabilization Bill . . . with the Quality Stabilization Bill enacted, neither manufacturer, reseller, nor the public would have any reason to rely upon any State Fair Trade Act or upon any proposed Federal Fair Trade Law.[26]

Despite the efforts of the Quality Brands Associates to differenciate between its Quality Stabilization Bill and the National Fair Trade Bill, sponsored by the National Association of Retail Druggists, the similarity of the two bills is evident.

The aim of both bills is that of stopping the practice of cutting prices on products identified by a brand, trademark, or trade name. The N. A. R. D. through its Bureau of Education on Fair Trade has published volumes of material telling of the "evils" of this practice. Quality Brands Associates joins in interpreting the "destructive" results of discount pricing on identified goods. And the provisions of both bills provide that the owner of a trademark shall retain his property rights in the trademark regardless of any sale or transfer of the goods.

Under the provisions of the National Fair Trade Bill (H. R. 1253) ". . . it shall be unlawful (i) for any distributor with notice of an applicable stipulated resale price established under paragraph (6) . . . to sell, offer to sell, or advertise such merchandise in commerce . . . at a different price or . . . at a lower price."[27]

Similarly under the provisions of the Quality Stabilization Bill (H. R. 9692), the right of any person to employ a trademark may be

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[26]Madden, p. 1.

[27]House of Representatives 1253, 86th Congress, 1st Session, line 19-5, pp. 6-7.

revoked by the owner of the trademark, on notice, for any of the following reasons:

(a) that the person reselling such goods has employed goods bearing the brand, or trademark in furtherance of bait merchandising practices;
(b) that the person reselling such goods, with knowledge of the owner's currently established resale price or prices, has advertised, offered for sale, or sold such goods at prices other than the currently established resale prices; or
(c) that the person reselling such goods, with intent to deceive purchasers, has published misrepresentation concerning such goods.[28]

Similarity can also be seen in the basis on which both bills are founded. That is the alleged property rights in manufacturer's trademark, which are seemingly taken for granted by the backers of both bills.

At this time it seems likely that H. R. 1253, H. R. 9692, and S. 1083 will die in committee, but this will not end attempts for the enactment of federal fair trade legislation. In the next session of Congress similar bills are certain to be introduced.

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[28]H. R 9692 86th Congress, 2nd Session, Lines 22-7, pp. 3-4.

CHAPTER VI

WHO BENEFITS FROM FAIR TRADE?

In presenting their arguments both opponents and supporters of fair trade have shown an unwillingness or inability to accurately define the long-run effects, trends, and repercussions traceable to resale price maintenance under fair trade legislation. As indicated earlier this is partially due to the instability of the legal atmosphere and the complexity of business and economic surroundings.

Among those points which demand serious attention is the question of who benefits from the passage of fair trade legislation.

Manufacturers and Fair Trade

Proponents of fair trade urge that the federal fair trade legislation is necessary to safeguard the goodwill embodied in the trademark of the manufacturer or distributor. They argue that without this protection "loss leader" selling leads to the destruction of the manufacturer of branded merchandise.

According to the usual argument, such a development has three stages. In the first, a few distributors offer an article as a leader and others are forced to reduce their prices upon it to make sales. At first, the lower prices may stimulate sales but not for long. In the second stage continuation of leader selling offers no particular advantage because the low price has become general; and all dis-

tributors begin to substitute rival products on which the margin of profit remains high. In the third stage, dealers, both price cutters and others, refuse to push the sale of the item and actually may reach the point of taking it out of stock. Sales of the product drop[1] and the proprietor, who has invested in his trademark through advertising and possibly in the development of the product, finds that he is operating at a loss.

There is little question that some manufacturers have suffered through the debasing of their trademarks by extreme cases of loss-leader selling.[2] But it is very difficult to get any reliable estimate of just how often such selling has actually harmed the manufacturers. It is believed that these losses have been greatly exaggerated, and such as they are, they have resulted from the unrestrained type of price cutting, not legitimate price reductions arising out of low cost merchandising.[3]

During the period 1931 to 1937, when resale price maintenance was an issue hotly debated in Congress, the opponents of resale price maintenance referred to a statement of the Federal Trade Commission in 1931 which stated that, "No instance, however, had yet been brought to the commission's attention in which there was conclusive evidence that

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[1]This is, of course, contrary to the results to be expected if the demand curve is downward sloping. The above, however, is simply argument, and is not necessarily valid.

[2]"The 'Fair' Trade Controversy," Fortune, April, 1949, p. 76.

[3]U. S. Congress, Select Committee on Small Business, House Report No. 1292, Fair Trade: The Problem and Issues, 82nd Cong. 2nd Sess. (Washington, 1952), p. 41.

an article of real merit has been driven off the markets by price cutting alone."[4] It is highly significant that no such evidence has been offered.

In fact just the opposite effect has been noted by Professor E. T. Grether, an authority frequently quoted by advocates of fair trade themselves. He has observed that thoroughly entrenched brands, backed by powerful sales efforts and with large consumer preference, frequently have gained greatly from price cutting.[5] A case may even be built that it is the less well known manufacturers whose brand is not used as leaders who suffer.

Apart from the advantages flowing from the fact that some sections of the retail trade favor price protection, there seems no evidence that manufacturers believe that uniform retail prices carry any other advantage for them.[6] This would in part explain why the manufacturers have not taken the lead in pressing for the passage and effective enforcement of fair trade laws.

The Wholesaler and Fair Trade

It has been argued that the wholesaler can expect two major advantages from fair trade: (1) He can expect a larger volume of sales

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[4]U. S. Congress, House Committee on the Judiciary, Price, Resale Maintenance, Hearings, 75th Cong., 1st Sess. (Washington, 1937), p. 150.

[5]E. T. Grether, Price Control Under Fair Trade Legislation (New York, 1939), p. 268.

[6]Where such advantage may exist due to the distinct nature of the product produced, other forms of resale price maintenance such as exclusive agency or consignment selling are available for the manufacturers use.

through the diversion of sales from the large retailer buying directly from the manufacturer to the small retailer whose source of supply is the wholesaler; (2) he can expect fair trade to ease the pressure of retailers for cut-rate wholesale prices and, for this reason, to receive a larger margin for himself.[7]

The realization of either of these advantages is doubtful. It is likely that under fair trade laws large retailers may reduce their purchases from wholesalers of some fair traded products. These products may well be replaced by private brands marketed by large retailers to be used to undersell the well-known national brands that are price fixed. It is therefore doubtful that the wholesaler can expect any increase in the total value of orders through the enforcement of fair trade laws.

Nor can the wholesaler expect any advantage in respect to margins. In both the drug and the grocery trades, many independent retailers are members of cooperative buying groups; in fact, they may own and operate regular wholesale establishments whose profits are distributed to the members on the basis of purchases. These wholesale cooperatives are now in existence and any minimum fair trade prices wholesale, which give a highly profitable margin for wholesaling, will benefit the wholesale cooperative at the expense of the independent wholesaler who can neither sell below the fixed minimum nor share his profits with the retailer.[8]

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[7]Edgar H. Gault, "Fair Trade," Michigan Business Studies, 1939, pp. 20-21.

[8]Ibid.

It does not, therefore, appear that fair trade laws will aid the wholesalers, and in general, wholesalers have not behaved as if fair trade would benefit them.

The Retailer and Fair Trade

As we have seen the source of nearly all recent propaganda and pressure for the passage and enforcement of fair trade laws has come from retailers and their associations, especially in the drug trade.

The large retailer, chain or independent, with effective display and service competition and private brands can logically expect no advantage from fair trade. Nor can the large discount houses, virtually established on the basis of price cutting of famous brands expect any benefit from fair trade.

Among the small retailers, the independent neighborhood druggist seems to expect greater benefit from fair trade laws than any other trade. This is due to the fact that a greater proportion of the products he sells lend themselves to resale price control.

Applicability of fair trade to any line of products is dependent upon many factors. These include the extent to which the trademarked articles involved are susceptible to substitution of private brand goods, other nationally advertised trademarked goods or unbranded merchandise. Also important is the question of whether the sale of items involves taking used merchandise as trade-ins, for if such is the case, larger and larger trade-in allowances are in effect price cuts.[9]

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[9]Federal Trade Commission, Federal Trade Commission Report on Resale Price Maintenance (Washington, 1945), p. 126.

Highly stylized seasonal merchandise and perishable commodities such as dairy products, vegetables, and fresh meats are also among those products which do not lend themselves to price control. Such items must be sold quickly, at reduced prices if necessary.

Among those items which over a period of years have become associated strictly with drug store trade, comprising prescription preparations and patent medicines, toilet goods, surgical and related supplies, there are few which do not lend themselves to fair trade pricing.[10] In fact, a large majority of these items are trademarked or otherwise identified and as a result of insistence on the part of retail druggists, described in Chapter IV of this study, a large proportion are sold under fair trade contracts.[11]

The neighborhood druggist may expect or hope that under fair trade his regular prices on these fair trade commodities will no longer be undercut by his cut-price competitors or by discount houses in the larger cities. Retail customers who he feels are logically his will be less apt to pass him by and patronize some less conveniently located cut-price retailer. The bottom which fair trade places upon prices may or may not be high enough to increase his markup, but he feels he will have some protection against price inducements which formally enticed his neighborhood trade to less convenient stores, and he should experience some increase in his volume of sales.

There is some question, however, whether the effective enforcement of fair trade laws will bring about all these advantages to the druggist

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[10] Ibid.

[11] Ibid.

as well as other small retailers. This question will be considered in the next chapter along with the question of primary importance to the consumer, are fair trade prices fair prices?

CHAPTER VII

Are Fair Trade Prices Fair Prices?

A question which has received considerable attention by both opponents and advocates of fair trade is concerned with the effect which fair trade has had on the price level.

This question has been the subject of extensive empirical inquiry. Economists, interested trade and business groups, government agencies, and private research organizations all have participated. Both fair traders and non-fair traders claim justification for their position on the basis of these inquiries.

The Battle of the Surveys

The drug trade has played host almost exclusively to the studies that have been made. A number of factors account for this phenomenon. Trade organizations in the drug field nurtured the fair trade movement from its beginnings and its strongest support over the years has come from these same organizations. They have sponsored several of the more widely publicized statistical inquiries and these dealt, of course, with drug products. The widespread use of price maintenance in the drug trade served further to encourage inquiries by other groups of agencies.

The reader should keep in mind that the concentration of studies in this one field restricts the degree to which their results, when

valid, can be generalized. What is true of one trade need not be true of another with differing organizational and product features.

A large mass of data has been collected, by opponents of fair trade, which indicates that prices in fair trade states tend to be higher than those in non-fair trade areas. Typical of this evidence is the following:

(1) The Federal Trade Commission concluded from its survey that the most common effect of fair trade was that "chain stores, department stores, and certain independent stores that were selling below the minimum set by resale price maintenance contracts in resale price maintenance territory were obliged to increase prices."[1]

(2) A study of comparative prices published in Fortune Magazine in 1949 found that:

> Congressmen and lesser residents of the District of Columbia can lather up with a big tube of Barbasol for 29 cents; in fair-trade Maryland, the same tube would cost 39 cents. The Congressmen can regenerate the blood cells with Lilly's Pulvules (84's) for $2.29, instead of the fair-trade price of $3.15. A bottle of Old Grand-dad is $5.45 in Washington, D. C., $6.65 (before state tax) across the line. BC headache powders are a dime instead of 19 cents.[2]

(3) A study of 117 branded drug items cited by Dr. Vernon Mund showed that thirty-five cost about one-third less in Washington, D. C., than in Maryland, thirty-eight are about a quarter less, and twenty-nine about a seventh less.[3]

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[1]Federal Trade Commission, FTC Report on RPM (Washington, 1945) p. lvii.

[2]"The Not-so-Fair-Trade Laws," Fortune, January, 1949, p. 70.

[3]Vernon A. Mund, Government and Business (2nd ed., New York, 1955), p. 447.

(4) An analysis of prices in Illinois, a fair trade state, and Missouri, a free trade state, revealed similar results. The St. Louis Star-Times reports that fifty-four drug items cost an average of 16.2 cents more in Illinois than in Missouri.

Dr. Mund concluded that the effect of price maintenance on trademarked goods, "is to enhance prices and profits and deny consumers the benefits of lower prices made possible by differences in the productive efficiency, methods of sales, and scale of operations of the various sellers."[4]

Defense of Fair Trade Prices

Supporters of fair trade deny the charge that fair trade prices are high prices. Their position is best presented in a pamphlet, Questions They Ask About Fair Trade and Their Answers, in which they state:

> Scientific research has proved that consumers pay less under Fair Trade for leading national brands even though retailers in non-fair trade areas can sell such brands at any price they choose. Two country-wide six-month surveys, covering all types of stores, large and small, rural and urban, were made in 1949 and again in 1951 by A. C. Neilson and Company, the world's largest independent market research agency.
>
> Both surveys showed that consumers in fair trade areas paid less, over-all for leading brands of drug products than consumers in the non-fair trade areas paid for the same products at the very same time.
>
> Fantastic statements have been made that fair trade cost the consumer money. These statements are based on spurious surveys in which carefully selected items were bought in certain stores at certain times when these items were being used as loss-leaders.[5]

In the most recent empirical inquiry the Bureau of Education on

[4]Ibid.

[5]BEFT, Questions They Ask About Fair Trade and Their Answers, p. 8.

Fair Trade commissioned A.C. Neilson and Company to undertake another study in 1958. This Neilson study covered a continuous six-month period, January through June, 1958. Included in the sample were 2,350 retail outlets, of which 750 were drug stores and 1,600 were food stores.[6] For purposes of the study, the country was divided into two areas, the fair trade area with 28 states and the non-fair trade area with 20 states and the District of Columbia.[7]

Neilson's investigators determined what food stores and drug stores, in each area, charged for each of 15 national brands over the six-month period, as well as the volume sold at each price. The prices shown in the study represent an average price weighted to reflect volume, which consumers paid.[8]

The findings of this study as reported by the sponsoring agency include the following:[9]

(1) The differences in weighted average price in the 45 comparisons shown are so small as to be statistically insignificant. Most price differences are of the order of one-third of 1% to 1%.

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[6]U. S. Congress, House, Committee on Interstate and Foreign Commerce, Fair Trade, 1959, Hearings, 86th Cong., 1st Sess. (Washington, 1959), p. 61.

[7]As of January 1, 1958, the non-fair trade area includes the following states which either never had a fair trade law or whose fair trade law was weakened by virtue of decision of their respective courts of last resort: Arkansas, Colorado, District of Columbia, Florida, Georgia, Indiana, Kansas, Kentucky, Louisiana, Michigan, Missouri, Nebraska, New Mexico, Ohio, Oregon, South Carolina, Texas, Utah, Vermont, Virginia, West Virginia.

[8]U. S. Congress, House, Committee on Interstate and Foreign Commerce, Fair Trade, 1959, Hearings, 86th Cong., 1st Sess. (Washington, 1959), p. 61.

[9]Ibid.

TABLE I

COMPARISON OF CONSUMER SELLING PRICE
FAIR TRADE VS. NON-FAIR TRADE STATES

6 Months - January, 1958 through June, 1958

Brand Number	Food Stores		Drug Stores		Food and Drug Stores	
	Fair Trade States	Non-Fair Trade States	Fair Trade States	Non-Fair Trade States	Fair Trade States	Non-Fair Trade States
1.	$0.684	$0.677	$0.674	$0.673	$0.678	$0.676
2.	0.649	0.648	0.650	0.649	0.650	0.648
3.	0.557	0.560	0.550	0.548	0.554	0.556
4.	0.251	0.252	0.250	0.251	0.251	0.252
5.	0.250	0.251	0.250	0.250	0.250	0.250
6.	0.340	0.341	0.343	0.343	0.341	0.342
7.	0.580	0.588	0.575	0.574	0.578	0.584
8.	0.492	0.492	0.493	0.494	0.493	0.494
9.	0.438	0.439	0.433	0.436	0.436	0.438
10.	0.363	0.360	0.364	0.363	0.364	0.361
11.	0.690	0.678	0.690	0.684	0.690	0.679
12.	0.514	0.515	0.499	0.513	0.511	0.514
13.	1.190	1.186	1.190	1.185	1.190	1.186
14.	0.466	0.467	0.433	0.462	0.455	0.466
15.	0.510	0.508	0.495	0.501	0.506	0.506

SOURCE: U. S. Congress, House, Committee on Interstate and Foreign Commerce, Fair Trade, 1959, Hearings, 86th Cong., 1st Sess. (Washington, 1959), p. 62.

(2) On seven of the 15 brands purchased in drug stores, the consumer paid slightly less in the fair trade area than in the non-fair trade area, and slightly more on six of the brands. The consumer in both areas paid exactly the same weighted average price for two brands.

(3) On six of the 15 brands purchased in food stores, the consumer paid slightly less in the fair trade area than in the non-fair trade area, and slightly more on eight. The consumer in both areas paid exactly the same weighted average price for one brand.

(4) Combining food and drug prices, consumers in the fair trade area paid slightly less for eight brands, slightly more for five brands. Consumers in both areas paid exactly the same weighted average price for two brands.

(5) Of the 45 price comparisons shown, 22 favor consumers in the fair trade states, while 18 favor consumers in the non-fair trade area. In five cases, the weighted average price is identical for both areas.

The findings of this study are representative of the inconclusiveness which has plagued all inquiries in this field. In view of these and the numerous other conflicting results it is understandably difficult to make any general statement concerning the actual effect which fair trade has had on prices based on these studies.[10]

Adding strength to this contention, in 1950, the American Fair-Trade Council invited Dun and Bradstreet to make a comparative survey

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[10] For an excellent discussion of the limitations and findings of the statistical studies in the fair trade field see Marvin Frankel, "Effects of Fair Trade: Fact and Fiction in the Statistical Findings," Journal of Business of the University of Chicago (July, 1955) pp. 182-194.

of the effect of fair trade laws on all prices and pocket books. This authoritative statistical firm declined on the ground that it would be impossible to do the job with sufficient scientific accuracy. Dun and Bradstreet pointed out that even after ascertaining comparative prices properly from both areas, it would still be necessary to determine the volume of fair trade items and the effect of fair trade prices, and they could "see no way to do that."[11]

The Effect of Fair Trade Higher Prices

Professor Grether observed, in 1939, that so far we have not had sufficiently normal times to judge the effects of fair trade properly.[12] This remains true today. In fact, the conditions under which fair trade has been forced to operate since its beginning have precluded the observance of its operation under what might be termed "normal" times. The uncertainty of its legal position, altered almost daily by reversals in the state and federal courts, and the weaknesses in its structure, discussed in an earlier chapter, have prevented trademark owners from taking advantage of the powers given them under this system of pricing.

Although, as we have noted, a fair trade is monopolistic in character the competition of retailers in non-fair trade areas through the use of mail orders has served to keep prices from rising to the

[11] In letter of February 28 1950, to American Fair Trade Council, printed in U. S. 82nd Congress, 2nd Session, House of Representatives Committee on the Judiciary, Antitrust Subcommittee, Study of Monopoly Powers (Washington, 1952), p. 744.

[12] E. T. Grether, Price Control Under Fair Trade Legislation (New York, 1939), p. 379.

levels economic theory would indicate.

If, as proposed under the National Fair Trade Bill and Quality Stabilization Bill, fair trade were made legal nationwide in interstate and intrastate commerce, then the effects of this power would likely soon be felt by the consumer in higher prices.

In regard to prices another contention is made, namely, that fair trade leads to an undesirable uniformity of prices. This contention is based on the observation that the established fair trade price is normally not merely the minimum; in practice it tends to become the actual price. Experience has shown it is rare, indeed, that any retailer can afford to charge prices above the official prices advertised by the manufacturer.

This uniformity of prices is highly undesirable in that it works severe hardships on low income families. Fair Trade means that these families who patronize low-price stores which offer few services and sell under less desirable conditions are forced to pay full fair trade price whether or not any additional services are actually rendered.

Effect of Fair Trade on Retail Margins of Profit

Underlying the effect of fair trade on retail prices is the question of its effect on profit margins. Are profit margins higher under fair trade than under free trade? Is it the very purpose of fair trade to increase and maintain high margins of profit?

The supporters of fair trade cannot deny that they have stressed the effects of maintained prices on markups as an advantage of fair trade, but they do deny that these markups are excessive. As the National Association of Retail Druggists states:

The typical merchant is not worried about average markups. He knows that the cost of doing business tends to be uniform, regardless

of the type of operation, and that his competitors require at least as wide a margin as he does. What concerns him most is to retain his volume, so that the accepted percentage of markup will produce enough gross margin to pay his operating cost. When competitors are permitted to use wanted brands as loss-leaders, they can, without reducing their own average margins, draw his customers away from him and thereby so impair his volume as to make it impossible for him to remain competitive.

The typical merchant wants fair trade, not in order to enable him to exact greater profit, but in order that margins may be equalized in the different departments of his business.[13]

It is difficult to understand how advocates of fair trade could expect anyone to believe these assertions. There seems no reason for the continuous struggle by retailers for maintained prices other than the effect on profit margins.

Two variables determine a dealer's gross margin, selling price and purchase price. If fair trade does not have any affect on the difference between the two, retailers would not be so insistent upon the program.

Opponents of fair trade object to the principle of uniform margins for all types of stores pointing out that costs of operation vary greatly with different stores due to the nature of the clientele. Fair trade does not recognize these differences and by fixing uniform prices requires all stores to operate on the same margins. "Joint, variable, and fixed costs necessitate the utmost freedom of the merchant to alter his selling prices at will," according to the economist for R. H. Macy Company.[14] Fair trade destroys this freedom, prevents adjustments of selling prices to cost and makes the retailer a mere "vending machine."[15]

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[13]NARD, What About Fair Trade, p. 13.

[14]U. S. Congress, House, Committee on the Judiciary, Price, Resale, Maintenance, Hearings, 75th Cong., 1st Sess. (Washington, 1937), p. 155.

[15]Ibid.

Fair Trade and Cost of Distribution

It would be generally agreed that no pricing system should be tolerated which tends to increase costs of operation. There is, as expected, wide disagreement as to the effects of fair trade in this area.

Advocates of fair trade vigorously deny the charge that price maintenance leads to the preservation of inefficient stores and generally tends to increase the cost of distribution. Typical of the evidence they offer in support of this view is a study made by Eli Lilly and Company. This study compared the operating efficiency of 1,122 drug stores, 1,051 in the fair trade states and 71 in the non-fair trade states. Using operating costs as a yardstick of efficiency, it revealed that drug stores in fair trade states have lower operating cost, 26.1% of sales, compared with 27.57% in the non-fair trade area.

Aside from the questionable accuracy of the data, the findings of this study may be challenged in that the difference noted is hardly statistically significant. Furthermore, operating cost as a percent of sales provides a very poor yardstick of efficiency. Suppose the fair trade stores doubled all their prices and suppose they retained the same volume. Then their operating costs would be only 13% of sales. This sort of indicator may hint the opposite of what Lilly wanted to show.

Critics of fair trade believe that price maintenance discourages the introduction of measures to increase efficiency in retailing, and generally adds to the cost of retailing. In support of this argument critics contend that fair trade imposes an unfair burden on improved methods of distribution at the same time it places an economic cushion

under those dealers who lack the initiative to improve their operations. By making it impossible to quote lower prices, fair trade removes the primary appeal of many new retailing devices such as supermarkets, discount houses, low rental shopping centers, et cetera, and retards their development. As the Report to the Temporary National Economic Committee states:

> Price maintenance protects the inefficient, the unprogressive, and those who have abandoned the hazardous struggle for profits in a preference for security, while it penalizes the ambitious and resourceful merchants. It, thus safeguards the living of one group but reduces the opportunities of the more progressive, and at the same time takes away from consumers the advantages of low prices.[16]

It is also alleged by critics of fair trade that price maintenance adds directly to the cost of marketing a product. It stimulates excessive advertising on the part of both manufacturer and dealer, and encourages the offering of unnecessary services in the effort to attract customers.

This argument is based on the fact that when selling prices become uniform between stores, price competition ceases. If then, as proponents of fair trade maintain, competition still persists at the retail level, what form will it take? Dr. Vernon Mund believes that when prices are subject to unified control, "Cost raising" methods of competition are used to increase volume and attract customers. These include a greater use of more expensive facilities, and the provision of extra services. "Since cost-raising methods of competition do not give consumers more goods, better goods, or lower prices" he says, "they

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[16] U. S. Congress, Temporary National Economic Committee, "Problems of Small Business," Investigation of Concentration of Economic Power (Washington, 1941), p. 195.

are not in accord with sound public policy."[17]

Finally, it is pointed out that guaranteed fixed prices and high resale margins are exceptionally attractive to potential competitors. The result is we wind up with a great many low volume inefficient stores characterized by slow turnover, and high costs.

Similarly, high resale margins, serve to encourage dealers outside the trade to add fair trade items to their regular line. In this connection, a statement in Fortune magazine is pertinent. The statement reads:

> The specific granting to individuals of power to fix prices for all other individuals is bad enough. But it is only the first step. As shown by the record in England, and Sweden, the exercise of this power tends to the creation of the further power to dictate who shall and who shall not sell the product. United States "Fair" traders protest that this is not their contention, yet they have begun to move in this direction. The minimum that they have set on most drug prices yield such high margins of profit that other types of stores, notably groceries, have taken to stocking drugs. There has been a consequent outcry from the druggist that only druggists should be entitled to handle these lucrative lines. The question then is raised as to who is a druggist, and this will inevitably lead to a demand for quotas . . . [18]

In summary, we have seen that statistical inquiries have been unable to accurately determine the effects of fair trade on resale prices. This difficulty can be contributed partly to the inability or unwillingness to obtain a representative sample. Primarily, however, the difficulty lies in the fact that the full monopolistic effects of fair trade have not been felt on the price system. This is due to the existence of competition from non-fair trade areas and also competition from within areas where the legal status of fair

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[17] Mund, p. 449.

[18] "The 'Fair' Trade Controversy," Fortune (April, 1949), p. 76.

trade was uncertain.

Should the National Fair Trade Bills or the Quality Stabilization Bill be enacted, then the exercise of additional monopoly power can be expected. This monopoly power would enable a manufacturer to increase his profits through restriction of production and an increase in prices.

Retailers expect to obtain a share of these increased profits through increased margins of profit. If this were not true there would be no reason for the retailers continuous struggle for fair trade.

Competition as it would exist under nationwide fair trade would not be price competition but "cost raising" competition. Increased advertising, expansion of services offered, and improvement of facilities will become the areas of competition for the consumer's dollar. There is no evidence that any of this would improve the quality of the product or decrease the price the consumer must pay. In fact, evidence indicates that just the opposite would be true.

It can, from this evidence, only be concluded that the effect of fair trade applied on a national basis, in interstate and intrastate commerce, would be to increase resale margins, increase the number of low volume inefficient retailers, increase the cost of distribution and increase prices of the fair-traded items.

CHAPTER VIII

SUMMARY AND CONCLUSIONS

This study has concerned itself with the legal and economic aspects of fair trade legislation. We have seen how small retailers, particularly in the drug industry, seeking protection from the keen competition of mass distributors, have encouraged the adoption of fair trade legislation. The purpose of this legislation is to eliminate the alleged "unfair" practice of cutting prices on well-known identified merchandise.

State fair trade laws, presently on the statutes of forty-four states in the United States, have proved to be ineffective in eliminating this practice. This lack of effectiveness has resulted largely from the discriminatory, or in many cases the complete lack of, enforcement of the state fair trade laws.

The difficulties encountered in the enforcement of fair trade have been traced to two important factors. The first has been the uncertain, constantly changing legal status of the fair trade laws within the states. Second, and perhaps most important, has been the reluctance on the part of a manufacturer or his distributor to rigidly enforce their established prices. This reluctance to clamp down on high volume department stores, discount houses, and other large independent as well as chain stores is understandable, for the manufacturer realizes that it is through these outlets that a large

percent of his production is distributed.

Other weaknesses in the structure of fair trade have also been cause for alarm on the part of fair traders. These include the wave of state supreme court decisions which have either partially or completely invalidated fair trade laws in many states. And a most important Supreme Court decision in the General Electric versus Marshall fair trade litigation which held that a retailer in a non-fair trade area could sell through the mail in a fair trade area at below the established minimum price.

Fair traders, recognizing these weaknesses in fair trade, are now mobilizing their strength to gain enactment of a national fair trade bill designed to legalize nationwide fair trade pricing in intrastate and interstate commerce.

In May, 1956, the National Association of Retail Druggists and its Bureau of Education on Fair Trade launched an intensive, long-term program to preserve the fair trade principle. The National Fair Trade Bill now before Congress is the culmination of this program.

Despite the obvious efforts to differentiate between the National Fair Trade Bill and the Quality Stabilization Bill, sponsored by the newly formed Quality Brands Associates, the similarity of purpose and content of the two bills is evident.

Under the provisions of both bills manufacturers, through a federal act, are to be allowed to establish minimum prices on the commodities they produce. The established prices become enforceable through actual "notice" to his distributors, thus eliminating the need for contracts, as well as the controversial non-signer clause.

The bills further provide that any person suffering damage by

reason of a violation of these acts may sue in any state or federal court for damages or injunctive relief, or both.

In seeking the enactment of this federal legislation, advocates of fair trade have attempted to justify the "need" for such legislation from a legal as well as economic standpoint.

To the economist the most important issue in the fair trade controversy is the effect of such legislation on the competitive system. Effective competition has been accepted by economists, statesmen and the courts as a necessary ingredient for the maintenance and development of our free enterprise economy.

Accepting this premise that effective competition is desirable and that monopoly and or acts tending to monopolization of any line of commerce is undesirable, advocates of fair trade contend that the proposed legislation is designed to protect and preserve competition.

To support this contention fair traders call attention to the provisions of the proposed federal legislation which provides, as do the state fair trade laws, that a product to be fair traded must be in "free and open competition" with articles of the same general class produced by others.

In practice, we have seen that the interpretation of this provision has been quite loose and superficial eliminating any effect it might have in protecting or maintaining competition.

That competition which does exist between brands is not the small-man kind of competition fair traders are in the habit of praising in support of fair trade. Only an extremely large firm with sufficient capital to advertise mationally can compete with a brand which has become well-known and accepted by the consumer.

It is also true that producers and distributors of competitive products have shown a tendency to make identical price agreements. The net effect is no different than if there were actual horizontal price agreements.

This evidence of horizontal collusion and the inability to meaningfully define "free and open competition" indicates that fair trade legislation is decidedly more a stimulant to monopoly than a deterrent.

The "evils" of the practice fair trade seeks to eliminate, cutting prices on identified products, have been greatly exaggerated. There is little evidence that the manufacturer of an identified product has been injured by price cutters. In fact, a case reflecting just the opposite may be built. Nor is there conclusive evidence of the destruction of competition and elimination of the small man which would allegedly result from this practice. It seems advocates of fair trade legislation would sacrifice all price cutting to eliminate the alleged predatory practices of those few retailers who desire to monopolize the market.

The effects of such a policy on the market has been the subject of extensive statistical inquiry. These statistical studies have been unable to conclusively determine the effects of fair trade on the market under state fair trade laws. This is partially the result of a lack of ability and or lack of desire to obtain a representative sample.

However, an even more important factor must also be considered. That is the conditions under which state fair trade laws have been forced to operate. Of unquestionable influence has been the uncertain legal status of the state fair trade laws which encouraged retailers such as Schwegmann Brothers to continue the practice of cutting prices

on identified merchandise. This competition from within the fair trade area and the additional competition from non-fair trade areas prevented the trademark owner from exploiting his monopoly power.

Should the federal legislation, presently under consideration in Congress, be enacted then for the first time will the full effects of fair trade be experienced in the market.

The principal effect of a national fair trade bill will be an increase in the prices of fair traded merchandise. This would result as the proprietor of the trademark seeks to maximize his profits.

The profit motive is of primary importance to the retailer also. If this were not so there would seem to be no logical reason for the retailers' continued support of fair trade. In fact, it has been the retailer associations, not the manufacturers, who have taken the lead in promoting the enactment of fair trade legislation. Retailers expect to realize a profit through an increase in resale markups. As indicated earlier, the drug trade may experience a greater influence because of the nature of its merchandise which lend itself so effectively to fair trade pricing.

This does not necessarily mean that the retailers' total profit will increase as many retailers must expect, but only that the margin of profit per unit will increase. The attractive profit margins are more than likely to encourage other retailers to handle the product, actually reducing the total profit per store.

It is believed fair trade legislation discourages the introduction of measures to increase efficiency in retailing. Its enforcement removes the primary appeal of many new retailing devices such as supermarkets, discount houses, low rental shopping centers, et cetera,

who by superior merchandising methods, are able to reduce their distribution cost and consequently to sell for less.

Certainly, as pointed out by those supporting this legislation, competition will continue to exist in the market place at the retail level. This competition must take the form of nonprice competition, including the expansion of advertising and the expansion of services and facilities, all of which we have termed "cost raising" methods of competition and none of which improve the quality of the product or decrease the price the consumer must pay.

Advocates of fair trade legislation have claimed to be trying to protect and preserve competition. Careful analysis, however, has indicated that what the advocates are up to is the protection of weak "competitors, which is precisely the opposite of protecting the institution of competition."[1]

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[1]This point is emphasized by Malcom P. McNair, "Competition and the Law," Michigan Business Review, March, 1951, and Clare E. Griffin, "An Economic Approach to Antitrust Problems," American Enterprise Association, Inc.

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