Dual Distribution and Vertical Integration Under the Robinson-Patman Act

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Application of the Robinson-Patman Act to vertically integrated businesses poses questions of uncommon complexity. Several decisions of the Federal Trade Commission illustrate the difficulty of achieving meaningful enforcement of the antidiscrimination provisions of the act against entrepreneurs performing marketing functions unlike those performed by their competitors. Intertwined with such situations is, on occasion, a kind of vertical integration descriptively called dual distribution, which is said to exist when a seller competes with certain of his customers for sales to other customers. Dual distribution and vertical integration in marketing were the subjects of hearings and a report by a Subcommittee of the House Select Committee on Small Business in 1963 and 1964.

As will later appear, remarkably little is known about the consequences of applying the antidiscrimination provisions of the Robinson-Patman Act to a business which sells to customers operating at more than one level in the marketing system. Because certain of his customers...
perform economic functions different from those of other customers, a seller may conclude that the former should be granted different prices. Traditionally, these price differentials have been referred to as "functional discounts," with the amount of the discount being greatest at the initial stage of distribution and progressively smaller at each successive stage. However, if both favored and unfavored customers compete with each other, the seller may be violating the act. Whether the act should be applied to these situations is the question to be considered. Candor requires the confession that no answer will be found here. What follows is a marshaling of significant decisions of the courts and the Federal Trade Commission, a summary of pertinent Congressional activity and an attempt to construct a meaningful framework within which the problems must be viewed. No more than threshold consideration is offered, but it is a threshold which should be crossed.

I

Early Federal Trade Commission Decisions

Dual distribution exists in numerous cases considered by the Federal Trade Commission. In one early proceeding, the Commission noted that the United States Rubber Company and its subsidiaries distributed tires

contained shall prevent price changes from time to time wherein response to changing conditions affecting the market for or the marketability of the goods concerned, such as but not limited to actual or imminent deterioration of perishable goods, obsolescence of seasonal goods, distress sales under court process, or sales in good faith in discontinuance of business in the goods concerned.

"(b) Upon proof being made, at any hearing on a complaint under this section, that there has been discrimination in price or services or facilities furnished, the burden of rebutting the prima-facie case thus made by showing justification shall be upon the person charged with a violation of this section, and unless justification shall be affirmatively shown, the Commission is authorized to issue an order terminating the discrimination: Provided, however, That nothing herein contained shall prevent a seller rebutting the prima-facie case thus made by showing that his lower price or the furnishing of services or facilities to any purchaser or purchasers was made in good faith to meet an equally low price of a competitor, or the services or facilities furnished by a competitor."

"(d) It shall be unlawful for any person engaged in commerce to pay or contract for the payment of anything of value to or for the benefit of a customer of such person in the course of such commerce as compensation or in consideration for any services or facilities furnished by or through such customer in connection with the processing, handling, sale, or offering for sale of any products or commodities manufactured, sold, or offered for sale by such person, unless such payment or consideration is available on proportionally equal terms to all other customers competing in the distribution of such products or commodities.

"(e) It shall be unlawful for any person to discriminate in favor of one purchaser against another purchaser or purchasers of a commodity bought for resale, with or without processing, by contracting to furnish or furnishing, or by contributing to the furnishing of, any services or facilities connected with the processing, handling, sale, or offering for sale of such commodity so purchased upon terms not accorded to all purchasers on proportionally equal terms." 15 U.S.C. § 13 (1963).
and allied products through their own retail stores, which competed with independent retail outlets, and in another proceeding the Sherwin-Williams Company escaped violation of the Robinson-Patman Act even though it granted an extra functional discount to certain of its dealers who sold to both consumers and other dealers. Liability for this particular practice was avoided because Sherwin-Williams required that favored dealers furnish monthly statements indicating amounts of paint sold to other dealers and computed the functional discount on only those amounts. Two of its wholly-owned subsidiaries, which also allowed extra discounts to dealers who sold to other dealers for resale but failed to secure such statements, were, for this and other reasons, found in violation of the act.

The Federal Trade Commission later condemned Champion Spark Plug Company's distribution policy which allowed distributors and direct jobbers, who sold to so-called franchise accounts, a greater discount than Champion allowed franchise accounts, despite the fact that all three (distributors, jobbers and holders of franchise accounts) competed for resales to consumers. The greater discount allegedly was granted to compensate distributors and direct jobbers for performing certain services, some of which (such as conducting business in a manner satisfactory to Champion and paying invoices promptly) were only vaguely described. It would be difficult to maintain that all of these services warranted a

5. In Empire Rayon Yarn Co. v. American Viscose Corp., 160 F. Supp. 334 (S.D. N.Y. 1958), a supplier sold yarn to processors, some of whom received an extra discount for those parts of their purchases which they resold as jobbers. The supplier, who competed with its favored purchasers for sales to other processors, argued that its favored purchasers were merely being compensated for the performance of additional services. It was the plaintiff's contention that such services were really for the purchasers', not the supplier's benefit. The plaintiff claimed it was qualified to render the same services and should be accorded the same discount. Both the plaintiff and the defendants (the supplier and the favored purchasers) moved for summary judgment. Stating that the case bristled with disputed issues, the trial court denied all motions, pausing to observe that the supplier's practice of dual distribution had not been challenged. 160 F. Supp. at 335 n.1. Seven years later the defendants' motions for summary judgment were granted. In the interim the plaintiff abandoned all claims under Section 2(a) of the Robinson-Patman Act and based its claim upon Sections 2(c), (d) and (e). 238 F. Supp. 556 (S.D. N.Y. 1965).
7. Champion granted the extra discount for performance of these services:
   1. Performing sales promotion work;
   2. Satisfactorily servicing franchise accounts;
   3. Submitting periodic reports of purchases by franchise accounts;
   4. Reporting names of dealers not using Champion's spark plugs;
   5. Selling Champion's spark plugs only to accounts approved by Champion;
   6. Paying accounts promptly;
   7. Conducting all business in a manner satisfactory to Champion;
   8. Permitting Champion to audit sales and customers' accounts.
larger discount or that the Commission was unjustifiably skeptical of their value. No doubt Champion also expected holders of franchise accounts to conduct business in a manner satisfactory to it and to pay Champion's invoices promptly. Illegality resulted, in the Commission's view, from the fact that distributors and direct jobbers competed for resales with certain of their own customers, holders of franchise accounts. Its opinion does not suggest that the Commission regarded as significant the cost to distributors and direct jobbers of performing the services which, in Champion's judgment, entitled them to the larger percent discount. Comparable distribution systems employed by competing manufacturers of spark plugs were challenged in companion proceedings.  

In light of its decisions in the spark plug cases, the Commission's observations in Doubleday and Co., Inc., were somewhat unexpected. The relevant portion of that proceeding came before the Commission on the question of the propriety of an evidentiary ruling by the hearing examiner. Believing that the right to a functional discount was determined by the character of a customer's selling function, and not the character of his buying function, the hearing examiner excluded Doubleday's evidence which tended to show that the alleged discriminatory price merely reflected a functional discount intended to compensate a vertically integrated distributor for services rendered to Doubleday.

Although the members of the Commission were divided on the point,  the author of the Commission's opinion disagreed with the hearing examiner and concluded that the proffered evidence should have been admitted. Parenthetically, it should be noted that Doubleday's evidence was insufficient to convince even those Commissioners who believed it to be admissible that Doubleday had demonstrated the legality of its marketing practices. Accordingly, Doubleday was found to have granted allowances not proportionally available to all customers in violation of Section 2(d) of the Robinson-Patman Act.  

Observing that vertical integration of marketing functions obscured the distinctions between traditional levels of distribution, the Commission recognized the futility of reliance upon customary labels, such as wholesaler or jobber. The opinion acknowledged that the Commission's earlier

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10. Chairman Howrey was author of the opinion and was joined by Commissioner Anderson. Commissioners Mead and Secrest concurred in result but expressly disagreed with the relevant portion of Chairman Howrey's opinion. Commissioner Gwynne concurred in result, without opinion.
decisions judged the legality of a functional discount by a purchaser's selling function, not his buying function. Functional discounts to vertically integrated distributors were, in the Commission's words, "in a suspended state of confusion."\(^1\)

The opinion continued:

"In our view, to relate functional discounts solely to the purchaser's method of resale without recognition of his buying function thwarts competition and efficiency in marketing, and inevitably leads to higher consumer prices. It is possible, for example, for a seller to shift to customers a number of distributional functions which the seller himself ordinarily performs. Such functions should, in our opinion, be recognized and reimbursed. Where a businessman performs various wholesale functions, such as providing storage, traveling salesmen and distribution of catalogues, the law should not forbid his supplier from compensating him for such services. Such a legal disqualification might compel him to render these functions free of charge. The value of the service would then be pocketed by the seller who did not earn it. Such a rule, incorrectly, we think, proclaims as a matter of law that the integrated wholesaler cannot possibly perform the wholesaling function; it forbids the matter to be put to proof."\(^2\)

The Commission warned that the legality of a discount granted for undertaking extraordinary marketing services depended upon actual performance of those services and assumption of customary risks and costs. Further, the amount of the discount must be reasonably related to the cost of performing the extra services. In the course of expressing its view that Doubleday's proof fell short of fulfilling each of these requirements, the Commission also indicated it might be necessary to demonstrate the benefit supposedly derived by the seller from the performance of those services by the favored buyer.

The following year, in *General Foods Corp.*, the Commission appeared to repudiate the position taken in the *Doubleday* case.\(^3\) General Foods was charged with violating Sections 2(a), (d), and (e) of the Robinson-Patman Act.\(^4\) It sold coffee and other products packaged for institutional buyers through institutional contract wagon distributors and regular institutional wholesalers. Wagon distributors were relatively

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12. 52 F.T.C. at 208.
13. *Id.* at 209.
15. See note 2 *supra*. 
small operators selling food products and supplementary merchandise, such as guest checks, from trucks to kitchens of schools, restaurants and hospitals. In an attempt to acquire a greater share of the institutional pack market, General Foods entered into agreements granting wagon distributors extra discounts of two cents per pound on coffee and ten percent on other products, in exchange for which they were to perform ten specific services, such as maintaining adequate stocks, providing delivery of merchandise at time of sale and arranging displays. It was contended that the allegedly discriminatory discounts were payments available to all customers on proportionally equal terms for services rendered to General Foods.

Following the rationale of the *Doubleday* opinion, the Commission held that the discounts were not sanctioned by Section 2(d) because the services were not actually performed, because there was no discernible relationship between the amount of the discount and the cost of the services and because the nebulous character of the services defied efforts to place a value on such services. Except for the last point, which suggests that as a matter of law the Commission would only consider evidence in justification of services susceptible of fairly definite valuation, the Commission’s reasoning was consistent with the view that extra compensation for a buyer’s performance of extraordinary services was permissible.

However, General Foods also claimed that wagon distributors were

16. To qualify for the extra discount, the wagon distributors agreed to:
1. Sell aggressively General Foods’ institutional products;
2. Provide delivery on all such products at time of sale;
3. Offer services generally offered by competitors in the designated territory;
4. Maintain adequate stocks;
5. Arrange to move older stocks first;
6. Handle damaged merchandise in accordance with General Foods’ policy;
7. Arrange for distribution and proper use of display and promotional material provided;
8. Maintain replacement parts for coffee-making equipment;
9. Arrange for appropriate displays of products in public feeding establishments;
10. Make deliveries, at General Foods’ request, of General Foods’ institutional products to individual units of multiple food service operators designated by General Foods, with General Foods to handle billing, the wagon distributor to make deliveries and to be reimbursed by credit memoranda for merchandise delivered.

17. 52 F.T.C. at 822.

18. Although all wagon distributors received identical discounts, the Commission believed that the nature of the services revealed that not all wagon distributors would perform the same services, in the same amount, nor would the quality of their performances be identical. Thus, General Foods’ argument was defective, said the Commission, because all such distributors received the same discounts for performance of different services.
a functionally distinct class which, because of the distributors' unique sales characteristics, was entitled to a lower purchase price. Departing from the view announced in the Doubleday opinion, to which no reference was made, the Commission found a complete answer to General Foods' argument in the fact that both wagon distributors and conventional wholesalers competed for sales to institutions. Since they sold to the same customers, they should buy at the same prices. That the wagon distributors might discharge their selling responsibilities in a manner different, more costly and more valuable to General Foods than conventional wholesalers was, the Commission believed, insufficient to overcome the fact that both distributors and wholesalers competed for resales. In order to satisfy the Commission's criticism, payments for services performed by the wagon distributors would have had to be available to all customers on proportionally equal terms. The Commission obviously was troubled by the prospect of approving, despite the plain language of Section 2(d) of the Robinson-Patman Act, allowances not proportionally available to competing purchasers, a result which would logically follow a determination that the performance of extra services placed the wagon distributors in a distinct functional class.

After the General Foods decision, there was acceptance of the notion that a purchaser's selling function measured his right to a functional discount. Suppliers were prohibited from compensating certain of their customers for extraordinary services, except as the suppliers' allowances could be made proportionally available to all competing customers. A fundamental legal and economic policy was established.

19. 52 F.T.C. at 824.
20. No apparent consideration was given to those services, e.g., central warehousing, which by their character cannot be proportionally divided among all customers.
21. Van Cise, How to Quote Functional Prices, How to Comply with Robinson-Patman Act (CCH Antitrust Law Symposium 1957). Note, Robinson-Patman Curtailments on Distribution Innovation: A Status Sought for Functional Discounts, 66 Yale L.J. 243 (1956). The author of the latter discussion urged that suppliers be permitted to grant discounts for the performance of services by their customers, subject to certain qualifications. First, suppliers must offer the discounts to all competing customers who are able and willing to perform the services for which the discounts are given. It was recognized that there might be a preliminary period of testing and development during which the discounts might be offered only to selected customers. Second, suppliers must police their customers to assure performance of the services for which discounts are granted. Third, discounts given must be reasonably related to the value of the services performed and must be granted in good faith.

These standards do not accommodate discounts granted for the performance of services, which by their nature are incapable of meaningful performance by more than one or a few customers in a particular market. For example, not every customer can serve as a central warehouse, nor will suppliers be prepared to pay all of their customers for the collection of duplicate data, such as the details of bids accepted by governmental agencies.
II

Judicial Decisions

While the Federal Trade Commission was formulating the view finally articulated in the General Foods case, several equally fundamental rules were generated by private litigation under the Robinson-Patman Act. These rules may explain the reason for some of the popularity of dual distribution and vertical integration in marketing and furnish a basis for predicting the direction of developments and innovations in marketing. Further, the treble damage cases which produced these rules suggest that federal courts may be less willing than the Commission to apply the antidiscrimination provisions of the Robinson-Patman Act to vertically integrated distribution systems.

Courts had decided that a supplier did not violate the Robinson-Patman Act when the difference between the supplier's price to consumers and his price to retailers was so slight that the latter could not profitably compete with the manufacturer.22 Suppliers also could lawfully abandon the use of middlemen and deal directly with consumers.23 Furthermore, suppliers might, if they wished, sell a portion of their output directly to consumers and the balance through middlemen. Consequently, a retailer who was denied the opportunity to purchase directly from a supplier and who was, therefore, compelled to place orders at higher prices through a middleman suffered no harm, cognizable under the Robinson-Patman Act, at the hands of the supplier since the retailer was not a purchaser from the supplier.24 Distribution at a uniform price to all functional classes of purchasers was unassailable, but a discount once granted (and not otherwise within a defense recognized under the Robinson-Patman Act) must, except as noted below, be available to those persons occupying the initial functional level in the distribution system.25

Within a period of four years after the Federal Trade Commission's decision in the General Foods proceeding, courts twice granted motions to dismiss complaints which alleged that dual distribution practiced by manufacturers violated the Robinson-Patman Act.26 Both cases con-

cerned oil refiners who marketed gasoline through traditional classes of
distributors and retailers and in the same market also sold directly to
quantity-purchasing consumers. The singular feature of these cases was
that the refiners sold gasoline to consumers at prices lower than those at
which they sold to middlemen. Had the refiners' functional prices to
retailers been less than their prices to wholesalers, the refiners would
have violated the Robinson-Patman Act, but by selling directly to con-
sumers the refiners preserved the legality of their systems of dual
distribution.

In granting motions to dismiss the plaintiffs' complaints, both
courts reasoned that the refiners could have avoided Robinson-Patman
price discrimination questions by selling to all purchasers, whether for
resale or consumption, at a single price. As a practical matter, because
of the necessity for a margin of profit, the complaining middlemen
would be in no materially happier position if the refiners' prices were
uniform than if they were discriminatory. In either case, the plaintiffs
could not long survive because some margin of profit would be essential.
The courts concluded that if uniformity in the refiners' prices would not
help, discrimination could not unlawfully injure.27

Although both courts accepted the soundness of the theory that,
if equality would not help, discrimination could not injure, as applied to
the gasoline industry, one court indicated doubt that the theory enjoyed
universal applicability. The theory appeared to produce logical results
when the industry to which it was applied engaged in the distribution of
fungible or roughly interchangeable goods, for consumers, such as com-
mercial users of gasoline, tend to select from competing products ex-
cursively on the basis of price. However, consumers' preferences for
products susceptible of substantial or unlimited differentiation, while
influenced by price, may be at least as greatly influenced by other con-
siderations such as style, availability of service, maintenance costs or

27. These decisions are severely criticized in Comment, The Robinson-Patman Act
and Vertical Conflicts in Distribution, 26 Ohio St. L.J. 109 (1965).

The Department of Justice appears to approve the courts' conclusions. In a state-
ment of the Department's position on problems of dual distribution delivered to a House
Subcommittee in 1963, it was said:

"Similarly, the Department doubts that manufacturers should be prevented by legis-
lation from selling to end users at a price below that at which they sell to their own dis-
tributors. For example, if, because of economies going with volume purchases, a manu-
facturer can afford to sell to a large user at a price lower than that at which the manu-
facturer sells to its independent distributors, this is entirely consistent with the premise
of the antitrust laws and with competition, for mass purchasers are and ought to be ent-
titled to economies which legitimately go with the size of their purchases." Hearings
Before Subcommittee No. 4 of the House Select Committee on Small Business on the
Impact Upon Small Business of Dual Distribution and Related Vertical Integration, 88th
durability. In such instances, the court suggested, equality might help, with the syllogistic consequence, presumably, that discrimination could injure.  

From the foregoing judicial decisions, it may be concluded that the courts, for the present at least, are hesitant to apply literally the provisions of the Robinson-Patman Act to vertically integrated distributors or suppliers engaged in dual distribution. It would be unwarranted to conclude that those decisions establish a rule of law or indicate more than a trend because none of the courts found it necessary to consider, much less decide, whether the act's prohibitions against discrimination could be applied meaningfully to vertical integration or dual distribution and, even if they could, whether they should be so applied. Treble damage litigation, shaped and motivated by the self-interest of private plaintiffs, probably offers an inferior vehicle for determination of such questions. The traditional role of the Federal Trade Commission in Robinson-Patman enforcement indicated that it probably would bear the responsibility for answers to those questions. Three of the Commission's recent proceedings show its disposition to adhere to the position taken in the *General Foods* case.

**III**

*Recent Federal Trade Commission Decisions*

In *Mueller Co.*, the Federal Trade Commission examined the marketing practices of a supplier of materials for use in the construction and

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28. Sano Petroleum Corp. v. American Oil Co., 187 F. Supp. 345, 354-55 (E.D. N.Y. 1960). Neither court, in Sano or Secatore, indulged in further speculation, but it may be there is at least one other qualification to the theory. Sophisticated consumers, such as commercial purchasers of industrial supplies or raw materials, are perhaps the least likely to be influenced by brand names or persuaded by product differentiation suggested by suppliers' advertising. On the other hand, ordinary consumers of the same products may be irrationally loyal to brand names and conclusively convinced by advertising claims of product differentiation. Bicarbonate of soda, fuel oil and canned fruits and vegetables may be typical of those products which to the professional buyer are fungible, or nearly so, but to the layman markedly different. Consequently, the theory which absolved the gasoline refiners might be less effective when the competitive impact of another refiner's price discrimination falls upon consumers to whom all gasolines are not identical. It may be that if equality will not help, discrimination will not injure, provided that the goods are fungible in the minds of the affected consumers.

For an example of identical products differentiated in consumers' minds by brand names and private labels, see *Borden Co. v. Federal Trade Comm'n*, 339 F.2d 133 (5th Cir. 1964), *cert. granted*, 85 S. Ct. 31 (1965), and note 1 supra.
The supplier distributed its products through two classes of jobbers, granting limit jobbers a discount ten percent greater than that allowed regular jobbers. The hearing examiner found that the extra allowance was really a functional discount no greater than necessary to reimburse the limit jobbers for warehousing an inventory of the supplier's products, a task not performed by the regular jobbers. Relying on the Commission's opinion in the *Doubleday* case, which never had been theretofore expressly limited or overruled, the hearing examiner vindicated the additional discount to limit jobbers on the grounds that it was granted only on products actually warehoused and did not exceed the cost of performing that extra service. Although it entertained doubt on the point, the Commission believed that the hearing examiner had concluded that the extra discount created no reasonable probability of substantial injury to regular jobbers.

Uncertain, however, whether that was the real basis of the hearing examiner's decision or whether he had decided that a discount granted for the performance of extra services is permissible regardless of competitive injury, the Federal Trade Commission held both bases invalid. In the Commission's view, to suggest that the extra discount caused no injury would disregard the competitive benefits to the businesses of the favored jobbers, and to permit such a discount, regardless of injury to regular jobbers, would add a defense not found in the Robinson-Patman Act. With all members joining in the opinion, the Commission decided that, insofar as the *Doubleday* decision was authority for either premise, it was rejected and that the *General Foods* case had already overruled the *Doubleday* decision. In a divided opinion the Court of Appeals for the Seventh Circuit sustained the Commission's determination on the ground that it was supported by substantial evidence.

A later proceeding involving the Purolator Company, a manufacturer of automotive filters, disclosed a fundamental difference in the views of the members of the Federal Trade Commission. Purolator was charged with, and found guilty of, violating Section 2(a) under an application of the indirect purchaser doctrine. All of the manufacturer's

31. See text accompanying note 19 supra.
32. Mueller Co. v. Federal Trade Comm'n, 323 F.2d 44 (7th Cir. 1963). The dissenting judge indicated a disposition to adopt the views announced by the Commission in the *Doubleday* case. See also Joseph A. Kaplan & Sons, Inc. v. Federal Trade Comm'n, 347 F.2d 785, (D.C. Cir. 1965), which involved an application of Sections 2(a), (d) and (e) and the indirect purchaser doctrine.
sales were made to warehouse distributors who resold both to jobbers and
to dealers (the jobbers' customers). Thus, warehouse distributors were
engaged in dual distribution,\textsuperscript{34} and Purolator allowed warehouse distributors a redistribution discount on sales made to dealers.\textsuperscript{35} Because of the
measure of control exercised by Purolator over the transactions between
warehouse distributors and jobbers, the latter were found to be customers
of Purolator, and under its price and discount policies jobbers realized
approximately two cents less on the sale of a filter to dealers than
warehouse distributors who also sold to dealers. While the warehouse
distributors, not the manufacturer, engaged in dual distribution, that
circumstance, plus the indirect purchaser doctrine, persuaded the Federal
Trade Commission and the Court of Appeals for the Seventh Cir-
cuit that Purolator had discriminated in price to its customers. Commis-
sioner Elman expressed doubt that the prohibitions of the Robinson-
Patman Act could deal effectively with a system of distribution in
which competing enterprises, performing different functions, pay
different prices for identical merchandise. The degree to which his
view departs from that of the other members of the Commission is
revealed in a subsequent proceeding brought against Monroe Auto
Equipment Company, another supplier of automotive parts, which like
Purolator marketed its products through dual distributors.

Monroe sold exclusively to warehouse distributors, and while most

\textsuperscript{34} Problems of dual distribution also came before the Commission in a proceeding
under Section 2(a) of the Robinson-Patman Act against a wholesaler of confectionery
and tobacco products. Ponca Wholesale Mercantile Co., Dkt. 7864, \textit{Trade Reg. Rep.}
\textit{p} p 16,814 (1964). In this instance the respondent was charged with violation of the
law because it attempted to compete against dual distribution. The major portion of
Ponca's revenues was derived from sales of cigarettes. Cigarette manufacturers distrib-
uted their products in Ponca's market through it and through direct-buying retailers,
such as chains of supermarkets. Thus, manufacturers sold to both Ponca and its cus-
tomers. To meet this competition from its suppliers, Ponca sold to chain stores at prices
lower than those accorded its other customers. It defended against the charge of dis-
crimination on the ground that lower prices to chain stores were required to meet the
equally low prices granted to chain stores by the manufacturers.
The wholesaler's defense was upheld. In effect, the wholesaler's efforts to meet its
suppliers' practice of dual distribution was exonerated out of the realization that a con-
trary result would deprive it of any practical hope for survival. Applicable state law
required that tax stamps be affixed to packages within state boundaries, a service which
the wholesaler was, but cigarette manufacturers were not, in a position to furnish. Coun-
sel for the Commission contended that the manufacturers' product, cigarettes without
stamps, was not in competition with the wholesaler's product, cigarettes with stamps. This
argument was rejected as absurd and criticized as a strained and hypertechnical defini-
tion inconsistent with the realities of business.

\textsuperscript{35} Dayco Corp., Dkt. 7604, \textit{Trade Reg. Rep. \textit{p} p 17,029 (1964), involved similar
issues, but the Commission found it unnecessary to pass upon them. The Commission
concluded that Dayco's discontinuance of the allegedly unlawful redistribution practices
prior to the Commission's investigation eliminated the need for an order. However, an
order to cease and desist was entered on other phases of the case, which is pending before
the Court of Appeals for the Sixth Circuit.
warehouse distributors in turn resold to independent jobbers, certain warehouse distributors were affiliated with jobbers and sold both to them and to independent jobbers. Consequently, the latter distributors were engaged in dual distribution, selling to jobbers and to dealers through affiliated jobbers.\footnote{As in the \textit{Purolator} case, the fact that Monroe confined sales to warehouse distributors was overshadowed by application of the indirect purchaser doctrine, and the Commission held that price discrimination in violation of Section 2(a) of the Robinson-Patman Act existed by virtue of indirect sales through warehouse distributors to independent jobbers and direct sales to warehouse distributors who were affiliated with jobbers.\footnote{37. Another Federal Trade Commission proceeding involving an application of the indirect purchaser doctrine concerned an attempt by jobbers of automotive parts to organize and operate a central warehouse distribution office. National Parts Warehouse, Dkt. 8039, \textit{T\textregistered}RA\textit{D}E \textit{R\textregistered}E\textit{P}. \textit{\textregistered} 16,700 (1964), \textit{aff'd} 346 F.2d 31 (7th Cir. 1965). The Commission there charged a violation of Section 2(f). Purchases by jobbers were channeled through a central office, which received warehouse distributors' discounts. In one year ninety-four percent of sales by that office were made to participating jobbers. Traditional warehouse distributors' functions were performed by the central office, including warehousing, purchasing for its own account, invoicing jobbers at manufacturers' suggested prices and paying its own obligations. During the period in controversy, participating jobbers received rebates of approximately ten percent on their purchases through the central office. In the Commission's view, it was clear that the jobbers controlled the central warehouse, and this compelled the conclusion that the jobbers were the actual purchasers, not the warehouse. That merchandise constituting eighty percent of the central office's sales was in fact warehoused did not alter this conclusion. Similarly, little significance attached to the fact that the prices granted by manufacturers to the respondent warehouse were identical to those granted to competing warehouse distributors. In dissent, Commissioner Elman warned against too quick acceptance of the classic automotive parts distribution system and its traditional middlemen: the distributors, jobbers, and dealers. He thought it at least worth considering whether the respondent warehouse performed the functions performed by other warehouse distributors and whether the competitive advantage which inured to the respondent jobbers was among those forbidden by the Robinson-Patman Act. Suggesting that the vertically integrated distribution system under review could not be dealt with meaningfully or equitably by application of the Robinson-Patman Act, he observed that a fully integrated manufacturer engaged in dual distribution could sell to its own retail outlets and to independent distributors at uniform prices, thus avoiding price discrimination, that essential element of every Section 2(a) offense. Problems of jobber integration would be better treated, he thought, by eliminating obstacles to integration so that all who choose may secure its benefits, rather than by prohibiting it. On appeal, the Commission's decision was affirmed. The Court of Appeals for the Seventh Circuit was persuaded that the participating jobbers, not the central warehouse, were the real purchasers. Heavy weight was given to the fact that ninety-four per cent of the warehouse's sales were made to participating jobbers. This, the court believed, indicated that the warehouse failed to perform the prime function of a bona fide warehouse distributor, namely, sale of suppliers' products.}
percent discount on intracompany transactions. No attempt had been made by the manufacturer to justify that discount by costs, which, the Chairman believed, placed this proceeding in the same posture as the Mueller case in which the Commission, without dissent, expressly rejected the Doubleday rule and held that the right to a functional discount depends upon the purchaser's selling function.

Commissioner Elman again dissented. He questioned whether a discount granted to a warehouse distributor vertically integrated with a jobber benefited the jobber. On the record before the Commission, he concluded that unless Section 2(a) prohibits, per se, vertical integration of successive levels of distribution, the Commission’s order was improper. The adoption of such a per se rule was, in his judgment, unwarranted. His analysis of the benefit achieved by vertical integration of the functions performed by a warehouse distributor and affiliated jobber dramatizes his differences with the other members of the Commission.

Evidence disclosed that one warehouse distributor, which was affiliated with jobbers, paid its salesmen smaller commissions on sales made to affiliated jobbers than to independent jobbers, a clear benefit and a saving of two percent of the jobber price. Reflecting on the question whether it was unlawful for the manufacturer to permit the warehouse distributor to retain that economy in sales commissions, Commissioner Elman declared that Section 2(a) was not suited for application to problems of vertical integration, and he perceived no basis for denying the warehouse distributor the benefits of integration, including, specifically, the savings in sales commissions. To hold otherwise, he said, would force manufacturers to subsidize their less efficient distributors and discriminate against the more efficient distributors, and because distributors would be denied the benefits of vertical integration, they would shun it. The practical effect, he thought, would be to bar vertical integration in distribution. Thus, he appeared to take the position that the achievement of a competitive advantage through integration does not constitute a violation of the Robinson-Patman Act, even though the same advantage achieved through price discrimination would constitute a violation. Commissioner Elman’s dissent had no perceptible effect upon the decision of the Seventh Circuit Court of Appeals. Treating the issues as questions of fact, the Court concluded that the Federal Trade Commission’s findings were supported by substantial evidence and affirmed its order.38

38. 347 F.2d 401 (7th Cir. 1965). The views of the Court of Appeals in the Monroe case should be compared with those stated in Alhambra Motor Parts v. Federal Trade Comm'n, 309 F.2d 213 (9th Cir. 1962), where the court set aside part of the Commission’s order and remanded the case for further proceedings. See Dkt.
In 1963, a Subcommittee of the House Select Committee on Small Business undertook a broad study of the impact upon small business of dual distribution and related vertical integration. Scholars and representatives from various industries presented an enormous amount of testimony and documentary evidence. The Subcommittee then submitted a lengthy report, describing the effect of dual distribution and vertical integration and making conclusions and recommendations. This report and the hearings upon which it was based have been preceded by other hearings and a report.

Except for the testimony of a few witnesses who had obviously devoted substantial effort to objective thought about the problem, the Subcommittee received less real assistance than complaints. Among the economic consequences of dual distribution which concerned the Subcommittee were, first, the foreclosure of competition for the purchases of an integrated supplier's captive retail outlets and, second, the "price squeeze." This latter term was employed by the Subcommittee to describe a manufacturer's practice of selling, for example, at relatively high prices to wholesalers, and at relatively low prices to the wholesalers' customers. See Ark-La-Tex Warehouse Distributors, Inc., Dkt. 7592, TRADE REG. REP. ¶ 16,441 (1963) and ¶ 17,205 (1965).

Similar problems have arisen in cases brought under Section 2(c), the brokerage provision of the Robinson-Patman Act. See Thomasville Chair Co. v. Federal Trade Comm'n, 306 F.2d 541 (5th Cir. 1962), dismissed by the Commission on remand, Dkt. 7273, TRADE REG. REP. ¶ 16,624 (1963), and Flotill Products, Inc., Dkt. 7226, TRADE REG. REP. ¶ 16,970 (1964).


40. The hearings, which began May 8, 1963, and ended December 10, 1963, are contained in nine volumes totaling 1,928 pages, including appendices.


43. Report, note 41 supra, at 6.
customers. Obviously, the narrow gross margin available to these whole-
salers reduces the likelihood of profitable operations.

Dual distribution was described to the Subcommittee by one witness
as having, generally, either of two consequences. On the one hand, it
could enhance market power by enterprises theretofore possessing at
least some measure of such power, and on the other hand, it could pro-
pose reduced costs, better the product or services connected with it or
improve the system of distribution. Measured by the public policy in-
olved, the witness concluded that the former consequence was less
desirable than the latter consequence, and he suggested that one reason
for forward integration by manufacturers was persistent and inflexible
mark-ups by enterprises performing distribution functions.

44. Hearings on Dual Distribution, note 39 supra, at 49. This witness, Jesse W.
Markham, Professor of Economics, Princeton University, expressed the view that it
would be necessary for the Subcommittee to conduct its study industry by industry be-
cause he believed that the problems of small business were so dissimilar as to preclude
meaningful generalizations. Accordingly, he commended the Subcommittee for its will-
ingness to receive testimony and other evidence from many different industries. Repre-
sentatives from forty-six separate industries or classes of business presented their views
and grievances to the Subcommittee. Id. at 1605.

45. "As I said, the most useful service economists could render this committee would
be that of providing it with a set of tests whereby the dual distribution that is anti-
competitive and socially harmful could readily be distinguished from that which is simply
a normal response to competitive market forces and the commercial incentives for greater
efficiency. Unfortunately, clear-cut tests of this sort have not yet been devised. Never-
theless, economic analysis does provide some useful guideposts.

"It can generally be concluded that dual distribution is at worst harmless and at
best may be a source of greater efficiency, when no firm in any of the identifiable stages
of production, fabrication, or distribution possesses any significant amount of market
power. If firms that supply both themselves and their unintegrated competitors do not
individually account for a substantial share of total output it follows, by definition, that
there is effective competition at all stages of production and distribution. In these cir-
cumstances integrated firms cannot apply leverage against smaller unintegrated competi-
tors because they have no monopoly profits to subsidize subsequent operations, and any
attempt to apply a price squeeze is frustrated by the forces of competition; when in-
tegrated firms arbitrarily raise prices of the previous stage they only succeed in driving
their customers to competing sources of supply.

"But what is perhaps of even greater significance, when the integrated firm con-
fronts effective competition at all stages it has a strong incentive to preserve the patron-
age of its unintegrated customers. Since it cannot hopefully strive for a high order of
market power, it must consider them its primary source of revenue. Dual distribution
under these conditions may work to the positive benefit of small unintegrated distribu-
tors since the integrated supplier, in its own self-interest, is likely to make available to
them any improvements in the techniques of distribution it may discover, techniques it
may never have discovered unless it distributed some of its own products. It follows
from this that the committee should be particularly alert to industrial situations where
dual distribution is accompanied by substantial market power in preceding stages of
production. That is, I have indicated that I think these are the most likely places where
dual distribution or dual pricing system is likely to work to the social disadvantage of
the economy.

"Another guidepost to the identification of harmful and beneficial dual distribution
is the persistence over long periods of time of standard or institutionalized markups at
wholesale and retail levels, especially if the markups appear on their face to be un-
reasonably high.
Whatever other conclusions might be drawn from the hearings, "For nearly a half century the reading public, at least that sector of the reading public that keeps up with the economic literature, has been treated to a steady stream of books and articles proclaiming the high costs of distribution. The offer 'I can get it for you wholesale' usually establishes the expectation of from one-third to one-half off the quoted retail price. While there are no readily available yardsticks for determining when markups are too high, it is known that wholesalers and retailers sometimes cling to margins long since rendered obsolete by changing conditions of demand and supply. "The postwar rise of the so-called discount house may not go down in history as America's greatest economic blessing, but it clearly evidenced the willingness of the consuming public to accept less service and greater shopping inconvenience in order to avoid high rigid markups of long duration. Moreover, when such markups remain insensitive to the changing conditions of supply and demand they offer manufacturers an incentive to move into the field and create the condition of dual distribution. I would hope, therefore, that in the course of these hearings considerable information will be developed on the magnitude and stability of markups, for both integrated and unintegrated distributors where dual distribution exists. If traditional wholesalers and retailers pursue the policy of high and inflexible margins this may explain in part why producers integrate forward into these trade channels. On the other hand, where such margins appear to have been responsive to changing supply and demand conditions, and traditional wholesalers and retailers appear by other indicia to have striven for efficiency, the invasion of these channels may suggest motives less beneficial to the consuming public.""Hearings on Dual Distribution, note 39 supra, at 50-51.

46. The Subcommittee's conclusions, in full, are as follows:

"1. Dual distribution is practiced in each of the industries studied by the subcommittee and, without exception, the use of the practice appears to be increasing. In some industries, such as petroleum, it was pervasive—indeed, it has become institutionalized as an accepted part of the industry at both jobber and dealer levels. In other industries it was found to be incipient in nature.

"Distinction must be made between entry into dual distribution in a manner which enhances economic concentration and that which may foster new competitive forces. A firm which has distributed its products only through integrated outlets obviously adds to the vigor of the independent sector of the economy when it becomes a dual distributor by adding independent outlets to its distributive structure. Conversely, when a firm which traditionally has distributed its goods only through independent outlets enters the distribution process through the addition of integrated units which compete with its independent customers, the opposite result occurs.

"2. While dual distribution, when practiced by a firm with substantial market power, can be harmful to small business, there should be no general or per se rule against dual distribution. Its misuse, however, creates many of the harmful effects found to exist.

"The misuse of dual distribution can amount to a perversion or distortion of our competitive free enterprise system, which is traditionally based on the assumption that the individual firm will seek to maximize its position, within the rules of the game. This should result in the greatest good for the greatest number; each individual's attempts at achieving the most advantageous result for himself should, overall, result in gains for the entire economy and the individual consumer.

"If, however, a retail, wholesale, or processing establishment engaged in dual distribution makes market decisions not on the basis of its own situation—the competition which it faces, and similar factors—but instead follows a market strategy based solely on what is best for its parent manufacturing plant, this is a basic change in the normal competitive relationship at that level of the market.

"3. Small business is inherently disadvantaged when competing with large, integrated firms. In part, this disadvantage arises because economies of scale are available only to larger firms. Additionally, a large, integrated firm can make a profit at any of a number of levels of operation. It may strive to conduct each level of operation on a profitmaking basis. However, it can recoup, at least temporarily, losses suffered at any one level from elsewhere within its integrated activities. Unfortunately, even within a temporary period of loss, the resources of a small competing firm could be exhausted.
they did clearly establish that no one claims to comprehend the exact causes of dual distribution or related vertical integration or their specific effects. Early in the hearings, the Subcommittee was told that dual distribution is not undesirable, per se.\footnote{47} Both the Chairman of the Federal

A dual distributor's nonintegrated customers who buy for resale have only their one level of operation at which to make the profit necessary to survive. It is most important to note that large, integrated firms engaged in dual distribution could conduct certain levels of their operation at a loss which could result in an unfair advantage.

4. Dual distribution has had varying effects within the 46 industries studied by this subcommittee. In those instances where dual distribution, combined with substantial market power or predatory tactics, is misused, it is clear that remedial steps are necessary.

5. The very essence of our antitrust laws is that, in the main, they are broad, almost 'constitutional' in nature. However, any proposed solution to the problems created by dual distribution must be tested against the situation within each industry. A solution that would make great sense in one industry might well prove highly disruptive within other sectors of the economy. Conversely, it does not appear either feasible or desirable to legislate on an industry-by-industry basis. Hence, any proposal advanced to increase small business' opportunity to compete with respect to the matters contained in this report must not be limited to any industry but should be weighed against conditions in all those affected.

6. A contributing factor to the harm suffered by small businesses in some industries is that the Robinson-Patman Act and other portions of the antitrust statutes are apparently being violated by some of the firms engaged in dual distribution. This, of course, is the responsibility of the Department of Justice and the Federal Trade Commission.

7. It is apparent that current policies which have resulted in more vigorous enforcement of section 7 of the Clayton Act and the Sherman Act regarding horizontal mergers, will tend to produce greater emphasis on vertical integration by those firms achieving economic growth. Recent decisions of the Supreme Court likewise point to the probability that internal growth, rather than vertical mergers, will tend to be the major means of accomplishing this predicted vertical expansion, if the principles advanced in recent decisions are applied and enforced effectively.

"Entry into processing, fabrication, or the various levels of distribution, by manufacturers, or the integration into manufacturing by retail or wholesale establishments, would tend to produce a higher incidence of dual distribution activities. The only other possibility is the adoption by these firms of a policy of exclusive distribution in which a firm distributes all of the goods that it manufactures. In either event, the impact upon small business will tend to be one of increasing seriousness.

8. As a result of its studies, the subcommittee fears that present antitrust laws may not be sufficient to cope with the practice of dual distribution arising from its misuse. However, it is felt that greater use can be made of existing law by enforcement and regulatory agencies. Examples are:

(a) Increased utilization could be made of section 5 of the Federal Trade Commission Act with reference to problems arising from dual distribution.

(b) Many industries could benefit by availing themselves of industrywide approaches, such as trade practice conferences and trade regulation rule procedures." \textit{Report}, note 41 \textit{supra}, at 103-5.

47. \textit{Hearings on Dual Distribution}, note 39 \textit{supra}, at 62. Leonard W. Prestwich, Associate Professor of Business Administration, George Washington University, who appeared in behalf of the National Small Business Association, testified that vertical integration and dual distribution were capable of producing both advantages and disadvantages, depending on how they were employed. He concluded:

"I do recognize that a vertically integrated company engaged in dual distribution is in a position to engage in unfair or predatory competitive practices if it is so inclined. But this does not, in my judgment, make vertical integration and dual distribution undesirable per se. And virtually all firms are in a position to engage in unfair practices of one kind or another if they are so inclined."
Trade Commission and the head of the Antitrust Division of the Department of Justice agreed with this view, which was adopted by the Subcommittee. It expressly decided against a per se prohibition of

48. *Hearings on Dual Distribution*, note 39 supra, at 1512. Specifically, the Chairman was describing the enormous burden being carried by the staff of the Federal Trade Commission in its effort to enforce the antitrust laws. He expressed his pleasure at having the Subcommittee make available to the Commission badly needed basic data.

“What should be done? Is there a short cut? If a law were to be passed forcing the public disclosure of this information, then such an abuse would stick out.

“This would be helpful. Even though we have the power to obtain this information, we do not have the manpower it would take to secure it.

“When I came to the Commission as Chairman in 1961, there were about 33 attorneys to enforce the antitrust responsibilities vested in the Federal Trade Commission. Today there [are] about 140.

“We have 700-and-some-odd merger cases we are studying, probably about 70 of them are moving along to where they are pretty active. We keep them alive with about 40 trial men.

“Moving on to the field of discriminations, where so much of the problem lies, I have about 40 trial men there.

“We have investigations underway in the larger chain grocery field as well as in the wearing apparel field, but it doesn't do any good to take the information we receive from such investigations and stack them up in a room, Mr. Chairman. It takes men. It takes men to complete these investigations on such a scale; then after we receive the information, it takes other men to go over this before the Commission is in the position to attack the problems involved.

“Now, if there can be a shortcut to this, I am for it. I am for it any way you want to approach it, because if you can give us basic information, within the limits of our manpower, we can sure proceed more intelligently. Dual distribution is not, per se, illegal.”

49. *Hearings on Dual Distribution*, note 39 supra, at 1580. The Assistant Attorney General, Antitrust Division, expressed views similar in fundamental concepts to those stated by Federal Trade Commissioner Elman in his dissenting opinions in thePurolator, Monroe, and National Parts Warehouse cases, notes 33, 36, and 37, supra. Assistant Attorney General Orrick stated the position of the Antitrust Division to be:

“Now, the difficulty that we face in dealing with the general problem of dual distribution is that not all of the practices involved fall into the category of market-restraining conduct which is customarily within our jurisdiction. And, Mr. Chairman, as I proceed here and use the term 'dual distribution,' I shall be using your definition as the practice of manufacturers acting both as supplier and competitor to independent retailers, wholesalers, and secondary manufacturers.

“We can and do cite the competitive disadvantages that will be faced with competing nonintegrated sellers in support of our contention that a merger violates section 7 of the Clayton Act; for example, where a manufacturer acquires a distribution system by stock or asset acquisition. And similarly, we may have ground to proceed against even a unilateral business decision by a manufacturer to engage in distribution of his own products by internal expansion when that manufacturer has a dominant market position.

“In many instances, of course, the problems faced by independent sellers who compete with the sales organizations of their manufacturer-suppliers are self-correcting in that the value of the independent sellers' services prevents overreaching by the manufacturer.

“In our view, the real evil of which the problems disclosed by your dual distribution hearings are symptomatic is the concentration of market power in just a few manufacturers. Our review of the subcommittee hearings and our examination of the legislative proposals which have been advanced leads us to conclude that there is no general disposition to recommend outlawing dual distribution as such, but only the curbing of some of its possible abuses. We agree with this general approach. We do not view the problems posed by dual distribution to be of such a nature as to warrant its complete prohibition.”

50. Report, note 41 supra, at 103.
dual distribution. Moreover, the Subcommittee, supported by several members of the Federal Trade Commission, specifically recognized that collection and study of economic data must precede meaningful analysis of dual distribution. The Chairman of the Commission invited attention to the fact that the parties who claimed to have been injured by dual distribution had been quite vocal but that relatively little had been heard from the dual distributors themselves.

Among nine recommendations made by the Subcommittee was the proposal that companies having assets or sales of one billion dollars or producing more than one-third of a nation-wide line of commerce, be prohibited from growth by merger, consolidation or acquisition of stock or assets. The Subcommittee endorsed legislation to remedy the price

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51. Chairman Dixon stated:
   "I merely say this as we begin, because as I, individually, have read each of these
   hearings and have had each of our principal staff people review them, and give us their
   appraisal of this problem, it is increasingly evident to me that there is not enough eco-
   nomic intelligence or data on this problem. I think this is the third time that this com-
   mittee has addressed itself to this problem. Although you have heard the manifest effect
   of some of these problems, the other side of the picture is still not completely developed." 
   *Hearings on Dual Distribution*, note 39 supra, at 1503.

He was joined by Commissioner Anderson, who observed:
   "But I think it calls for the greatest objectivity that is possible on the part of your
   committee, if I might be so bold as to even make the suggestion, and certainly on the part
   of the Federal Trade Commission that is principally law enforcing.
   "So I want to say that we have got a lot of background and a lot of know-how to
   acquire, before we can come out and say that dual distribution is unlawful. I think that
   it is most valuable that we can have this interchange of ideas between these two groups." 
   *Id.* at 1504.

Commissioner Elman expressed his concurrence:
   "If I may say so, the committee has performed a most useful public service in bring-
   ing this difficult and complicated question of dual distribution out into the open and at-
   tempting to explore its various ramifications.
   "We all know that the crying need in antitrust enforcement is to obtain the facts.
   Any action that we take has to be based upon information. Knowledge must precede
   judgment.
   "This committee has done the necessary initial work of obtaining the economic intel-
   ligence that is so badly needed, and I would congratulate you gentlemen on having


53. "You have heard from the man being injured. But not from many of the people
   who have been accused of committing such injuries although you offered them the
   opportunity to come before you and tell their particular problems, which must be con-
   sidered by someone if the entire problem of dual distribution is to be resolved either
   legislatively or by enforcement.
   "Take a basic industry—steel, aluminum, copper—where you have had testimony
   complaining against their pricing policies. To determine how they keep their books and
   records and what their costs are and whether there has been any abuse of power, is
   going to take a fight, sir, and a real two-fisted one." *Hearings on Dual Distribution*, 
   note 39 supra, at 1511.

54. *Report*, note 41 supra, at 107. The entire text of the Subcommittee's recom-
   mendations follows:
   "1. It is recommended that there be a comprehensive study of the antitrust laws and
   their effect on competition, economic growth, integration, and economic concentration.
   "Many observers have expressed doubts as to whether the present structure of anti-

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squeeze by requiring dual distributors to preserve differentials between prices charged as a supplier and prices charged as a competitor sufficient:

trust and trade regulation law is wholly relevant to the realities of the current structure of the American economy. These have included spokesmen for both big business and the small business community.

"It would be of prime importance that there be included among those conducting such a study representatives of both of these sectors, and Members of Congress, as well as representatives of regulatory and enforcement agencies, consumer and other interested groups.

"2. It is recognized that those conducting this study should determine those aspects of the antitrust laws which deserve special attention in determining the degree to which such factors as changes in the structure of the American economy, both domestically and in foreign trade, necessitate the modification of existing antitrust law or the addition of supplemental legislation to assure to small business equality of opportunity to compete. The following may be considered:

"(a) The proposal that dominant companies—defined as companies having assets or sales of $1 billion per year or companies producing more than one-third of a nationwide line of commerce—be prevented from engaging in any merger, consolidation, or acquisition of stock or assets.

"(b) The degree to which collection of economic data is necessary in order to intelligently determine the impact upon small business and other sectors of the economy of increasing vertical integration.

"(c) It is recommended that legislation be introduced which provides that any person engaged in commerce who, in the course of such commerce, engages in competition in the sale of commodities with those to whom he sells such commodities, or a major ingredient or component thereof which is processed by the purchaser into such commodities, shall maintain differentials between those prices charged as supplier to such purchasers and those prices charged as a competitor of such purchasers sufficient to prevent substantial lessening of or injury to competition.

"3. It is recommended that Congress consider legislation to require companies engaged in dual distribution to maintain annual operating data on each of their levels of operation which compete with independent customers of such companies in the sale and industrial use of their products.

"4. It is recommended that the appropriate legislative committee give consideration to legislation extending provisions similar to those of the automotive dealers' 'day in court' bill to all independent holders of distributive franchises from firms possessing substantial market power.

"5. It is recommended that the Federal Trade Commission make greater use of section 5 of the Federal Trade Commission Act in attempting to cope with dual distribution and other problems arising from vertical integration.

"6. It is recommended that those industries undergoing industry-wide problems caused by structural or behavioral patterns arising from dual distribution or related forms of vertical integration, in those cases where purely private action cannot achieve a solution, give serious consideration to applying to the Federal Trade Commission for a trade practice conference or a trade regulation rule proceeding as a means of devising appropriate solutions.

"7. Greater use should be made by the Federal Trade Commission of powers granted to it by section 6 of the Federal Trade Commission Act as the means for assembling the data essential to proper policy formulation. Adequate funds must be supplied the Commission to carry out this objective.

"The need for more economic data on the extent and effects of dual distribution and other manifestations of vertical integration is woefully apparent. Both the Federal Trade Commission and the Assistant Attorney General in charge of the Antitrust Division testified that the dearth of this economic intelligence prevents their knowing what present conditions are, and thereby makes it difficult to reach informed decisions with respect to these problems.

"8. It is recommended that the President's Committee on Consumer Interests con-
to prevent substantial lessening of or injury to competition. It was urged that Congress consider legislation compelling dual distributors to maintain annual operating data on each level of their operation. Several bills implementing the Subcommittee’s recommendations were introduced.

V

Vertical Integration

Since the Federal Trade Commission has decided in the Monroe, Mueller, and Purolator proceedings that the granting of discounts to certain purchasers for the performance of marketing services not performed by competing purchasers can violate the Robinson-Patman Act, and since there have been, after extended Congressional hearings, legislative proposals that dual distribution and vertical integration in distribution be subjected to further regulation, the time has arrived for preliminary thought about the course of the Commission’s and Congress’ determinations. Courts will be requested, to a greater extent than they heretofore have, to admit into the framework of established national trade regulation policies particular rules which tend to discourage vertical integration by enterprises engaged in distribution. Consideration should be given to the recognition of factors which are significant when the issue is the legality of dual distribution or vertical integration in distribution. To this must be added, hopefully at an early date, the thorough economic inquiry, which members of the House Subcommittee and Federal Trade Commission have said to be essential to an adequate understanding of these subjects. At the outset there should be a willingness to reconsider whether, despite the accepted interpretation

duct a study to determine the degree to which the consumer interest might be served by the use of standards based on octane rating and similar factors in the marketing of gasoline.

9. It is recommended that the effect of ‘dealer aid’ during gasoline price wars be determined through appropriate study and the holding of hearings by the House Small Business Committee. ‘Dealer aid’ has been described both as a destabilizing factor tending to make price wars more prevalent and as the only means of survival for the dealer in a troubled market. Emphasis should, therefore, be placed upon attempting to determine the impact of this practice upon the individual service station operators.” Id. at 107-8.

59. See notes 51 and 54 supra.
of the Robinson-Patman Act to the contrary, competing sellers must be treated alike even when they perform unlike functions. If the Act means that, and certainly its words support such a construction, vertical integration of distribution functions must go uncompensated or, if compensated, risk violation of the act.

The foregoing Federal Trade Commission proceedings involved three common examples of vertical integration in distribution. While the varieties of vertical integration are as unlimited as the ingenuity of businessmen, the examples in these three cases provide a suitable beginning point. First, the Monroe case concerned warehouse distributors who were fully integrated with jobbers, the next middlemen in the prevailing distribution system, and who performed all functions in both levels of distribution. The entrepreneur, like Monroe, who undertakes to perform all of the functions embodied in the next level of distribution, comes close to the classic example of vertical integration. Second, the Mueller proceeding involved competing distributors operating at the same distributive level, some of whom performed and were compensated for a service not performed by the other distributors. No distributor purported to perform all or even a major part of the functions normally undertaken at another level of distribution, but the favored distributors did carry an inventory of goods, a responsibility otherwise discharged by Mueller. Third, the Purolator case dealt with redistribution discounts. Purolator's customers (warehouse distributors) sold to jobbers and dealers, receiving an extra discount on sales to the latter. As phrased by Commissioner Elman, Purolator was willing to pay a premium for distribution by warehouse distributors through dealers. The greater discount was earned simply by selling to a specified class of customers.

1. Vertical Integration of Two Levels of Distribution.

Because there might be a temptation to commingle indiscriminately the foregoing three kinds of vertical integration, it is essential to recognize that they are distinct marketing practices which require separate consideration and, perhaps, different treatment. When distributors, like those favored warehouse distributors in the Monroe proceeding, perform all the functions of two successive stages of distribution, there are persuasive reasons for believing that they are entitled to the lower of the functional discounts accorded to the two stages. If vertically integrated distributors perform the functions of both stages of distribution in a manner indistinguishable from that of their nonintegrated competitors, the economic justification for granting them the better price seems clear, especially if they have a similar capital investment, for they
necessarily have earned that price by a commercial performance equal to that of their nonintegrated competitors.

However, wholly apart from the literal provision of the Robinson-Patman Act, there is a consequence of allowing the lower functional price to integrated distributors which, manifestly, troubles the Federal Trade Commission. There may be, in such circumstances, a benefit to the integrated distributors which gives them a competitive advantage over their nonintegrated competitors. Their purchases are accorded functional discounts not available to those with whom they compete for sales, and as the Chairman of the Commission has stated, the integrated distributors obtain a functional discount for selling to themselves. Whether the integrated distributors actually derive any benefit, and thus any potential advantage over competitors, is a question of fact, as is the question whether that advantage, if one is proved, produces competitive injury. The ultimate legal issue, though, is whether the benefit and injury resulting from vertical integration fall within the sweep of the Robinson-Patman Act.

2. Partial Vertical Integration of Two Levels of Distribution.

Difficult as the foregoing questions may be, they are compounded when the favored distributors, like those found to have been favored unlawfully in the Mueller proceeding, perform some but less than all the functions involved in a second level of distribution. In the Mueller case, favored distributors warehoused an inventory of the respondent's products, thereby qualifying for an extra discount. As compared with their competitors, they simply performed an extra service and received an extra discount. The enforcement problem these distributors pose is enormous.

Three tests of legality were expressed by the Federal Trade Commission in the Doubleday proceeding, which concerned this same variety of vertical integration. First, the service for which the extra discount is allowed must actually be performed. This suggests that the service must be measurable by objective standards. While it may be relatively easy to decide whether, during a specified period, favored distributors have each warehoused an inventory worth X thousand dollars, it may be virtually impossible to determine whether each has fully developed his market area or used his best efforts to promote sales of the supplier's products. At risk are those many services by their nature incapable of objective demonstration. There could be involved the question whether discrimination exists among the favored distributors since it is possible, if not likely, that their "full development of markets" or "best efforts"
will not be uniform. Some will do less, some more, for the same extra discount.

Second, the Federal Trade Commission stated in the *Doubleday* case that there must be a reasonable relationship between the value of the service performed by the favored distributors and the discount allowed on account of the service. Valuation of the service requires some notion of its worth to the supplier and its cost to the distributors, neither of which may be uniform from one favored distributor to another. As a guide in that case, the Commission observed that the discount should not exceed the cost of that part of the supplier's function which a distributor performs. When the extra service is unrelated to the supplier's function, not even that assistance is available to gauge the relationship between discount and service.\(^6\)

Third, the *Doubleday* opinion suggests that the extra service must benefit the supplier, which implies that he must demonstrate good faith in allowing more favorable treatment to distributors who perform that service than to those who do not. Granting an extra discount for a worthless service approaches subterfuge.

There is another standpoint from which special compensation for the performance of an extra service may be considered. If the Robinson-Patman Act should be held inapplicable to price differences derived from vertical integration, it is inevitable that the benefit of that holding will be claimed by some parties who are not entitled to it. Even though intent may be irrelevant to the determination of whether a price difference exists,\(^6\) it could be significant when the choices are between differences caused by bona fide vertical integration on the one hand or by deception through pseudo integration on the other. It will be helpful to recognize, if intent does become important, that certain services are reasonably within the capability of all distributors, while other services obviously are not. Furthermore, with regard to each of those kinds of services, there are some services which suppliers are willing to pay every distributor to perform, and there are other services which suppliers are willing to pay only a few distributors to perform. For example, all of a supplier's distributors in a particular market may have the capability of warehousing an inventory of the supplier's products, or collecting information on bids to public agencies, but the supplier may be unwilling to pay an

\(^6\) In the development of standards for the measurement of legality of prices granted for the performance of an extra service, there is danger that suppliers and their integrated distributors will be compelled to channel their marketing ingenuity into accepted legal patterns. Hopefully, it will be possible to formulate general principles which will accommodate legitimate innovations.

extra discount to each distributor to maintain a central warehouse or collect duplicate information.

If the service which allegedly supports the extra discount is reasonably within the capability of all distributors, and only certain distributors have been asked to perform it, that weighs against the claim that only bona fide vertical integration was involved. Similarly, if experience and common sense indicate that a supplier should be anxious for all distributors to perform a particular service and be willing to compensate them for it, the fact that only certain distributors are invited to do so throws further doubt on the supplier's claim. The same reasoning suggests that the performance of services, not reasonably within the capability of all distributors and not of the kind that economically motivated suppliers would ask all their distributors to perform, could properly support the payment of an extra discount.

3. Redistribution Discounts.

As compared with the foregoing kind of vertical integration found in the *Mueller* case, the kind found in the *Purolator* case is simple. There the supplier allowed its warehouse distributors a redistribution discount, granting greater discounts on sales to dealers than on sales to jobbers. Vertical integration occurred in the sense that on direct sales to dealers the warehouse distributors performed, in addition to their own functions, the jobbers' primary responsibility of supplying dealers. Obviously, the kind of vertical integration produced by redistribution discounts possesses many of the attributes of that kind of vertical integration typified by the *Monroe* proceeding (performance of all the functions of two levels of distribution) and, at the same time, the kind typified by the *Mueller* case (performance of less than all of the functions of the second level of distribution). However, the novelty of vertical integration born of a redistribution discount lies in the fact that the discount is obtained by selling to a particular class of customers and not necessarily by the performance of any service uncommon to the favored distributor's own level of distribution. Depending on the circumstances surrounding individual sales, the favored distributor may do nothing extra to earn or justify the redistribution discount, but he would nonetheless circumvent one level of distribution, thus achieving what could be a substantial economic advantage for the supplier.

Additional observations about the three kinds of vertical integration can be made. When the favored distributors perform all the functions of two levels of distribution, the lessons of experience and industry tradition are some assistance in determining whether there is economic
reason for the amount of the discount. A thirty percent discount solely
for performance of functions which have historically commanded a
twenty percent discount is indefensible. On the other hand, when the
favored distributors perform for an extra discount one or a few of the
services normally undertaken in another level of distribution, these lessons
count for little, and if the extra service should happen to be an innovation
in marketing, they are probably worthless. This suggests that the greater
the display of ingenuity in marketing services, the more difficult it will
be for the suppliers and distributors involved—and for enforcement
agencies—to assess the legality of discounts granted for performance
of these services.

VI

Dual Distribution

It is significant that in the previously discussed Monroe, Mueller,
and Purolator proceedings, dual distribution existed only in the first and
the last. Dual distribution can occur whenever a distributor sells to two
levels or classes of customers, as in the Monroe and Purolator proceed-
ings, but it does not occur when he sells to a single level or class of
customers even though those customers may perform a service uncommon
to their own distributional level, as in the Mueller case. Thus, despite
the common characteristics which exist in the kinds of vertical integration
covered by those three proceedings, dual distribution appears only when
a distributor performs the functions of two levels of distribution
(Monroe) or sells to two classes of customers (Purolator). More
important than these distinctions, however, is the influence which judicial
and Federal Trade Commission decisions exert on suppliers to engage in
dual distribution.62

At an early date, the Federal Trade Commission revealed its disposi-
tion to doubt that performance of extra services entitled distributors to
extra discounts, and its skepticism of arbitrary reclassifications of
customers, which had the effect of granting “functional” discounts to
favored buyers, is beyond fair criticism.63 However, in the present state
of limited knowledge about dual distribution and vertical integration
there may be almost no place for a rule which, without a full economic
inquiry, prevents suppliers from compensating distributors for the per-
formance of one or more extraordinary services or all the services of two

62. Dual distribution can occur without noticeable effect upon the legality of a
supplier's marketing system. See United States v. White Motor Co., 194 F. Supp. 562,
levels of distribution or for selling to a particular class of customers. If suppliers are prevented from compensating their distributors for the performance of these services, no distributor will regularly perform them. As a consequence, suppliers are encouraged to perform some or all of the marketing responsibilities connected with the distribution of their products and to resort to dual distribution.

Furthermore, because enforcement of the Robinson-Patman Act is largely directed toward suppliers, and because manufacturers are the initial suppliers in the traditional chain of distribution, manufacturers have been the parties proceeded against both by the Commission and by private claimants seeking treble damages. Thus, despite the fact that the alleged discrimination has resulted from attempts to compensate distributors, manufacturers typically have been the respondents and defendants. While this is the result of what may be a necessary enforcement technique, it also is a real restriction on manufacturers' enthusiasm for vertical integration or other forms of creativeness in marketing services by enterprises in their distribution systems. Consequently, dual distribution may have a special appeal to manufacturers who sense the need for innovations in their own marketing systems, but who refuse to risk paying their usual distributors to undertake them.

Accordingly, one result of prohibiting suppliers from compensating distributors for services extraordinary to their functional class and allowing suppliers complete freedom to distribute their own products through various functional classes of customers is to increase the attractiveness of dual distribution. If that is undesirable, a question open to considerable dispute, it surely would be less drastic to permit compensation for such services than to attempt to curtail that freedom and regulate the suppliers' distribution systems. It seems preferable that suppliers' decisions to engage in or avoid dual distribution, or otherwise market their own products should be based upon relevant economic and commercial considerations, and not upon a rule of law that precludes them from employing their own distributors to perform special marketing services at appropriate compensation.

While suppliers have been the parties most often proceeded against under the Robinson-Patman Act, they do enjoy, in the area under consideration, a unique advantage over distributors. Under the act, suppliers may integrate forward through the chain of distribution as their

64. Cf. Nuarc Co. v. Federal Trade Comm'n, 316 F.2d 576 (7th Cir. 1963).
65. The House Subcommittee investigating dual distribution observed that vigorous enforcement of the Clayton and Sherman Acts against mergers and acquisitions tends to encourage growing businesses to expand by vertical integration and, in turn, to engage in dual distribution. REPORT, note 41 supra, at 104.
capital, personnel and other resources permit and may at each step in the
distribution process sell in competition with their customers. To the
extent that it is thought to be desirable, suppliers also may attempt to
preserve their traditional methods of distribution and experiment with
their own integrated systems.

Distributors, however, probably are no better suited than suppliers
to integrate vertically into areas of business in which they have little
experience and, more importantly, could encounter resistance from sup-
pliers if they do so. Should a distributor attempt to integrate forward
or backward through the chain of distribution and obtain functional
discounts based upon his buying function, or perform a special service
for extra consideration, his supplier risks violation of Section 2(a) of the
Robinson-Patman Act. Suppliers, therefore, are under some pressure
to discourage their distributors from integrating or performing such
services, notwithstanding normal inclinations to the contrary. Con-
sequently, while manufacturers may integrate, in a leisurely manner if
need be, from the manufacturing level through the entire system of
distribution, distributors may not as blithely indulge in the same process
and integrate either forward or backward through the system of distri-
bution, unless they promptly include the manufacturing level. Once
this is accomplished, they are no longer purchasers risking themselves
or their suppliers in Robinson-Patman violations, but are, instead, merely
manufacturers engaged in dual distribution.

VII

Conclusion

For the present at least, the inability of distributors to engage in
vertical integration without risking violation of the Robinson-Patman
Act, combined with acceptance of dual distribution by manufacturers,
is encouraging the circumvention, and conceivably the elimination, of
those middlemen and retailers who commonly are believed to be the
intended beneficiaries of the act. Prohibition of dual distribution per se
is unacceptable in an economy predicated upon maximum freedom of
commercial choice. Therefore, the solution must be found in an accom-
modation of vertical integration to the restrictions imposed by that act.

Until it can be confidently said that specific instances of vertical
integration in distribution produce the consequences which the Robinson-
Patman Act was intended to prohibit, care must be taken that suppliers
and distributors are not unnecessarily denied the benefit of a needed
marketing technique.