January 1937

The Fair Trade Acts—The Latest Attack on the Loss Leader Problem

Ollie Richard Arens

Follow this and additional works at: http://openscholarship.wustl.edu/law_lawreview

Part of the Antitrust and Trade Regulation Commons

Recommended Citation

This Note is brought to you for free and open access by the Law School at Washington University Open Scholarship. It has been accepted for inclusion in Washington University Law Review by an authorized administrator of Washington University Open Scholarship. For more information, please contact digital@wumail.wustl.edu.
But it is also probable that in the future there will be a movement towards declaring disclaimers in particular fields invalid as contrary to public policy. Then it is possible too for legislatures to adopt a policy of imposing additional statutory obligations wherever it is feasible and deemed necessary for the protection of a wide class of buyers. It is true that present usages indicate a limited sphere for the operation of these protective measures, but there is nothing which confines these trends to their present bounds. These weapons of the legislature should prove sufficient to withstand any combined threat on the part of vendors throughout the country to re-establish the doctrine of *caveat emptor*.

J. ROBERT GOTH.

---

**THE FAIR TRADE ACTS—THE LATEST ATTACK ON THE LOSS LEADER PROBLEM**

The loss leader system is a business scheme whereby a widely advertised product of standard quality and popular demand is sold at little or no profit as an inducement to the customer to enter the store.¹ The loss leader problem has been an outgrowth of modern marketing. Although it represents only a segment of the larger problem of price cutting, it has been the subject of a flood of controversy.² The theory is that the impression of low prices created by offering the leader at a low price will induce the customer to buy other goods which yield a large profit to the retailer.³ The result of this plan, so the proponents of resale price maintenance argue, is a detriment to the interests of other distributors, to the producer and to the general public.⁴ It is asserted to be a detriment to the retailers because it results in

---


². The chief arguments against resale price maintenance are put forth in Note, 19 Col. Law Rev. 265 (1919). See also 28 Adv. and Sel. 29-30 (Dec. 17, 1936). The contrary opinion is expressed in Miller, The Maintenance of Uniform Resale Prices (1914) 63 U. of Pa. L. Rev. 22; 178 Printers Ink 100-2 (1937); 40 Sales Management 400 (March 1, 1937). A comparison of the arguments pro and con may be found in Note, 36 Col. L. Rev. 293 (1936), and Oppenheim, *Cases on Trade Regulation* (1936) 834 et seq.; Note, 13 N. Y. U. L. Q. Rev. 267 (1936).


cut-throat competition. Its effect on the producer is said to be a loss of retailers and hence a restricted distribution; its effect on the public, although less direct, is claimed to be undesirable because the system leads to an emphasis on price, rather than on the quality of the merchandise. This note will treat the practical effect of the various resale price maintenance devices that have been attempted, including the most recent device, the Fair Trade Acts.

I.

The earliest cases allowing resale price maintenance were not based upon contract but upon notice attached to patented and copyrighted articles. The theory underlying these decisions was that the exclusive right to produce included also the right to fix the resale price of the patented or copyrighted article by notice to the dealer. As a result, if the price fixed by the owner of the patent or copyright was not maintained, he was given a right of action against the price cutter, not for breach of contract, but for an infringement of his patent or copyright. This principle, however, was not extended so as to allow the owner of trade-marked goods to control the resale price merely because of the trade-mark. This right of action, moreover, existed solely in the person owning the copyright or patent. However, in subsequent decision the courts refused to follow these early holdings. Thus, in 1908 in Bobbs-Merrill Company v. Straus the Supreme Court of the United States refused to permit the publisher of a copyrighted book to compel the maintenance of the resale price of the book by virtue of the copyright law; and in 1913 in Bauer v. O'Donnell the same court in effect overruled the cases involving patented articles. Thus, contrary to the early cases, the doc-

5. 40 Sales Management 202-2 (Feb. 1, 1937).
7. Ibid.
trine arose that after a patented or copyrighted article had been sold by the producer he could no longer, simply because of his monopoly, fix the resale price by notice.

At common law the courts uniformly upheld contracts between the manufacturer and the dealer to maintain resale prices, provided that the contracts did not constitute an unreasonable restraint of trade. Such contracts were generally upheld even after the enactment of the federal and state anti-trust laws. The manufacturer in those instances was given a remedy for breach of the contract by an action for damages. Equitable relief was given him by injunction. However, he had no remedy as against one not in privity of contract save the usual action that the manufacturer was the beneficiary of the contract. Moreover, in *D. Ghirardelli Co. v. Hunsicker* the court allowed the manufacturer to sue for breach of a price maintenance contract entered into between a jobber and retailer on the theory that the manufacturer was the beneficiary of the contract.

In 1911, however, the Supreme Court of the United States in the leading case of *Dr. Miles Medical Company v. Park and Sons Company* declared such contracts invalid under the Sherman Anti-trust Act in so far as they affected goods in interstate commerce. A strong dissent was voiced by Mr. Justice Holmes who wrote:

13. Moreover, the law is well settled that after the sale of the patented or copyrighted article the validity of the contract of sale is to be considered as if there were no monopoly. United States v. Kellogg, 222 Fed. 725 (D. C. Mich., 1915).

14. Fowle v. Park, 131 U. S. 88, 9 S. Ct. 658, 33 L. ed. 67 (1889); Dr. Miles Medical Co. v. Goldthwaite, 133 Fed. 794 (C. C. Mass., 1904); that resale price maintenance contracts are generally upheld in most foreign countries see Miller, *The Maintenance of Uniform Resale Prices* (1914) 63 U. of Pa. L. Rev. 22.


20. 164 Cal. 355, 128 Pac. 1041 (1912).

“I cannot believe that in the long run the public will profit by this court permitting knaves to cut prices for some ulterior purpose of their own and thus to impair, if not destroy, the production and sale of articles which it is assumed to be desirable that the public should be able to get.”

It is to be noted that the Court clearly indicated that these contracts might be validated by legislative sanction. The Miles decision was followed with slight modifications, not only by later federal holdings, but by states having anti-trust legislation. However, in the absence of prohibitory legislation the state courts have generally held resale price maintenance agreements to be valid.

Various non-contractual price maintenance devices have also been employed with varying degrees of success. One of the earliest schemes was the rebate system whereby the manufacturer allowed a rebate to retailers who abstained from selling the merchandise below the trade price fixed by him. Although the court held that such arrangements were not in violation of the anti-trust laws, this plan proved practically ineffective because the dealer was not bound to maintain the price fixed by the manufacturer. Another plan frequently employed by the manufacturer was that of refusing to sell to price cutters. In United States v. Colgate and Company this plan was held valid on the ground that the inherent right of every individual to refuse to deal with any person, for any reason, or for no reason whatever, included the right to refuse to deal with one who does not maintain a designated resale price. For a time it was thought that this decision had greatly modified the effect of the Miles case, but subsequent cases restricted its application to such an extent that its effect was virtually nullified. Thus in Federal Trade Commission v. Beech Nut Packing Company the Supreme Court of the United States held that it was an “unfair method of com-

22. Supra, note 21, l. c. 405: “Nor can the manufacturer by rule and notice, in the absence of contract or statutory right, even though the restriction be known to purchasers, fix prices for future sales.”
petition" within the meaning of the Federal Trade Commission Act of September 26, 1914, for a manufacturer to issue circulars to his trade suggesting that they maintain resale prices fixed by him, and to discontinue selling to any dealer who refused to comply with his suggestion. Price maintenance was also attempted under the so-called "agency" system, whereby the dealer was appointed the exclusive sales agent of the manufacturer who fixed the resale price of the merchandise. Although this plan was sustained by the courts where a bona fide agency relationship existed,\textsuperscript{30} it was declared invalid when used as a subterfuge in order to get around the effect of the \textit{Miles} decision.\textsuperscript{31}

It appears, therefore, that two chief obstacles mitigated against these varied attempts at resale price maintenance, namely, the difficulties of administration and the anti-trust acts. Although price cutting had direct effects on persons other than the producer of the merchandise, the existing remedy could be used only by the manufacturer, who was often reluctant to endanger the dealer's goodwill.\textsuperscript{32} Even if the manufacturer was willing to risk the loss of the dealer's goodwill, he was frequently unable to exercise supervision over the dealer adequate to inform him whether or not the price he had fixed was being maintained.\textsuperscript{33} As a matter of law the manufacturer was remediless in all cases against persons other than those with whom he was dealing.\textsuperscript{34} The \textit{Miles} decision invalidated price maintenance contracts affecting interstate commerce. Thereby the producer was forced to rely on ineffective non-contractual devices in all cases in which he shipped his goods across state lines.\textsuperscript{35}

\textbf{II.}

As a result of the situation outlined above, advocates of resale price maintenance took their cause to the legislatures. Attempts at securing federal legislation were unsuccessful. Following the decision in the \textit{Miles} case, numerous bills were introduced in Congress to legalize price maintenance contracts in interstate commerce.

\begin{itemize}
    \item \textsuperscript{31} For an analysis of the legal requirements of an agency so as to enable the manufacturer to fix the resale price see Seligman and Love, \textit{Price Cutting and Price Maintenance} (1932) appendix three; see also Straus v. Victor Talking Machine Co. 243 U. S. 490, 37 S. Ct. 412, 61 L. ed. 866 (1917).
    \item \textsuperscript{32} 28 Adv. and Sell. 24-5 (Jan. 1, 1937).
    \item \textsuperscript{33} Supra, note 29.
    \item \textsuperscript{34} Supra, note 18.
    \item \textsuperscript{35} Supra, note 32.
\end{itemize}
commerce, but none of them was passed. The most notable was the Capper-Kelly Bill which contained provisions similar to those in the state Fair Trade Acts, although it did not contain the compulsory features thereof. Under the code requirements of the N.R.A. some attempt was made to provide for the control of resale prices, but the courts were greatly influenced by the Miles case, in interpreting the code provisions and hence the requirements were of little practical effect.

Prior to 1913 the states either did not legislate at all on the subject of resale price maintenance, or else passed statutes which restricted or condemned the practice. In 1913, a New Jersey statute was enacted and subsequently sustained, which made it unlawful for any merchant to cut prices on a trade-marked product where the goods carried a notice prohibiting such practice. Thus, the Act obviated the necessity for proof of a contractual relationship between the manufacturer and the retailer. In addition, the Act provided that recovery might be had not only by the manufacturer, but also "by any other injured person," and so permitted persons other than the producer to bring actions against the price cutter. These innovations unquestionably contributed towards more effective price maintenance.

For almost twenty years the New Jersey act was the only legislation which expressly sanctioned resale price maintenance. In 1931, California enacted the first of the Fair Trade Acts. As originally passed, it was merely a codification of the law that had been laid down by the decisions in that state, and was not even as broad as the New Jersey statute referred to previously. The purpose of the statute, as stated in the Act was "to protect trademark owners, distributors and the public against injurious and

36. 171 Printer's Ink 7 (June 27, 1935); Miller, The Maintenance of Uniform Resale Prices (1914) 63 U. of Pa. L. Rev. 22.
37. 70th Congress, 1st Session; H. R. 11, Sen. 1418; see also 16 Advertising and Selling L. c. 26 (Nov. 26, 1930).
uneconomic practices in the distribution of articles of standard quality under a distinguished trade brand or name.\textsuperscript{7} The Act merely authorized the producer of trade-marked commodities, which were in fair and open competition with commodities of the same general class produced by others, to provide in the sales contract that the buyer would not resell such commodity except at the price stipulated by the producer, and that the buyer would require a similar contract from his vendee. The Act gave no remedy against those not in privity of contract, nor did it allow recovery by anyone other than the promisee, or the manufacturer.\textsuperscript{42} In 1933 the California statute was amended so as to include these two features in cases involving the sale of commodities included within the scope of the act. The amendment provides that the wilful selling of such commodities at less than the price stipulated in a maintenance agreement is unfair competition and is actionable by any person damaged, regardless of whether or not the person who cut prices is a party to the contract.\textsuperscript{44}

Some sixteen states have followed the lead of California by enacting similar statutes. At the present time fair trade bills are pending before the legislatures in several other states, including Missouri.\textsuperscript{45} Moreover, due to the impetus given by a recent decision of the Supreme Court of the United States in Old Dearborn Distributing Company v. Seagram-Distillers Corporation\textsuperscript{46} which sustained the Fair Trade Acts of Illinois and California, these bills are almost certain of passing. It has been suggested that by sustaining the Fair Trade Acts the Supreme Court has gone in a complete circle in its holdings on this point, and that it is merely returning to the principles that it adhered to in the early cases which permitted price maintenance agreements.\textsuperscript{47}

\textsuperscript{43} Supra, note 42. This purpose is also stated in virtually all of the present Fair Trade Acts; see note 45 below.
\textsuperscript{44} Laws of Calif. (1933) c. 260.
\textsuperscript{45} Ill. Smith-Hurd Rev. Stat. of 1935, c. 121\textsuperscript{1/2}, sec. 188 et seq.; Iowa Sess. Laws 1935, c. 106, sec. 1-6; Laws of Md. (1935), c. 212, sec. 106-9; Laws of N. J. (1935), c. 68, sec. 1-6; Laws of N. Y. (1935), c. 976, sec. 1-6; Ore. Laws (1935), c. 296, sec. 1-7; Laws of Pa. (1935), No. 155, sec. 1-6; Laws of Wash. (1935), c. 177, sec. 1-7; Laws of Wisc. (1935), Ass. Bill 343; To the effect that Arizona, Ohio, Louisiana, and Rhode Island have also recently passed similar acts see Business Week 13 (Dec. 12, 1936). See also 40 Sales Management 400 (March 1, 1937); 40 Sales Management 24-5 (Ja. 1, 1937); A Missouri Fair Trade Bill is now before the state legislature, House Bill No. 118.
\textsuperscript{46} 40 Sales Management 400 (March 1, 1937); 40 Sales Management 202-2 (Feb. 1, 1937).
\textsuperscript{47} 28 Advertising and Selling 24-5 (Ja. 1, 1937).
The Dearborn case, however, did not overrule the Miles case in so far as the Miles case applied to contracts affecting goods in interstate commerce, but simply upheld the validity of intrastate contracts. Furthermore, it appears that the court in the Dearborn case sanctioned an extension of protection to the owner of trademarked merchandise. This protection formerly was denied to him and given to the owner of patented and copyrighted articles.

III.

Although the Fair Trade Acts mark an advance in the direction of resale price maintenance, they present some acute problems. The highest courts of three states have declared the acts invalid. This raises the first problem. However, one of these states, New York, recently reversed itself, and in view of the influence of the Dearborn case, similar action by the other two states may well be expected. Another problem is the difficulty that may be encountered with the federal anti-trust acts which, as previously noted, have been held to prohibit resale price maintenance contracts which directly affect interstate commerce. Various schemes have been suggested as means of surmounting this barrier. One suggestion is that in view of the recent favorable attitude of the Supreme Court of the United States in the Dearborn case toward price maintenance contracts the court might well be expected to overrule the Miles case. It might hold that the effect on interstate commerce of the control of intrastate retail sales by a foreign manufacturer would be too remote to be violative of the Sherman Act, notwithstanding the feature of interstate shipment. Again, it has been suggested that the manufacturer might incorporate in each state, ship the goods to his own warehouse within the state, and then enter into contracts with the dealers. Still another proposal is for the manufacturer to “suggest” to the wholesalers within each state that after they receive the goods they should require price maintenance contracts from the dealers. The best solution to the problem, however, lies in the Tydings-Miller bill which is designed to validate

48. Supra, note 21.
49. Supra, note 10.
50. Business Week 24-25 (D. '19, 1936); 28 Adv. and Sell. 29-30 (D. 17, 1936). New York, Wisconsin, and New Jersey prior to the decision in the Old Dearborn case held the non-signers clause invalid as against both state and federal constitutions.
52. Supra, note 21.
in interstate commerce such agreements and contracts as are valid when applied intrastate. This bill recently was passed by the Senate and is expected to receive favorable action by the House in the present session.55

Various problems arise as to the type of contracts that may be employed under the acts. In the first place it should be noted that the scope of the acts is limited to vertical agreements, that is, as between persons in successive market stages.56 The application of the Acts does not extend to all classes of commodities, nor even to all branded merchandise. It extends only to branded commodities that are "in fair and open competition with commodities of the same general class produced by others."57 Furthermore, assuming that the product of a manufacturer is within this class, it is still an open question whether it would be to his interest to take advantage of the provisions of the Acts, for only a limited type of merchandise is suitable to be used as a loss leader.58 Thus if a particular brand is not in popular demand there will be no inducement for the dealer to use it as 'bait' for the consumer. Again, if the product is of such strong popular demand that no dealer can afford to refuse to handle it, the manufacturer is assured of unrestricted distribution regardless of its use as a loss leader. It appears, therefore, that the brands that will gain by the standardization of prices under the acts are those that are strong enough to make them attractive as price leaders, but not so dominant as to be considered independent of the goodwill of the dealers.59 Moreover, in designating the resale price it will be necessary for the manufacturer to consider fluctuations in the market and the possibility of a decrease in the demand for his product. Thus it appears that the contract fixing

55. Business Week 13 (Dec. 12, 1936); Comment, 31 Ill. Law Review 793 (1936); 80 Cong. Rec. 8433 (1936); 28 Adv. and Sell. 29-30 (D. 17, 1936).

56. "This Act shall not apply to any contract or agreement between producers or between wholesalers or between retailers as to sale or resale prices;" sec. 3 of the acts. This section forbids the application of the act to "horizontal" price-fixing agreements. See also Fowle v. Park, 131 U. S. 88, 9 S. Ct. 658, 33 L. ed. 67 (1889); Park and Sons Co. v. National Wholesale Druggists' Ass'n, 175 N. Y. 1, 67 N. E. 136, 62 L. R. A. 632 (1903).

57. This provision is generally found in sec. 1 of the acts, supra, note 45.

58. 28 Advertising and Selling 24-25 (Ja. 1, 1937).

59. Ibid.; see also Oliphant, Cases on Trade Regulation (1936) 906; Seligman and Love, Price Cutting and Price Maintenance (1932). However, of course, the producer of merchandise that is not included in the Fair Trade Acts may employ the means suggested supra, notes 29 to 32, to maintain resale prices, but it appears that the loss leader practice is the chief problem in predatory price cutting; see article VIII, N. R. A. Code of Fair Competition for the Retail Trade.
the price should be flexible rather than rigid, and several different types of contracts with varying provisions have been suggested. The acts expressly provide that the provisions in any contract shall be deemed to imply that the commodity may be sold below the stipulated price in instances where the dealer is closing out his stock, where the goods are damaged, or under court order.

As to the probable effect of the Fair Trade Acts and their desirability from the standpoint of public interest there is considerable disagreement. On the one hand it is contended that the acts are directed against the chain stores where the loss leader system is most frequently practiced, and that there will result a "battle of brands" between the national brands handled by the independent dealers, and the private brands that the chain stores will be forced to market. On the other hand it is claimed that the chains will profit by the Acts and have advocated their passage. It is argued further that the consumer will be forced to pay higher prices because of the restricted competition; but this argument is met by the proposition that fair prices will result because the stability of the system will make for economy. Even the effect on the manufacturer has been the subject of dispute. Thus, although the result of the acts remains to be seen, they may fairly be said to be the latest attack on predatory price cutting. They constitute a legislative attack upon the loss leader system, which has been condemned by the public generally.

OLLIE RICHARD ARENS

62. These provisions are generally found in section 2 of the Fair Trade Acts, supra, note 45.
63. 40 Sales Management 400 (March 1, 1937).
64. 178 Printers Ink 100-2 (1937).
66. 127 Pub. Week. 136 (1935); 40 Sales Management 400 (March 1, 1937); 130 Pub. Week. 2281, 2283, 2296 (Dec. 12, 1936); Bus. Week 13-14 (Dec. 12, 1936); 171 Printers Ink 7 (June 27, 1935).