



KEELEY, KUENN & REID

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WHAT EVERY  
BUSINESS  
SHOULD KNOW  
ABOUT  
PRICE  
DISCRIMINATION

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*Keeley, Kuenn & Reid, a Chicago based law firm with government relations affiliates in Washington D.C., is engaged in the practice of business law, commercial litigation, employment law, taxation, antitrust, product liability, estate planning and legislative matters. Through its affiliates, the firm also meets client needs in protecting intellectual property rights and international commercial law matters.*

## PREFACE

This discussion is not intended to be a legal treatise or a detailed explanation of the many provisions of the federal price discrimination laws. *It is not a substitute for sound legal advice and does not take the place of competent legal counsel required in analyzing specific problems.*

This material is intended as a non-technical explanation of the major provisions of the federal price discrimination laws, to stimulate awareness of the more common problems encountered by businesses and the general principles which govern these areas.

## INTRODUCTION

The Robinson-Patman Act, enacted by Congress in 1936, is concerned with discrimination in the prices charged by sellers to various customers. More business decisions are affected by the Act than by any other antitrust law. Virtually every interstate sale and promotion of commodities through wholesale distribution and other channels is subject to its terms.

This law, like other antitrust laws, introduces uncertainty and complexity into the day-to-day operation of a business. However, compliance with the antitrust laws is not an option. Therefore, a basic understanding of these laws is necessary for the business person who must comply with its requirements and meet the business challenges presented in today's highly competitive markets.

Finally, states have enacted laws which complement

the federal law and in some cases impose additional limits on pricing practices. These laws must also be observed when applicable to business activities.

## PROVISIONS OF THE LAW

The Robinson-Patman Act prohibits price discrimination in certain circumstances. The Act requires allegedly discriminatory transactions to satisfy certain jurisdictional prerequisites before its substantive prohibitions apply. In order to bring the substantive portions of the Act into play, there must be:

- two or more consummated sales in commerce,
- reasonably close in point of time,
- of commodities,
- of like grade and quality,
- with a difference in price,
- by the same seller,
- to two or more different purchasers,
- for use, consumption, or resale within the United States, and
- which may result in competitive injury.

These jurisdictional elements are strictly interpreted. For example, both transactions must be actual sales. A long term lease or a quote to sell will not suffice. The

sales also must be reasonably contemporaneous. In addition, commodities are covered by the Act only if they are tangible goods. Leases of realty, services such as advertising, and loans are not covered.

## COMPETITIVE INJURY MUST BE PRESENT

The Act contains a number of separate substantive provisions applicable to the “competitive injury” element of an offense. Section 2(a) prohibits a seller from discriminating in price between two or more competing purchasers in the sale of commodities of like grade and quality, where the effect of the discrimination may be substantially to:

- lessen competition in any line of commerce; or
- tend to create a monopoly in any line of commerce; or
- injure, destroy, or prevent competition with any person who grants or knowingly receives the benefit of the discrimination, or with the customers of either of them.

The crucial question is the type and extent of potential injury to competition that can satisfy this standard. Two types of possible injury are most commonly alleged. The first is often referred to as “primary line injury,” because the actual or threatened injury is to competition between the seller granting the discriminatory discount and other competing sellers. The Federal Trade Commission has held that primary line injury can be established, subject to rebuttal, by show-

ing that a seller engaged in predatory pricing conduct, such as by making sales at prices below average variable cost for a significant period of time in order to destroy its rivals.

The second type of injury is often referred to as “secondary line injury,” because the actual or threatened injury is to competition between the favored customer who receives the discriminatory price and the disfavored customers of the seller. The existence of this type of injury may be established directly by evidence of displaced sales caused by the price discrimination. It also may be established by proof of a substantial price discrimination between competing purchasers over time. That is, it may be inferred from evidence that some purchasers had to pay their supplier substantially more for their goods than their competitors had to pay.

This inference of injury, however, can be overcome by evidence breaking the causal connection between a price differential and lost sales or profits. Evidence on that score might include a showing that the advantaged and disadvantaged buyers operate in different geographic markets, or at different levels of distribution, or for other reasons are not in competition with each other. Some courts have held that the inference of injury may also be overcome by a showing that competition in the market generally remains healthy.

## DEFENSES TO PRICE DISCRIMINATION

Not all price differences are illegal. The Robinson-Patman Act contains a number of exceptions to the prohibitions embodied in section 2(a).

**MEETING COMPETITION.** The most significant defense is the “meeting competition” defense. An otherwise unlawful price difference becomes completely lawful when it represents a good faith effort by the seller to meet the competition of one or more other rival firms. The essential principle is that firms should be able to compete by lowering their prices, in order to match the prices of their rivals, without violating the Act. The Supreme Court has said that the standard is whether the seller can show the existence of facts which would lead a reasonable and prudent person to believe that offering a lower price would, in fact, meet the equally low price of a competitor.

The Supreme Court has also ruled that *territorial* price differences that are in fact responses to competitive conditions may satisfy the requirements of the defense. The Federal Trade Commission has similarly stated that if a seller has a good reason to believe that competing firms are charging lower prices in a particular market, it may respond with comparably low prices on a *territorial* basis throughout the market, rather than on a customer-by-customer basis. Moreover, the seller may reduce prices in order to secure new customers from its competitors, as well as to retain old ones.

**COST JUSTIFICATION.** The cost justification defense permits price differentials that make only due allowance for differences in the cost of manufacture,

sale or delivery resulting from the differing channels of distribution or quantities in which the commodities are sold. A seller’s cost savings in sales to a particular customer may result from efficiencies in manufacturing and production, from lower distribution and transportation charges or from marketing cost savings. If properly interpreted, this exception can ensure that the Act prohibits only price differences that are discriminatory in an economic sense. This defense is the most technical and difficult to establish, so much so that it has been called largely illusory in actual practice.

**CHANGED CONDITIONS.** The Act permits price differences due to changing conditions affecting the market or the marketability of the goods concerned, such as the deterioration of perishable goods, the obsolescence of seasonal goods, distress sales under court process, or bona fide “going out of business” sales.

## FUNCTIONAL DISCOUNTS

A functional discount is one given to purchasers based on their role in the supplier’s distribution system and reflecting the distribution and marketing services the purchasers actually perform for the supplier. A wholesaler-distributor may be eligible to receive a functional discount corresponding to any part of the functions actually performed in distributing and marketing the supplier’s goods.

The Supreme Court has held that, to the extent that a supplier grants a functional discount (i.e., a price differential) to a purchaser that merely accords due recognition and reimbursement for actual marketing functions performed by the purchaser, such discounts are

not illegal under the Robinson-Patman Act. At the least, a functional discount that constitutes a “reasonable reimbursement” for the purchaser’s distribution and marketing functions actually performed will not violate the Act.

The Court also cautioned that not every price differential labeled as a functional discount will be found lawful. For example, a functional discount completely untethered to either the supplier’s savings, or the purchaser’s costs to perform the distribution and marketing functions, could violate the Act. Labeling a purchaser as a wholesaler-distributor does not necessarily entitle that person to receive a functional discount - - only to the extent that the purchaser actually performs distribution and marketing functions, assuming the risks and costs involved, will the purchaser lawfully qualify for a functional discount as reasonable reimbursement for such services.

On the other hand, a supplier need not satisfy the rigorous evidentiary requirements of the cost justification defense to prove that a particular functional discount is reasonable. Nor is it necessary for the supplier to provide exact proof that the functional discount does not exceed the purchaser’s costs in performing the distribution and marketing functions.

Granting a lawful functional discount takes on added complexity for a supplier selling to a purchaser who operates at multiple distribution levels. These “dual distributors” may resell a supplier’s goods at the wholesaler-distributor level (selling to retailers) *and* at the retail level (selling directly to end users). In these instances where a dual distributor buys only part of the goods as a wholesaler-distributor, the functional dis-

count should be claimed and paid only on those goods for which the purchaser actually earns the functional discount as reasonable reimbursement for the distribution and marketing functions actually performed.

## IS THE LOWER PRICE PRACTICALLY AVAILABLE

The courts have ruled that the Act does not impose liability in situations where the disfavored purchaser could have obtained the lower price through the exercise of reasonable efforts, but the purchaser simply did not take advantage of the opportunity. To excuse a price differential on these grounds the purchaser must know of the lower price and it must be practically available to the purchaser - - not just available on a theoretical basis. In many cases cash discounts and some discount programs based on the volume purchased have been ruled lawful under the Act based on their practical availability to all other purchasers.

## PURCHASER LIABILITY: INDUCING A DISCRIMINATORY PRICE

Section 2(f) of the Act applies these same principles to the conduct of purchasers, by making it unlawful for a purchaser knowingly to induce or receive a discrimination in price prohibited by other parts of the Act. There is no liability unless the purchaser knew or should have known that the discrimination it induced or received was an illegal discrimination. Purchaser liability under section 2(f) is completely derivative of the seller’s liability under section 2(a). The injury to competition requirements therefore apply. However, a

purchaser cannot be found liable unless a price discrimination that violates section 2(a) can be established *and* the meeting competition, cost justification, and changed conditions defenses cannot be proved by the seller.

## PROMOTIONAL ALLOWANCES AND SERVICES

Sections 2(c), 2(d), and 2(e) of the Robinson-Patman Act address allegations that firms have granted discriminatory discounts indirectly, through the provision of brokerage, advertising and promotional allowances or services. Section 2(c) prohibits a seller from paying to or receiving from a purchaser certain commissions, brokerage fees, or other compensation, or any allowance or discount in lieu thereof, except for services rendered. Sections 2(d) and 2(e) prohibit a seller from granting advertising and promotional allowances or services to particular customers unless the same allowances or services are available to all customers on proportionally equal terms.

The seller has an obligation to notify customers about the availability of promotional allowances and services. The services or payments at issue must be in connection with the processing, handling, sale, or offering for sale of a product by the customer, *i.e.*, they must bear a direct relationship to the resale or preparation of the product for resale. Promotional services include cooperative advertising, displays, demonstrators, catalogs and similar services.

All three subsections create greater or lesser degrees of *per se* liability (1) because proof of likely adverse competitive effects need not be presented in order to estab-

lish a violation; (2) because there are no defenses to a claim under section 2(c); and (3) because only the meeting competition defense can be raised in response to a claim under section 2(d) or section 2(e).

## CONCLUSION

The Robinson-Patman Act does not prohibit all price differences and it is not intended to protect businesses from all competitive disadvantage. The courts and the Federal Trade Commission have recognized, in particular, that the Act permits price differences that can be justified on the basis of cost differences attributable to cost advantages to the seller, or that result from efforts by a seller to meet the competition of other sellers.

The courts have further recognized that the Act permits a seller to grant functional discounts to certain purchasers as due recognition and reasonable reimbursement for distribution and marketing functions actually performed by the purchaser. Finally, a price discrimination will not constitute a violation of the Act unless the price discrimination produces the requisite degree of actual or threatened competitive injury as described above.