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PRICE SYSTEMS AND COMPETITION: THE BASING-POINT ISSUES

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The death of Underhill Moore reduces the small company of those who have, in our time, forged new tools for legal thought. It takes from the Law School a brilliant and well-loved teacher. And it deprives the Journal of a valued contributor and friend. He will be missed. His work remains.

Price Systems and Competition: The Basing-Point Issues

In a decade remarkable for attacks on Supreme Court decisions, few have been denounced so violently as the "basing-point" case, FTC v. Cement Institute. Perhaps none has been scored with less reason. Businessmen,

1. 333 U.S. 683 (1948).
lawyers and Commissioner Lowell B. Mason of the FTC have cried that the decision spells f.o.b. pricing throughout American industry.\textsuperscript{2} It does not. But neither is it a panacea for our economy's monopolistic ills, as others have hoped. This discussion will attempt to outline what the \textit{New Cement} decision and the earlier cases require of business pricing methods and what they promise in the way of promoting effective competition.

But before taking up the cases it is necessary to describe what "delivered price" policies are, what they are used for, and what kinds of economic situations the courts and the enforcement agencies are attempting to change.

\section*{A Glossary for Geographic Price Systems}

In the United States, buyers and sellers of almost any product are all over the map. Shipping costs vary among different sales transactions. The individual businessman may therefore vary his net returns on sales by varying the extent to which he makes different buyers pay the freight.\textsuperscript{3} A so-called "industry-wide price system" develops when all or most producers adopt the same pattern of charging shipping costs. The following are the major types of industry-wide price systems.

\textit{F.o.b. price system.} Each seller quotes a single price \textit{effective at his plant.} Each buyer pays the freight to his delivery point. The feature of quoting at the plant is unique with f.o.b. pricing. In all other price systems, prices include freight and are \textit{effective at the point of delivery}; hence the term "delivered price" systems.\textsuperscript{4}

\textsuperscript{2} See, e.g., Head, \textit{The Basing Point Cases}, 26 Harv. Bus. Rev. 641, 655 (1948); N.Y. Times, Nov. 16, 1948, p. 45, col. 3, p. 49, col. 7-8; N.Y. Herald-Tribune, Nov. 24, 1948, p. 30, col. 4. For Mr. Mason's extreme interpretations see \textit{Hearings before a Subcommittee of the Senate Committee on Interstate and Foreign Commerce on Sm.}, 241, 80th Cong., 2nd Sess. 64, 66 (1948).

Not all business groups have been fooled: "... one of the most popular interpretations of the destructiveness of the basing point decision is that it prescribes that all Sales must be priced on an f.o.b. plant basis. How it is possible to read that into the dictum of the court the impartial student cannot readily discern. ..." Oil, Paint and Drug Reporter, Sept. 6, 1948, p. 40, col. 1-2, cited in Zlinkoff and Barnard, \textit{Basing Points and Quantity Discounts}, 48 Col. L. Rev. 985, 1004 (1948), which also gives a limited interpretation of the decisions.

\textsuperscript{3} Varying the extent to which customers pay the freight is of course just one method of setting a pattern of relative prices. A firm may set a high price in a "strong" market, a low price in a "weak" market, with no particular reference to freight charges at all. See sources cited in note 29 infra.

\textsuperscript{4} The term "delivered price system" is restricted to cases where other than actual freight is charged some buyers—i.e., where the net mill price varies among different customers. An f.o.b. seller may quote a so-called delivered price, but it would in every case be f.o.b. plus \textit{actual} freight. Similarly a delivered-price seller may quote an "F.O.B." price to a buyer, but it will be a phony f.o.b. price if the buyer cannot accept delivery at the plant. See Fetter, \textit{Exit Basing Point Pricing}, 38 Am. Econ. Rev. 815, 817-3 (1948), and note 29 infra.

Delivered price systems, as defined, have been used in the marketing of hundreds of items, including iron and steel products, electrical equipment, chemicals, tires and tubes,
Freight equalization system. All sellers have the same mill price. Each seller quotes the mill price plus actual freight costs to all buyers within his normal market area. In selling to a distant buyer, however, the seller quotes the standard mill price plus the freight that would be charged by the competing seller nearest the buyer. Freight charges to any particular buyer, then, are "equalized." And all sellers actually competing for a sale tend to quote the same delivered price to any one buyer regardless of each seller's location. On sales in areas nearer a competitor, a seller receives a lower net price than on sales within his own area since actual freight is not included in the delivered price. This deficiency is called "freight absorption."

Multiple basing-point system. The simplest form is much the same as freight equalization. The only difference is that mill prices may vary from seller to seller. Where all sellers' plants are "basing points," each seller quotes a delivered price to a given buyer computed as the lowest total of a base price plus delivery cost from that base. On nearby sales the seller's own base price will be used; on distant sales, the base price used will usually be that at the base nearest the buyer. More commonly, however, one or more sellers do not adopt base prices at their plants, but quote all prices on other basing points. Since a non-basing-point seller in making local sales computes price as the total of a base price elsewhere plus freight from that base, he is said to collect "phantom freight" on such sales. Whether or not there are non-basing-point sellers, all producers tend to quote the same delivered price to any one buyer since all use the same price formula.

Single basing-point system. A single city is designated as the basing point. All sellers quote the same delivered price to any one buyer by adding to the single base price the would-be freight charges from the basing-point, regardless of the actual freight costs. Only a seller located at the basing-point receives equal net prices on all sales.

Zone price system. The country is divided into several more or less arbitrary zones. All buyers within a zone tend to be quoted the same delivered price by all sellers regardless of the sellers' locations, but the price varies among zones.

Uniform delivered price system. All buyers are quoted the same delivered price by all sellers regardless of location.

The Effect of Delivered Prices on Competition

Delivered price systems become important when they deprive buyers and the economy in general of the benefits of competition. The systems may do
this. They need not. Price systems are just one aspect of competition.\(^6\) The effect of delivered price depends on the market structure in which they are used.\(^7\)

Individual sellers use delivered price policies in a multitude of markets that are competitive by any reasonable standard. There is no need to worry about these. Only a purist would cry "monopoly" when a particular brand of candy bars, shirts or shoes sells at uniform prices throughout the country or "slightly higher west of the Rockies."\(^8\) Delivered price policies are there adopted to facilitate advertising and permit a nation-wide market for the individual seller.\(^9\) Or they may be used simply because transportation costs are too small to be worth the accounting bother of separate calculation. Prices on many of these items respond quickly to changes in cost and consumer demand.\(^10\) Where they do not, effective competition takes the form of variations in quality.\(^11\) New businesses can move into these industries fairly readily, and inefficient firms are regularly forced out by competitors are needed they could be produced, and when the need falls the resources could produce something else. See, e.g., BAIN, PRICING, DISTRIBUTION AND EMPLOYMENT 119–20 (1948) (hereinafter cited as BAIN), or any recent elementary economics textbook. The forces of such an ideal market would irresistibly press price to the level of minimum achievable costs, and would constantly adjust producing capacity to consumer demand.

Such an ideal market is unobtainable, but an industry lacking one or more of its features may still yield something approaching competitive results.

6. All actual industrial markets are tapestries of "competitive" and "monopolistic" threads. They are most fairly classified not by counting strands but by studying the tapestry as a whole. Price policy is just one of the strands: "Determination of the status of an individual trade . . . requires nothing less than a detailed analysis, product by product, market by market, and year by year, of output and prices, of quality, service and terms of sale, of costs and profits, of private agreements and public regulations and of the effectiveness with which they are enforced." WILCOX at 19–20.

The presence of one monopoly element may be counteracted—and the market made more competitive—by the presence of another. See, e.g., Clark, Toward a Concept of Workable Competition, READINGS IN THE SOCIAL CONTROL OF INDUSTRY 454–5, 464–5 (1942).

7. For an excellent discussion of market structures, and a criticism of the popular "competition v. monopoly" dichotomy, see Adelman, Effective Competition and the Antitrust Laws, 61 HARV. L. REV. 1289, 1298–1304 (1948).

8. The monopoly element is in trade-marks, which differentiate the product of one seller from that of another—e.g., one producer has a "monopoly" in Arrow shirts. But ordinarily this does not give the individual producer substantial control over his price. Close substitutes will relieve the producer of his market if he raises his price noticeably. See BAIN 241, 243; CHAMBERLAIN, THE THEORY OF MONOPOLISTIC COMPETITION 58–63 (3rd ed. 1939).

9. This is not to say that all advertising is necessarily useful or even a matter of indifference. See Brown, Advertising and the Public Interest: Legal Protection of Trade Symbols, 57 YALE L.J. 1165 (1948). But advertising per se is not indicative of monopoly in the sense of substantial market control, and among industries here being discussed there is no such control.

10. E.g., cotton textiles, WILCOX at 32; knitted goods, id. at 38; men's clothing, id. at 40.

11. E.g., boots and shoes, id. at 46; women's clothing, id. at 43, BAIN at 249.
petitive pressures. The fact that individual sellers in these industries quote delivered prices is of little or no significance to monopoly problems.

But delivered prices have also been a common feature of what may be called "basically non-competitive markets." These are markets in which sellers, come what may, will do everything possible to suppress competition. They usually succeed in that aim. In such markets, delivered price systems appear not in the form of flexible individual prices policies but as a rigid price structure for an industry. These delivered price systems and these non-competitive markets present the real problem and require more than cursory analysis. The principal questions include (1) what market elements produce rigid price structures; (2) how those elements produce rigid prices; (3) the harmful economic results; (4) the possible effects of imposing f.o.b. pricing; and (5) the effects of prohibiting common use of a complex pricing formula.

Market elements producing rigid delivered prices

Few sellers. Where a product is produced or sold by a limited number of firms, a price change by any one firm is likely to have a sizeable effect on the sales and therefore the prices of the others, particularly those closest in location. In other words, the price policies of the various sellers are interdependent.
High fixed costs. The presence of high fixed costs—usually caused by heavy capital investment—tends to widen the range of potential price instability. When demand falls, for example, price will also fall until enough capacity is put out of operation to restore equilibrium. Generally, firms will keep on producing as long as returns from their sales exceed the “marginal”—other than fixed—costs of production, since any contribution to fixed costs is better than none. But where fixed costs are high, marginal cost will be well below average unit cost for most of the range of output up to capacity. Accordingly, if price originally was high enough for all costs to be covered, it may have to fall a great deal before any substantial elimination of capacity takes place—while everyone incurs severe losses.16

Scattered location of sellers and buyers. Businessmen are compelled to go afield when faced with an insufficient market in nearby areas. Since a general reduction of price would reduce profits on sales to close buyers, taking lower net prices only on distant sales is a more appealing price policy.

Significant transportation costs. If delivery costs are noticeable but not prohibitive, any one firm can profitably extend its market some distance, but only by accepting lower net returns in its competitors' territories.

Standardized product. If the product is standardized, and is sold to manufacturers who will further process it, buyers have little reason to prefer one seller over another except on the basis of price. Advertising, for example, has little or no effect on sales of sheet steel. Buyers of sheet steel, in their official capacity, are interested in specifications not slogans. Accordingly, a price slightly higher than those of his competitors will cost a producer most of his sales; a slightly lower price will expand his business tremendously.

In contrast to the highly sensitive demand facing any one seller, the total demand for a standardized product not sold to consumers is almost certain to be fairly insensitive to price changes. A fall in price will lead to a less than proportionate increase in total sales by the industry. Assume for example that the price of steel is 10 per cent of the cost of a car. A 20 per cent reduction in the steel price would reduce car prices only 2 per cent. Neither the demand for cars nor the “derived” demand for steel would rise noticeably and total receipts by steel producers would fall.17

The presence of large buyers. Important customers occupy a peculiarly


The presence of high fixed costs will not necessarily increase potential price instability, although there is a probability that it will do so. If an industry has "marginal" firms, just covering out-of-pocket costs, at most levels of demand, then a slight fall in price will drive out some capacity. But it is a fair guess that such marginal firms represent an unimportant percentage of capacity in most mass-production industries. For the importance of fixed costs in relation to steel pricing, see DAUGHERTY, DE CHAZEAU AND STRATTON, II THE ECONOMICS OF THE IRON AND STEEL INDUSTRY 1098 (1937).

17. THE BASING POINT PROBLEM 15 (TNEC Monograph 42, 1941). See also PURDY, LINDAHLEND CARTER, CORPORATE CONCENTRATION AND PUBLIC POLICY 450–1 (1942). The cost of cement does not exceed 16% of the final cost of the products in which it is used.
strong bargaining position whenever general demand is low. Individual sellers are eager to secure a sale that may mean the difference between profit and loss. The large buyer can obtain a concession by playing, or pretending to play, one seller against the other. If the buyer's mastery is complete, he may drive the price down to the level of marginal costs.

**How a rigid delivered price structure develops**

When the above market elements are woven together, business price policies tend to drift into a definite pattern. The immediate interests of an individual seller whose plant is partially idle would appear to dictate a price reduction on distant sales so long as the price remains above additional costs. But this assumes too much.

Price-cutting by one of a few sellers will cut deeply into the others' sales. But the other sellers cannot tolerate this "piracy." They too will play the price-cutting game and relative market shares will wind up about the same. And if total demand is only slightly responsive to a price drop, the small increase in sales shared by each producer will not make up for the fall in price. The efforts of the price-cutter to better himself will not only have been in vain—they will have increased his losses. Moreover, if the price-cutting spirals all the way down to marginal cost, the losses in unrecovered fixed costs will be extremely severe among all sellers. Nor is this all. A general price cut may "spoil the market" by making it difficult to increase prices in the future. It may actually reduce sales if buyers interpret the cuts as merely the first cracks in the price wall and wait for further disintegration. In short, price competition in this type of market becomes financial disaster. All sellers are put under tremendous pressure to stabilize open price quotations, even in the face of a sizeable fall in demand. The struggle for sales takes on other forms.

Instead of making an open price-cut on distant sales, the producer may expand his sales slightly by merely meeting, but not undercutting, the

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18. Perhaps the best example is the tire industry, where automobile manufacturers and mass distributors extract heavy concessions. 
19. This reaction occurs frequently in such durable goods industries as steel.
20. "Under such circumstances, only the most sanguine or the most foolhardy seller would start an open price-war. . . . And it is the importance of average overhead costs
prices of competitors in markets where they have a natural geographic advantage. Simply because this policy is less effective, it is much less likely to invoke a price retaliation by competitors. However, all sellers tend to reason in the same way and all tend to snake into each other's markets by meeting the going prices. This is the genesis of a freight equalization or basing-point system. Each seller becomes the "price leader" in his own area. His competitors merely follow any price changes that he makes. But such a system does not operate as a price-fixing device if it merely stabilizes openly quoted prices, for there is another course available to a producer dissatisfied with his slice of the market.

The dissatisfied seller, instead of making an open price-cut or merely meeting the prices of other sellers, may secure additional sales by secret price concessions to important buyers. This "price shading" takes several forms. The seller may tack on quality or service extras or grant an unusually large discount for quantity purchases. He may also cut the effective delivered price by giving the buyer the benefit of truck or water shipment, while other sellers are still charging rail freight. These practices are price-cutting. In sufficient number, they mock open prices, restore open price-cutting, and inflict greater and greater losses.

Hence the harried members of an industry faced with the prospect of ruinous price competition must do more than adopt similar open price formulas. They must also refrain from secret cuts and must standardize their practices with respect to other terms in the bargain. As a practical matter, such complete identity of price practices cannot be achieved by telepathy. At least a regular exchange of information is required to give every seller sufficient assurance of what the other is doing. It may take some gentle, or not so gentle, policing as well. In any event, the limited number of sellers involved makes the job of containing price competition a comparatively easy one.

Summary. It is market structure that, first, puts tremendous pressure on sellers to stifle competition, and then makes it possible for them to do so. A complex delivered price formula is simply a convenient method of per-

which makes for disastrously low limits to price declines once such price wars begin." Neale, op. cit. supra note 13, at 77.

In cement, marginal cost is approximately one-half average total cost at normal levels of output. Hence if prices were driven to the level of marginal cost, the losses would be tremendous. Clark, Basing Point Methods of Price Quoting, 4 Can. J. of Econ. & Pol. Sci. 477, 478 (1938). See note 16 infra.


23. Ibid.

24. See Clark, supra note 20, at 479; Adelman, supra note 7, at 1331-2, n. 167; Purdy, Lindahl and Carter, op. cit. supra note 17, at 485, 488.

fecting the restraints. Were the formula denied sellers in this position, the need to avoid price competition would still remain. And the sellers would doubtless find another answer. An informal market-sharing agreement, a merger, or a nicely balanced f.o.b. price system would solve the problem.

An individual seller's delivered price policy becomes significant as an anti-competitive device only when every other seller is using the same formula, and when all sellers are confident that gladly or reluctantly everyone will stick to it. When delivered price policy is so stripped of its individuality, sellers forego completely the privilege of initiating price changes outside their own territories—and they make few changes even at home.

The ultimate function of the whole mechanism is to establish price levels that are stable and high enough for each producer to make profits even though operating at less than full capacity. It is these rigid delivered price systems that work economic harm.

The harmful effects of rigid delivered price systems

Price systems are harmful to the economy (1) if they force unnecessary shipping costs; (2) if they produce a higher level of prices than would result from reasonably free response to changes in economic conditions; (3) if they make some groups of buyers pay higher prices than others without regard to cost, location or competitive pressures; (4) if they cause buyers and producers to alter their location merely because of quirks in the price structure; and (5) if they waste economic resources by creating excess capacity. Although regularly indicted on all these counts, rigid delivered price systems are unmistakably guilty of just the first two. The other complaints are justified only in certain circumstances.

Unnecessary transportation costs. Under a rigid delivered price system, all sellers quote the same price to any one buyer. Accordingly the buyer has no strong reason for trading with the nearby, rather than the distant, producer. This gives rise to a considerable amount of "cross-hauling"—e.g., a St. Paul buyer purchases from a Chicago firm at the same time that a Chicago buyer purchases in St. Paul.

Not all purchases from other than the nearest seller represent unnecessary transportation costs. Frequently, for example, the buyer desires quicker

26 "The statements of the [steel] executives who appeared before the TNEC are replete with references to the iniquity of cutting below announced prices, the desirability of 'meeting' but no more than 'meeting' competition, the need for 'stabilized' prices, the impossible situation which would be created by daily fluctuations in price, the importance of looking at price reductions 'from the point of view of the industry as a whole,' the desirability of discussing price changes with customers before they are announced, the need for an agreement under which no company would quote any price below its own cost plus a fair profit, the unfairness of a price which includes no profit, and the desirability of prices which would permit profitable operation at 35 per cent of capacity," Wilcox at 151.

Cement producers have been fairly successful in maintaining profits over periods of low demand, Adelman, supra note 7, at 1346; but steel producers on the whole have not. Wilcox at 153.
delivery than the distant seller may be able to make. But there is little doubt that the waste of cross-hauling is substantial.

High price levels. Rigid delivered price systems cause higher price levels than would result from independent pricing by each seller. That is what they are for. But it is extremely important to repeat that the underlying market structure creates the desire and opportunity for rigid high prices. A delivered price formula is just one way of getting there.

Injury to buyers. Whenever a seller collects different net prices from different buyers for the same commodity, he indulges in economic “price discrimination.” All delivered price policies involve geographical price discrimination by individual sellers. Even under a uniform delivered price system, the net prices paid by buyers for the product vary inversely with the freight service they receive. Only under f.o.b. pricing do all buyers pay the same net price to any one seller.

Unfortunately, the term “discrimination” implies that all price differences are necessarily injurious to the buyer paying the higher net price. They are not. Assume a simple case of freight equalization, with Buyer A and Mill A in Chicago, Buyer B and Mill B in Pittsburgh, mill prices of $10 and freight between Chicago and Pittsburgh of $2. In January, Mill A sells to both buyers, collecting net prices of $10 from Buyer A and only $8 from Buyer B. In February, Mill B sells to both buyers and now Buyer B pays the higher net price. Each buyer appears to both “benefit” and “suffer” from the system. Actually, however, the discrimination means only that both buyers have an advantage of location near a mill which the would-be distant seller must recognize. The discrimination has no effect on the relative position among

27. Moreover, if (1) technical conditions require the joint production of several varieties of a product, and (2) buyers in particular localities use only one or two of the varieties, some so-called “cross-hauling” is inevitable. MILLER at 183. But strictly speaking this is not cross-hauling, since the products are not the same.

28. MILLER at 182; Clark, supra note 20, at 482-3.

29. For the prerequisites and economic effects of various types of price discrimination, see MILLER at c. IX, particularly at 122-30; Adelman, supra note 7, at 1328-37; ROBINSON, ECONOMICS OF IMPERFECT COMPETITION, cc. 15, 16 (1933).

One essential condition for successful price discrimination is the ability to separate markets and keep them separated. Unless the producer can prevent re-sale, customers buying at the low price will over-buy and sell the surplus to other customers—thus in effect making the producer compete against himself until the price differences disappear. Geographical dispersion of customers provides the producer with natural barriers against resale, and enables him to maintain a delivered price system. The prices must be quoted at point of delivery—varying net prices at the mill could not be maintained. See note 4 supra.

30. “... [P]rice uniformity in the presence of cost differences is no less a discrimination than price differences in the face of cost uniformity.” MILLER at 145 n. 7.

31. “... [I]f a buyer in a given locality already has a low price available to him from one seller merely because of his location ... the offer of an equally low price by a second seller merely adds another potential source of supply and is not likely, in itself, to injure competition with the buyer by the second seller’s other customers.” Corwin Edwards, Director, Bureau of Industrial Economics, FTC, Remarks before the Machinery and Allied Products Institute, Dec. 10, 1948 (FTC Mimeo. Release, p. 6).
buyers, which depends not on the seller's net prices but on the delivered prices to the buyers, regardless of how they are computed.

It is possible that the relationship between delivered prices charged Buyers A and B in the above example would change if f.o.b. pricing were adopted by each mill. Under f.o.b. pricing, Mill A would always sell to Buyer A and the saving in freight would enable him to lower the price. But he might just pocket the savings as profit. The same could be said of Mill B and Buyer B. Only a detailed examination of actual market structures, and a prediction of how relative prices would change under non-discriminatory pricing could determine which if any buyer is being placed at a competitive disadvantage.

This difficulty of establishing injury to particular buyers applies to freight equalization, multiple basing-point pricing where all plants are basing points, and to any uniform or zone-price system where transportation costs are a small part of the price.

However, the possibility of harm to individual buyers is less a matter of guesswork where the delivered price structure bears no relation to the location of producers. Assume in the above example that Mill A was not a basing point but, instead, calculated its prices as Pittsburgh mill price plus freight. Then Buyer A would always pay $2 more than Buyer B and solely because of the peculiar price formula used. Wherever there is non-basing-point or highly artificial zone-pricing, buyers near the non-base or off-zone mill suffer an unreasonable disadvantage—i.e., they do not get the advantage of their location.

The principal injury caused by rigid delivered price systems of any type is injury to buyers as a group, which results from the high average price levels that are maintained. But this could be said of any price-fixing scheme in a non-competitive industry. The geographic price discrimination inherent in delivered price systems is an incidental, not an essential feature of high prices.\footnote{Paradoxically, rigid delivered price systems can maintain high price levels only by eliminating a form of price discrimination which, although possibly operating to the relative disadvantage of specific buyers from time to time, ends up in progressively lower prices to all buyers. If one or more sellers wink at the quoted price and make concessions to some customers, other sellers may be forced to meet the offer or drop out of the market. The quoted price then gradually becomes a fiction. A series of such disconnected discriminations will shatter the high price level.\footnote{In summary: (1) all delivered price systems involve systematic price discrimination by sellers; (2) not all rigid delivered price systems favor some}}

In summary: (1) all delivered price systems involve systematic price discrimination by sellers; (2) not all rigid delivered price systems favor some

\footnote{32. \"... [T]he particular system of discrimination which results is not such as would result from a careful and purposive estimate of the relative elasticities of demand of buyers located at different points. Although the discrimination is incidental to the system, it is not the explanation of the particular system.\" M\textsc{iller} at 181.}

\footnote{33. See sources cited, notes 22-4 supra.}
buyers over others; (3) the principal injury caused by all the systems is high prices to buyers in general; (4) this injury is substantially due to the fact that the systems—through assurance of open price quotations—freeze out sporadic semi-concealed price-cutting, which, although "discriminatory," produces lower prices in general.

Location. The pattern of relative prices to different buyers as such has little or no effect on the location of producers.44 The most economic location for producers is that which minimizes total costs, for it will yield the largest net profits regardless of the price system. The minimum cost point depends not only on the location of consuming markets, but on the location of raw materials and labor supply and on comparative transportation costs of raw materials and finished product.45 In practice, however, rigid delivered price systems may affect location of producers in two ways. First, they tend to stay the departure of firms whose location has been rendered obsolete by changing circumstances, simply because, like any monopolistic arrangement,

34. "To elucidate this point, consider a highly simplified hypothetical case. Pittsburgh and Detroit are two sites for steel expansion designed to serve a given market in Detroit. Detroit is the lowest cost center (freight on finished product being included in cost). Under an f.o.b. mill pricing arrangement, Detroit should be the site selected for expansion, ceteris paribus. Unless price concessions were granted, Pittsburgh could not compete in the Detroit market. Under a single basing system, where Pittsburgh is the base, Pittsburgh could sell in the Detroit market. Nonetheless the expanding steel company which has the choice of a Detroit or Pittsburgh location in serving the Detroit market, will select Detroit... In that way, given the price at Detroit, it will maximize the spread between total revenue and total cost. If a multiple basing point system were in effect, with Detroit also a base point, Detroit would again be the more profitable location, even if Pittsburgh had a favorable differential in base price." Isard and Capron, Observations on the Future Locational Pattern of Iron and Steel Production in the United States (to be published in a forthcoming issue of the J. Pol. Econ.).

The argument that relative price structures as such have sizeable effect on location of producers is a persistent one. The FTC in the not too distant past argued that basing point pricing both (1) prevented decentralization of production and (2) stimulated the construction of plants at the outlying edges of a basing point area (i.e., stimulated decentralization). The Basing Point Problem 58, 133 (TNEC Monograph 42, 1941). Both arguments are still being used. For the first, see Fetter, Exit Basing Point Pricing, 38 Am. Econ. Rev. 815, 826 (1948); Walter Wooden, Associate General Counsel, FTC, Remarks before the National Industrial Conference Board, November 23, 1943 (FTC Mimeo. Release, p. 3). For the second, see Corvin Edwards, Basing Point Decisions and Business Practices, 38 Am. Econ. Rev. 828, 841 (1948). Dr. Edwards also uses a variant of the first argument—the seller at a non-base-point is claimed to have been handicapped in expanding since "... in selling toward the base... as his transportation cost is increased, the delivered price and his mill net... fell lower and lower." Id. at 842. But if this is a "handicap," how can it be removed? Assume a "Pittsburgh plus" system, with prices of $10 a unit at Pittsburgh and $15 in Chicago (i.e., freight of $5). If Chicago is now established as a base point, Chicago firms are in no better position to sell toward Pittsburgh for they still cannot get a higher price than "Pittsburgh plus."

they afford the protection of a high price level. Second, certain of these systems tend to have a reflex action on location of producers by shifting the location of buyers.

An artificial delivered price system may well alter the location of industrial buyers if the price of the product is a significant factor in their own costs. Uneconomic location is most likely where a large amount of production is carried on at non-basing-points. If material costs are of a certain point plus, buyers tend to move toward that point. An example is "Pittsburgh Plus," a single basing-point system once used in the iron and steel industry. Steel fabricators were pulled toward Pittsburgh and away from such natural producing areas as Chicago-Gary. However, this dislocation will not occur where every plant is a basing point—as in freight equalization or simple multiple basing-point systems.

Excess capacity. "Excess capacity" means very little without reference to business cycle patterns and the long-run trend of demand for a particular commodity. Moreover, capacity is in no wise affected by the pattern of comparative prices to different buyers. It is the general level of price and its flexibility which influence capacity.

If national income and demand were stable, price levels which averaged above those of competition would doubtless serve to promote excess capacity. They would hold a protective umbrella over inefficient producers and attract newcomers to the field. Where demand fluctuates violently, however, rigid price systems not only keep prices from falling as rapidly as they would under untrammeled competition, but also inhibit price rises. Thus the burning ardor of outsiders to enter the industry on the upswing is cooled. In general, therefore, the net effects for good or ill on average long-run capacity are uncertain.

If the proposition which some have advanced is accepted, namely, that production, past and present, has tended to be unduly concentrated at Pittsburgh, this should not be attributed causally to the existence of the basing point system. . . . [That system] may only have veiled a partially obsolete locational structure which an f.o.b, mill system would have brought to light." Isard and Capron, supra note 34.

There is also the possibility that delivered price systems may enable established producers more easily to prevent development of new capacity by running the newcomers out of business. See Fetter, Exit Basing Point Pricing, 38 Am. Econ. Rev. 815, 826 (1948). But Fetter's further conclusion, ibid., that delivered price prevents geographical decentralization does not necessarily follow. See note 34 supra.

36. "If the proposition which some have advanced is accepted, namely, that production, past and present, has tended to be unduly concentrated at Pittsburgh, this should not be attributed causally to the existence of the basing point system. . . . [That system] may only have veiled a partially obsolete locational structure which an f.o.b, mill system would have brought to light." Isard and Capron, supra note 34.

37. MILLER at 181.
38. Edwards, supra note 34, at 833.
39. In any industry—competitive or non-competitive—involving heavy investment in durable equipment, excess capacity will be a recurrent phenomenon of depression, and a persistent phenomenon of declining long-run demand and technological changes in production technique. The problem is considered in THE BASING POINT PROBLEM 61-3, 130-2 (TNEC Monograph 42, 1941), but in a fashion corrupted by advocacy.
40. Id. at 61.
42. There is some reason to suspect a tendency toward excess capacity. During pre-war years, neither the cement nor steel industries ever operated at full capacity during any
Summary. Highly artificial delivered price systems are likely to injure some buyers and distort the location of industrial consumers. These facts and the wastes of cross-hauling aside, the principal ill effects of rigid delivered price systems stem from their use to produce higher price levels than competitive pricing would insure. Such artificially high prices injure buyers in general, and under some conditions may promote excess capacity and protect poorly located producers from seasonable extinction. But the blame for high prices must go not to the delivered price formulas but to the underlying market structure which makes them possible.

Hence, the effects of rigid delivered price systems must be compared with the probable results under price policies of any other type which could be anticipated in such markets. The only alternative different in mind is f.o.b. pricing. Although not to date accepted by Congress or the courts, the suggestion that f.o.b. pricing be required of all sellers is a popular one. Its appeal is probably deceptive.

The effects of f.o.b. pricing

Imposing f.o.b. pricing on a basically non-competitive market would improve matters very little if at all. The effects on competitive relationships among buyers are not subject to easy generalization—as has been previously indicated. Cross-hauling might be materially reduced. But there is no a priori reason to suspect that a one-price system will produce lower prices than a system of discriminatory pricing. The effects of f.o.b. on price levels, capacity and location are highly uncertain and may even be downright undesirable.

Cross-hauling. F.o.b. pricing would tend to eliminate cross-hauling if freight costs were more or less proportional to distance. Each seller would have a "protected" market surrounding his plant. The boundaries of this area would be determined by the relation of his own to his competitors' prices, and he could extend them only by reducing his price to all buyers.

But shipping costs are not uniform, and a likely result of f.o.b. pricing would be more haphazard discrimination in freight rates. Whatever cross-hauling means to the economy in terms of waste, it means business to the railroads and other transport facilities. Producers precluded from absorbing freight would still want to reach distant markets and shippers would still...
want the freight business. Downward pressure on key freight rates would tend to sustain cross-hauling. The only difference in such case would be that shippers instead of producers would absorb freight.

*Price levels.* In a basically non-competitive industry, f.o.b. pricing might increase the peptic ulcer rate among producers but it is unlikely that it would promote independent pricing. Business men still would be well aware of the consequences of price competition, and would still seek the comforts of stable high prices. F.o.b. would make containment of price-cutting more of a problem. But once achieved, the price floor would perhaps exceed that of delivered price systems in its rigidity.

F.o.b. pricing makes it more difficult to establish and maintain satisfactory market shares for all sellers by reducing the leeway that market inter-penetration affords. Constant geographical shifting of demand would disrupt the shares of individual sellers. But the problem is not uncontrollable. Leeway may be restored by pressing down freight rates in sensitive areas. Circulation of sales statistics can point the way to salvation. If Mill A has a dearth and Mill B a sheaf of orders, redistribution can be accomplished by Mill B raising its price as well as by Mill A making a price-cut. Later on, Mill A can return the favor. And if by chance f.o.b. should make allocation too exasperating a problem, it may drive firms into merger.

The ultimate effect of f.o.b. pricing may be a higher average price level than under delivered price systems. There is certainly reason to believe that f.o.b. would increase upward flexibility of price. Wherever geographical shifting of demand results in temporary local shortages of capacity, prices must rise in order to bring distant sellers into the market. No seller would lower the price on his entire output just to pick up a few additional sales. Under delivered price systems, the distant seller does not have to do it and local surpluses of demand tend to be filled at the going price.

But there is a more serious disability of f.o.b. pricing. It would immobilize the potent competitive weapon of hidden price-cutting as no operating de-

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45. Clark, supra note 20, at 487.
46. "... [To] enforce a system of uniform mill net prices, which would bring about the price structure characteristics of pure competition, would not necessarily induce the price level of pure competition. Where sellers are few and separated geographically, each would soon learn to consider the effect of its price cuts on a competitor. While any firm by cutting its uniform mill price to all might extend its market geographically, if rivals did likewise, the initiator of the change would gain only the additional volume due to a lowering of prices in its old market territory. The fact that the competitor met the cut would prevent the first seller from extending its market geographically." Miller at 190.
47. Clark is of the opinion that division of the field would result only "after the wars had run their course and producers had learned that reductions of price were certain to be met." Supra note 20, at 485. It is suggested that producers are well enough aware of this fact without subjecting it to empirical testing.
48. For a discussion of the serious monopoly problems presented by mergers, see Comment, Corporate Consolidation and the Concentration of Economic Power, 57 Yale L.J. 613 (1948).
livered price system has ever been able to do. The mere occurrence of a sale in another's territory would indicate a price concession and invite prompt and costly retaliation. By so discouraging price-cutting, f.o.b. would introduce a new element of rigidity in prices.51

Excess capacity. The long-run effects of f.o.b. on capacity are no more certain than those of delivered price systems. A rigid price floor at the same or higher levels would be no improvement. And greater upward price flexibility would entice new capacity well beyond that resulting from more stable prices.

Location. F.o.b. pricing might alter the location of some industrial buyers if it replaced a system involving non-basing-points or highly arbitrary zones. But so would any delivered price system that eliminated such features. Moreover, these effects and the impact on location of producers—if any—would tend to be swamped by technological developments, utilization of new sources of raw materials and shifts in consuming markets because of other dynamic changes.52

In most respects, therefore, enforced f.o.b. pricing is far from a satisfactory answer to the problems posed by rigid delivered price systems en-

50. Clark, supra note 20, at 485.
51. Zinkoff and Barnard, among others, go even further: "If a mill must sell f.o.b. and must not receive varying prices for the commodities it produces, then there will be an area around each mill that will be reserved to the mill free of competition. . . . Local monopolies might indeed be promoted in such a case." Supra note 2, at 1012-3. The theory is incorrect in all but a few instances. "F.O.B. mills cannot raise their base prices in comparison with adjacent mills without restricting the area in which they can sell, and thus reducing their sales, so that their potential monopoly power is strictly limited. . . ." Fetter, supra note 33 at 824-5. See also Comment, 55 Yale L.J. 555, 569 (1946).

But neither is it true that f.o.b. would promote vigorous competition, as is argued by its proponents. Generally speaking, no relative price policy is either "competitive" or "monopolistic" per se. The result depends on the total market structure and the purpose for which a price system is used.

52. The shift of the steel industry to f.o.b. pricing in July 1948, plus the general misapprehension over the effect of the New Cement case, occasioned a rash of investigations, comments, and announcements as to the impact on location. With the possible exception of some movement of consuming industries towards sources of supply, the general conclusions seem to be (1) that f.o.b., if enforced, would have negligible short or long-run effects; (2) any effects will be lost in the shuffle occasioned by changes in the more important determinants of industrial location—increase in transportation costs, new methods of production, new sources of raw materials, the usual expansion of capacity induced by a boom. Communication to the Yale Law Journal from Dr. M. A. Adelman, Assistant Professor of Economics at Massachusetts Institute of Technology, November 19, 1948, in the Yale Law Library, summarizing data available as of that date, including surveys by the staff members of Federal Reserve Banks of Boston, Philadelphia, Atlanta, Cleveland, Chicago, St. Louis, and Dallas. Communication to the Yale Law Journal from Mr. W. A. Capron, Dept of Economics, Harvard University, November 29, 1948, in the Yale Law Library.

A Philadelphia economist, when asked for "straws in the wind on industrial migration," replied: "As far as I have been able to observe, there has been considerable wind but almost no straws at all." Adelman, supra.
meshed in basically non-competitive markets. Another alternative would be to knock out some of the devices that enable agreement on prices.

The effects of prohibiting concerted action

As a practical matter, the maintenance of a rigid delivered price system over any length of time requires some form of agreement among the producers. Persistent standardization of the intricacies of freight charges, delivery methods, service extras and discounts is no easy task. Deliberately or unknowingly, individual sellers will shade prices and prejudice the whole price structure. If discipline or strong persuasion is necessary to keep errant producers to a common price formula, the same discipline and a similar formula would be necessary to make other forms of “price leadership” effective.

Competitive pricing would accordingly be stimulated by prohibiting any forms of agreement, including the mutual confessionals known as “statistical information bureaus.” Such sanctions would create the uncertainty that makes room for sporadic semi-concealed price-cutting and generally lower price levels. At the same time, they would leave the way open for individual “freight absorption,” to which no detectable stigma attaches, and which has the positive advantage of providing a flexible means of adjusting supply to demand without price increases or overbuilding of local capacity.63

But too much cannot be expected of these remedies either. They would merely make each seller less certain of what the others would do. That would be enough to promote independent pricing in an industry with such a large number of sellers that agreement on a delivered price formula is necessary to avoid competition. But where industries are strongly non-competitive, the improvement in price results would be modest. Further gains would require more drastic remedies—perhaps the fracture of horizontally-integrated firms, perhaps outright regulation. Achieving competition or

53. “It would be neither practical nor economic in each individual area to have sufficient plant capacity to meet maximum possible demand, with excess overhead representing a heavy charge upon the price structure.” Nelson, supra note 49, at 620.

54. Break-up of firms is itself no cure-all for the problems of monopoly. The principal issue in every case would be whether enough firms could be created to destroy recognized interdependence without at the same time creating an inefficiently small scale of operations. This may be very hard—if not impossible—with many industries. Where transportation costs are high, for example, producers sell largely within limited areas. A comparatively large number of firms nationally would not preclude strong interdependence—in the form of a series of overlaps—among firms in local markets. To illustrate, assume that Firms A1, A2, A3, ..., A100 are strung out from San Francisco to New York. Firm A1 could not change its price without severely cutting the sales of A2; A2 without affecting A3 and A4; A3 without affecting A2 and A4; and so on.

Moreover, the most efficient scale of production is not always the size of plant best designed to produce one commodity. At least the following problems are involved: (1) utilization of by-products; (2) manufacture of joint products; (3) savings in technical production cost through vertical integration; (4) lowering unit administrative and/or
the goals of competition is an industry-by-industry proposition that has no simple answer.

Summary

Classification of actual markets into "competitive" and "non-competitive" types is a drastic over-simplification. But it perhaps suffices to indicate the general nature of the relation of delivered price policy to effective competition. In basically non-competitive markets, perfected delivered price systems are primarily symptoms and not causes of economic ill health. Their chief harm is in the high price levels established, an indictment common to any monopolistic price restraints. Competition may be strengthened by the elimination of agreement, but strong pressures toward containment of independent pricing will remain. In basically competitive markets on the other hand, delivered price systems are _prima facie_ innocent. Any sensible application of the anti-trust laws must take all of these market factors into account.

THE ILLEGALITY IN DELIVERED PRICE SYSTEMS

Section 1 of the Sherman Act purports to forbid all deals in restraint of trade. In the earlier cases, delivered price systems appeared only as incidents of complex trade association activities, a field in which the Supreme Court has wavered considerably in deciding whether or not there were illegal restraints. Delivered price policy had no law unto itself. Price systems stood or fell with the changing tide of judicial opinion on a more pervasive issue—the extent to which industry could engage in practices that influenced the general level of price.

In the _American Linseed_ case of 1923, the Supreme Court struck down a price-fixing agreement which included a carefully arranged and strenuously enforced zone-price system.55 Two years later in the _Maple Flooring_ and _Old Cement_ cases, basing-point systems escaped condemnation.56 But the circumstances were peculiarly favorable. Maple flooring producers used a single basing-point plan, yet most plants were close to the basing-point and the producers would quote f.o.b. if customers so desired.57 These circumstances and the convenience of quoting prices on a single base, said the Court, justified the differences between actual and fictitious freight.58

A more significant comment on price formulas was made in the _Old Cement_ case, relied on with misplaced trust by defendants in its more celebrated

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56. Maple Flooring Mfr.'s Ass'n v. United States, 268 U.S. 563 (1925); Cement Mfr.'s Protective Ass'n v. United States, 268 U.S. 583 (1925).
57. 268 U.S. 563, 570-1 (1925).
58. Id. at 571.
successor. Justice Stone remarked that multiple basing-point pricing appeared to be a "natural" expedient adopted by sellers "in order to compete." This misapprehension of the purpose of a common price formula may have been due in part to the Government's focus on informational activities, which outwardly at least make an innocent appeal. For in both the Old Cement and Maple Flooring cases the Court emphasized that there was no specific charge of agreement to fix prices or to maintain the price system, and that the evidence did not indicate price uniformity or rigidity. But the Court was not completely in the dark. A strong dictum in Maple Flooring indicated that price formulas, freight-rate books and the like could be used as the basis of price-fixing arrangements and that if so used they were illegal. And in Old Cement the Court warned that price uniformity, especially if accompanied by an "artificial" price level, would be evidence from which agreement could be inferred.

The Maple Flooring dictum came alive in the Sugar Institute case of 1936. Sugar refiners used a basing-point price system as part of an extremely intricate plan of open price quoting. Security-minded refiners had been continually harassed by competitors who wanted to compete, and who did so by secretly shading the price. Hence the plan was devised to secure "adherence, without deviation, to prices and terms . . . announced." But this "cut off opportunities for variation in the course of competition"—the plan was held an unreasonable restraint of trade.

The Sugar Institute case implied that the charity shown common price formulas in Maple Flooring and Old Cement was no longer so readily available. The Socony-Vacuum case of 1940—condemning in extremely broad terms any measures whose purpose or effect is to alter market price—virtually brushed the old cases aside.
Enforcement by the F.T.C.

After the Sugar Institute case, the Federal Trade Commission replaced the Department of Justice as chief enforcing agent of the antitrust laws in the field of delivered price systems. It had already been established that combinations in violation of Section 1 of the Sherman Act could also be "unfair methods of competition" under Section 5 of the F.T.C. Act. The favorable drift of the Sherman Act cases gave the Commission something to work with.

The FTC had long been concerned over delivered price. But after issuing an uncontested cease-and-desist order against "Pittsburgh Plus" in 1924, the Commission had withdrawn from the field—a bill under the impression that Maple Flooring and Old Cement prevented any effective action. The Commission ended its inactivity with a group of four direct attacks on delivered price systems. These cases reached the Seventh Circuit during the period 1943–46. The complaint in each case was combined use of a delivered price system to eliminate price competition among sellers—a Sherman Act charge via Section 5 of the F.T.C. Act. The Commission was uniformly successful. Further maintenance of a single basing-point, a freight equalization and two zone-price systems by planned common course of action was forbidden. In only one case did the parties deem it worthwhile to request certiorari and that request was denied.

In each of these cases before the Seventh Circuit there was considerable direct evidence of agreement on price formulas, cash discounts, freight rate factors and/or other terms of sale. There was also the usual exchange of statistics. But the court was quite willing to draw an inference of agreement from the mere fact of unnaturally identical prices. "On the face of the situation," the Milk Can Institute decision said, "it taxes our credulity to believe, as argued, that petitioners employed this system without any" protects that vital part of our economy against any degree of interference. . . . [Congress] has not permitted the age-old cry of ruinous competition and competitive evils to be a defense to price-fixing conspiracies." Id. at 221.

Regarding Maple Flooring and Old Cement, the Court said merely that they "were decided . . . on the express assumption that any agreement for price-fixing would have been illegal per se." Id. at 217. But in comparison with the Socony-Vacuum doctrine, the old Court's willingness to allow activities which had a "necessary leveling effect upon prices" seems startlingly out of date. See ¶ (b) note 60 supra.


70. United States Steel Corp., 8 F.T.C. 1 (1924).

71. Salt Producers Ass'n v. FTC, 134 F.2d 354 (7th Cir. 1943); U.S. Maltsters Ass'n v. FTC, 152 F.2d 161 (7th Cir. 1945); Milk and Ice Cream Can Institute v. FTC, 152 F.2d 478 (7th Cir. 1946); Fort Howard Paper Co. v. FTC, 156 F.2d 899 (7th Cir. 1946).


73. 134 F.2d 354, 355–6 (7th Cir. 1943); 152 F.2d 478, 489–2 (7th Cir. 1946); 152 F.2d 161, 163–4 (7th Cir. 1945); 156 F.2d 899, 901–3 (7th Cir. 1946).
agreement or plan among themselves." The court was no more impressed with the argument six months later in the *Fort Howard* case: "... [T]he artificiality and arbitrariness of the zone structure [here employed] is so apparent it cannot withstand the inference of agreement." 75

Nor was the court misled with the claim that each seller used the price formula in order to compete. It would go along with the idea that competition required meeting a price *decrease*, but that all sellers must meet a price *increase* did not make sense. 76

Meanwhile the FTC had begun an entirely new line of attack on delivered price policies via Section 2 of the Clayton Act, as amended by the Robinson-Patman Act of 1936. 77 The new approach won hands down in the *Corn Products* and *Staley* cases, 78 decided concurrently by the Supreme Court in 1946, but only in the course of a perplexing piece of statutory interpretation.

Sections 2 (a) and 2 (b) forbid any price discrimination which *may* lessen or injure competition among sellers or buyers, *unless* (1) the price differentials make only due allowance for cost differentials or (2) the seller can show that his *lower* price was made in good faith to meet an equally low price of a competitor. In both the *Corn Products* and *Staley* cases, individual use of a single basing-point system was found to have the "prescribed effect" on competition among *buyers*. That each system produced this result was clear enough. In fact, the Commission may have overproved its case.

Corn Products, a glucose manufacturer with plants at Chicago and Kansas City, quoted all prices f.o.b. Chicago so that Kansas City candy-makers receiving delivery from the Kansas City plant paid "phantom freight." 79 The price of glucose is of serious moment to candy-makers, who operate on low profit margins in a bitterly competitive market. Evidence showed that some Kansas City purchasers actually moved to Chicago to avoid the price disadvantage. 80 The Staley company, another glucose manufacturer located in Decatur, Illinois, simply followed the Corn Products' f.o.b. Chicago price policy so that candy makers in and around Decatur were suffering. 81 Neither company could justify the discrimination on the basis of meeting *lower* prices of competitors. 82 There weren't any lower prices to be met. So the two aspects of injury and "good faith" were taken care of handily.

But the F.T.C. apparently need not have gone so far in proving injury

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74. 152 F.2d 478, 482 (7th Cir. 1946).
75. 156 F.2d 899, 907 (7th Cir. 1946).
76. Id. at 906.
77. 49 Stat. 1526 (1936), 15 U.S.C. § 13 (1946). The relevant portions are §§ 2(a) and 2(b) only.
79. 324 U.S. 726, 733 (1945).
80. Id. at 739.
81. 324 U.S. 746, 748-9 (1945).
82. *Corn Products* did not raise the issue. The Staley company did but to no avail. 324 U.S. 746, 753-4 (1945).
to buyers. For the statutory command, said Chief Justice Stone, requires not "that the discriminations must in fact have harmed competition, but only that there is a reasonable possibility that they 'may' have such an effect." 83

The Court's difficulties over the meaning of the statute occurred in defining "price discrimination" and in applying the proviso on cost differentials. The basic problem is whether "price" means seller's net price or buyer's delivered price. If the former, then all delivered price systems are inherently discriminatory. The seller receives varying net prices and by definition the variance is not attributable to cost. The question of illegality under the Act would then reduce to the two questions of injury and "good faith." But Congress in passing the Robinson-Patman Act specifically rejected the suggestion that price be defined as seller's net price, and the Court was aware of that fact.84

However, any delivered price system except uniform delivered price is also "discriminatory" in that delivered prices also vary from buyer to buyer. Apparently on this basis, Justice Stone found that basing-point pricing constituted price discrimination. But he then proceeded to measure the discrimination by the difference between actual and fictitious freight.85 So seller's net price became the real standard after all. Naturally enough, this left uniform delivered pricing in a state of complete confusion. A dictum in the Staley case stated that uniform price was not price discrimination.86 But the discussion of legislative intent appearing in Corn Products clearly inferred that it could be.87 Moreover, in the Staley case Justice Stone defined

83. 324 U.S. 726, 742 (1945). The phrase "reasonable possibility" is a slippery one. The Chief Justice apparently meant "probability": "... [T]he use of the word 'may' was not to prohibit discriminations having 'the mere possibility' of those consequences, but to reach those which would probably have the defined effect on competition." Id. at 738.

But in the Morton Salt case, the Court held that "possibility" means "possibility," and resorted to legislative history to support the conclusion that § 2(a) of the Robinson-Patman Act was intended to be broader than § 3 of the Clayton Act, which Justice Stone had analogized in Corn Products. FTC v. Morton Salt Co., 334 U.S. 37, 46 n. 14 (1948).

84. 324 U.S. 726, 737 (1945).

85. For the Court's acceptance of the "phantom freight" and "freight absorption" tests, see 324 U.S. 726, 732–3 (1945); 324 U.S. 746, 751 (1945).

That the Court was using delivered price variations to find discrimination seems necessarily implied in the lengthy discussion of the legislative history of the Act. 324 U.S. 726, 737 (1945). And see 324 U.S. 746, 756–7 (1945). But the process is not clear. Compare notes 86–7 infra.

86. "But it does not follow ... that sellers ... may not maintain a uniform delivered price at all points of delivery, for in that event there is no discrimination in price." 324 U.S. 746, 757 (1945).

87. "We think this legislative history indicates only that Congress was unwilling to require f.o.b. factory pricing, and thus to make all uniform delivered price systems and all basing point systems illegal per se. On the contrary we think that it left the legality of such systems to be determined accordingly as they might be within the reach of § 2(a), as enacted, and its more restricted prohibitions of discriminations in delivered prices." 324 U.S. 726, 737 (1945) (emphasis added).
a non-discriminatory price system as one "giving to purchasers, who have the natural advantage of proximity to . . . [a] plant, the price advantage which they are entitled to expect over purchasers at a distance." By that very persuasive standard, uniform delivered price could be the most discriminatory of all.

For all their punishing complexities, the Corn Products and Staley cases were off on a side issue in concentrating on injury to buyers. The core of the problem was exposed in June 1947 when the Commission issued a complaint against Corn Products, Staley and several other manufacturers charging conspiracy to restrain price competition among sellers. If valid—and a good guess would be that it is—the charge reveals the previous cases as "merely particular instances of the discrimination inherent in an industry-wide collusive plan." 89

The strength and significance of the New Cement case lies in the fact that the decision, unlike Corn Products and Staley, concentrated not on the discriminatory aspects of delivered price systems but on their use in promoting organized price leadership. In New Cement, the multiple basing-point system used by cement producers was held to violate both the F.T.C. Act and the Clayton Act.90 But the violation of the latter stemmed from injury to competition among sellers;91 and the violation of the F.T.C. Act, as in the earlier Seventh Circuit cases, was in effect a violation of the Sherman Act as well. The crux of the findings on both counts was the now-familiar one of combination and agreement shown not only by more or less persistent identity in prices92 but by direct collusion as well.93 There had been organized opposition to the erection of new plants and organized discouraging of delivery by truck or barge. There had also been punitive action against "price-cutters." The fact that some companies "probably unwillingly abandoned competitive practices" did not save them from blame where their delivered prices "were, with rare exceptions, identical with the delivered prices of all their competitors." 94

In view of the finding that the basing-point system of price quoting had lessened price competition among sellers, the Clayton Act was inescapable.

88. 324 U.S. 746, 757 (1945).
90. FTC v. Cement Institute, 333 U.S. 683, 720, 725-6 (1948).
91. The "discriminations substantially lessened competition between [sic] respondents." Id. at 726.
92. Id. at 713. Moreover: "Thousands of secret sealed bids have been received by public agencies which corresponded in prices of cement down to a fractional part of a penny." Ibid.
93. Id. at 710, 714.
94. Id. at 719. The Court also stated: "It is enough to warrant a finding of a 'combination' within the meaning of the Sherman Act, if there is evidence that persons, with knowledge that concerted action was contemplated and invited, give adherence to and then participate in a scheme." Id. at 716 n. 17, citing Interstate Circuit v. United States,
For it was impossible for respondents to justify the price discriminations inherent in the system as good faith efforts to meet competition. But the decision carries the Clayton Act no further. It does not enforce f.o.b. pricing nor does it eliminate all but sporadic "freight absorption" by individual sellers. In reply to an objection that the F.T.C. order had these effects the Court was specific in its denial:

"The Commission disclaims that the order can possibly be so understood. Nor do we so understand it. . . . [T]he order by its terms is directed solely at concerted, not individual activity on the part of the respondents."

In the *New Cement* opinion, Justice Black reaffirmed that combination is not essential to a violation of Section 5 of the F.T.C. Act, and that individual behavior which *may* restrain competition is "unfair." The Seventh Circuit had occasion to use the first principle only sixteen days later in the *Rigid Steel Conduit* case. Again producers were held to have violated the F.T.C. Act by their use of a multiple basing-point system. But in this case, the Commission extended Section 5 beyond Section 1 of the Sherman Act. Not only was combination charged, but on a second count producers *as individuals* were held to have violated the F.T.C. Act:

". . . through their concurrent use of a formula method of making delivered price quotations with the knowledge that each did likewise, with the result that price competition between and among them was unreasonably restrained."

The court reached the same legal result it would have from drawing an inference of agreement from parallel pricing. This is reasonable enough as the economic result is the same whether the practices are called "con-

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95. 333 U.S. 683, 725 (1948).
96. Id. at 727-8.
97. Id. at 721 n. 19.
98. Id. at 693, 703.
99. Triangle Conduit & Cable Co. v. FTC, 168 F.2d 175 (7th Cir. 1948).
100. Id. at 176.
101. "In this situation . . . the legal question presented is identical with the one that the Supreme Court considered in the Federal Trade Commission v. Cement Institute case . . ." 168 F.2d 175, 181 (7th Cir. 1948). See note 94 supra.

It has been claimed that the F.T.C. order in this case banned all freight absorption and enforced f.o.b. pricing. FTC v. Cement Institute, 333 U.S. 683 (1948), Brief of General Electric Co. as *amicus curiae*, p. 19; Head, *supra* note 2, at 651. But as in the *New Cement* order, the specific prohibitions of the *Rigid Conduit* order were limited by a general modifier. The companies were ordered to quit practices carried on "for the purpose or with the effect of systematically matching delivered price quotations with other of said respondents." 38 F.T.C. 534, 595 (1944) (emphasis added).
current” or “collusive.” The possibility of individual guilt is also useful for enforcement purposes. Singling out one big firm is much easier than bringing in an entire industry.

The Current Law of Delivered Price

The cases permit several definite conclusions on the current legal status of delivered price policies. First, concerted maintenance of a price structure which reduces price competition among sellers violates Section 1 of the Sherman Act and consequently also violates Section 5 of the F.T.C. Act. Rigid uniformity of prices by itself is evidence of agreement, since it requires precise matching of all terms of the price bargain. Second, individual use of a price policy is an “unfair method of competition” where all or most producers are using the same policy and where the practice restrains competition or “might lead to such restraint if not stopped in its incipient stages.”

Third, delivered price policies which lessen or may lessen price competition among sellers are inevitably a violation of the Clayton Act, since the inherent variation in sellers’ net prices cannot be justified as a good faith effort to meet competition. Fourth, non-basing-point or highly artificial zone-pricing by an individual seller—which deprives some buyers of locational advantages—violates the Clayton Act since those buyers are placed at a competitive disadvantage in relation to other buyers.

Fifth, so long as their activities do not flower into a rigid price structure or promise to do so, individual sellers and their competitors may persistently “absorb freight” on distant sales. The price discrimination that results is not illegal price discrimination. There is no injury to competition among sellers so long as a discrete collection of individual price systems does not merge into an industry price system. And as indicated earlier in this discussion, it is highly unlikely that any particular buyers are injured by simple freight absorption. Moreover, even if some buyers are injured, the discrimination might be justified under the good faith proviso.

The “Basing-Point” cases and antitrust policy

New Cement and its companion cases got to where they are because the antitrust laws are supposed to promote effective competition. Had the decisions gone the other way, they would have crippled antitrust enforcement in this field.

Yet the cases raise two further questions. Do the remedies supplied go far enough to promote effective competition? And do the antitrust laws go too far and permit the condemnation of innocent practices along with the bad?

103. Uniform delivered price may be an exception. See notes 86–7 supra.
104. P. 435 supra.
The answer to the first question is a conditional "no." The line of attack represented by these cases is inadequate where the drive toward non-competitive behavior lies in the market structure and surface agreement on a common price formula is merely one technique. The burden of altering market structures falls on the Department of Justice, which, under Section 2 of the Sherman Act, can split a few firms into many in order to restore a measure of competition.5 Where this is not practical, an industry is a fit subject for regulation.

Regarding the prospective extent of the antitrust laws, attention necessarily concentrates on the Federal Trade Commission. Section 5 of the F.T.C. Act and Section 2 of the Clayton Act, as amended by the Robinson-Patman Act, cut a wide swath. Both ban individual activities which "may" harm competition. This is a thoroughly estimable purpose so long as a particular proceeding makes sense in view of the over-all purpose of the antitrust laws to promote competition. Whether sense is made or not depends in large measure on the insight of the F.T.C., for a particular activity may be "competitive" in one market and "monopolistic" in another.

Generally speaking, the present Commission has said enough about delivered price policies to indicate that it knows what competitive and non-competitive uses are.

THE VIEWS OF THE F.T.C.

Critics of the "basing-point" cases, when not shouting "confusion and uncertainty," have insisted that the F.T.C. plans to press business pricing into the narrow mold of f.o.b. These complaints receive unwarranted support from Commissioner Mason. But the Commission's "official" statement of policy toward delivered price—issued in October 1948—is both specific and carefully confined.

Section 2 (a) of the Clayton Act prohibits price discrimination which may injure competition among sellers or buyers. With respect to competition among buyers, the Commission believes that showing of actual or sub-

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106. See, e.g., Head, supra note 2, at 650-1. The article is a hopeless misinterpretation of the cases and of what the FTC was after in trying them. An example follows. The FTC argued before the lower court in the New Cement case that direct collusion is not necessary to achieve a price formula that suppresses competition. Mr. Head cites the argument to support this conclusion: "The Commission has felt that this uniformity of price in a market is bad regardless of whether it is the result of agreement or competition." Id. at 643 (emphasis added).

107. See note 2 supra.

stantially probable injury from a delivered price policy must be made—the easier standard of "reasonable possibility" of injury will apparently not do. In competition among sellers, the test of injury from geographical price discrimination "is to be found in collusion or in tendencies toward monopoly." The problem under section 5 of the F.T.C. Act, states the Commission, is "merely the old one of price-fixing." The legality of any price system depends on whether or not it serves as a device for the elimination of price competition, and the answer is "one of fact in particular cases." Some types can be more readily used to achieve "typically identical prices" than others. F.o.b. pricing is not ordinarily suspect because it does not lend itself to an orderly industry-wide price system. With delivered price policies this result is more likely, and the inference of collusion increases as the industry price structure becomes "more rigid, more complex, and more inconsistent with immediate competitive interests." But freight equalization by a single or by several sellers raises no problem the Commission thinks, under the F.T.C. Act so long as "a pattern of pricing generally used" does not develop "with resultant matching of delivered price quotations." And uniform or zone-pricing by one of several sellers does not imply collusion where there are "simple and logical explanations in the nature of the market, the product, and the transportation costs." In every case of rigid price structure investigated, the Commission notes, it found "direct proof of collusion" in establishing and maintaining the system.

And to conclude: "In approaching these questions, the Commission sees no public interest and has no legal authority to proceed against the practices of a single seller except where probable or actual injury to competition appears in that seller's pricing practices."

Analysis of the FTC's Position

The Commission's views are well within the boundaries set by the cases. But there is an omission of opinion on a potentially dangerous feature of

109. *Id.* at 8. In other words, the FTC in dealing with delivered price systems will not make use of the full leeway granted by the *Corn Products* case, 324 U.S. 726, 738, 742 (1946); and by FTC v. Morton Salt Co., 334 U.S. 37, 47 (1948).


111. *Id.* at 1.

112. *Id.* at 2.


114. *Id.* at 3.


116. *Id.* at 4.

117. *Id.* at 2.

118. *Id.* at 9 (emphasis added).

For the individual views of six staff members of the FTC on various economic and legal aspects of geographic price systems, see 37 Geo. L.J. 135-231 (1949).
the Robinson-Patman Act, and the definition of standards under the F.T.C. Act is not so clear as it needs to be.

Clayton and Robinson-Patman Acts. It would be hard to quarrel with the Commission's insistence on a substantial showing of competitive injury to buyers in proceedings against an individual seller's price policy. As emphasized earlier in this discussion, such injury cannot be deduced merely from variation in a seller's net prices. Injury to particular buyers appears only in circumstances like those of the Corn Products and Staley cases.

The injury to buyers usually found in this field is that all are injured by a delivered price system that produces high price levels by decreasing competition among sellers. Yet here there is little reason to use the Clayton Act at all. It is not price discrimination that is important but the pattern of collusive or "parallel" behavior. The Sherman Act applies. Section 5 of the F.T.C. Act applies. The Clayton Act is superfluous and misdirected in emphasis.

There is an even stronger reason for avoiding the Clayton Act as amended by the Robinson-Patman Act. As the statute now stands, it threatens sporadic semi-concealed price-cutting. This activity is price discrimination, for some buyers benefit from the secret price and others do not. But it is such a powerful competitive force that industries adopt rigid delivered price systems to stop it. The Sugar Institute case was a perfect example. Use of the Robinson-Patman Act against sporadic hidden price-cutting would tend to calcify the prices that the antitrust laws in general are supposed to make flexible.

It is on this issue that the F.T.C. has failed to contribute much enlightenment. The Commission has clearly indicated that it does not consider injury to sellers to be involved: "Except where . . . a tendency toward monopoly appears, the Commission does not regard an effort to get business from a competitor by sporadic price reductions as illegally injurious to that competitor." But this gives no clue as to whether such activity is illegally injurious to other buyers.

For several reasons, however, the possibility of extensive use of Section 2 in this field is slight. First, the discrimination must affect competitive relationships among buyers. In an industry like steel, many buyers are simply not in competition with each other—for example, automobile manufacturers and the producers of toy tractors. Second, it may be hard to classify a hidden price-cut as discrimination where (a) the producer grants

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119. P. 435 supra. Zinkoff and Barnard question the Commission's position: "There does not appear to be any reason why the Commission should adopt one test of injury to competition in a basing point case and a different test in a quantity discount case." Supra note 2, at 1010 n. 98. But variation in quantity discounts is much more likely to be injurious than variation in net prices paid resulting from freight absorption—which by itself proves nothing at all with respect to injury.


121. FTC, supra note 108, at 7.
similar concessions to most buyers or within a short period of time open prices fall. Depending on timing, a concession may be in actuality the first indication of a price change, not discrimination. Third, a secret price concession is by definition one that is hard to find and prove. Fourth, a concession in the form of truck or water shipment is not discrimination if other buyers are subsequently given the same alternative. Fifth, the buyer who knows he is being discriminated against will complain to the seller before he runs to the F.T.C.—and he is likely to be appeased.

In summary, to bring the potential ill-effects of the Robinson-Patman amendment to full bloom would probably require extensive and speedy action by the F.T.C. against small, transient price variations. At present, fortunately, the Commission seems preoccupied with the rigid and systematic nature of delivered price systems, not with the petty internal discriminations that weaken their very structure.

The F.T.C. Act. The Commission recognizes that natural market factors may make such systems as uniform delivered price and zone-price perfectly legitimate. It stresses the factual nature of the problem. It points to "complex rigidity" as the warning sign of collusion. These views are accurate enough. But in two instances the Commission's "grounds for suspicion" are, if not inaccurate, at least not very clear.

The phrases "typically identical prices" and "matching delivered price quotations" are too broad to be signals for restraint on competition. With any standardized commodity, identity tends to be the rule, for no seller can set a price higher than his competitors' and hope to make sales. Perhaps a better statement of the criterion would be "reasonable flexibility." As a practical matter, an identity which is unbroken by hidden or open price-cutting over a variety of market conditions is the identity which deserves suspicion.

An even less fortunate choice of words occurs in presuming collusion where pricing is "inconsistent with immediate competitive interests." The phrase implies that every change in demand or cost should call forth an immediate response in price. But actual industrial patterns vary considerably. This requires a flexible standard for price response. Immediate competitive interests do not necessarily mean that a seller should take any lower price that remains above marginal costs. Inflexibility of quoted price in the face of minor changes in demand or cost, particularly where those changes are believed to be temporary, does not necessarily mean collusion. But some concealed price-cutting probably would result after a period of declining demand or after a substantial reduction in the sales of a particularly unfortunate seller, and that this would lead to a falling of the openly quoted prices. This type of price-cutting would normally result where a seller is not sure what his competitors are really doing. And uncertainty there will be unless producers have evolved an explicit or implicit plan for erasing it.

In short, there is little chance of confusing a competitive with a monopolis-
The FTC, despite occasional vagueness, is not likely to make a mistake on delivered price systems. It hasn't yet.

Review of the legal status of delivered price policies

The Commission's position does not evidently extend the scope of the anti-trust laws. If anything, the Commission is more conservative than the courts. There is no reason to change the conclusions drawn on the legal status of delivered price policies in the light of the cases. F.o.b. pricing is not required. Individual uniform delivered and zone-price systems are legal where delivery costs are small, where the systems are used with nationally advertised and marketed consumer goods, or where they are subject to other logical explanations consistent with effective competition.

Individual sellers in other types of industries may "absorb freight" freely when necessary to extend their markets and their competitors may do likewise. However, delivered price policies are put to illegal use if rigid industry-wide price structures emerge, or if rigidity appears in a substantial part of the market. Standardization of all terms of the price bargain is suspicious. And direct evidence of agreement or disciplinary measures against price-cutters makes the hiring of defense lawyers a waste of time and—since anti-trust lawyers come high—a great deal of money.

SUMMARY AND CONCLUSIONS

The cases culminating in the New Cement decision have caught up with delivered price systems and recognized them for what they are. The courts

122. As a practical matter, it is easy enough to separate competitive from non-competitive patterns of identical prices. Dr. Corwin Edwards, Chief Economist of the FTC, has given an excellent summary of the contrasting features:

"Under competition two forces are at work—the incentives which induce competitors to meet each other's prices, thus establishing identities, and the incentives which induce them to vary their prices thus destroying identities. . . . [U]nder competition prices are not likely to be continuously identical if the business opportunities of the sellers are different. One seller may have more good will than another. One may need new business badly, whereas another does not. . . . One may differ from another in his predictions about the trend of future sales. . . . Differences such as these lead to experiments by one seller which other sellers do not necessarily match or which they concur in only after hesitation and delay. . . . Even where there is formal conspiracy, the forces of competition are likely to break through from time to time and produce differences in price which the conspirators discourage by disciplinary measures. In general, brief and recurrent periods of price identity are not likely to offer any proof of conspiracy but long sustained identities when analyzed are likely to have been maintained at considerable sacrifice and by various artificial devices the purpose of which is to prevent prices from diverging."

Dr. Edwards also points out that collusive pricing, unlike competitive pricing, involves (1) such perfect knowledge of what "competitors" will do that identical sealed bids occur time after time, and (2) rigorous price leadership, with all price changes in an area made by the local mill. Statement prepared for delivery before Senate Subcommittee on Trade Policies, Dec. 8, 1948 (FTC Mimeo. Release, pp. 5-6). See also Edwards, Remarks before the Machinery and Allied Products Institute, Dec. 10, 1948 (FTC Mimeo. Release, pp. 3-5).
have thus informed business once more that the antitrust laws are concerned with illegal results, and not with the techniques employed to achieve them. The cases may make business men uncomfortable, but the peace of mind of monopoly is not yet a recognized reward for economic endeavor. It would become that if delivered price systems received the full sanction of law.

Nevertheless the decisions do not point the way to unvarying success in breaking the back of monopoly power. In basically non-competitive industries, it takes more than prohibitions of "basing points" to achieve this goal. The seeker of this result must choose either to reorganize drastically the market structure or to accept it as inevitably monopolistic and regulate it as such.