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Meeting Competition under Sales below Cost Statutes

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I. Introduction

This Comment examines the defense of meeting competition under statutes in force in a majority of jurisdictions which prohibit sales below cost for the purpose of injuring a competitor or destroying competition. The statutes have been aimed primarily at the institutional practice of "loss leader" selling in the retail grocery industry; hence, the statutes will be examined in that light. Examination will be made of reported cases at the trial and appellate levels and of opinions of attorneys general. A comparison with federal cases arising under the various federal antitrust laws will be made where helpful.

The statutes apply generally to wholesalers and retailers and prohibit selling below cost with the intent to injure a competitor or destroy competition, if the result would be to lessen competition substantially. In many states, the effect of injuring a competitor is made an alternative to the requirement of intent to injure as an element of the violation.

The statutes generally attempt to define cost as the lower of invoice cost or replacement cost, plus cartage (if paid for by the merchant), state and federal taxes, a presumed markup to cover the cost of doing business (usually six per cent), and less trade discounts (except discounts for the prompt payment of cash). The standard is, of course, artificial, since it requires that each product bear the same proportion of the cost of doing business despite differences in the cost of displaying and packaging different products, and because it makes the markup a percentage of invoice cost although it is usually expressed as a percentage of gross sales. Other objections could be urged; for example, a merchant who is able to prove that he has a lower cost is not required to use the statutory formula, but as a practical matter very few merchants go to the

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1 A complete compilation is found in 2 CCH Trade Reg. Rep. (10th ed.) 5510001-15505 (1958).
2 "Loss leader" selling in the retail grocery industry is the practice of advertising and selling certain products at a low price, usually below retailer's cost, in order to attract customers and increase the volume of business.
3 See note 36 infra for an "intent or effect" clause.
trouble and expense of computing their actual cost on specific items. This Comment uses the word "cost" in the statutory sense, that is, cost as computed under the statutory formula.

There are three types of sanctions provided for by the statutes: one may sue for damages as a result of being injured by the unlawful practices of his competitor; he may seek an injunction against his competitor for selling below cost in violation of the act; or the state may bring criminal action against a violator. Injunction seems to be the popular remedy.

In all but three states having below cost legislation, an exception is made permitting a merchant to cut his price below his cost in order to meet competition. This exception is granted upon three conditions: (1) some statutes permit a merchant to sell below cost "in good faith to meet the prices of a competitor" (subsequently referred to as "meeting competition" statutes); (2) others permit a merchant to sell below cost "in good faith to meet the legal prices of a competitor" (subsequently referred to as "legal price" statutes); and (3) the Oklahoma statute permits a merchant to sell below cost "in good faith to meet the price of a competitor who is selling . . . at cost to him . . . ."

II. NATURE OF THE STATUTORY EXCEPTION

A. Meeting Competition Statutes

In the states which allow the meeting of a price without reference to its legality, the term "good faith" means that a merchant

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8 An examination of the cases reveals that in most instances the plaintiff sought an injunction against the defendant.
9 Namely, Connecticut, Rhode Island, and South Carolina.
10 Idaho Code Ann. § 48-407 (1947). Kansas also has the exception worded in this form. The Arizona, Maryland, Massachusetts, Nebraska, Pennsylvania, and Wisconsin statutes word the exception as follows: "a price made in good faith to meet competition."
11 The Arizona statute was declared unconstitutional in part in State v. Walgreen Drug Co., 57 Ariz. 308, 113 P.2d 650 (1941); the Maryland statute was declared unconstitutional in Cohen v. Frey & Son, 197 Md. 586, 80 A.2d 267 (1951).
must intend to meet the price of his competitor. For example, in *Kansas v. Commercial Candy Co.*, the plaintiff sought to enjoin the defendants from selling below cost. The defendants answered that their competitors were selling at the price complained of by the plaintiff. The supreme court reversed the judgment for plaintiff, stating that while the defendants had the burden of proving facts entitling them to the benefit of the exception, this meant that they must prove simply "that they made the sales in question in good faith to meet the price of a competitor in the same locality," and were not required to show that the price they were attempting to meet was itself legal. In accord is *Cohen v. Frey & Son*, in which the court stated that the word "legal" was omitted from the statute and the court could not insert it.

**B. Legal Price Statutes**

Under this type exception, the initial question is whether a merchant can take advantage of the good-faith exception when he knows that the price he is meeting is an illegal one. The Attorney General of Utah has stated that the good-faith exception is not available to one selling below cost if he knows that his competitor's price is unlawful, for in such instances he will not be endeavoring "in good faith to meet the legal prices of a competitor." And the Oklahoma Supreme Court in a recent case denied use of the good-faith exception by Safeway Stores because it set prices "for the sole purpose of meeting prices . . . which it thought to be illegal." Thus, it would seem that in the legal price statutes, the phrase initially means that the merchant must believe that the price he is meeting is a legal one.

The statutes declare a price illegal when set with the intent to

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14 201 P.2d at 1039.
15 197 Md. 586, 80 A.2d 267 (1951). This should be contrasted with the approach taken by the Maryland Circuit Court for Anne Arundel County in Obrecht v. Kotzin, CCH Trade Reg. Rep. (1950-1951 Trade Cas.) ¶ 62694, at 64017, 64018 (Md. Cir. Ct. Aug. 28, 1950), where the court stated that "If one distributor can lower his price and keep it lowered just because another does, or others do, then we have a vicious circle where everyone lowers his prices to meet the competition of others, and the law becomes unenforceable. . . . While the word 'legal' is not in the exception on which the defendant relies, I think it is implicit that the competition therein referred to is 'legal competition' . . . ." The problem is now moot in Maryland because the court in the Cohen case declared the statute unconstitutional because of the indefinite nature of the cost provisions. 16 Op. Att'y Gen. of Utah, CCH Trade Reg. Rep. (1952-1953 Trade Cas.) ¶ 67410, at 68079 (Dec. 31, 1952).
17 Safeway Stores, Inc. v. Oklahoma Retail Grocers Ass'n, 122 P.2d 179, 181 (Okla. 1942). Although Oklahoma is not a "legal price" state, the interpretation of its good-faith exception in this respect, would be the same as in the legal price states. See text on the Oklahoma statute infra.
injure a competitor or destroy competition. Therefore, since a merchant in a legal-price state may meet only a price which he believes is a legal one, the interpretation of the phrase "intent to injure" is of first importance. To date, the courts which have discussed the matter have seriously divided as to its meaning. Thus, in \textit{Sandler v. Gordon},\footnote{94 Cal. App. 2d 258, 210 P.2d 314 (Cal. Dist. Ct. App. 1949).} the court found that the plaintiff had sold below cost. The plaintiff testified that his purpose was to increase his business and that he did not care from whom he got the business. The court held that this evidence was sufficient to rebut the presumption that the plaintiff's sales were made for the purpose of injuring a competitor or destroying competition. In \textit{Henderson v. Hogue},\footnote{CCH Trade Reg. Rep. (1956 Trade Cas.) § 68462, at 71933 (Tenn. Dist. Ct. App. Aug. 23, 1956).} the court held that the defendant had not violated a Tennessee milk act simply because he used milk as a loss leader for the purpose of attracting customers. And in \textit{Ellis v. Dallas},\footnote{74 N.E.2d 841 (Ohio Ct. C.P. 1946), aff'd, 74 N.E.2d 813 (Ohio Ct. App.), aff'd, 148 Ohio St. 119, 76 N.E.2d 91 (1947).} the trial court found that the defendant had made sales below cost for the purpose of inducing, promoting, and encouraging the purchase of other merchandise, but not for the purpose of injuring plaintiffs or destroying competition.

In \textit{Serrer v. Cigarette Serv. Co.},\footnote{12107 Colo. 38, 108 P.2d 529 (1940).} however, the defendants indiscriminately sent cards to their retailers advertising the defendants' prices. The court stated that this showed an intent to procure business from other wholesalers (not just to retain customers), and thus to injure competitors. In accord with this approach is \textit{Dikeou v. Food Distributors Ass'n}, which held that the defendants had violated the Colorado statute because "it may be presumed in a civil action that the natural and probable consequences of the act were intended by the actor."\footnote{107 Colo. 38, 108 P.2d 529 (1940).}

The statement just quoted points up the essential conflict between those cases which find an intent to injure and those which do not, for if a merchant intends to increase his business, he knows he must do so at the expense of his competitors, assuming relative inelasticity of demand in the industry. Consequently, under the \textit{Dikeou} approach, if he is successful in increasing his own business he had the intent to injure because he presumably intended the reasonable consequences of his act. Under the approach of the \textit{Sandler} case, however, it is a specific intent to injure which the statute requires.

The effect of the \textit{Dikeou} approach is to render the good-faith
exception meaningless, since any merchant who reduces his prices below cost "intends" to injure his competitor, and a competitor who loses volume as a result of the price cut cannot meet his competitor's below-cost price. In other words, the competitor's knowledge that he is injured by the first merchant's below-cost sales is equivalent to knowledge that the price to be met is illegal, and the competitor is therefore barred from pleading good faith if he cuts his prices to meet the lower price. Acceptance and application of the Dikeou approach would stifle effective competition among merchants. Furthermore, in the "intent or effect" states, the phrase "or effect" is superfluous if the Dikeou approach is used.

The writer believes that the better approach and the correct one for purposes of statutory construction is recited in the Sandler case, which held that only unfair diversion of trade is condemned and implied that the only unfair diversion is one which has the ruination of a competitor as its specific and primary purpose. The good-faith exception itself becomes meaningful only when this definition of intent is used. We may conclude, therefore, that the statutes contemplate the treatment of various intents and purposes as mutually exclusive; that is, proof of the intent to meet competition in good faith will negative an intent to injure a competitor or destroy competition.

Once a merchant has demonstrated that he thought he was meeting a legal price, is it of any consequence whether that price was legal in fact? In commenting on this problem, the Supreme Court of Washington stated that "if a merchant in good faith reduces his prices to meet those of a competitor who he in good faith believes has a legal price, he will not be violating either the intent or the wording of the act." Under this approach, it would seem immaterial whether the price met was lawful in fact.

A contrary position was taken by the Attorney General of Utah...
in an opinion stating that a merchant does not come within the exemption privilege if he sells at the actual but unlawful prices of a competitor although lacking knowledge that the competitor’s prices are unlawful. “One may endeavor to meet the ‘legal’ but not the ‘illegal’ prices of a competitor.” Of similar import is the statement of the Attorney General of Minnesota that a merchant wishing to take advantage of the meeting-competition defense must show that his competitor’s price is legal.

This approach seems unsound and out of harmony with the language and purpose of the statute. A merchant, of course, has the burden of proving facts entitling him to the benefit of the exception; that is, he must prove his “good faith.” But once this burden is met, it would seem that the merchant has done all that he is required to do under the statute. This proposition was stated by the Supreme Court of Minnesota, contrary to the opinion of the Attorney General, supra:

If a merchant in good faith sets the price of an article on the basis of a competitor’s price, which price he in good faith believes to be a legal one, there is no violation.

Indeed, the very qualification of “good faith” would seem to obviate any necessity for proving the absolute legality of the competitor’s price, and certainly the position taken by the two attorneys general, previously mentioned, renders the good-faith qualification meaningless. Furthermore, there are practical objections to such an
approach. In *State v. Packard-Bamberger & Co.*, the supreme court made the following observation:

How a person is to determine the legality of the price of a competitor is not declared, and the impracticability, if not the impossibility of determining the "legality" of a competitor's price is obvious.  

C. A Procedural or Substantive Defense?

A question never directly considered by any state court is whether the defense of meeting competition is procedural or substantive. The statutes declare that evidence of sales below cost is prima facie evidence of the intent to injure a competitor or destroy competition, thus shifting to the defendant the burden of proving some other purpose sufficient to rebut that presumption. Thus, if the defense is substantive, proof of meeting competition in good faith is sufficient to exempt the defendant from the operation of the statute; if the defense is procedural only, proof of meeting competition in good faith would have only the effect of requiring the plaintiff to go forward with further proof of his allegations of unlawful pricing.

In three cases, the courts have had occasion to make statements which indicate the trend of judicial thinking on the question. In *Cohen v. Frey & Son*, the Maryland Court of Appeals states that section 114 provides that the provisions of the act shall not apply to sales "where the price of merchandise is set in good faith to meet competition" or in seven other enumerated cases. Manifestly, these eight cases are not exceptions to the prohibition of sales at less than cost with intent to injure a competitor. Section 114 is a statutory declaration that these eight cases are not to be regarded as sales with intent to injure a competitor.  

Of similar import is the statement in *State v. Wolkoff*, previously referred to:

If a merchant in good faith sets the price of an article on the basis of a competitor's price, which price he in good faith believes to be a legal one, there is no violation. (Emphasis added.)

Finally, in *Kansas v. Commercial Candy Co.*, the court had occasion
to remark that "even if sales by the defendant resulted in injury to other competitors and tended to destroy competition, such sales must be made with the intent to bring about those results to constitute a violation." A fair inference from the language in these cases is that these various state courts would hold that the defense is substantive rather than procedural.

There is evidence in the statutes to indicate that this is the correct result. First, in those statutes which require a specific intent, there can be no violation unless the trier of fact finds specifically the requisite intent. Since, as stated in State v. Wolkoff, proof that prices were set on the basis of competitors' prices "would fairly negate any claim that the prices were established to injure competitors or destroy competition," a finding of the latter fact would in most instances preclude a finding of the former. The problem is somewhat different in those statutes which proscribe sales below cost when made with the intent or effect of injuring a competitor or destroying competition. This was the question in Standard Oil v. FTC. The Commission held that evidence that Standard was meeting competition was irrelevant in the face of a finding that the effect of Standard's low prices was to injure, prevent, and destroy competition. In the course of its opinion reversing the Commission, the Supreme Court stated:

The proviso in §2(b) as interpreted by the Commission, would not be available when there was or might be an injury to competition at a resale level. So interpreted, the proviso would have such little, if any, applicability as to be practically meaningless. We may, therefore, conclude that Congress meant to permit the natural consequences to follow the seller's action in meeting in good faith a lawful and equally low price of a competitor.

Moreover, the statutes themselves afford ample evidence that in the "intent or effect" statutes the defense is substantive rather than procedural. The statutes in these states (and in the specific intent states) invariably set out exceptions to the operation of the act, prefacing

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24 201 F.2d at 1039.
25 85 N.W.2d at 407-08.
26 "Any retailer who, with intent, or effect, of injuring competitors or destroying competition, advertises, offers to sell or sells at retail any item of merchandise at less than cost to the retailer . . . shall be fined . . . ." N.H. Rev. Stat. Ann. § 358:2 (1951). The intent or effect states are Arizona, Idaho, Kansas, Louisiana, Minnesota, Nebraska, New Hampshire, North Dakota, Oregon, Pennsylvania, Tennessee, Utah, and Wisconsin.
28 Id. at 250. Technically, the issue in the Standard Oil case was whether Standard's discriminatory pricing was exempted by the "good faith" exception in the Robinson-Patman Act, 49 Stat. 1528 (1936), 15 U.S.C. § 13(a) (1952), but the legal issue is the same as in below-cost legislation.
the exceptions with such declarations as "the prohibitions of this Chapter . . . do not apply to any sale made . . . ." which are followed by a list of circumstances in which the statutes are inapplicable. By the plain language of the statutes, then, sales made in good faith to meet the prices of a competitor are not within the ban of the act, and any merchant who can bring himself within the exception has not violated its terms, although the effect of his sale below cost is otherwise prohibited by the statute.

D. Statutes Having No Express Exception

What of the defense in Connecticut, Rhode Island, and South Carolina, the three states having no express exception for meeting competition? Logically, the defense is available. The statutes in these states purport only to prohibit sales below cost when made with the intent to injure a competitor or destroy competition. In this case, the defense is implicit: one who sells below cost for the purpose of meeting competition probably does not intend to injure his competitors. In *Ben Hur Coal Co. v. Wells*, the plaintiff brought suit for treble damages, alleging that the defendant had sold at unreasonably low prices for the purpose of destroying competition or eliminating a competitor. The district court found that the defendant's actions had been prompted by the shrinkage of the competitive market, a decline in the prices set by immediate competitors, pressure from wholesale customers, and a desire to maintain and increase profits. The district court also found that the defendant's prices were not low in relation to competitive prices for like products and that the defendant had no intent to injure his competitors. The circuit court affirmed the judgment for the defendant, stating that "one who reduces his prices in defense of his economic life cannot be guilty of eliminating competition or his competitors."

The defense, then, in states having no express exception for meeting competition but requiring proof of a specific intent to injure a competitor or destroy competition, is presented by way of direct rebuttal to the allegations and not by affirmatively pleading an exception. Therefore, the defense of meeting competition is probably substantive; that is, proof of the intent in good faith to meet a com-

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41 242 F.2d 481 (10th Cir. 1957).
42 Id. at 486.
petitor's price would negative an intent to injure a competitor or destroy competition. It should be noted that the approach outlined above for the three states mentioned is also available in states which have the express statutory exception. Therefore, a defendant charged with violation of the act who did not wish to rely solely on this exception could plead the various factors which prompted his decision to sell below cost. Logically, he has not violated the statute because he has not sold below cost with the intent to injure a competitor or destroy competition. As indicated previously, when proof of the specific intent is required, the defense should still be substantive. But if a merchant in an "intent or effect" state pleads outside the statutory exception, his defense in all likelihood would be procedural only, since he would have no express statutory exception to rely upon when confronted with positive evidence that the effect of his sale below cost was to injure a competitor. His action is condemned as a matter of law when it has the prohibited effect but for the express exception. Having pleaded none, the defense logically falls.

E. The Oklahoma Statute

As stated earlier, a merchant in the legal-price states may meet a price which he believes to be legal; in the meeting competition states and in those states which have no express exception, a merchant presumably may meet any price his competitor sets, so long as the merchant does not intend to injure a competitor or destroy competition; and in those states where intent to injure is a necessary element of the violation, a merchant may plead outside the statute if he can prove that he had no specific intent to injure a competitor or destroy competition.

The problems are different, however, in Oklahoma, where the good-faith exception permits

any retailer or wholesaler [to] advertise, offer to sell, or sell merchandise at a price made in good faith to meet the price of a competitor who is

43 See notes 10 and 11 supra for a list of states having an express exception.
44 In fact, pleading outside the exception should give a broader defense than pleading the exception, since one would not be burdened with the necessity of proving that he believed in good faith that his competitor's price was legal. But cf. People v. Pay Less Drug Store, 143 P.2d 762 (Cal. Dist. Ct. App. 1943), aff'd, 25 Cal. 2d 108, 153 P.2d 9 (1944); Safeway Stores, Inc. v. Oklahoma Retail Grocers Ass'n, 322 P.2d 179 (Okla. 1957). The courts in those cases seem to adopt an "either-or" approach—either the defendant is within the statutory exception, or he has acted in violation of the statute. This approach, of course, cannot be logically harmonized with the language of the statutes.
46 But see note 44 and accompanying text.
sells the same article or products of comparable quality at cost to him as a wholesaler or retailer. (Emphasis added.)

As in the legal price states, a merchant in Oklahoma surely can take advantage of the exception if he believes in good faith that he is meeting a competitor who is selling at cost or above. And, by pleading outside the statutory exception, a merchant should be able to meet the price of a competitor selling below cost, if the merchant has no intent to injure a competitor or destroy competition. The only Oklahoma case to discuss the matter, however, apparently held to the contrary. In this case, the supreme court denied the defendant the use of the exception because the defendant thought it was meeting an illegal price; logically, this denial required that the decision be based on extrastatutory grounds. Although the court found that the defendant's "sole purpose" was to meet the price of its competitors, it enjoined the defendant from selling below cost. A defense outside the statute, then, is probably not available in Oklahoma.

The operation of this exception can best be explained through analysis of a series of hypothetical examples, since there are no reported decisions discussing it. Assume that the statutory cost of coffee for both A and B is $1.00 per pound, but that merchant A sells the coffee for 99¢. Merchant B reasonably believes that A is selling at or above his statutory cost. B may meet the price of A by selling his coffee at 99¢ per pound since the fact that A is selling below statutory cost is immaterial once B has established his good-faith belief that A is selling at or above cost. But suppose that A, wishing to increase his business by offering a special price on coffee, sets his price at 90¢ per pound. Under the Oklahoma exception, B cannot meet this price; he could not believe in good faith that A was selling at cost or above because the price differential is too great. In

48 But cf. the statement of the trial court in Oklahoma Retail Grocers Ass'n v. Safeway Stores, Inc., CCH Trade Reg. Rep. (1955 Trade Cas.) ¶ 68195, at 70906, 70910 (Okla. Dist. Ct. Oct. 21, 1955): "The logical presumption ... would be that the defendant Safeway should know that something was wrong with the competitor's price .... [T]hey can probably buy as cheap, or cheaper, than anyone else, and should know that there was something wrong." Apparently, if a chain store, or perhaps a large independent, sells below cost, it cannot be in good faith, since it has a presumed lower cost. Thus, these merchants can safely meet a price only when it is in fact at or above the competitor's cost.
49 Safeway Stores, Inc. v. Oklahoma Retail Grocers Ass'n, 322 P.2d 179 (Okla. 1957).
50 This statement assumes, of course, that the merchant is able to get around the presumption discussed in note 48 supra.
51 The trial court remarked, "As I understand the Act ... if—store 'B' ... has been able to make a good deal ... store 'C' would be permitted to meet that competition ...." Oklahoma Retail Grocers Ass'n v. Safeway Stores, Inc., CCH Trade Reg. Rep. (1955 Trade Cas.) ¶ 68195, at 70906, 70910 (Okla. Dist. Ct. Oct. 21, 1955).
Such an instance, the Oklahoma Supreme Court has said that "the appropriate remedy is by injunction."\textsuperscript{52}

The injunctive remedy suggested by the court may be small consolation, however, for section 598.5 of the statute permits the issuance of an injunction only when there is a "violation or threatened violation" of the act.\textsuperscript{53} Section 598.3 declares a below-cost price illegal only when set

\textbf{with the intent and purpose of inducing the purchase of other merchandise or of unfairly diverting trade from a competitor or otherwise injuring a competitor.} \textbf{... where the result of such sale is to tend to deceive any purchaser, or to substantially lessen competition, or to unreasonably restrain trade, or to tend to create a monopoly in any line of commerce.}\textsuperscript{54}

This statutory language indicates that obtaining an injunction is not as simple as the Oklahoma court intimated. As stated earlier, merchant A intends only to build up his own business. This purpose involves no specific intent to injure competitors or destroy competition. Likewise, only the unfair diversion of trade is deemed contrary to the act. The issue, then, becomes whether A is guilty of "inducing the purchase of other merchandise." The phrase "or otherwise injuring a competitor" refers to the language immediately preceding it in the statute and suggests that "inducing the purchase of other merchandise" is, as a matter of law, done with the intent to injure a competitor.\textsuperscript{55} Despite this implication, a similar "loss-leader" provision was construed by a California court to require the finding of a specific intent to injure in order to constitute a violation.\textsuperscript{56}

\textsuperscript{52} Safeway Stores, Inc. v. Oklahoma Retail Grocers Ass'n, 322 P.2d 179, 181 (Okla. 1957). In this case, the court refused to enjoin Safeway's competitors from giving trading stamps with sales at statutory cost, since a trading stamp is not a reduction in price, but a "cash discount." See the section on trading stamps, infra.

\textsuperscript{53} Okla. Stat. tit. 15, § 598.5 (1951).

\textsuperscript{54} Okla. Stat. tit. 15, § 598.3 (1951).

\textsuperscript{55} However, it may create only a rebuttable presumption. This approach would go far toward harmonizing the particular language quoted with Okla. Stat. tit. 15, § 598.5(c) (1951), which raises a presumption that any sale below cost is illegal. If this is the case, then the language quoted has no independent effect.

\textsuperscript{56} Ellis v. Dallas, 113 Cal. App. 2d 234, 248 P.2d 63 (1952). Cal. Bus. and Prof. Code § 17030 defined a "loss leader" to mean, \textit{inter alia}, a product sold for the purpose of inducing, promoting, or encouraging the purchase of other merchandise; § 17044 declared that the "practice of using any article or product as a 'loss leader' is included among the prohibitions of this chapter." Still, the court held that a loss leader was proscribed only when there was an intent to injure competitors or destroy competition. Subsequent to the decision in the Ellis case, the legislature amended § 17044 to read: "It is unlawful for any person engaged in business within this State to sell or use any article or product as a 'loss leader' as defined in Section 17030 of this chapter." (amended by Stat. 1953, ch. 334, § 1). However, a California lower court recently stated that the amendment of § 17044 did not change the result of the Ellis case. Northern Cal. Food Dealers v. Farmers Market, CCH Trade Reg. Rep. (1956 Trade Cas.) § 68402, at 71723.
Under this approach, whatever its merits, the injunction could not issue, unless in addition to finding that A sought to "induce the purchase of other merchandise," a court also found that A did so with the specific intent to injure a competitor. Under the alternative approach, that an intent to "induce the purchase of other merchandise" is as a matter of law the intent to injure a competitor, the injunction is still only problematical, for there is no violation under the statute unless the requisite intent is accompanied by one of the results enumerated in the statute, viz., deception, the substantial lessening of competition, the unreasonable restraint of trade, or the tendency to monopoly. Only if one of these be the result or probable result can A be enjoined. It is doubtful if there is any deception of the purchaser, since he can purchase his coffee for 90¢ and is not required to make any other purchases in order to receive this bargain. Whether any of the other results are present is a question which could only be answered through analysis of the prevailing market conditions in the trade area. If A is a small independent grocer with one store, it is difficult to see how his actions would be accompanied by any of the prohibited results; if A is a chain store, or a large independent, the injunction may well issue. B, therefore, may be in the anomalous position of being able neither to meet A's price nor enjoin it.

To take another example: A competes with B; B is a competitor of C, but C and A are not competitors because they are not in the same trade area. The statutory cost of coffee to A is $1.00 per pound, while the statutory cost of coffee to B and C is $1.05. If A sells his coffee at $1.00, B may match A's price and also sell coffee at $1.00. C cannot sell at that price; C is B's competitor, not A's, and the exception which permits B to meet A's prices denies C the right to meet B's prices.

Meeting a competitor's lawful price in Oklahoma is not permitted when the competitor is selling below his cost, although the statute in other sections purports to prohibit sales below cost only if made with intent to injure a competitor. Regulation of this sort is of no value.

(Cal. Super. Ct. June 29, 1956). Apparently, the Ellis case is still the prevailing view in California.

And, if the presumption is only rebuttable, a finding of the specific intent to injure would be necessary.

Safeway Stores, Inc. v. Oklahoma Retail Grocers Ass'n, 322 P.2d 179 (Okla. 1957). The supreme court enjoined the defendant although it found that the defendant's sole purpose was to meet its competitors' prices. The defendant was denied the use of the "good faith" exception because it thought it was meeting illegal prices.
A word remains to be said as to when the prices of competitors may be met. Although the writer could find no authority on this point, it is believed that the price cannot be met in advance; meeting competition, as an economic concept, is defensive in nature, and the exception can be relied on only when a merchant can demonstrate that his competitor set the lower price first. Outside of this qualification, the price can be met anytime after that lower price has been set. After a merchant's competitor has restored his price to the former level, the exception is no longer available to the merchant.

IV. PRODUCT DIFFERENTIATION

Many of the statutes limit a merchant to meeting the price or legal price of a competitor who is selling the "same" product, others use the phrase "the same article or products of comparable quality," and still others have no qualification of this type. The qualification expressed in the first two groups is fairly implied in the last, however, for the terms "meeting a competitor's price" or "meeting a competitor's legal price" can be fully understood only by reference to the product on which the competitor has set his lower price. Accurate definition of the word "same" or the phrase "same article or products of comparable quality" is therefore relevant to all three groups.

There is a paucity of authority on this matter. The three times the phrase has been construed, either expressly or impliedly, one court and two attorneys general have opined that a brand name alone is not determinative of whether goods are the same or of comparable quality. Furthermore, this authority comes from jurisdictions which either employ the word "same" in the statute or have
no express qualification. On this point, therefore, the interpretation of the statutes, regardless of form, would seem to be uniform. Yet, what other factors are pertinent? Should the raw materials used be considered? Is the manufacturing process a criterion? Or is price the determining factor? Is one of these criteria or some combination of them valid for one product and invalid for another? Further discussion of this problem will assume with a California court that the word "same" in the statute means "the same or similar," and that in the absence of an express qualification a merchant under the statute may meet his competitor's price on the same or similar products. This approach is best calculated to harmonize this portion of the statute with its declared purpose to prohibit sales below cost when made with the intent to injure a competitor or destroy competition.

The most important criterion, within statutory limits, should be whether the goods are substitutes for each other. To illustrate: suppose a store sells canned spinach, fresh spinach, and frozen spinach. Are these products all substitutes for each other because they are all spinach? Or is the market to be appraised in terms of canned vegetables, fresh vegetables, and frozen vegetables? From the consumer's standpoint, no satisfactory answer can be given; the factors governing his choice at one time are not necessarily determinative at another, that is, the consumer may on one occasion want simply "a vegetable," on another "a frozen vegetable," and on another "some kind of spinach." The interpretation of the statutory language hinges upon this sort of determination, difficult as it may

68 Cf. Gamco, Inc. v. Providence Fruit and Produce Bldg., 194 F.2d 484 (1st Cir. 1952), cert. denied, 344 U.S. 817 (1952).
70 An analogous problem has arisen with respect to the interpretation of the phrase "like grade and quality" in the Robinson-Patman Act, 49 Stat. 1528 (1936), 15 U.S.C. § 13(a) (1952), but one should not fall into the trap of using Robinson-Patman cases as conclusive authority in this area. That act was designed, at least in part, to prevent unfair discrimination by a seller which would give to his purchaser a competitive advantage at a resale level, a purpose not present in below cost legislation, which was designed to prevent unfair competition between sellers at the same distributional level. Another difference is that under the federal act, the plaintiff must prove that the products were of "like grade and quality" in order for the act to apply, while under below cost legislation, proof of the similarity of products sold is a part of the defense to a charge of illegal pricing. See Rowe, Price Differentials and Product Differentiation: The Issues Under the Robinson-Patman Act, 66 Yale L.J. 1, 8 (1956).
71 Cf. the discussion in Samuelson, Economics 476-93 (2d ed. 1951).
be. The statutory language seemingly contemplates a physical identity between the products claimed to be competitive, and this is the normal meaning of the word "same" and the meaning best calculated to insure effective administration of the statutes.

The following test is proposed for determining whether the products are the same or similar:

1. The products must be physically identical. This requirement is construed broadly enough to encompass differences in processing and manufacturing; that is, canned spinach, fresh spinach, and frozen spinach are physically identical products.

2. A change in the price of the physically identical products in one form must stimulate or retard substantially the demand for the products in other forms. In other words, there must be a great cross-elasticity of demand between the products in the various forms: if a change in the price of product A stimulates or retards substantially the demand for product B, the second test is met.

This test is broad enough to be applied to different brands of identical products (e.g., brand A frozen spinach and brand B frozen spinach) as well as to different finished forms of the same basic substance (e.g., frozen spinach and canned spinach). It also permits a consideration of the variables of quality and quantity. A change in the price of a twenty ounce can of brand A pears may substantially affect the demand for a twenty-eight ounce can of brand B pears. If this is so, the statute permits a merchant to meet a price cut in a twenty ounce can of brand A with a price cut in a twenty-eight ounce can of brand B. The suggested approach is, of course, quite flexible, and allows ample latitude for equitable results in particular situations.

V. Price Differentials

The issue of price differentials is inextricably bound with the problem of product differentiation. Quite often, slight differences in what is essentially the same product will result in the two products' being sold for different prices. A question thus arises as to the treatment of price differentials under the statutes.

72 See Bain, Pricing, Distribution, and Employment 51 (rev. ed. 1953): "precisely defined, it should be noted that cross-elasticity measures simply the tendency of buyers to shift from one good to another when the price of the latter changes, regardless of the ability or disposition of the sellers of the latter to supply them."

73 Caution, however, should be used in applying this test. If there are several brands competing with each other, a change in the price of brand A may effect only a small change in the demand for each competing brand. In such a case, the test contemplates measuring the effect of the change in A against the sum total of changes in demand for all other competing products.
The simplest case has been discussed by the Attorney General of Wisconsin. Chain stores were selling their own bread at 19¢ per loaf and the bread of local bakers at 25¢ per loaf. Independent merchants also sold the local bread at 25¢ per loaf. The question posed was whether the independent merchants could sell local bread at 19¢ per loaf to meet the competition of the chain store bread. The Attorney General held that if the local bread for which consumers were willing to pay a higher price were sold at the lower price, a claim of meeting competition in good faith could not be sustained.

This approach is sound. Effective competition at the retail level often exists between similar products sold at different prices. Courts have declared that state agencies regulating prices may take into account this price differential when fixing the prices to be charged for the regulated product. Our task is to determine whether the sales below cost statutes recognize this economic fact.

The statutes permit a merchant to meet the "price" or "legal price" of a competitor selling products of comparable quality. This language does not require that competition take place solely between goods of the same price. As previously noted, the word "same" is uniformly construed to mean "comparable" with regard to the brand of the product concerned. The fair inference is that only similarity, not identity of price, is required by the statutes.

For example: brand A sells at 30¢ per unit; brand B sells at 27¢ per unit. If a merchant (assuming he can legally do so) reduces the price on brand A to 27¢, his competitor may reduce his price on brand B to 24¢ per unit, if the test outlined in the preceding section of this Comment is met. The more difficult question is whether brand B can be reduced below the price of 24¢ per unit.

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66 Borden's Farm Products Co. v. Ten Eyck, 297 U.S. 251 (1936). This case held, over claims of unconstitutionality, that the New York Board of Health could order well-advertised brands of milk sold at 1¢ per quart more than unadvertised brands: "there had resulted . . . a balance maintained by a price differential. To attempt the maintenance of that balance was to strive for equality of treatment . . . ." 297 U.S. at 262.
68 The burden of proof may be difficult. To establish good faith, a merchant should be prepared at least to show that a price differential had existed long enough to establish a competitive equilibrium at the former price levels.
If this can be done at all, it can probably be done only upon a showing that the lower price of 24¢ was not sufficient to re-establish the competitive equilibrium historically existing between the two products.

The reverse is equally true, as indicated by the Attorney General in the opinion discussed above. The merchant in the preceding example who reduced his price on brand A to 27¢ could hardly justify his action on the theory that he was meeting competition; to hold that he was meeting competition in good faith would be to exalt form over substance because the merchant who sets brand A at 27¢ will effectively beat the competition of brand B. The matter was succinctly stated by the Attorney General's National Committee to Study the Antitrust Laws:

Here a mechanical test would defeat the objective of permitting a realistic equalization of an actual competitive situation. An inflexible cent-for-cent rule would enable a seller of the preferred commodity in fact to undercut the price for a less desirable product, or conversely, deprive a seller of the less popular product of the full benefit of the "meeting competition" defense. We therefore urge a flexible rule which regards the nominal price of the rival product as only a presumptive boundary of a seller's permissible price reduction under the "meeting competition" proviso, adjustable up or down upon satisfactory proof by the person questioning its reliability. In practical operation, such a test in some circumstances necessarily must permit a seller of a less accepted brand to cut substantially below the more popular product's price. . . . In each case, the heart of the matter is whether actual competition, not merely a nominal price quotation, is realized.\(^7\)

There is another aspect to the problem of price differentials: may a merchant offset added services of his competitor by a lower price? Ostensibly, this problem is solved through the cost provisions of the statutes; that is, a merchant who offers no added services will have a lower cost, which presumably will enable him to set lower prices. But this remedy is more illusory than real. For example, a merchant selling on credit—a service which may be of great value to the purchaser—may always lower his price to meet his cash competitor's price. Further, the practical difficulties of computing the cost of doing business for a particular item are almost insurmountable. Furthermore, since the writer has found no

\(^7\) Att'y Gen. Nat'l Comm. Antitrust Rep. 184 (1955). Situations could be multiplied ad infinitum. As a practical matter, a merchant will probably prefer to reduce his own brand selling at the same price as the brand on which his competitor reduced his price; but the statute does not require this. Cf. Comment, The Meeting Competition Defense Under Section 2(b), 49 Nw. U.L. Rev. 261, 266-67 (1954).
case in which a merchant attempted to prove that his cost of doing business was less than what the statute presumed, it seems that virtually all merchants use the statutory formula in calculating cost for any single item.

For one Ohio court, the statutory policy of declaring the cost of doing business the same for all merchants, regardless of the services offered, discriminated against cash-and-carry merchants vis-a-vis merchants who extended credit, and the entire statute was declared unconstitutional because it destroyed the "natural competitive advantage resulting from lower prices, based upon lower costs . . . ."\(^{80}\) In another case, the Supreme Court of Minnesota expressly rejected this argument of unconstitutionality by declaring that

sufficient answer is furnished by the act itself in the exemption . . . of sales made by any merchant "in an endeavor made in good faith to meet the local [sic] prices of a competitor . . . ."\(^{81}\)

It is a fair inference that the Minnesota opinion supports the argument that under the exemption a cash-and-carry merchant can legally sell below cost in order to offset the added services rendered by the credit merchant. The policy underlying this argument is sound. But the writer cannot agree with the Minnesota court that the cash merchant is statutorily entitled to sell below cost, for the meeting-competition exception deals with the competitive pricing of commodities _qua_ commodities and its language will not support the Minnesota approach.

This does not mean, however, that there is no remedy available to the cash-and-carry merchant in this situation. Before he has violated the statute, he must be guilty of selling below cost with the intent to injure his competitor, or with the effect of injuring his competitor; thus, he may seek his remedy outside the exception. But, since the meeting-competition defense does not protect him in this situation, he must recognize the possibility that his competitor who gives credit will follow him down, price for price.

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\(^{80}\) Serrer v. Cigarette Serv. Co., 74 N.E.2d 841 (Ohio Ct. C.P. 1946), aff'd, 74 N.E.2d 853 (Ohio Ct. App.), aff'd, 148 Ohio St. 519, 76 N.E.2d 91 (1947). Cf. Florida Dry Cleaning and Laundry Bd. v. Everglades Laundry, 137 Fla. 290, 198 So. 380, 382 (1939): "There is a distinct difference between delivery and the cash and carry aspect of the laundry and dry cleaning business. . . . In fixing a schedule of prices, it is the duty of the Board . . . to take into consideration these elements and establish a differential in charges between the two methods accordingly."

\(^{81}\) Fredricks v. Burnquist, 207 Minn. 590, 292 N.W. 420 (1940). The statute reads "legal."
VI. Trading Stamps

To date, the courts and attorneys general who have considered the impact of trading stamps on below cost legislation have uniformly held that a trading stamp is a "cash discount" rather than a reduction in price. Their rationale runs something like this: A merchant cannot sell below a certain price; a trading stamp is a cash discount; a cash discount does not reduce price; *ergo*, giving a trading stamp with sales at statutory cost does not reduce the price below cost. This approach is artificial and demonstrably erroneous.

One need not quarrel with the terminology, for it makes no difference what one calls a trading stamp; the result is that the consumer gets a token of value in addition to the article he purchases. If merchants $A$ and $B$ sell coffee at $1.00$ per pound, and $A$ gives trading stamps with the purchase, the consumer is getting more for his money, no matter how it is phrased. A court which maintains that the net result to the consumer is the same in both instances is ignoring the facts.

Why do courts follow this line of reasoning? One obvious explanation is their acceptance of the "cash-discount" theory without critical analysis of the legal issues presented. Under the cash-discount theory, intent and effect are immaterial, for if a cash discount does not reduce price, the transaction takes place outside the statute. Furthermore, a merchant may not reduce his price by a value equivalent to that of a trading stamp, for in so doing he "beats," not "meets," his competitor's price. Thus, a merchant who desires to compete effectively with his competitor who gives trading stamps must give trading stamps himself.

A closer examination of the cases leaves one with the impression that underlying the courts' analyses is the thought that trading stamps are *de minimis*. How else explain the statement of the New Jersey Supreme Court in *Sperry & Hutchinson v. Margetts*: "The true cash discount of . . . 2% . . . bears no relation to the object and policy of the law," or that of the Idaho Attorney General:

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83 For a full discussion of trading stamp law, see Note, 105 U. Pa. L. Rev. 242 (1956).

84 Food and Grocery Bureau v. Garfield, 20 Cal. 2d 228, 125 P.2d 3 (1942).

85 Safeway Stores, Inc. v. Oklahoma Retail Grocers Ass'n, 322 P.2d 179 (Okla. 1957).

86 See the note on the Safeway case in 36 Texas L. Rev. 691, 694 (1958): "The rule of the principal case eliminates [the] . . . most potent weapon, price competition, and therefore virtually forces retailers to use trading stamps."

87 15 N.J. 203, 104 A.2d 310, 312 (1954). The case arose under a New Jersey statute.
So long as the giving of "trading stamps" is nothing more than a customary cash discount we seriously doubt . . . that it would constitute a violation of the Unfair Sales Act. But if trading stamps are given in amounts greater than is customary and with an intent or having the effect of doing or accomplishing things proscribed . . . it could amount to a violation.88

But there is no de minimis exception in these statutes. They prohibit sales below cost when accompanied by a prohibited intent or effect. And at what point do trading stamps cease to be a cash discount and become a price cut?89

There is evidence in the statutes themselves to demonstrate that the cash-discount argument is incorrect. Statutory cost at the retail level may be presented by the following equation:

Statutory cost equals invoice cost90 plus cartage91 plus taxes92 plus a percentage markup93 minus trade discounts.94

But a court which determines that a cash discount does not reduce cost has in reality added another element to the equation so that it becomes:

Statutory cost equals invoice cost plus cartage plus taxes plus a percentage markup minus trade discounts minus cash discounts.

In essence this latter equation redefines statutory cost and reduces it to the extent of the discount permitted. This approach subordinates the legal issues to the accounting conclusion, although there is a clear legislative mandate to the contrary.

It does not follow that the result of the cases discussed above is wrong insofar as they refused to enjoin the giving of trading stamps with sales at statutory cost. For purposes of interpretation, trading stamps should be treated like any other reduction in price

prohibiting the sale of motor fuel at less than cost and further providing that no "rebates, allowances, concessions or benefits shall be given directly or indirectly, so as to permit any person to obtain motor fuels from a retail dealer below the posted price or at a net price lower than the posted price applicable at the time of the sale." N.J. Stat. Ann. § 56:6-2 (1937).


89The Oklahoma Supreme Court held that "single" stamps (one for every 10¢ purchase) were a cash discount, but then enjoined "double" stamps (one for every 5¢ purchase). Apparently, "double" stamps were a price cut, although the reason for the injunction does not appear. Safeway Stores, Inc. v. Oklahoma Retail Grocers Ass'n, 322 P.2d 179 (Okla. 1957).

90Or replacement cost, whichever is lower.

91If paid for by the retailer.

92State and federal.

93Usually 6%, but ranging up to 12% in Arizona.

94Except cash discounts. The cash discount here excepted is, of course, the one which the retailer gets for paying cash.
and should be enjoined only when they are given with the intent or effect of injuring a competitor or destroying competition.

VII. Conclusion

The good-faith exception is based largely upon the fiction that a merchant investigates his competitor's prices before meeting them; as a practical matter, this is seldom done. Outside of the impracticability or impossibility of determining the legality of the price being met, there is always the salient fact that in a vigorously competitive industry, such as the retail grocery industry, prices change rapidly, and a merchant who is not prepared to meet his competitor day by day, price for price, is quite likely to be lost in the shuffle. Therefore, the good-faith test more often than not is apt to be a hindsight test: if the prices met were legal, and if the defendant's counsel is able to marshal sufficient economic data, the merchant has acted in "good faith"; otherwise, he has not. And as pointed out in the body of this Comment, the presence of the "good-faith" qualification has led some courts into the fallacy of adopting an "either-or" approach—either a merchant has acted "in good faith" or he is enjoined, although there may be no evidence to show that his sales were accompanied by the proscribed intent, effect, or result. The language of the exception, therefore, could be improved if the phrases "good faith" and "legal price" were removed from the statutes altogether, so that a merchant would feel free to meet his competitor on a price-for-price basis without worrying about statutory requirements which are, in reality, superfluous to the determination of that issue. Such an exception could be phrased to read simply: "The prohibitions of this act do not apply to a price which meets competition." The exception worded in this form shifts from a subjective test of "good faith" to an objective standard of comparing prices, and a merchant has fulfilled his burden of proof under the exception when he shows either that his competitor set the same lower price first, or that his price cut did no more than reassert the historic price differential.

This change alone is not sufficient. Specifically, the statutes make evidence of sales below cost prima facie evidence of the intent to injure a competitor or destroy competition. This provision, which is of doubtful constitutional validity, bears no reasonable relationship to actual market conditions. The motives for selling below cost are innumerable, but in the face of this obvious fact, legisla-
tures deem a sale below cost prima facie evidence of the prohibited intent. The effect of this provision on a meeting-competition exception, whatever its form, is obvious: a merchant who meets his competitor's price by selling below cost has furnished a potential adversary with prima facie proof of an unlawful intent. Hence, the exception could be made more effective by removing this provision altogether.

The exception could also be improved if it explicitly recognized that cash-and-carry merchants and credit merchants do not stand on an equal footing. Few people are willing to pay cash when credit is available at no extra cost. Thus, the exception should include a clause expressly permitting a cash-and-carry merchant to sell at a price lower than his credit-giving competitor in order to offset the extra service furnished.

The question of the impact of trading stamps on below-cost legislation is just beginning to emerge. As noted earlier, the courts have not yet clearly perceived the issues involved. A New Jersey "anticoncession" clause did not prevent the New Jersey Supreme Court from holding that a trading stamp was a "cash discount" and not a price cut within the meaning of the statute. If such attitudes persist, legislatures should be prepared to provide that a merchant may reduce his prices by a value equivalent to the value of a trading stamp given by a competitor.

Allen Butler

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98 See note 87 supra, where the "anti-concession" clause is quoted.