

ADDRESS OF  
HON. ROBERT E. FREER, COMMISSIONER,  
FEDERAL TRADE COMMISSION,  
BEFORE  
PHILADELPHIA CHAPTER,  
PENNSYLVANIA INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS.  
MANUFACTURERS AND BANKERS CLUB, PHILADELPHIA, PENNA.,  
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ACCOUNTING PROBLEMS UNDER THE ROBINSON-PATMAN ACT.

I take it for granted that an audience composed of accountants and business men would like me to talk about the accounting aspects of the Robinson-Patman Act. A better talk on this subject could be made a year or two hence; for the Commission has not yet heard final argument in the Standard Brands case, the first case which turns largely upon controverted questions of cost. Moreover, another year or two should bring a more nearly adequate test of the experiments with accounting for costs of distribution which many enterprises now have under way. You will realize, I am sure, that at this stage of developments under the act, I can not deal explicitly with some of the more important phases of cost allocation.

Accounting has a peculiar status under the Robinson-Patman Act. Injurious discriminations in price are unlawful if they make other than due allowance for differences in cost of manufacture, selling or distribution, but are lawful if they can be shown to make only such due allowance. Thus differences in cost furnish an important test of whether price differences are permissible.

However, the use of this test is at the respondent's option. A complaint might be brought, a case tried, and a cease and desist order issued without any reference to cost. The statute forbids price discriminations which injure, prevent, or destroy competition or tend toward monopoly, and authorizes the Commission to prevent such discriminations, unless the respondent can and does show that they are justified by differences in cost. Discrimination and injury to competition are the essential features of the offense. Though saving in cost may be used as a defense to the charge, the burden of bringing it into the case and of showing that it justifies the discrimination rests wholly upon the respondent.

The effect of this feature of the statute is to make the administration of the law simpler, quicker, and less formal. The Commission is not required to bring into the record the accounts of each corporation against which a complaint is issued. If the price differentials of the concern cannot be explained by its cost accounts, no question of accounting may ever arise. If, however, the costs of doing business will explain the differentials in price, the respondent concern, which possesses the cost information, must take the initiative in presenting such data for the record.

Sometimes cost analyses have been presented voluntarily and informally to the Commission. Concerns which have an obviously good cost defense are glad to present it, and the Commission is glad to receive it and check it during the investigation.

Sometimes, too, the Commission and the respondent cooperate to determine the questions of fact involved as quickly as possible. Members of the Commission's staff are often given access to the books of account, and special tabulations are sometimes prepared by the respondent at the Commission's request. To those of you who are familiar with the complex process of determining costs in a public utility rate case, the saving to both business and the Government will be apparent.

During the first year and three-quarters under the act, few points have become clearer than the need of business men for greater knowledge in order to meet their responsibilities under the law. The act makes it expedient to base one's price policy upon a knowledge of the market and a knowledge of costs. Since injury to competition among buyers may involve a breach of the law, the seller needs to know which of his customers are engaged in competition with one another and to what extent price differences are likely to affect that competition. Thus one effect of the Act is to encourage analysis of the markets in which one sells.

Since differences in cost may justify injurious price differences, the seller may avoid breaches of law by basing his system of prices upon his costs; but for this purpose he needs to know the relative costs of serving different customers, a matter upon which little light was shed by most of the cost accounting systems in use before the act was passed. Thus the act provides a stimulus to the extension and improvement of cost accounting. Indeed, a friend of mine once facetiously remarked that its sub-title should be, "An act to restore prosperity to, and thenceforward to safeguard the future of, accountants."

In the detail of cost accounting concepts, there will necessarily be a good deal of development under the act. The character of this development may be inferred in part from what is now going on. Perhaps the most helpful way for me to approach the question is to indicate some of the issues which generally arise in considering a charge of discriminatory prices under Section 2(a) of the Robinson-Patman Act.

The most conspicuous problems of discrimination in price which arise under the act pertain to what I shall call quantity discounts, volume discounts, or functional discounts. By quantity discounts I mean non-cumulative discounts which are based upon the dollar amount bought at a single time, and usually delivered at a single place. By volume discounts I mean cumulative discounts based upon the total dollar purchases over a period of time, perhaps for delivery at a number of different places. By functional discounts I mean discounts which depend upon the distributional status of the customer--that is, wholesale discounts, retail discounts, etc.

In the case of quantity and volume discounts, as so defined, complaints usually allege that the larger buyers are receiving favored treatment by virtue of unjustified discounts which give them a competitive advantage over the smaller buyers. In the case of functional discounts, the usual charge is that wholesale discounts are being given to retailers, or that an unduly large discount is being given to one or more distributors whose distributive service is somewhat more complete than that of competitors.

No one of these discounts is inherently either lawful or unlawful. Any of them may be unlawful if it is granted under circumstances in which competition is injured and if none of the defenses set up in the act are available. Any of them are lawful if no injury results from its granting or if savings in cost properly attributable to the purchases which receive the discount are sufficient to justify it.

I emphasize this point because it is frequently misapprehended. Recently, for example, the Commission issued a complaint against a maker of bakers' supplies, charging him with having contracted to grant to three large grocery chains volume discounts running as high as five per cent without adequate cost justification.

The complaint also set forth in detail the purchases of two of these chains, showing that for one of them a total of less than nineteen thousand dollars' worth of purchases was shipped to thirty different warehouses in orders which were so small that at each of six warehouses deliveries for the year amounted to less than one hundred and one dollars; and that the purchases of another chain were shipped to eleven different points, at five of which it bought, during the whole year, less than one hundred dollars' worth.

The respondent admitted the material facts, offered no cost defense, and waived hearing. Thereupon the Commission issued an order directing the respondent to cease and desist from this admittedly indefensible violation of the statute.

The Commission's order has been widely misinterpreted as a condemnation of all volume discounts, without regard to the size of the discount classes, the amounts of the discounts, or the nature of any savings in cost which may result. That such was not the purport of the Commission's decision should be clear from a reading of the opinion which contains the following paragraph:

"A cumulative discount is sound only where savings have been achieved by the seller with respect to individual sales made to a particular buyer over a period of time, which savings were not reflected in the price at which the buyer purchased and which are reserved for the purpose of refunding at the end of a period of time. But any system of discounts based on the amount of annual sales is a price discrimination contrary to Section 2 (a) of the Clayton Act, as amended, if it has any of the injurious effects on competition enumerated in the statute, unless justified as by making only due allowance for differences in cost not previously allowed and resulting from the quantities sold or delivered."

Quantity and functional discounts, like volume discounts, may be lawful or unlawful, depending upon whether they cause injuries under the statute which are not justified by the economies to the seller.

In examining more closely the issues presented by a discount structure, I shall confine myself to quantity and volume discounts, since there will not be time to discuss also the problems of discounts based on the character of the customer's business. To be lawful, quantity or volume discount must meet,

among others, the following tests. Discount classes must not be unduly large and too few in number. The boundaries between classes must be reasonably placed. No class must receive a discount which is excessive as compared with those granted to other classes.

If the discount classes are broad, the costs of serving different customers within the same class will be dissimilar. An average of these costs probably will be unrepresentative of customers at the boundary of the class, and there is likely to be an indefensible discrimination between the largest buyers in one class and the smallest buyers in the next.

Sometimes, for example, a part of the seller's business consists of a very few small purchases which he accepts as a convenience to his customers at very high cost to himself. If, in preparing a quantity discount schedule, he includes in his lowest quantity bracket both these "nuisance" orders and the regular stock orders of his small customers, the effect is to charge these small customers with nearly the entire cost of the "nuisance" business, to raise the apparent cost of serving them, and to appear to justify for the larger customers a discount which is greater than the facts warrant. This is an example of a discount class which is too large.

Similarly, if the larger portion of the "nuisance" business is combined with the smaller portion of the commercially attractive business placed by small customers, the resulting class may not be too large, but its boundaries will be improperly located and there may be an unlawful discrimination between the smallest customers and the next smallest.

Determination of the size and boundaries of customer classes is in part a matter of discovering where and how the costs of doing business change most conspicuously. It depends, however, not merely upon a cost analysis, but also upon analysis of the market to discover what purchases originate in the same way and represent the same kind of transaction.

Given a reasonable system of discount classes, the determination of the maximum discount which can be justified by cost is a straight-forward, but by no means simple, problem of cost accounting. In congressional debate before the passage of the act, it was generally stated that the economies which arise merely from an increase in the total volume of business cannot be attributed to the last or the largest orders booked, nor used to justify special discounts upon these orders.

The broad field of manufacturing costs creates relatively few difficulties in cases where production is for stock. Producers who have discussed the matter with the Commission's staff have been substantially unanimous in their statements that when goods are produced for stock and purchases are filled from stock, there is no manufacturing economy in serving one customer as compared with another. Consequently, saving in manufacturing cost does not enter into the cost defenses of a wide variety of industries. In production to special order, however, the costs of dies, equipment, and adjustment of the machinery may constitute fixed expenses attributable to a particular customer which tends to decline as the customer's purchases are enlarged.

The major cost problem of the last year and a half has been that of costs of distribution. Most concerns have known little about such costs. In

preparing to justify their discounts under the act they have set out for the first time to discover the relative expense of packing full and broken cases, the expense attributable to paper work in placing and filling an order, the number of calls made per sale in serving different groups of customers, and the average cost attributable to each call by a salesman.

Such information can seldom be derived from the present books of account. Packing costs have been determined by a stop-watch. Costs of handling invoices have been determined by counting the number of invoices or the number of entries for a period of time and attributing to each operation a charge based upon the personnel it took and the space it occupied during that period. Sales costs have been worked out by the timing of calls, the recording of the number of each type of calls made to each type of customer, the analysis of the comparative number of productive and non-productive calls, and the use of various devices for apportioning salesmen's salaries, commissions, and expense in accord with the facts discovered.

Often it has been considered necessary to modify the classifications used in the books of account. In some concerns, for example, the chief executives spend such a considerable portion of their time in making sales to the larger accounts, that it has been considered necessary to re-apportion a part of their salaries as sales expense, before the comparative costs of selling to large and small customers could be determined.

Since these methods of analysis are expensive, many concerns have done no more than select a sample territory or a sample period of time and to assume that the results of the sample are fairly representative of the rest of their business. Of course, in instances where such sample studies have been offered to the Commission's investigational staff in justification of price differentials, a question has immediately arisen as to adequacy of these short-cut methods to show the relation of the costs to the discriminations and the Commission's accountants have examined the books and the methods of doing business of the particular concern to determine whether the sample was fairly chosen, and whether its results might be expected to be typical of the whole.

It is my personal hope and belief that a by-product of the Robinson-Patman Act will be the development of a more adequate system of accounting for costs of distribution, capable of helping businessmen to be not only law-abiding, but also more efficient. The devices which have been used thus far to give the immediate knowledge of costs made desirable by the act have often proved to be inadequate.

Special analyses have not proved to be economical. The job must be done over when a concern decides to change the boundaries of its discount classes or the character of its discounts. In one case, for example, the Commission had no sooner examined and found not unlawful a quantity discount system established by a large manufacturer than the manufacturer decided to inaugurate a system of volume discounts. Thereupon, when certain customers complained and the Commission renewed its investigation, the manufacturer found that an entirely new analysis of his costs was necessary.

Even when the discount structure remains unchanged, there probably will be need for repeated examination of costs in order that businessmen may

determine whether the cost differences which prevailed some time ago still represent the current situation. To avoid such reiterated studies, thoughtful accountants are experimenting with methods of making the books of account tell the management currently what it costs to serve different types of customers, to fill orders of different sizes, and to supply different volumes of goods in a given period.

The Commission knows of one trade association which has attempted the development of a procedure for thorough functional analysis of the books of account which, when once made, will, the association hopes, permit its members to answer questions about the relative cost of distribution by a simple reclassification of such costs as are now recorded. These possibilities offer a challenge to the accountant, to which I hope and believe the members of your profession will promptly and effectively respond.

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