ADDRESS

by

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MONOPOLISTIC PRICING PRACTICES AND THEIR ERADICATION

It is with some trepidation that I appear here in response to your kind invitation to speak to you on the subject of "Monopolistic Pricing Practices And Their Eradication." Knowing as I do that an organization of governmental purchasing executives perforce must be thoroughly familiar with the country's business practices both monopolistic and competitive, any undertaking to educate you in that field would be a case of my walking where angels fear to tread.

At the outset, I want to say that the purchasing executive for a large consumer, public or private, is often in a position to do more to eradicate monopolistic selling practices than is either the Federal Trade Commission or the Department of Justice; and I shall feel that I have done a real missionary job if any remarks of mine have the effect of stimulating any of you into redoubling your individual efforts toward eliminating such monopolistic practices as may confront you.

As you know, commerce in the United States is based on the theory of a free competitive market, where buyer and seller can meet on more or less equal ground, and to which any citizen has access as a matter of right provided he can survive the competition. The competitive theory is grounded in the ancient common law, and it has been written into the statute law of the Federal Government and of most of the States. Since enactment by a unanimous Congress of the Sherman Act in 1890, the problem of preserving competition against the inroads of monopolistic practices has engaged continuously the attention both of the Federal courts and of the public.

As a matter of historical interest, after two decades under the Sherman Act it became apparent to Congress that its broad provisions, which are directed at monopolies as such and against combinations in restraint of trade, should be supplemented by further Federal legislation of a prophylactic nature, designed to prevent all specific business practices found to be leading to accomplished monopolies and to full-blown conspiracies in restraint of trade. The Federal Trade Commission was established in 1914 with the broad directive to prevent unfair methods of competition, and with powers under the contemporaneous Clayton Act to prevent certain types of discrimination, restrictive contracts and agreements as well as acquisition of competitors by dominant concerns.

In its early years before it demonstrated to the courts its "respectability" the Commission was considerably handicapped by a number of restrictive court decisions. As one of the oldest of the so-called administrative agencies, created to operate in a field theretofore exclusive in the courts, the Commission had to assume the usual risks of pioneering.

At the outset, the subject of monopolistic practices and their eradication is like the subject of sin -- it covers a great deal of territory, more ter-

ritory than I can hope to skip over in the few minutes we have here today. So rather than to speak in broad platitudes, I should like to cover in some detail certain aspects of monopolistic delivered pricing systems and recent efforts by the Commission directed toward their eradication.

In your business of purchasing for various governmental organizations, you are aware that when you seek certain commodities in the market you are likely to receive quotations and bids identical, down to the last fraction of a cent, with all transportation and other charges equalized, so that it makes no difference, from the standpoint of price or any factor affecting price, from which seller you ultimately purchase. There are other industries in which prices or terms or conditions of sale are the basis of competition and you can expect to receive varying quotations, or at least to receive the benefit of cheaper transportation charges from the bidder located, freightwise, more economically to the destination of the purchase.

The identical price industries contend that they are engaged in "true competition," but their bidding for business is a peculiar form of competition based upon personality of the several sales organizations or upon some other factor which is not permitted by them to affect quoted prices, terms or conditions of sale. I submit that this is not competition within the meaning of the Federal anti-trust laws or within the meaning of the statutes requiring competitive bidding on many government purchases. The consistent bidding of identical delivered prices on invitations for competitive bids is a hollow mockery of competition.

Over the years the Commission has had occasion to examine practices in many industries that have been thoroughly indoctrinated against price competition, that have apparently been sold on the idea that any concession on the part of any member will result only in a general lowering of prices in the industry without any significant benefit to the price-cutter. They appear to have become imbued with a mutual forbearance and the result has been a voluntary concession of competitive advantages in certain markets or certain lines on a reciprocal, back-scratching basis. The members of these industries have no desire or wish to compete on a price basis, and will go to extreme lengths to see that price competition is wholly negatived.

In industries where transportation charges are of any real importance in determining the laid-down cost of the goods to the customer, the desire to avoid price competition and to present a united front to any purchaser involves a number of special problems. For a manufacturer in one of these industries to match exactly the laid-down cost to a distant customer with the delivered price quotation of his competitors, some systematic method of equalizing transportation charges must be employed. Various methods of accomplishing this nullification of freight differences have been, and now are employed. One of the best known is the basing point system, wherein each industry member, regardless of factory location, quotes delivered prices made up of the combination of a base price at some arbitrary point and the freight from that point to the customer's location.

Assuming a hypothetical case, suppose that St. Louis, Missouri, is the basing point in some industry, and that each seller regardless of location quotes a price based on St. Louis. For a manufacturer located in Cincinnati and selling to customers in Cincinnati, the delivered price in Cincinnati would be derived by adding to the St. Louis base price the freight rate from St. Louis to Cincinnati. To sell to a customer in St. Louis, on the other hand, such a manufacturer would obtain a net price less than that received from his Cincinnati customer by the amount of the freight from St. Louis to Cincinnati and then back again to St. Louis. The addition of the charge of freight from St. Louis to Cincinnati in the first illustration, is commonly referred to as "phantom freight" since it represents the imposition in the delivered price of a charge for transportation which was never performed. This illustration is of a single basing point system, and it has many advantages to an industry which does not wish to compete on a price basis. Only one set of freight rates is necessary to quote delivered prices, which reduces the chances of differing delivered prices through clerical errors. For another thing, only one price is quoted, the basing point price, so that it is very easy to keep up with what everyone in the industry is quoting at any time.

A modification of the single basing point system which has proved very popular as a matched price device is known as the multiple basing point system. As its name would suggest, it differs only in that instead of one there are several basing points, at each of which a so-called base price is quoted -- the delivered price to the customer being derived by adding to the price at the customer's nearest basing point the freight charges which would be paid if the goods were shipped from that point. Like the single basing point system, this method frequently involves "phantom freight" charges and each seller receives widely varying net prices after deducting freight charges. One so-called advantage of the multiple basing point method of fixing prices is that when it becomes necessary to deal with a truly competitive situation in some area, the competition may be met without disrupting the price structure over the entire country. Further, if some member of the industry needs discipline for any unorthodox (competitive) practices, a "punitive" base may be installed in his primary market area, or the price at his primary base may be reduced without affecting other market areas. One of the chief so-called drawbacks to the multiple basing point system as a method of price fixing is that for any concern to do a widespread business it is necessary to have on hand, for the purpose of matching delivered prices with competitors, a mass of accurate and up-to-date freight rate information, showing rates from every basing point to every destination controlled by each point. As you who are engaged in purchasing know full well, freight rates and routes are a complex subject and it is not at all easy for several traffic experts to arrive at the same result for an unfamiliar and complicated joint route and rate. Thus, in order to match delivered prices under a multiple basing point system some common compilation of freight rates is usually necessary, to be used by each member in computing delivered prices, but not for shipping purposes. And, unfortunately for the success of such a device, common use of freight books for pricing purposes has been considered by the Commission and the courts to be persuasive evidence of an understanding to fix prices.

Another manifestation of the basing point system is the so-called freight equalization method of delivered price quoting. Under this method each factory is in effect a basing point, an f.o.b. factory price being quoted by each seller, who offers to equalize freight with the competitor nearest to the customer. Actually this method works out in about the same way as the multiple basing point system, except that since every factory is a basing point no direct charge of "phantom freight" is made, although whenever a seller equalizes freight in the "backyard" of another competitor he receives a mill net return smaller by the amount of freight that is absorbed, so that the customers in the mill city and the nearer markets in effect pay the freight to the more distant ones. Just as in the multiple basing point system, operation of the freight equalization method requires use of a mass of accurate freight data from the factory locations of all competitors to all destinations in the areas in which the seller wishes to seek to do business.

Another device which has been employed for the purpose of quoting identical delivered prices on commodities where freight is an important part of the laid-down cost to the consumer is the zone pricing method. Under this method all customers located within a designated geographical area pay the same delivered price, and freight is either prepaid by the seller, or allowed on the invoice if paid by the buyer. The Commission has encountered zone systems ranging in complexity from two or three simple zones encompassing the entire country to those employing more than a score of zones which set forth detailed and elaborate geographical divisions. For price fixing purposes, the zone method has a number of distinct advantages over the other delivered pricing systems. For one thing, transportation charges are completely eliminated as a factor in calculating the delivered price, so that an error in figuring a freight rate cannot possibly affect the delivered price. For another thing, once the zone system is established, no further overt agreements are necessary to its continued operation if each of the sellers is advised of the prices being charged within each of the zones and of the territorial limits of the zones. Furthermore, any price competition which develops can be confined in most instances to the zone within which it occurs, without affecting prices in the other zones.

I have run the risk of boring you with these detailed descriptions of the basing point system and its variations. My purpose has been to emphasize two fundamental facts. In the heavy goods industries, transportation charges are an important part of the cost of such goods to the consumer, and it is impossible to match prices in such industries without employing some artificial method of eliminating transportation as a factor in price.

In recent years the Commission has issued orders in a number of important cases calculated to prevent the continuance of such delivered price schemes to fix prices, and several of the cases have been reviewed by the Circuit Courts of Appeals and the Supreme Court of the United States. A number of years ago the Commission issued an order against certain concerns in the steel industry, finding it illegal to continue the so-called Pittsburgh plus method of pricing steel. An appeal has been taken on this order and it is now pending in the U. S. Circuit Court of Appeals for re-

view. More recently the Commission completed a long and elaborate inquiry into the pricing of cement, finding the multiple basing point system in that industry to be in purpose the product of collusion and agreement among producers and to entail in effect serious price discriminations among purchasers of cement. An appeal has been taken from the order of the Commission against continued use of the system of pricing, and a decision by the Court of Appeals for the 7th Circuit is expected momentarily. In that connection, the taking of testimony in the cement case covered several years and nearly fifty thousand pages of stenographic transcript. Seventy-five corporations were respondents in the proceeding and more than forty prominent law firms participated in the trial. Arguments by counsel before the Commission and before the Circuit Court consumed more than a week. The difficulties involved in enforcement are reflected by the record in this case.

Two other cases of interest in this field were decided by the Supreme Court of the United States in April, 1945. The Commission proceeded under the Robinson-Patman Act against a number of producers of corn syrup or glucose, finding after hearing that use of a Chicago base price plus freight to destination amounted to an unlawful discrimination in price which had the effect of injuring competition. The Supreme Court sustained the Commission's orders in the two cases which were appealed. In one of the cases, involving a producer whose plant was not located at the basing point, the late Chief Justice Stone said:1/

> "In none of the markets in which respondents had a freight advantage over their Chicago competitors did respondents reduce their prices below those of their competitors. Instead they met and followed their competitors' prices by prices rendered artificially high, by the inclusion of unearned freight proportioned to the amount by which their competitors' delivered costs exceeded their own.
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> "We cannot say that a seller acts in good faith when it chooses to adopt such a clearly discriminatory pricing system, at least where it has never attempted to set up a nondiscriminatory system, giving to purchasers, who have the natural advantage of proximity to its plant, the price advantages which they are entitled to expect over purchasers at a distance."

You will note that the steel and glucose cases do not depend on an allegation of conspiracy in restraint of trade, but are based on charges of individual price discrimination. In the cement and other recent cases the Commission has alleged also that the delivered pricing systems were maintained by agreement among the sellers. More important cases in this same category which have recently been the subject of court decisions are those involving malt for brewing, milk and ice cream cans and crepe paper.

1/Federal Trade Commission v. A. E. Staley Mfg. Co., et al., 324 U. S. 746.

In the malt case, involving a single basing point, Chicago, and the addition of freight, Judge Major, writing the opinion of the Seventh Circuit Court of Appeals, stated:2/

"We are of the view that the Commission's findings that a price fixing agreement existed must be accepted. Any other conclusion would do violence to common sense and the realities of the situation. The fact that petitioners utilized a system which enabled them to deliver malt at every point of destination at exactly the same price is a persuasive circumstance in itself."

The milk and ice cream can case involved systematic freight equalization, under which each producer equalized freight with the competitor nearest to the customer, utilizing a common compilation of freight rates for the purpose. In upholding the Commission's order in this case, Judge Major again writing the Court's opinion stated:3/

"It is argued, perhaps correctly, that such a freight system had long been employed by industry so that members thereof might deliver their product at the same price. .... Such being the case, the fact still remains that it was employed by petitioners for the purpose of fixing the delivered price of their product and by such use price competition was eliminated, or at any rate seriously impaired. On the face of the situation, it taxes our credulity to believe, as argued, that petitioners employed this system without any agreement or plan among themselves."

The crepe paper case involved use of a system of delivered pricing whereby the country was divided into two and three zones, within each of which customers paid the same delivered price, irrespective of cost of transportation from the seller. Judge Kerner also of the Seventh Circuit Court of Appeals stated in that Court's opinion affirming the Commission's order:4/

"One glance at the three zone map for bulk crepe will show the artificiality of the zone structure and the intention to obviate any natural advantage of location from price determination.

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"We think the artificiality and arbitrariness of the zone structure is so apparent it can not withstand the inference of agreement. The Commission evidently could not believe that Wisconsin companies would deprive themselves of the natural benefit of location in the midwest, and proximity to the west, over eastern competitors, were it not agreed that they would have equal chance for the eastern business, where most of the crepe paper manufacturers were located."

2/U. S. Maltsters Ass'n., et al. v. Federal Trade Commission, 152 F. 2d 161.
3/Milk and Ice Cream Can Institute et al. v. Federal Trade Commission, 152 F. 2d 478.
4/Fort Howard Paper Co., et al. v. Federal Trade Commission, F. 2d

As you will observe, these decisions hold, as a practical matter, that the mere existence of basing point, freight equalization or zone system of quoting delivered prices, accompanied by identical prices, evidences an agreement in restraint of trade. From the point of view of the Federal Trade Commission this realistic approach to the problem renders effective enforcement of the anti-trust laws much less onerous than it has been in the past. And ultimately it promises a shrinking of that once-long list of commodities upon which a government purchasing agent could usually expect to receive identical bids.

In addition to supplying information to the enforcement agencies regarding monopolistic practices encountered, there is also a field in which the governmental purchasing officer, by his individual efforts, may help to eradicate such monopolistic practices, or at least may inconvenience those engaged in them. In this connection, I recall hearing a former Secretary of the Interior whom I shall only describe as a very outspoken man, testify before a U. S. Senate Committee. He told of the many millions of dollars of identical bids which had been submitted to his department during a period of time when the market for heavy goods was strictly a buyers' market bearing no faint resemblance to conditions today; he then detailed his unsuccessful efforts to stimulate truly competitive bids; and finally of his adoption of the policy of awarding contracts wherein bids were identical on heavy goods to the most distantly located bidder, saying that he did so on the theory that if the government could not receive any advantage by reason of the favorable location of a bidder to the destination, at least the railroads would be helped to get a little something out of the transaction by this expedient.

The Federal Trade Commission is grateful for the assistance it has received in the past from those of you engaged in purchasing who have so kindly supplied information to the Commission regarding identical bids. In certain instances some of you have appeared as witnesses in cases wherein the Commission was seeking to eradicate monopolistic pricing practices. In that type of case, as well as in many other types you always have proved a very valuable source of general and special information on business practices. I hope that our cordial relationships of the past will continue in the future.