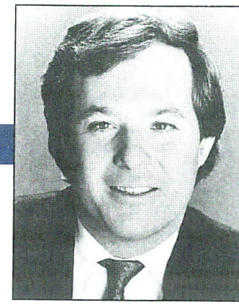

Antitrust, Part III: Price Discrimination

By Steven Mitchell Sack

The prime objective of antitrust law is to preserve competition. Who can argue with that?

Obviously though, a lot of people do, and will continue to as competition intensifies in the marketplace. However, unreasonable restraint of trade (or an unfair method of doing business) that has, or probably will have, adverse effects on competition is illegal.

Section 2 of the Clayton Act states that it is unlawful for a seller to discriminate in price among different customers when the discrimination has a proscribed competitive effect.

It is also unlawful for a buyer to knowingly induce or receive a discrimination in price. Section 3 of the Robinson-Patman Act goes so far as to make it a *criminal offense* to be a party to or to assist in discriminations between competing purchasers.

Although these laws are harsh, their purpose is to encourage "equality of opportunity" for all. As the courts have recognized, this principle ordinarily requires sellers to treat similar buyers equally in price and terms of sale. Theoretically, this enables buyers to have an equal start in their competitive races in the marketplace.

How it happens

Price discrimination typically occurs in two ways.

1. Relations with competitors. It is unlawful *per se* to make any of these arrangements, directly or indirectly, with competitors: "To agree to fix prices, stabilize prices, agree to a formula to determine prices, or enter into any agreement which may even have a remote or indirect effect on prices."

Examples of this include:

• Divide or allocate markets, territories or customers.

• Rig bids or submit bids knowing that they will be unacceptable.

• Charge a maximum price.

• Limit production, set quotas, or discontinue a product.
• Boycott third parties.
• Depress the prices of raw materials with other raw materials purchasers.
• Establish uniform discounts or credit terms, or eliminate discounts.
• Establish a system for determining delivered prices or a specific method of quoting prices.

These examples were all taken from actual cases where competitors were found to have committed *per se* antitrust violations — they could not be defended or justified in any way, even though the intentions behind the actions may have been honorable and were considered an industry-wide practice.

In many of these cases, the existence of a written agreement did not have to be proven to find a conspiracy to manipulate price. Any understanding, (oral, formal or informal) that gives the parties a basis for expecting that a business practice or decision adopted by one would be followed (or even not opposed) by the other, is sufficient. One court stated, "A knowing wink can mean more than words."

In addition, even if a salesperson attempts to regulate prices with a competitor and *fails* to do so, the salesperson is still liable for violating the law.

2. Relations with customers and distributors. Under the Clayton Act, a seller may not charge one customer a higher price or offer more favorable terms when the two customers should be treated equally, except in certain limited situations.

All customers and distributors should be treated as equally as possible so as not to stifle competition by giving one an unfair advantage over the other. Customer pricing, therefore, is not just a matter of individual price negotiation — antitrust laws require it to be a carefully organized and documented business policy.

The law also covers discrimination in terms of sale other than price. This happens when, for instance, favored customers are permitted to purchase at different terms. This may include giving advertising or a freight allowance, cash discount, free merchandise, equipment or a bonus to one customer and not another. This frequently occurs when salespeople aggressively pursue accounts.

Exceptions to the rule

Sales managers and executives should be mindful that the giving favored terms to certain customers may violate antitrust laws. Thus, I recommend that salespeople be instructed to quote different prices, terms and incentives *only* after approval from management has been obtained.

In addition, a salesperson should know the nature of the customer to whom he is selling. For example, if a customer combines retail and wholesale functions, a company violates the law by granting a wholesaler's discount to such a buyer, as that buyer may gain an unfair price concession compared to his retail competitors.

Furthermore, if a manufacturer sells to a buyer who uses the product during normal business operations and also resells the product to others, a user discount cannot be granted to that buyer. In this situation, the salesperson must regulate the granting of the user discount only to those transactions that do not result in a resale.

However, many of these prohibitions are subject to a number of exceptions. Although customers are theoretically entitled to be charged the same prices, the law does recognize situations in which customers are *not* entitled to such a guarantee. A price differential or different terms of sale can be defended on either of the following grounds:

- If the price differential was given in good faith to *meet* (not beat) a price offered by a competitor.
- If the price differential is based on a cost saving, reflecting a difference in the cost of manufacture, sale or delivery that resulted from the differing methods or quantities in which products are sold or delivered.

For instance, price breaks are allowed when they're based on volume ordered, close-out sales, lower shipping and selling costs, good-faith meeting the competition and lower commissions paid by the seller to its employee salespeople. All of these "cost defenses" will justify a difference in terms of price or sale.

Protect yourself

For protection, companies should establish proper accounting methods that reflect cost variances in this area. For example, if you are establishing affirmative pricing policies, or are granting advertising and promotional allowances and services, be sure that your accounting methods and procedures reflect cost differences that permit you to reduce prices or terms of sale to selected customers.

This can be done by maintaining a variety of records, kept in the ordinary course of business, that document and reflect company policies or reveal the nature of a business transaction or decision.

For example, records of rejected orders (and the reasons why) may dispel boycott inferences. Cost accounting records may provide a defense to a price discrimination charge. Pricing records may refute a charge that prices were fixed by agreement rather than independently. Prices quoted to customers may afford a seller the good-faith meeting-of-competition defense. Notices of promotional allowance plans may show that such plans were made available to all customers.

Finally, since the exchange and communication of price information is so carefully scrutinized, any perceived cooperation among competitors is suspect under antitrust laws. The exchange of price information is more subject to suspicion than any other type of information exchange.

Thus, salespeople and management should avoid any contact with competitors if possible, especially at trade shows and social gatherings. Although this sounds unfair, it is good business practice — many price-fixing cases arise at these sessions. Remember — any discussion of prices, warranties, uniform practices or industry conditions between competitors is prohibited.

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