COST JUSTIFIED PRICE DISCRIMINATION: SECTION 49(2)(a) OF THE *TRADE PRACTICES ACT* 1974

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Discriminatory trading by sellers of goods is prohibited by s.49(1) of the *Trade Practices Act* 1974.[1] The section[2] is closely modelled upon the scheme and language of the *Robinson-Patman Act* 1936[3]. This statute has attracted considerable criticism, principally because of its allegedly anti-competitive side effects.[4] Similar criticisms were made of s.49 of the Act by the Trade Practices Act Review Committee[5] which consequently recommended repeal of the section[6] This recommendation was rejected

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1 Act No. 87 of 1977 (Cwth) (hereinafter referred to as 'the Act'.)

2 Section 49(1) of the Act provides that:

> A corporation shall not, in trade or commerce, discriminate between purchasers of goods of like grade and quality in relation to—
> (a) the price charged for the goods;
> (b) any discounts, allowances, rebates or credits given or allowed in relation to the supply of the goods;
> (c) the provision of services in respect of the goods; or
> (d) the making of payments for services provided in respect of the goods,

if the discrimination is of such magnitude or is of such a recurring or systematic character that it has or is likely to have the effect of substantially lessening competition in a market for goods, being a market in which the corporation supplies, or those persons supply, goods.

3 49 Stat. 1526 (1936), 15 U.S.C. 13 (1970). Section 2(a) of the Robinson-Patman Act provides in part:

> That it shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between the different purchasers of commodities of like grade and quality, . . . where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them . . .

4 E.g. see Adelman, 'The Consistency of the Robinson-Patman Act' (1953) 6 *Stan. L. Rev.* 3; McGee, 'Some economic issues in Robinson-Patman land' (1965) 30 *Law and Cont. Problems* 30; Austern, 'Difficult and diffusive decades: an historical plaint about the Robinson-Patman Act' (1966) 41 *N.Y.U.L. Rev.* 897; Posner, *The Robinson-Patman Act, Federal Regulation of Price Differences* (1976)

5 In its *Report to the Minister for Business and Consumer Affairs*, (August, 1976) the Committee declared that 'section 49 has produced such price inflexibility that the detriment to the economy as a whole from the operation of the section outweighs assistance which small business may have derived from it'. (at 46)

6 Id.

by the Government and s.49 was virtually untouched by the comprehensive 1977 amendments to the Act.[7] Repeal of the section was again recommended, this time by the Trade Practices Consultative Committee, which was appointed to monitor the effects of the section.[8] This recommendation was opposed by the Trade Practices Commission[9] which moved against the widespread incidence of price discrimination, particularly in the petroleum industry.[10] Parliament appears to have been persuaded by the Commission and in the *Petroleum Retail Marketing Franchise Act* 1980 a prohibition of price discrimination is contained in substantially similar terms to s.49 of the *Trade Practices Act.*[11]

The forty years during which the *Robinson-Patman Act* has been in force in the United States has seen the development of a very considerable body of case law and academic commentary.[12] This corpus of authority will obviously be useful in interpreting the Australian Statute. Despite some differences in wording, the basic linguistic similarities between the two statutes are 'striking'.[13] Also, similar, are the policy objectives of each provision. The Robinson-Patman Act sought to remedy the competitive imbalance between the large merchandising chains and the small single-store retailers,[14] s.49 was retained, according to the Minister for Business and Consumer Affairs, 'in the interests of assisting the competitive position of small businesses'.[15]

Excepted by s.49(2)(a) of the Act from the proscription of price discrimination are those discriminations represented by a supplier's attempt to pass on to its favoured purchasers those cost savings attracted by dealings with those favoured purchasers.

The American experience with cost justification under the Robinson-

[7] See Giles, 'The 1976 Report of the Trade Practices Act Review Committee' (1976) 50 *A.L.J.* 549, 555.

[8] Trade Practices Consultative Committee, *Small Business and the Trade Practices Act*, vol. I (1979), Ch. 10.

[9] *Ibid.*, vol. II, 525-552.

[10] Trade Practices Commission, *Price Discrimination in the Petroleum Industry* (1980).

[11] Petroleum Retail Marketing Practice Act 1980, Part III.

[12] Among the leading critiques of the Robinson-Patman Act are Austin, *Price Discrimination and Related Problems under the Robinson-Patman Act*, 2d ed. (1959); Edwards, *The Price Discrimination Law* (1959); Rowe, *Price Discrimination under the Robinson-Patman Act* (1962), *Supplement* (1964); Baum, *The Robinson-Patman Act, Summary and Content* (1964).

[13] Mnookin, 'An American lawyer's views of section 49 of the Trade Practices Act' (1975) 1 *U.N.S.W.L.J.* 121,.122.

[14] United States, H. of R., *H. Rep. No. 2287*' 74th Cong., 2d sess., 3-4 (1936); U.S., Senate, *S. Rep. No. 1502*, 74th Cong.

[15] Second Reading speech, Australia, H. of R., *Debates*'vol. 105. at 1476.

Patman Act is frequently cited as evidence of the likely futility and impracticability of the s.49(2)(a) exception.[16]

The Robinson-Patman Act defence has been described as 'largely illusory in practice',[17] 'delusive,[18] and prohibitively expensive to mount.[19] The allegedly vast expense and commensurate managerial effort involved in mounting the defence is principally blamed for what has been declared to be the scant use of the defence.[20] A number of commentators claim, however, that this criticism misrepresents the efficacy of the defence. Murray[21] identifies a number of successful utilizations of the defence, attributing those cases in which the defence has failed to 'gross defects' in the defendants' cost studies.[22] He quotes the appraisal of Stedman that

> in many cases where the cost justification defence fails, it should fail. It is a commonplace that the cost defence is often an afterthought — the respondent has in fact sold at a discriminatory without the consideration of whether there was a savings in cost to justify it, and raises the point only in a desperate and belated effort to beat the rap.[23]

In a detailed analysis of all the cases employing the defence prior to 1966, Copeland[20] identifies a 'high success rate' for the defence in terms of the number of Federal Trade Commission investigations dismissed as the result of its utilization.[25]

Von Kalinowski[26] identifies a reluctance of sellers to take advantage of the cost justification defence which he attributes to four factors:

> (1) the prolixity and obscurity of the statutory language; (2) the failure of the Courts and Commission to ensure workable legal

16 E.g. Mnookin, supra n. 13, at 137-138; Donald & Heydon, *Trade Trade Practices Law, Vol. I, (1978) 418-419.*

17 U.S. Attorney General, Report of the Attorney General's National Committee to study the Antitrust Laws (1955) 176.

18 Kintner, 'The revitalized Federal Trade Commission: a two-year evaluation' (1955) 30 *N.Y.U.L. Rev.* 1143, 1162.

19 Rowe, supra n. 12, at 307-308.

20 Taggart, *Cost Justification* (1959) 546; Rowe, 'Cost justification of price differentials under the Robinson-Patman Act' (1959) 59 *Columb. L. Rev.* 584, 608; Elias, 'Robinson-Patman: Time for Rechiseling' (1975) 26 *Mercer L. Rev.* 689, 728 n. 149; Edwards, 240, 612, 616.

21 Murray, 'Cost justification under the Robinson-Patman Act: impossibility revisited' [1960] *Wisc. L. Rev.* 227.

22 Id. at 262.

23 Id., quoted from an address by Stedman, Wisconsin Bar Assoc., 12 June 1958.

24 Copeland, 'Significance of the cost justification defense' (1966) 11 *Antitrust Bull.* 925.

25 Id. at 936-946.

26 von Kalinowski, *Business Organization, Antitrust Laws and Trade Regulation* (1977) s.32.03[1] at 32.80 to 32.93.

> criteria; (3) the tendency of those authorities to require 'meticulously accurate data' on the seller's cost in dealing with each individual customer and (4) the absence of officially sanctioned accounting standards, that is, accounting standards acceptable to the peculiarities of the cost of defense.

The debate on the Robinson-Patman cost justification defence usefully raises the issues which will determine the scope and application of the s.49(2)(a) exception[27] and if the stultification of the exception is to be avoided the American experience counsels a realistic application of cost justification standards.[28]

1. *Cognizable Costs*

(a) Introduction

Section 49(2)(a) provides that s.49(1) does not apply in relation to a discrimination if:

> the discrimination makes only reasonable allowance for differences in the cost or likely cost of manufacture, distribution, sale or delivery resulting from the differing places to which, methods by which or quantities in which the goods are supplied to the purchasers.[29]

Thus only four heads of cost saving are cognizable under the exception, viz., manufacturing, distribution, sale or delivery costs, and these are allowable only if attributable to one of the underlying causal factors mentioned by the exception, viz., the differing places to which goods are supplied to purchasers, the differing methods by which they are supplied, or the differing quantities in which those goods are supplied.

The three causal factors from which the four categories of cognizable cost must arise occur prior to the supply of goods to purchasers, leading to the conclusion that s.49(2)(a) permits allowance only for savings in

[27] For a general discussion of the Robinson-Patman defence in businessman's terms see Taggart, *Cost Justification* (1959); Sawyer, Business Aspects of Pricing Under the Robinson-Patman Act (1963) ch. 4; Flynn, 'Cost justification: a primer' (1964) 45 *Chic. B. Rec.* 277; Sawyer, 'Cost justification' (1964) 9 *Antitrust Bull.* 285; Kintner, *A Robinson-Patman Primer, A Businessman's Guide to the Law Against Price Discrimination* (1970) ch. 8.

[28] See Kuenzel and Schiffres, 'Making sense of Robinson-Patman: the need to revitalize its affirmative defenses' (1976) 62 *Virg. L. Rev.* 1211, 1231-1232; Standridge, 'Justification defense under section 2(a) of the Robinson-Patman Act' (1978) 9 *Rutgers-Camden LawJnl.* 219, 240.

[29] *Cf.* s.2(a) of the Robinson-Patman Act which provides:

> That nothing herein contained shall prevent differentials which make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such persons sold or delivered.

the costs of the seller rather than savings made by buyers. For example, as Donald and Heydon explain,[30] the incurring of warehousing expenses by a buyer does not relieve the seller from the necessity to maintain its warehouse if the buyer purchases direct from the factory floor.

(b) Actual Costs

Cost justification under the Robinson-Patman Act has eschewed the accounting conception that prices are dependent upon 'incremental' or 'marginal' costs,[31] which are those additional costs incurred by the seller in making those product units involved in each particular sale transaction. The practice has been to tax all customers with their aliquot share of pertinent costs.[32] A similar interpretation may be expected of s.49(2)(a) which requires that the differential granted to a particular customer traceable to differences between the cost of dealing with it and other customers. The economies of scale attributable to an increased level of production cannot be attributed to a single customer to justify discriminatory conduct as such economies will be computed by reference to the fixed costs which will be common to all customers.

(c) Manufacturing Costs

Since most manufacture is for an undifferentiated inventory from which orders are filled, there will usually be no manufacturing cost economy in filling one order as opposed to another. Examples of cognizable manufacturing cost differences suggested by the Federal Trade Commission's Advisory Committee on Cost Justification[33] include 'product development and design, tooling, varying manufacturing methods, set-up and make-ready, fluctuations in efficiency due to interruptions of production flow, employee training costs, methods and standards development, product costing and others'.

Two examples of allowable manufacturing cost economies suggested in the Congressional deabtes prior to the passage of the *Robinson-Patman* Act[34] were:

> where one customer devoid of storage facilities, requires spot deliveries during the rush of the season, for which the manufacturer must produce in advance and store himself in order to make the fullest utilization of his plant capacity; while another customer orders for delivery in off-seasons, handling the storage himself and

[30] Donald & Heydon, supra n. 16, at 419.

[31] See Sawyer, 'Accounting and statistical proof in price discrimination cases' (1951) 36 *Iowa L. Rev.* 244, 249ff.

[32] Rowe, supra n. 12, at 281; Murray supra n. 21, at 230-31.

[33] Reproduced in Taggart, supra, n. 27, at 573-574.

[34] 81 Cong. Rec. 9417 (1936) quoted by Rowe, supra n. 12, at 282.

> saving the manufacturer that cost, such a saving may be expressed in a price differential.

Similarly, it was suggested that differentials would be permitted:

> where one customer orders from hand to mouth during the rush of the season, compelling the employment of more expensive overtime labour in order to fill his orders; while another orders far in advance, permitting the manufacturer to use cheaper off-season labour, with the elimination of overtime, or perhaps to buy his raw materials at cheaper off-season prices, such savings as between the two customers may likewise be expressed in price differentials.[35]

Savings in manufacturing costs have rarely been asserted under the Robinson-Patman Act. In *United States Rubber Co.*,[36] the defendant succeeded in establishing different manufacturing costs at two different factories and in *Hanson* v. *Pittsburgh Plate Glass Industries, Inc.*,[37] specially cut glass sizes were found to produce manufacturing cost differences, but it is probable that significant differences in the cost of manufacture will result from goods not being of 'like grade or quality'.[38]

(d) Distribution Costs

Distribution costs are not a specifically mentioned source of cognisable costs in the Robinson-Patman defence,[39] but in the interpretation of that defence such costs are considered to be synonymous with those incurred in the sale or delivery of goods.[40] The Federal Trade Commission's Advisory Committee on Cost Justification included among the distribution costs of an integrated manufacturing company: any aspect of transportation, advertising, sales promotion, selling and technical services, warehousing and storage, credit, inclusion of the word 'distribution' in the s.49(2)(a) exception, however, will probably differentiate it from sale and delivery costs which are elsewhere mentioned in the exception.[41] This will probably confine the meaning of the word to those structural costs incurred in organizing the distribution of goods such as warehousing and storage, depreciation of inventory, packaging, labelling and branding, and the purchase maintenance and repair of delivery vehicles.

35 Id.
36 (1950) 46 F.T.C. 998, 1012.
37 (1973) 487 F. 2d 220, 235, cert. denied, (1974) 414 U.S. 1136.
38 Standridge, supra n. 28, at 226.
39 See n. 29 supra.
40 E.g. Murray, supra n. 21, at 231; Rowe, supra n. 12, at 281; Standridge, supra n. 28, at 227.
41 *Report to the Federal Trade Commission* (1959) reproduced in Taggart, supra n. 27, at 553 and 575.

The Neal Commission[42] recommended that the Robinson-Patman Act cost justification defence be amended to include the word 'distribution' in order, it has been argued, to include brokerage and sales commissions as cognizable costs,[43] such costs having been excluded from the defence.[44] If this view is correct then brokerage costs and sales commissions may justify discriminations otherwise in contravention of s.49(1) provided such costs are actually incurred by the favoured buyers.[45]

Savings in the distribution costs will only be cognizable under the exception if related to one of the three causal factors mentioned therein and only if actually realized in dealings with favoured customers. For example, if a buyer is given an allowance for holding the full range of a seller's goods, that allowance is only justifiable as cognizable cost if holding this range of goods exonerates the seller from storage expenses or inventory depreciation.

(e) Selling Costs

Under the Robinson-Patman Act this category of costs is taken to include all those costs incurred in the advertising, promotion and financing of sales transactions, together with the recovery of purchase moneys. Thus included under the general rubric of selling costs will be advertising expenses, promotional expenses, payment of sales personnel, technical services performed for the purpose of aiding customers and prospective customers in the use of goods, sales accounting, invoicing, inventory accounting, the maintenance of credit facilities, debt collection and post contractual enforcement expenses.[46] Other selling costs that may be cognizable under the exception are those incurred in the maintenance and repair of goods purchased by customers, provided that such services are not the dominant aspect of sales contracts.[47] An important limiting factor upon those latter costs are their relationship to the three causal factors mentioned in the exception. Subject to this, selling costs provide considerable scope for the cost justification of discriminatory conduct.

(f) Delivery Costs

Delivery costs include all those costs incurred in the transportation of goods from the point of production to purchasers, and are an obvious

42 White House Task Force on Antitrust Policy (1968).
43 Report reprinted in (1965) 1 *J. Rep. for Antitrust Law & Econ.* 633, 691.
44 Elias, supra n. 20, at 727.
45 Discussed in Kuenzel & Schiffres, supra n. 28, at 1223.
46 Report, supra n. 41, at 573-574.
47 Compare Bartholemew, 'Contracts for the sale of goods and contracts for work and labour' (1961) 35 *A.L.J.* 65 and Samek, 'Contracts for work and material and the concept of sale' (1962) 32 *A.L.J.* 67.

source of cost-justified discrimination. Savings in delivery costs resulting from the different places to which goods are delivered will include the savings in salaries, fuel and vehicle maintenance attributable to dealings with closer customers, as well as the costs of protecting perishable or fragile goods which have to undergo lengthy transits. Savings attributable to the different methods by which goods are supplied to different purchasers will include handling economies where mechanization can be used, for example, by sales to larger purchasers who buy containers or wagon-loads as opposed to carton loads. These savings may also be attributed to the quantities in which goods are supplied. These will include the delivery economies realized by bulk drop shipments at a buyer's central warehouse contrasted with, for example, the greater expense of many smaller shipments to buyers' individual stores.

The absorption by a seller of the delivery expenses incurred in dealing with its distant customers may be discriminatory if the commensurate savings in dealing with its more proximate customers are not passed on to them, as will be the discriminatory charging by a seller for unincurred 'phantom' freight.[48]

(g) Investment Costs

A seller's return on investment in plant facilities has been held not to be cognizable within the Robinson-Patman defence. In *Thompson Products, Inc.*[49] the respondent sought to justify its practice of charging higher prices for customers purchasing automobile replacement parts from its own distribution network, than it charged original equipment manufacturers. As part of its defence, Thompson claimed that its sales to the disfavoured distributors required the use of special facilities. Applying the rate of return it enjoyed on its other investment in plant, to the investment made in these special facilities, Thompson argued that the impugned discriminations reflected a cost of dealing with the distributor that was absent in transactions with original equipment manufacturers.

The Federal Trade Commission ruled that the tendered cost, representing return on investment but was 'an allocated portion of the total profits of the company' which were, therefore, 'entirely outside the sphere of actual cost differences'.[50]

Similarly, in *Borden Co.,*[51] the respondent argued that lower investment costs, resulting from difrerent inventory practices, justified price reductions to private label purchasers. Reaffirming the reasoning in

48 See Neale, *The Antitrust Laws of the U.S.A.* 2nd ed. (1970), 266-268.

49 (1959) 55 F.T.C. 1252.

50 Id. at 1276.

51 (1963) 62 F.T.C. 130; reversed on other ground (1964) 339 F. 2d 133.

Thompson, the Commission concluded that investment costs are not actual or incurred costs, but merely a return on capital investment and therefore impermissible as a source of cost savings under the defence.[52]

Rowe argues that placing investment costs 'outside the sphere of actual cost differences' ignores economic and commercial realities,[53] he argues:

> The investment of the seller in distribution facilities necessary to serving some customers but not others (who may have invested in their own facilities) is an elementary fact of economic life in many industries where diversity of distributive organization flourishes. To the extent the seller ties up his capital in facilities devoted to a particular customer class, rather than investing the amount elsewhere, he is entitled to an economic return on his investment in those specialized facilities.

If a seller can reasonably allocate investment costs among different customers, such cost savings could arguably be recoverable as savings in manufacturing or distribution costs provided such savings are attributable to one of the three causal factors listed in s.49(2)(a).

(h) Recognition of Countervailing Costs

Converse to the cognizable sources of cost savings discussed above is the question of whether countervailing costs should be taken into account in cost justification. A company selling at a lower price to some customers may be able to point to certain cost economies which account for the entire price disparity between the seller's customers. However, another area of costs may entirely neutralize this co lete cost justification by indicating certain economies to the seller from dealing with the disfavoured purchasers. For example,[54] assume a situation where by reason of lower labour costs in a slack period in Victoria, a Sydney seller saves five cents per unit if it is packed and shipped from its Melbourne warehouse to customers in Albury. At the same time, however, the seller incurs a freight cost of ten cents per unit more than if the shipment originated in Sydney. Assuming the relevant market to be New South Wales, may the seller justify the five cents lower price charged to Albury customers as compared with its Sydney customers solely by reference to its savings in labour costs, without taking into account the more costly freight ex Melbourne, or must the seller subtract any countervailing costs that conflict with the lower price?

The requirement that such costs be recognized seems to go beyond

52 (1963) 62 F.T.C. 130, 180.
53 Row, supra n. 12, at 282.
54 Suggested Id. at 287.

the language of s.49(2)(a), additionally, such an approach would add to the technical complexity of the exception,[55] although Taggart suggests that a person questioning a cost study should bear the onus of proving the contrary.[56] However, the recognition of countervailing costs does seem consistent with the objective of the exception to remove the economic discrimination inherent in certain pricing activities.

(i) Conclusion

An obvious criticism of the cost justification exception is that the sources of cost cognizable by the exception do not necessarily correspond with those factors which businessmen would monitor or consider significant.[57] Also the defence seemingly obscures the commercial reality of the concept of cost. For the businessman the concept of 'cost' is a more inclusive term, encompassing all the monetary and non-monetary elements of value such as credit risks, investment expenditures, general marketing and engineering research, legal expenses and other non-quantifiable items not precisely segregable to each product sold or to each customer dealt with.[58]

The usefulness of the exception will depend in some small measure on the extent to which these inchoate cost elements can be subsumed within the more precise sources of cognizable cost enumerated in s.49(2)(a).

(2) *'Reasonable Allowance'*

Section 49(2)(a) does not require an exact correspondence between cost savings and discriminatory prices, but only that a 'reasonable allowance' be made for cognizable cost differences. The utility of the exception will depend to a very large extent upon the range of disparity between cost savings and price which can be fitted within this formula. The analagous Robinson-Patman defence insists upon a 'due allowance', which is probably a more restrictive standard,[59] although in *Minneapolis-Honeywell Regulator Co.*[60] the Federal Trade Commission

55 Id.
56 Taggart, supra n. 20, at 508.
57 See Haslett, 'Price discriminations and their justification under the Robinson-Patman Act' (1948) 46 *Mich. L. Rev.* 450, 472; van Cise, 'The Robinson-Patman Act and the accountant' (1958) 3 *Antitrust Bull.* 325, 332; Warmack, 'Cost accounting problems under the Robinson-Patman Act' (1947) C.C.H. Robinson- Patman Symposium 105.
58 See (f) *infra*.
59 The view of Wells, 'Justifying price discrimination' (1976) 46 *Australian Accountant* 338, 342; Taperell, Vermeesch and Harland, *Trade Practices and Consumer Protection*, 2nd ed (1974) 353-354.
60 (1948) 44 F.T.C. 351, reversed, (1951) 191 F. 2d 786; cert. dismissed (1952) 344 U.S. 206.

acknowledged that 'cost studies of the sort presented in this matter do not afford precise accuracy, but must necessarily embrace a number of conjectural factors and allocations. There is inherent in them a reasonable margin of allowable error'.[61]

Minor discrepancies were allowed by the Commission in *United States Rubber Co.*[62] where it declared that unjustified price differentials 'in the amount of 0.0064, 0.0047 and 0.0092 per dollar of gross sales would be considered by the Commission to be *de minimi* and would not warrant the issuance of an order to cease and desist if they were the only price differences found to be not justified by differences in costs'.[63] A Robinson-Patman example where the disparities were considered too great to be allowable under this *de minimis* approach was *Thompson Products, Inc.*, where cost justification could account for all but three to seven per cent of impugned discount totals. The Commission considered this discrepancy greater than 'due allowance', particularly in an industry 'where competition is unusually keen, where margins of profit on individual items are exceedingly small, and where even the two per cent cash discount allowed by the respondent is so important to its distributor customers'.[64]

The key to the Federal Trade Commission's attitude towards discrepancies between a discrimination and justifiable costs is that they can be ignored provided no adverse competitive effects could flow from them. This approach was articulated in the Commission's decision in *B. F. Goodrich Co.*[65] where cost justification was established for all the seller's prices except one which accounted for less than one per cent of the total volume of sales at issue. The Commission declared 'There can be no public interest, and the commission would not be warranted in pursuing an inquiry relating to a discount bracket affecting such an insignificant proportion of respondent's business from which no possible substantial injury to competitors could result.'[66] Similarly, in *Hamburg Brothers, Inc.*[67] the Commission accepted disparities in a cost justification defence that were 'so small, figured either on a percentage basis or on a total dollar basis, that they could not substantially lessen, injure, destroy or prevent competition between respondent's customers'.

This *de minimis* approach is recommended as the basis of the 'reasonable allowance' for discrepancies between justified costs and prices con-

[61] (1948) 44 F.T.C., 394.
[62] (1950) 46 F.T.C. 998, 1012.
[63] (1959) 55 F.T.C. 1252.
[64] Id. at 1274.
[65] (1954) 50 F.T.C. 622.
[66] Id. at 623.
[67] (1958) 54 F.T.C. 1450, 1453.

sidered under s.49(2)(a). Any unjustified cost discrepancy ought not to be considered offensive, provided it is not likely to have the anti-competitive effect proscribed by 3. 49(1). This approach should not, however, disguise the fact that the offence is expressed in absolute terms and that if cost justification is not reasonably possible, the relevant impact upon competition is that of the entire discrimination and not that of the difference between such costs as can be justified and the quantum of discriminatory benefits offered favoured customers.

3. *'Likely Cost'*

The allowance for 'likely cost' made in s.49(2)(a) probably covers the situation where a supplier bases its price on an expected cost saving which is not achieved either in while or in part. A question not answered by the provision is the relevant time at which the likelihood of cost saving is to be judged. Two alternatives have been mooted: at the time of entry into the contract to sell or the time the goods are to be supplied. Taperell, Vermeesch and Harland suggest that 'the interpretation which seems best to coincide with the apparent intent of the section is that the cost saving must be likely at the time of entering into a binding commitment to sell'.[68] The learned authors argue that where a supplier has indicated a price for goods but has not bound itself to supply at that price and the realized cost savings turn out to be less than estimated, the supplier will not be able to rely on the exception unless its price is revised to reflect actual cost differences.[69]

The words 'or likely cost' considerably expands the exception beyond the Robinson-Patman Act's cost justification defence, which insists that the range of costs legally cognizable must be cost economies already recognized at the time of the transaction.[70]

4. *Amount of Relevant Discrimination*

Section 49(2)(a) excepts from prohibition, discriminations which make reasonable allowance for the cost savings that are cognizable under the exception. It will thus be necessary to identify at the outset, the quantum of discrimination which it is necessary to justify. The relevant differential between purchasers will be obtained by comparing net prices paid by the buyer to the seller after the deduction of any discounts, allowances, rebates or credits given in relation to the supply of goods, together with the value of any services supplied by the seller and promotional payments made to favoured buyers by the seller.

68 Taperell et al., supra n. 59, at 350-351.
69 Id. at 351.
70 U.S. v. Borden Co. (1962) 370 U.S. 460, 467.

As is explained above, the relevant discrimination for the measurement of anti-competitive effects is the total quantum of discrimination rather than of any unjustifiable portion of a discrimination, subject to the *de minimis* exception of insignificant residues.

5. *Cost Allocation Procedures*

(a) Introduction

The difficulty of assembling adequate cost data has been an important obstacle to cost justification under the Robinson-Patman Act.[71] Businessmen compute their prices in the heat of competitive pressure, often without the benefit of precise cost information and their prices are invariably justified on an *ex post facto* basis.[72] Of particular complexity is the allocation of a seller's costs among product or customer classes. The process of cost allocation in accountancy is extremely subjective and cost estimates for accounting purposes may not be sufficiently detailed to satisfy the prevailing legal standard.[73] For example, in *Automatic Canteen Co.* v. *Federal Trade Commission*[74] the Supreme Court observed:

> The elusiveness of cost data, which apparently cannot be obtained from ordinary business records, is reflected in proceedings against sellers . . . whenever costs have been in issue, the Commission has not been content with accounting estimates; a study seems to be required, involving perhaps sto-watch studies of time spent by some personnel such as salesmen and truck drivers, numerical counts of invoices or bills and in some instances of the number of items or entries on such records or other such quantitative measurement of the operation of a business.

The allocation of costs by estimate has been consistently disallowed under the Robinson-Patman Act, as falling short of the acceptable legal standard. For example in *Reid* v. *Harper & Bros.*[75] the Court stated that 'price differences ought to be justified by concrete and specific evidence of cost variances in dealing with different purchasers, and not by conjectural estimates alone'. Similarly, in *Federal Trade Commission* v. *Morton Salt Co.*[76] the Supreme Court rejected the assertion that deliveries of salt in carload lots created an obvious saving to a seller, in

[71] See Murray, supra n. 21, at 262-264; Kuenzel & Schiffres, supra n. 28 at 1225-1227 and the authorities referred to in n. 59 *supra*.

[72] Rowe, supra n. 12, at 306.

[73] Standridge, supra n. 28, at 233-234.

[74] (1953) 346 U.S. 61, 68.

[75] (1956) 235 F. 2d 420, 421-422; cert denied (1956) 352 U.S. 952.

[76] (1948) 334 U.S. 37.

the absence of actual proof of such savings.[77] On the other hand, in *Kraft-Phenix Cheese Corp.*,[78] the Federal Trade Commission agreed that loaf and package cheeses carried in the same truck shared almost equal delivery costs per unit, recognizing the 'practical impossibility of making an actual allocation of costs to each kind and amount of the product delivered'.[79]

The liberalization of acceptable accounting standards has been urged by all the principal commentators on the Robinson-Patman defence[80] and implies an appropriate attitude towards the enforcement of the s.49(2)(a) cost justification exception if the exception is not to be stultified by practical unworkability.

Cost justification is a fairly uncomplicated task where price differentials can be explained by reference to direct costs which only arise with respect to certain customers or products. For example, where a Perth manufacturer finds that it can deliver its product to purchasers in Perth for one dollar per unit less than to purchasers in Fremantle, the justification of a commensurate price differentiation in favour of its Perth purchasers is straight forward. Problems of cost allocation will arise, however, where the seller's price must be computed from elements of cost which are spread over a range of products and between a number of customers.

(b) Multi-product Cost Allocation

The separate ascertainment and justification of numerous and disparate prices in a seller's product line may impose onerous technical burdens and create an unrealistic cost analysis. The seller may wish to simplify the task of cost justification, not by accounting for each individual item sold, but by averaging the prices paid by one customer class as compared with another. This method of product cost allocation is inevitably subjective and vulnerable to attack on that basis.

The only major example of multi-product cost averaging succeeding under the Robinson-Patman Act is *Standard Motor Products, Inc.*[81] In

[77] Id. at 48.

[78] (1937) 25 F.T.C. 537, 545-546.

[79] Kuenzel & Schiffres, supra n. 28, at 1225 (n. 79) distinguished these latter two cases on the basis that the defence in Morton Salt was an example of mere 'office calculations' whereas in Kraft-Phenix there was actual data from which inferences could be drawn.

[80] Campbell & Emanuel, 'A proposal for a revised price discrimination and predatory pricing statute' (1975) 13 *Harv. J. Leg.* 125, 202; Elias, supra n. 20, at 729; Neal Commission Report, supra n. 43, at 691; Kuenzel & Schiffres, supra n. 28, at 1231-1233; Standridge, supra n. 28 at 233-234.

[81] (1957) 54 F.T.C. 814; affirmed, 265 F. 2d 674; cert. denied (1959) 361 U.S. 826.

that case the Federal Trade Commission rejected a two product line cost breakdown, arguing that the allocation formulae were 'demonstrably irrational' or 'out of accord with accounting principles'. The Appeal Court rejected the Commission's argument as being merely a preference for its own accounting system.[82]

Rowe[83] and Taggart[84] also cite *Sylvania Electric Products, Inc.*[85] as an example of a successful averaging of multi-product costs. Sylvania sold almost 600 types of replacement radio tubes and granted a price concession to Philco which bought for resale through its own distribution network. In its cost study, Sylvania did not attempt to justify the price differential between its sales to Philco and to its own distributors on each of the types of tube it marketed. Instead it employed a weighted average whereby the average price per tube to its distributors and to Philco was calculated. This classification combined considerable price differentials for some tubes with negligible or non-existent differentials for others.[86] Sylvania tendered evidence of greater distribution costs incurred in selling to distributors and correlated the aggregate of those additional costs with the aggregate price difference arrived at by use of the weighted average.[87] This approach was accepted by the Commission because of the impact on competitors of the impugned discrimination had competitive significance only by reference to Sylvania's entire product line.[88] This, and the fact that purchasers were obliged to stock the entire line of Sylvania's tubes to be able to meet the requirements of any particular radio set have been argued as the basis for confining the case to its own facts,[89] but the Sylvania opinion was cited as good authority by the more recent decision in *Hanson* v. *Pittsburgh Glass Industries, Inc.*[90]

In appropriate circumstances there seems to be no reason why an averaging technique based upon a reasonable and consistent accounting procedure would be impermissible under s.49(2)(a) to deal with the problem of multi-product cost allocation.[91]

[82] See Mervin, 'Robinson-Patman Act cost justification and CPAs (1971) 137 *J. Accountancy* 59, 60-62.
[83] Rowe, supra n. 12, at 276-277.
[84] Taggart, supra n. 20, at 365 ff.
[85] (1954) 51 F.T.C. 282.
[86] Id. at 284.
[87] Id. at 286-287.
[88] Id. at 289.
[89] E.g. Kuenzel & Schiffres, supra n. 18, at 1228.
[90] (1973) 482 F. 2d 220, 225; cert denied (1974) 414 U.S. 1136.
[91] see also Dowling, 'A period of uncertainty - section 49 Restrictive Trade Practices Act 1974 (Price Discrimination)' (1975) 3 *Aust. Bus. L. Rev.* 100, 108.

(c) Customer Groupings

Similar to multi-product cost averaging is the grouping of similar customers for cost accounting purposes. Theoretically, a seller's price differentiation among his customers might require precise analysis to ascertain the comparative costs attributable to specific transactions with individual purchasers. Practically, however, the division of a company's total costs into identifiable segments allocated to specific transactions or customers for comparative purposes is often administratively unworkable. An obvious strategy, therefore, is to address cost justification not to individual customers or transactions, but to reasonably homogeneous customer groupings, whose members receive equivalent price greatment from the seller.

United States v. *Borden Co.,*[92] the leading Robinson-Patman case on customer grouping, indicates the problems which will have to be resolved if the technique is to meet with approbation under s.49(2)(a). In that case, two Chicago dairies, Borden and Bowman, were accused of granting preferential prices to grocery chains while charging regular prices to independently owned grocery stores. Both dairies granted the independents percentage discounts on volume which was graduated to a maximum discount. The grocery chains were granted a uniform discount which ignored volume and which exceeded that available to independents. Both dairies sought to justify their discriminatory pricing on the basis of cost studies.

Borden's cost justification defence was based upon a cost study that divided the purchasers into five categories: two chains with 254 stores constituted one category, and 1,322 independents, subdivided on the basis of volume were grouped into the remaining four categories.[93] Borden compared its average cost per one hundred dollars of sales to the chains to its average cost of similar sales to the four categories of independents.[94] The Supreme Court rejected Borden's defence because not all members of the favoured class possessed identical characteristics which permitted their favourable treatment while some members of the non-favoured groups should have qualified for the preferential discounts.[95]

Bowman attempted to justify its classification of favoured and non-favoured customers, principally on the basis of how much time its delivery men had to spend in making deliveries,[96] calculating that the

92 (1962) 370 U.S. 460.
93 Id. at 465.
94 Id.
95 Id. at 469-470.
96 Id. at 465.

independents generated more costs per delivery because of the greater variety of services they required.[97] But Bowman's classification was rejected for similar reasons to those which induced the Court to decide against Borden.

The Court recognized as 'a matter of practical necessity', that a seller dealing with many customers 'cannot be required to establish different cost-reflecting prices for each customer'[98] but held that a seller could not justify price differentials on the basis of 'arbitrary classifications, or even classifications which are representative of a numerical majority of the individual members'.[99] In the Court's opinion the use of customer classifications for cost justification was recognized only when the classes

> are composed of members of such self sameness as to make the averaging of the cost of dealing with the group a valid and reasonable indicium of the cost of dealing with any specific group member. High on the list of 'musts' in the use of the average cost of customer groupings . . . is a close resemblance of the individual members of each group on the essential point or points which determine the costs considered.[100]

An objection to the Borden rule is that if more than a substantial number of customers must bear similar costs of dealing in order to render a group sufficiently homogenous, then sellers must employ the sort of individual customer analysis which the technique seeks to avoid, in order to assure that the relevent classification satisfies the standard.[101] Also, 'since a seller cannot have pre-cognition or cost-price relationships with each of its buyers', compliance with the test suggests the onerous obligation of constant review by a seller of its cost data.[102]

Applications of Borden do not give much firm guidance for s.49(2)(a) practice. In *National Dairy Products Corp.* v. *F.T.C.*[103] the Appeal Court rejected a multi-tiered volume discount structure which included two low volume purchasers in relation to whom cost savings did not justify the discount.[104] The Borden standard was more liberally applied in *American Motor Corp.* v. *F.T.C.*[105] in which the Appeal Court approved a customer division into only two classes with four retail distri-

97 Id. at 470-471.
98 Id. at 468.
99 Id. at 468-469.
100 Id. at 469 (footnote omitted).
101 E.g. Kuenzel & Schiffres, supra n. 28, at 1230.
102 Standridge, supra n. 28, at 233.
103 395 F. 2d 517; cert. denied (1968) 393 U.S. 977.
104 (1968) 395 F. 2d, 524-429.
105 (1967) 384 F. 2d 247; cert. denied (1968) 390 U.S. 1012.

butors in the most favoured class, as opposed to 6,000 retail purchasers in the disfavoured group.

One of the problems with the Borden standard, as was pointed out in *F.T.C.* v. *Standard Motor Products, Inc.*,[106] was that the Supreme Court in Borden did not prescribe what degree of homogeneity was required within each class of a customer grouping system.[107]

Given the obvious administrative economies inherent in customer grouping for the purposes of price or discount schedule formation, it will be essential to formulate a standard of reasonable group comparability for s.49(2)(a) purposes. This question is considered below in the general context of standard of proof.

6. *Burden of Proof*

The onus of establishing that s.49(1) does not apply to a dsicrimination by reason of 3. 49(2)(a) is imposed by s.49(3) upon the party asserting the application of the cost justification exception.[108] This is presumably because the supplier, asserting the exception, is invariably in the best position to demonstrate its application.

7. *Standard of Proof*

It is in the elaboration by the courts of the standard of proof expected of defendants, that the usefulness of the cost justification exception will be determined. As the Robinson-Patman experience indicates, the imposition of an unreasonably onerous or impractical burden upon defendants will result in the stultification of the exception. A seller ought to be obliged to exercise no more than reasonable, good faith judgment in its accounting procedures. Although a prior determination of costs is to be recommended, ex post facto cost studies should not be impermissible.

The guiding principle to be recommended in evaluating a seller's attempt to comply with the cost justification exception ought to be the good faith standard which animates the meeting competition exception contained in s.49(2)(b) of the Act.

CONCLUSIONS AND CRITIQUE

The unsatisfactory history of cost justification under the Robinson-

106 (1967) 371 F. 2d 613.

107 Id. at 621.

108 Section 49(3) provides:

> If any proceeding for a contravention of sub-section (1), the onus of establishing that that sub-section does not apply in relation to a discrimination by reason of sub-section (2) is on the party asserting that sub-section (1) does not so apply.

Patman Act might simply be an acknowledgment that cost justification defies substantive formulation[109] or, more fundamentally, that there is only a dubious causal nexus between prices and costs in competitive markets. Reference has been made to the unreality of the legal, as opposed to the commercial, concept of cost, 'price not only must reflect the costs of the raw material, but must consider the value of the entire operation which transmutes managerial skill, raw materials, technology, labor and physical plant'.[110]

The limited range of cognizable costs is an important shortcoming, but even ignoring this deficiency, there is the more fundamental objection that cost in actuality is but one ingredient in price formulation. The determination of price depends ultimately upon the seller's target return on investment conditioned by its appraisal of external market conditions. In addition the seller must forecast the demand for its product and predict the reactions of competitors to price changes.

A final theoretical objection to the cost-price nexus, upon which the exception is predicated is raised, by Rowe who queries whether in fact it could be said that costs determine price at all. He argues that it is probably price which determines cost, since it is the price obtainable for a product which governs the efficiency of plant utilization and which in turn determines the unit cost of a product.[111] He explains:

> A cost justification tendered in a Robinson-Patman proceeding thus is ordinarily an ex post facto rationalization ofprice differences that spring from the interplay of other factors. As an artful reconstruction of a missing link between cost and price, it is an enterprise at once contrived and suspect.

The artificiality of joint cost allocations has already been noted, few costs are clearly segregable and the allocation of the rest is 'determined by policy decisions which masquerade as mere accounting procedures'.[112]

Given the conceptual misgivings with the cost justification procedure, an obvious question which must be answered is whether the exception performs any useful role. Rowe suggests that the presence of a cost justification defence may force a firm to raise its standards of record keeping and accounting procedures with a consequent halo effect of good faith.[113] A far more important justification for the exception is that its

[109] Advisory Committee on Cost Justification, *Report to the Federal Trade Commission* (1956) 15-17.

[110] Rowe, supra n. 12, at 304.

[111] Id. at 306.

[112] Edwards, *Maintaining Competition* (1949) 161.

[113] Rowe, supra n. 12, at 309-311.

very *raison d'être* is the provision of a facility for cost economies to be passed on to purchasers and, thence, ultimately to consumers.[114] As the Attorney General's National Committee to Study the Antitrust Laws reported, because any accounting apportionment of costs involves subjective business judgment, and not objective fact, a reasonable approximation of production or distribution cost variances to price differentials is recommended, when demonstrated in good faith through any authoritative and sound accounting procedures.[115] 'Applied this way, the Act should impede no price variation reasonably related to economies in any of the seller's costs deriving from significant differences among customers or broad categories of commercial transactions.'[116]

[114] Kaysen & Turner, *Antitrust Policy- An Economic and Legal Analysis* (1959) 185-187.

[115] Attorney General's Report, supra n. 17, at 174-175.

[116] Id. at 175.