THE CONCENTRATION OF ECONOMIC POWER

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The concentration of economic power is not the product of a particular method of pricing nor can it be destroyed merely by the elimination of basing point formulas and other types of formula pricing. It is facilitated by the peculiar opportunities for assembly and management of large aggregates of capital which inhere in our loose corporation laws and in the structure of our capital markets. It is promoted by the many forms of bargaining advantage available to the large enterprise, not only in the purchase and sale of commodities but also in the purchase of credit and labor, in the manipulation of public opinion, and in the pursuit of the concern's interest in the law courts and in politics. Even modern technology contributes something to the concentration of economic power in many fields, though its role has been vastly overstated. To eradicate this concentration would require a sustained attack at many points, among the least important of which would be the particular forms of pricing that might be employed.

But though geographic price formulas do little to create the concentration of economic power, the power of great enterprises does much to determine the character and use of geographic pricing formulas. The purpose of this article is to point out some of the ways in which this influence makes itself felt.

Basing point price formulas have held the center of attention in most discussions of geographic pricing methods. Accordingly, more information is available about them than about alternative methods, and what is known has been more fully analyzed. Therefore, this article will be devoted primarily to basing point systems.

Implicit in the industry-wide use of a basing point pricing system is

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an understanding by which the interests of large and small enterprises are adjusted in a working compromise. The large enterprise surrenders a part of its ability to attack the small. In effect, it guarantees that little business will not be ruthlessly destroyed. In return the small enterprises surrender most of their initiative in making prices and most of their opportunity to grow in size and power. By this mutual surrender, a situation is created in which the small concerns live impotently but not unsuccessfully under the large concern’s umbrella.

To see how this compromise works, it will be necessary to examine the lines of action which are available to large and small business enterprises in the absence of an industry-wide pricing formula and to consider in some detail the parts of these opportunities which are surrendered in compliance with the basing point formula.

A notable feature of the large business enterprise is the wide geographic sweep of its market. Sales are made in many localities. In so far as the buyers in these various places are not fully informed about opportunities to buy elsewhere or in so far as they cannot readily go elsewhere to make their purchases, each of these localities can be treated as a separate market in which the large seller follows a separate price policy. Since ignorance and immobility are common among buyers, the large seller can usually reduce or increase prices locally rather than generally if he so chooses.

By contrast, the small seller is relatively unlikely to do a substantial portion of his business at points remote from his point of production. Being small, he lacks facilities to locate distant customers and lacks the funds to advertise his name or his product throughout a wide area. He does business most easily in the local community where he is best known.

The effect of this difference in the geographic scale of operations is to place the small concern at the large concern’s mercy. The local market which may supply one-half or three-fourths of the business of a small producer is likely to afford a large producer no more than one or two per cent of his business. A price reduction in that local market would be disastrous to the former and unimportant to the latter. Thus the large enterprise can cut prices in a single locality without regard to the costs or profits of its sales there, and in doing so it can ruin its small rival no matter how efficient he may be. Such local price cutting was identified as early as 1911 as a monopolistic practice indicative of a

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violation of the Sherman Act. It still remains one of the most effective weapons of big business against little business. It can be used to destroy the small concern, to induce the small concern to merge with a larger rival, or to force the small concern to follow business policies approved by a larger rival. Even where local price cutting has not been employed, the possibility of its employment exposes a small enterprise to continuous jeopardy and causes such a concern to be avid for the good will of the large competitor by whose sufferance it lives.

Though the large enterprise has discretionary power to destroy the small, it will do so only as an act of discipline or in a move toward monopoly. In ordinary competition which falls short of such extreme measures, the small concern has many opportunities to harass and outmaneuver its larger rival. The small business knows its small market intimately and is capable of reducing its price to get business before the large concern has time to move. The small business can treat as a business decision what the large concern would have to treat as an exception to an established policy. Moreover, weakness may induce the small enterprise to cut prices rather than lose business while the larger rival is grimly trying to maintain the established price level. It is nearly always a small enterprise which is regarded as a chiseler, a price cutter, an irresponsible member of the industry, or whatever else may be the name given to the most active competitive force in a market.

Under a basing point formula, the large enterprise surrenders its freedom to destroy and the small enterprise surrenders its price flexibility.

Localized price cutting is inconsistent with the basing point formula. A mill located at the base, as the mills of most large enterprises are likely to be, is committed to a formula under which, throughout the basing point area, delivered prices rise with each increase in the distance from the base by the full amount of the additional freight charge incurred, so that the net realization at the mill does not differ from one locality to another. Within the base area, special price reductions at particular localities are inconsistent with the formula. If, by any chance, the large concern has a non-base mill, this mill is committed to maintain delivered prices equal to those quoted by the base mill. This means

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3 Standard Oil of New Jersey v. United States, 221 U.S. 1 (1911).
4 For simplicity's sake, the analysis ignores the case in which the freight charge added to the delivered price is computed for a method of transportation more expensive than that actually used by the seller.

4 Temporary National Economic Committee, Monograph No. 42, The Basing Point Problem. To Prevent Uniform Delivered Prices, Hearings before Committee on Interstate
that the non-base mill will not cut prices in its own local territory nor in directions away from the base and that its price reductions in shipments toward the base will put no pressure upon the prices quoted by the base mills. In selling into some other basing point area, base mills and non-base mills alike are committed to quote but not undercut the delivered prices already prevailing there. Thus price reductions are either avoided or routinized in such a way that no special pressure is put upon the prices of any concern in any locality.6

This means that, so long as the formula is followed, the small enterprise is immune from threats of local price cutting. Every mill selling into the home territory of the small concern will observe there the same formula price which the small concern is also quoting. If the small enterprise is located at the base, this formula price will be high enough to give the small concern the same mill realization as is enjoyed on sales within the basing point area by the base mill of its large rival. If the small concern is located away from the base, the price in its own local market will be higher than the base price by the amount of the computed freight charge from the basing point, and in consequence its local sales will realize more than a base mill realizes in its own local market. In either case, mills from other basing point areas will observe the established price structure and leave to the base mills of any particular area the initiative in reducing prices in that area.

In turn the use of the basing point formula guarantees that the small enterprises will no longer show initiative in cutting prices in ways inconvenient to the large concern.6 In so far as the small enterprises are located away from a basing point, their practice of computing delivered prices by adding to the price at the basing point the freight rate from the basing point to the point of delivery is a guarantee that they will show no price initiative of their own. The role of such non-base mills becomes merely that of following the prices established by the basing point mills. Moreover, even a small enterprise located at a basing point is unlikely to take the initiative in price cutting; for any reduction in a base price means a uniform cut in delivered prices throughout the bas-

Commerce on S. 4055, 74th Cong. 2nd Sess. (1936), especially testimony of Robert Gregg, Vice President, United States Steel Corp.

* Robert Gregg, Vice President of United States Steel Corporation, said in 1936: "... if that plan [the basing point system] were universally followed there would be no competition in so far as one element of competition is concerned, namely price, ..." Id. at 207.

ing point area and therefore has an application so general that the reduction will necessarily be met by the large enterprise. By removing the possibility of unsystematic, localized, and unimportant price reductions, the formula guarantees that all price cuts will be treated as important and therefore that no small business will have anything to gain by becoming admittedly a price cutter. If a small enterprise decides to reduce prices, it is almost certain to resort to secret departures from the basing point formula rather than to overt reductions of the formula price.

In most cases, the basing point system can be easily used by a large enterprise to discipline a small price cutter who does not observe the basing point price formula. If the small concern operates a non-base mill, the large concern may take the initiative in establishing a base price at the mill of the small price cutter.\(^7\) If the small enterprise operates at a base where there are no other producers, the large concern may take the initiative in cutting the price at that base. Either of these two actions runs counter to the established practice of basing point industries, under which each enterprise decides whether it will name its mill as a base and the base mills take the initiative in making price changes within their respective base areas. For punitive purposes, however, these conventions may be abandoned. By quoting an appropriately low base price in the home territory of the price cutter, the large concern can punish him without lowering prices in other markets and thus without significantly affecting other producers. Only in the case in which the price cutter is located at a base where there are also other producers is there any difficulty in using the basing point system for disciplinary purposes.

The existence of the power to discipline the small concerns within the limits of the basing point formula is evidence that the protection from localized reductions in price which the formula affords to small enterprises is not a mere mechanical matter, determined by the mathematical characteristic of the formula, but is instead an expression of a working compromise among members of the industry by which the little concerns have overtly or tacitly undertaken not to be troublesome and the big concerns have overtly or tacitly undertaken to let their neighbors live in peace.

A second broad characteristic of an industry-wide basing point system is that it tends to facilitate the growth of large enterprises and to limit the growth of small enterprises, so that discrepancies in size within the industry are maintained and may even be enhanced.

\(^7\) Id. at 91-92. See also FTC v. The Cement Institute et al, 333 U.S. 683 (1943).
Several features of the basing point formula contribute to this result. The first is the fact that under the formula the home markets of small producers are usually fully open to the large producers, whereas the home market of the large producer may be effectively closed to the smaller producers. This result is not inevitable, since it depends upon the relative location of large and small producers with reference to basing points. In general, however, the large producer is likely to be at a basing point, whereas it is relatively rare for a base to be established at a point where there is only a small producer. In any case in which the bases are the production points of the large concerns, the markets of the small concerns are likely to be one-sidedly vulnerable. If any small enterprise is located at the large concern’s base, its market is, of course, fully open to the large concern. Small concerns located away from the base quote prices in their home markets which are computed as the sum of the base price plus the full freight from the base to these markets, and therefore any enterprise at the base can invade these outlying markets without financial sacrifice. The entire market area lies open to the basing point mill. By contrast, the home market of the basing point mill is not fully open to anyone except another concern also located at the same base, for the outlying producers who sell toward the base find that in such sales their delivered prices go down while their freight costs rise, so that their net receipts are reduced by roughly double the amount of the freight outlay.

With a protected home market and full access to the home markets of others, the base mill has both unusual stability and unusual opportunity to grow. With a vulnerable home market and with ready access only to other markets which lie in directions away from the base, the non-base mill is badly placed for growth. It is to be expected that the pressures of obsolescence, inefficiency, and change in the location of demand will have a lighter effect upon base mills than upon non-base mills.

The handicap thus incurred by the non-base mills is partially offset by the higher realization which such a mill enjoys upon sales in territories adjacent to its plant. By virtue of this higher price upon local sales, it may bear the doubled cost of selling toward the base for an appreciable distance before its realization in such sales falls as low as the realization of the base mill. If freight costs are uniform with distance, however, this cushioning effect is felt only in sales to points which are less than half the total distance to the base. Moreover, it is possible
that the non-base mill’s limited sales area may mean a small volume of business, and that this in turn may mean high unit costs. If so, it is possible that the non-base mill’s higher realizations upon local sales will be consumed by increased costs instead of becoming a source of profit.

The importance of the difficulty experienced by small non-base mills in selling toward the base is enhanced by the likelihood that the market at the base will be the most important market. Except as other factors give offsetting advantages, the large producer who established the base is likely to have placed it in or near a substantial market. Moreover, under the basing point formula the cost of goods to a buyer located at the base is necessarily lower than their cost to a buyer located away from the basing point. This difference in cost of raw materials is a standing incentive for fabricators to go into business at the base rather than elsewhere. It is also a standing advantage tending to assure the success and growth of fabricators located at the base in their competition with fabricators elsewhere. The market at the basing point is likely to be larger than it would have been but for the basing point system, and unless other influences offset the advantages attached to this market, it is likely to be the largest market in the basing point area. To be excluded from such a market or admitted to it under severe handicap is a substantial disadvantage for a non-base mill.

Another feature which tends to strengthen large enterprises against small ones in basing point industries is the fact that large concerns frequently have several producing establishments. The basing point system works in favor of the multiple plant enterprise as compared with the single plant enterprise. With plants at several basing points, the large concern can make sales in each base area, yet hold to a minimum the number of instances in which it absorbs freight in order to sell from one base area into another. Within a single base area, a large concern which has both base and non-base mills may enjoy the high local realizations of the non-base mill and yet, by supplying intermediate territory from the base, minimize freight absorptions from the non-base mill. As the number of plants under one ownership is increased, the occasions when freight is absorbed grow fewer, though the opportunities to collect phantom freight remain as numerous as before. By contrast, the single plant enterprise located away from a base cannot enjoy phantom freight without being forced to absorb freight or forego markets toward the base; and the single plant enterprise located at a base cannot sell in other base areas without freight absorption. Only the multiple plant enterprise can eat its cake and have it too.
In summary, the foregoing analysis means that the benefits the small seller obtains from industry-wide use of a basing point system are limited to protection against localized price cutting by his larger rival and provision of a relatively high return upon his local sales if he is situated far from the basing point. The sacrifices imposed upon him by such a system are loss of his initiative and independence in making prices, abandonment of any effort to give a nearby customer a price incentive to deal with him rather than with a distant producer, and impairment of his opportunity to enlarge his business by reaching out to markets nearer the basing point. A concern which is willing to remain permanently small and docile is well suited to the use of such a pricing system, but a small concern which desires to grow is likely to find the system a serious handicap.

With the price structures of basing point industries thus skewed in a direction adverse to the ambitions of small enterprises, it would be reasonable for such concerns to express discontent with basing point price formulas and to welcome the abandonment of these formulas. In hearings recently held by the Senate Committee on Trade Practices, some spokesmen for small business have expressed such views. For example, George Burger, Director of the National Federation of Small Business, testified as follows:

"... either you can recommend that Congress take no action on this matter, which will represent a ringing affirmation of your belief in free, competitive enterprise and freedom of opportunity, or you can recommend that Congress legalize this so-called 'individual' use of the basing point system, which will represent disavowal of our antitrust laws and a solid step away from free, competitive enterprise and freedom of opportunity."

Summarizing the views of various small business men with whom he had talked on the West Coast, Vernon Mund, economist of the University of Washington, expressed similar views. He said:

"To the extent that fabricators buy basic commodities at eastern base prices plus rail freight, cost prices in the Pacific Northwest are high. As a result, local fabricators are unable to ship their products eastward to any appreciable extent in competition with others situated near an eastern basing point. . . . Many business men in the Pacific Northwest state that the practice of 'freight absorption' by which distant eastern mills 'dump' into this area by absorbing some of the freight has definitely served to retard the development of local

industry—such as steel-making—because local demand is readily supplied by the eastern mills. . . .”

Others who spoke for small business before the committee expressed dissatisfaction with the recent basing point decisions. Some of them were not interested in defending basing point systems but believed that the legal principles established in the decisions condemn other methods of pricing as well as basing point pricing. Others who criticized the decisions did so because of effects upon their business interests which are the direct result of current conditions of shortage in particular key industries and which, therefore, must be regarded as temporary difficulties. Still others opposed the decisions primarily because of the inconvenience attached to changes in business methods and changes in the relative advantages enjoyed by rival business men in serving particular customers.

Let us examine the bearing of these three lines of criticism upon the interests of small business.

The first criticism comes from small business men who wish to be allowed to absorb freight to meet competition, to quote a uniform delivered price, or otherwise to avoid a strict system of pricing f.o.b. mill, and who believe that f.o.b mill pricing is required of them by the present law. The Federal Trade Commission has officially stated that the law neither requires f.o.b. mill prices nor forbids freight absorption to meet competition. Thus, if the Commission’s interpretation of the law is correct, this type of criticism springs from misapprehension. In any case, the purpose of the criticism is to protect pricing methods which fall far short of basing point pricing.

Some of the witnesses emphasized disadvantages for small business which they thought would result from inability to absorb freight. For example, it was said that a large concern with many plants or warehouses could avoid the laws against price discrimination by charging a uniform price in all sales from a single plant or a single warehouse and yet could vary the level of price at different plants or warehouses; whereas the small concern with only one establishment could not meet the large

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concern's prices without unlawful discrimination. Similarly, it was said that a concern which owned its own fleet of trucks could average the cost of making deliveries in them, whereas a small concern using common carriers for delivery would not be free to meet the average prices of the large enterprise by averaging its common carrier costs. Arguments of this kind rest upon the assumption that freight may not be absorbed to meet competition; and the contention that the interests of small business are harmed by such anomalies is no stronger than the legal assumption upon which it rests.

The criticism which grows out of conditions of shortage is centered among the consumers of cement and steel. After the cement decision, most enterprises in the cement and steel industries announced that they would sell f.o.b. mill without freight absorption and asserted that this method of selling is now required of them by law. Their willingness to adopt this interpretation of the law probably was enhanced by the fact that their products were in such short supply as to enable producers generally to sell their whole output in nearby markets, thus avoiding costs of freight absorption in distant markets which they formerly served. Although the costs of freight absorption were eliminated by f.o.b. mill selling, the level of mill and base prices, which had been high enough to permit freight absorption, was generally maintained. Thus, the effect of the change was to increase the delivered prices which were quoted to all customers who had previously been served on a freight absorption basis. If ample supplies had been available, these customers probably would have turned to nearby sources of supply, thus obtaining their goods as cheaply as before; and under this kind of pressure, it is doubtful that the distant producers would have continued to disregard the Federal Trade Commission's statements that freight absorption to meet competition is not necessarily unlawful. Under conditions of shortage, however, the nearby producers were already selling their whole output, and the customers who were asked to pay freight that had formerly been absorbed by the seller had no alternative but to pay it. In some instances, the effect was merely to raise the cost of goods. In other instances, it was also to put the buyer at a disadvantage in competing against other buyers who experienced no price increase because they had been purchasing from nearby producers who did not absorb freight.

Single enterprises have, no doubt, undergone real hardship because of the fact that the sellers in a few key industries have chosen to adjust their prices to the law in this particular way. For other enterprises,
however, the effect of the shortage has been lightened by the basing point decisions. The effort to minimize freight absorption by ceasing to sell to customers in freight absorption territory had gone so far before the basing point decisions as to become in itself a source of hardship. Fabricators, particularly users of steel, frequently complained that their former supplier would no longer sell to them and that other suppliers would not accept new customers. After the basing point decisions and the adoption of f.o.b. mill pricing by steel producers, some of these fabricators found that they could once more buy goods, provided they were willing to pay the additional freight cost. To such concerns, the inability to buy had been a death sentence, unless supplies could be obtained at large premiums on the black or gray markets. By comparison, an additional freight charge was a minor inconvenience.

No information is available from which the number of concerns, the amount of business, or the aggregate cost involved in such maneuvers can be accurately determined. Private and informal estimates of freight absorption in the steel industry at the time of the cement decision indicate that absorption may have averaged from 75 cents to $1 a ton. Other such estimates suggest that about ten per cent of the industry's product may have been sold on a freight absorption basis, about half of this going to the automobile industry. No estimates at all are available as to the total number of concerns which had been denied steel by suppliers who wished to avoid absorptions nor as to the aggregate effect of such denials upon such concerns. Whether small enterprises lost more than they gained through the adoption of f.o.b. mill pricing is problematical. But even if there had been no offsetting gain, it would still be clear that the maximum increase in the delivered cost of steel attributable to the abandonment of freight absorption—something like a dollar a ton, on the average—was much less important to steel users than the industry's subsequent price increase of about $8 a ton, which was admittedly unrelated to the abandonment of the basing point system.

The third type of argument points to the difficulties which arise inevitably wherever there is a change in the status quo. Under a basing point system, as under any other kind of price structure, there comes to be an industry-wide network of established price relationships, in terms of which the members of the industry, large and small, have located their businesses, attained their sales volume, and ascertained their relative ability to get and hold business. When the basing point system is abandoned, non-base mills may be able to sell more readily toward
the base; base mills may experience greater difficulty in selling at points distant from the base; and customers near basing points may no longer be able to count upon substantially cheaper raw materials than are obtained by their competitors remote from basing points. These alterations in the relative market opportunities and in the relative costs of sellers and their customers necessarily create new business problems for every concern which now finds itself less advantageously situated than before. However, since these problems grow out of change in the relative position of competing enterprises, it is obvious that one concern’s loss is necessarily another concern’s gain. Those to whom the change is harmful may be expected to complain, while those to whom it is helpful have no special reason to advertise their new advantages. For this reason, any change brought about by law is likely to take place in an atmosphere of complaint from the defenders of the status quo. The rigorous adoption of f.o.b. mill pricing in the steel and cement industries, without exploration of other less drastic alternatives, has probably enhanced the changes in relative position among the customers of those industries and thus intensified this type of complaint. The problem is not different in kind but only different in degree from that which arose in the steel industry during the 1930’s, when new bases were announced by various mills and well-established base price differentials were abandoned. Short of a freezing of the nation’s price structure, there is no way to avoid transitional problems and transitional complaints.

The complaints of small business men before the Senate Trade Practices Committee do not challenge the essential soundness of the view that a basing point price structure serves the long-run interests of large enterprises at the expense of small and promotes the consolidation of economic power. These complaints merely assert that there are painful elements in all far-flung changes of the price structure, that in times of shortage customers are helpless against any price increases which their suppliers may wish to impose, and that the immediate interests of various small enterprises would be adversely affected if they found it necessary not merely to abandon basing point systems but also to adhere strictly to f.o.b. mill pricing.

Space is not available to attempt a full analysis of the relation of other forms of delivered pricing to the concentration of economic power. It is apparent, however, that the basing point system weights the scales in favor of the large enterprise, as against the small, more decisively than do other types of geographic price structure, even when these other
methods of pricing are also adopted rigidly upon an industry-wide basis. Three examples may be used to illustrate this point.

A system of delivered prices which are uniform for all destinations gives the large concern less advantage over the small than does the basing point system. In such a system, large and small enterprises alike enjoy their highest realizations from sales adjacent to their respective plants, and each incurs the necessity of absorbing freight in selling away from the plant in any direction. When they sell toward each other, each encounters a deterrent of freight absorption as some inducement to stay out of the other’s local market. In selling in the opposite direction, either concern has an advantage over its rival because, being nearer the buyer, it need absorb less freight to reach him. In such a price structure, the small enterprise is not automatically deprived of initiative. It is automatically given a cost advantage in some small part of the market.

Under a system of so-called freight equalization, every mill has a mill price for sales at the mill and stands ready to sell to customers in adjacent territory at a delivered cost consisting of the mill price plus actual freight expense, so long as this delivered price is not higher than that quoted by a competitor. Wherever the competitor’s delivered price is lower, the mill stands ready to meet that lower price. Under such a system, even the smallest business enterprise which is located at a place not also occupied by its competitors may have a mill price of its own and a sales territory in which it is the sole seller who does not absorb freight, provided its mill price is not set high enough to include full freight from a competitor’s mill. In consequence, a freight equalization system gives small enterprises greater chance to take the initiative in raising and lowering prices in their home markets than such enterprises enjoy under a basing point system. Moreover, since the large concern may find it necessary to absorb freight to invade the small concern’s home market, such a system increases the chance, as compared with the basing point system, that the small concern will serve a substantial portion of the customers who are adjacent to its plant.

In an f.o.b. mill pricing system, the initiative enjoyed by the small concern in territory adjacent to its plant is similar to that enjoyed under freight equalization. However, since the large enterprise cannot meet the prices of the small concern in this territory except by lowering its mill realizations upon all its business everywhere, the sales advantage enjoyed by the small concern in its home territory is more substantial than that obtained under freight equalization. Competition between the
large enterprise and the small will take place at a boundary between their respective sales territories, and the stakes of the competition consist in possible changes in the location of the boundary. By a low price policy, a small concern can enlarge its home market without much likelihood that the large enterprise will find it worth while to retaliate. Thus the opportunity for growth by the small enterprise is greater under this system than under the basing point system.

Whatever may be the pricing methods which replace basing point pricing in consequence of the decisions in the recent cases, the long-run effect of the changes is likely to be a reduction in the strategic advantage which attaches to concentrations of economic power and a gain in the opportunity for small business enterprises to pursue their own price policies, develop their own markets, and grow bigger. It would be easy to overstate the extent of this effect. Surely it will not be great enough in itself to bring about any decisive change in the trend toward concentration of enterprise which has been evident in recent decades. But though the scope of the change is uncertain and may be relatively small, the movement is in the right direction.
THE RESTRICTIVE INCIDENCE OF BASING POINT PRICING ON REGIONAL DEVELOPMENT

. WILLIAM SUMMERS JOHNSON*

OTHER articles in this series deal with particular aspects of the basing point system. Similarly, this article is directed toward a particular aspect of the system, namely, its relation to the growth of industry in the outlying, or newer industrial regions. While this subject is, in itself, one of broad scope, the treatment given it here must necessarily be both narrow and selective.

Perhaps the best way of focusing attention on the subject is to indicate what the article is not about. Specifically, this article is not concerned with presenting a comparison of the effects of basing point pricing on regional development as contrasted with other forms of geographic pricing, such as freight equalization systems, zone price systems, f.o.b. systems, etc. Each of these alternative pricing methods has many variants; and each variant would have to be analyzed from the point of view of its effects upon a number of different, though interrelated, factors. An attempt at such an analysis would not only run to great length but it would involve a number of assumptions of highly debatable validity.

Therefore, this article consists simply of an analysis of certain ways in which the operation of the basing point system tends to hold down the expansion and growth of mills in the outlying areas, without reference to the question of whether the various alternative geographic pricing systems, and the numerous variants thereof, would be more or less restrictive in their effects upon regional development.

Whatever value this article may have will be in its exposition of the logical, mechanical way in which the basing point system does and must operate against the outlying producer and, concomitantly, his nearby customers.¹

As an example of basing point operations, the general structure of that employed in the steel industry—until recently—is chosen. Here it should be noted that the so-called "basing points" have usually been

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¹ For fuller expositions of several of the basic principles demonstrated here, see Smithies, Aspects of the Basing-Point System, 32 Am. Econ. Rev. 705 (1942).
at the principal centers of surplus—and at the sites of the largest producers—while the smaller producers in the outlying, deficit, areas have typically been "non-base."

The article is divided into two parts, the first of which concerns the relationships between the base-mill and a non-base mill, and the other, relationships between base mills. Since space does not permit examination of a number of varied assumptions, the following considerations presuppose the "normal" or "long-term" conditions—that is, capacity adequate to meet prevailing demand and mills willing to accept additional business.

**Non-Base Mill - Base Mill Relationships**

In order to illustrate the major points to be made, several semi-pictorial models have been constructed. (They are not drawn to any mathematical scale.) The first (Chart I), consists of Base Mill A and Non-Base Mill B, located along an east-west line, with a certain distance between them. Only these two mills are necessary for an examination of the principles involved. More mills can be added with more complex results, but the central forces are the same. Moreover, it does not matter what the distance between them is, in so far as the principles

![Chart I](chart.png)

Delivered prices to any one location are identical from both mills, Non-Base Mill B has to charge its nearby customers more than its distant customers. It charges its customers located to the west more than its customers of equal distance to the east. Base Mill A's charges to its customers, vary with freight costs.
are concerned, but it will be apparent that the freight costs must be significant in relation to the profit margin.\(^2\)

There is also included in the model a segment of the market area in which both Mills A and B sell. This market area has been designated as "customer locations" numbers 1 through 10.

Base Mill A sets the delivered prices. The delivered price for any particular location is composed of Mill A's base price plus the rail freight charges to the customer's location. As long as Mill A sells only in the territory pictured in the model, its delivered prices are the sum of two prices—the price of the commodity being sold and the price of the transport services. Delivered prices are thus lowest at Mill A's back door, and increase with the freight costs to locations either east or west of Mill A. Mill A's commodity price (mill net realization) is therefore the same to buyers at all locations.\(^3\)

As an illustrative figure, a base price of $56 per ton is shown on the chart. This was a price which actually prevailed at Pittsburgh—and at several other basing points—for several important steel products on January 1, 1948.

Non-Base Mill B, on the other hand, has no base quotation. It simply

\(^2\) The charts assume equal freight cost difference rather than equal mileage differences. That is to say, the lines representing even increments in delivered prices are shown as straight lines as a matter of illustrative convenience. In reality, freight rates do not increase in even increments with distance. For example, the rate for shipping one carload of freight over a distance of 100 miles is less than the rate for shipping 2 carloads over a distance of 50 miles.

\(^3\) This is not an f.o.b. mill price, however, since producers operating under the basing point system have usually refused to transfer goods at the mill or to permit the buyer to choose his own mode of transportation. It has been a practice, moreover, to discourage shipments by motor truck, and in those exceptional cases where the buyer has been permitted to transport steel from the mill in his own trucks, the practice has been to charge him the delivered price less a credit of only 65 per cent of what the rail freight charges to his plant location would have been. See, for example, testimony of Mr. Benjamin F. Fairless, President of United States Steel Corporation in Hearings before the Temporary National Economic Committee, Part 26, p. 14182. Similarly, the usual practice of the industry has been to charge the customer delivered prices which include full rail freight charges where cheaper means of transportation (e.g., water transport) were actually used. This practice is explained in the monograph prepared by the United States Steel Corporation for the Temporary National Economic Committee:—Ref. TNEC Monograph #42, p. 36.

For description of practices with references to both motor truck and water transport see also testimony of Mr. Frank H. Moeschl, Vice President of Newport Rolling Mill Co., Hearings before Committee on Interstate Commerce on S. 4055, 74th Congress, 2d Sess. 140 et seq. (1936).
"meets competition." That is to say, it determines what delivered price quotation to offer at any location by taking Mill A's base price and adding to it the rail freight costs from Mill A to that location. In so doing, the non-base mill pays whatever transport charges are actually incurred for shipment from its plant to the customer's location, and charges the customer as though the shipment were made from Mill A. Hence the customers at any one location receive identical delivered price quotations from both mills. Non-Base Mill B's mill net price thus varies according to the customer's location. If Mill B pays less actual freight charges than the amount computed in the customer's bill, it is said to be taking "phantom freight." If it pays more, it is said to be "absorbing freight."

If we should imagine for a moment that the customers are all of equal size—i.e., buy identical amounts of steel—and an equal number is at each location, and that Mill B sells to half of the customers at each location, then we should find that Mill B's average mill net price is $56, the same as Mill A's.

One of the consequences of the system is that Non-Base Mill B inevitably discriminates "against" its more westerly located customers in favor of its more easterly located customers. On shipments east, it receives decreasing mill net prices, to the location of Mill A. And on shipments west, it receives a uniform mill net price.

The non-base mill is, moreover, in the further position of having to charge a customer located to the west, say, at location 9, more for its products than a similar customer located an equal distance to the east, at location 8. This may put the customer at 9 at a serious disadvantage, particularly if he has to sell his products in the same or an equally competitive market as his competitor located at 8. Whatever his chances were for making good when he located in this unfavored spot, this price penalty may be the margin which determines whether he or his competitor grows and prospers or whether he goes out of business.

The claim that the basing point system "protects" the market of the smaller producers who are trying to get a foothold in relatively unindustrialized areas is one which has doubtless lent persuasive support to the system. This notion of "protection" seems to arise from a recognition of the fact that under competitive conditions the producer located at a distance from other producers has a natural "protection" in his local market amounting to the freight costs from the place of the distant producers—that is, goods at one place must overcome the obstacle of freight costs in order to move to another place. Thus it is reasoned,
since the local producer is not expected to sell all of his output in his immediate home town, but must sell also in places which are somewhat nearer to the distant producers, the local producer may maximize, as it were, this natural protection by adopting delivered prices for various locations which exactly reflect the price plus freight costs from the distant producers. Some reflection on this proposition will show that the practice described does not "protect" the market of the local producer, but quite the contrary, it redounds to the special benefit of the distant producers. But perhaps the best way to examine the proposition systematically is to begin by considering the question of where customers are likely to buy their supplies under such a system.

The fact is that when the customer is offered identical products and services (or products and services that are undifferentiated in his mind) at identical delivered prices from several different sellers, he has only a subjective basis, at best, for choosing one seller in preference to the others, and is about as likely to choose one as the other. Let us consider for a moment the elements of competition in steel.

1. **Price-competition?** The customer at any location is offered identical prices from all mills wishing to sell to him.

2. **Quality-competition?** Specifications for steel products are highly uniform, conform to the "Manufacturer's Standard Practices Manual" as established by the American Iron and Steel Institute. These specifications are known to the buyer through the uniform "Extra List," where deviations from standard dimensional and workmanship tolerances are likewise classified and priced uniformly among all producers. Orders for products which do not precisely conform to the specifications listed in the finely denominated "Extra Lists" are subject to the standard rule of being priced at the next higher-priced specification which is listed. There are, moreover, with minor exceptions, no trade mark appeals or other prevalent bases for believing that the products of one producer are superior to those of another—elements of non-price competition which can sometimes be claimed for products of other industries.4

3. **Service-competition?** Promptness of delivery is, on occasion, of paramount importance to the customer, and on such occasions one mill will likely be able to deliver sooner than the other. But this will depend more on the state of the mill's production cycle at the particular time than upon the shipping time involved. As a regular matter the steel producers' order books are made up long in advance of actual production, and differences in shipping times are generally unimportant. The quality of salesmen's services are of course impor-

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4 The United States Steel Corporation puts the matter this way: "Buyers have excellent technical knowledge of the product to be purchased; and since nearly all steel is purchased on specification, the identical grade and type of steel may be obtained for the most part from any one of a number of producers."—Some Factors in the Pricing of Steel (for TNEC).
tant, but since we have no basis for believing the quality of those of one producer will be higher than those of another, we shall assume uniformly high quality.

Traditional mill-customer relationships usually provide an advantage to the mill enjoying the old ties, but we have no good basis for assuming that one of the mills in our model would have better customer relations than the other. We could, of course, call upon our premise that outlying Mill B is the newer and, therefore, has had less opportunity to make the better and stronger ties, but this would seem a rather weak assumption. Now it is not contended that steel customers shift from one supplier to another on a rather promiscuous, month-to-month basis, or that individual ones will not have found reasons, satisfactory to themselves, for preferring one mill over the other. It is contended, however, that in the aggregate the tendency of these preferences will be such that the customer is about as likely to choose a distant mill as one nearer at home.

Now if it is assumed that the two mills in our original model are competitively equal on the matter of customer ties and services, from which mill will the customers buy? Each customer at each location is offered identical delivered prices from both mills; therefore we will assume that each customer’s choice of a mill is left to chance, and that each customer is as likely to buy from one mill as the other. Since the decision of each customer is left to chance, we assume that the laws of chance work out, on the whole, and that half the customers at each location will buy from Mill A and the other half from Mill B. This case is illustrated in Chart II, where it will be noted, much economic waste results from unnecessary “cross-hauling.”

We would not expect, of course, to find in reality a perfect random distribution of this kind very often. But since chance must play such a very large part in the customer’s choice of a supplier under the conditions described, we will deal only with the chance element. A very real point to be made however is that: \textit{It is not necessary for distant producers to “undersell” the local producer in order to take away a large share of his customers; it is only necessary that they offer identical products and services at identical delivered prices.}

If we accept the idea that customers have little or no preference as to mills, the question then arises as to which customers the mills will prefer.

Now it is very clear which customers Mill B prefers; it prefers first, the western customers; and second, the nearby eastern customers. The
Delivered price to the customer is the same from both mills; since the customer has no price basis for preferring one mill over the other, he is as likely to buy from one as the other. A great deal of “cross-hauling” results.

Farther it has to ship toward Mill A, the lower the delivered price it takes, and the more freight charges it has to absorb.

It will also become clear that Mill B would find itself in a non-base position only if it were rather small in relation to Mill A, and had substantially less than half the customers. Whereas, in the perfectly symmetrical market illustrated in Chart II, Mill B has half of the customers—in a random scatter—and receives the same net price as does Mill A, it is evident that if such a market existed it would, under these price conditions, remain symmetrical only very briefly. The reason of course is, that if there is any competition among the customers the price advantage afforded the customers near Mill A would cause them to become increasingly larger outlets for steel, relative to the customers near Mill B.

Since Mill B would then find itself shipping increasingly larger proportions of its output into the area of Mill A (where it would have to absorb freight) and shipping increasingly smaller proportions into its own area (where it could take offsetting amounts of phantom freight), it must be concluded that Mill B would tolerate its non-base position only if it were so much smaller than Mill A that it could not declare itself a base mill also. Finally, it may be noted that if the distance between the two mills is very large the market could not be equally divided between the two mills. Whereas Mill A can ship into Mill B’s area no matter what the freight costs, Mill B cannot ship toward Mill A...
beyond the point where freight costs equal Mill B's marginal profit on the sale.

Now it will appear that Base Mill A will prefer the same customers as Non-base Mill B does. The reasons are simple. On the one hand Mill A's net price is not reduced by shipping into Mill B's territory since the customer pays the freight, but on the other hand, there is a great deal to gain. By shipping into B's territory and causing B to ship back toward A, whereby B takes a lesser net price, Mill A accomplishes the following:

(a) Prevents Mill B from gaining sufficient commercial strength to allow it to reduce prices in its natural territory, in which case Mill A would either be driven out of Mill B's area or forced to absorb freight in order to continue shipping into it.

(b) In times of satisfactory demand, prevents Mill B from gaining the profits and incentive to expand capacity (new capacity in the hands of B will cause pressure on A's prices later).

(c) In times of low demand, drains B's resources so that it is inclined to go out of business or sell out, and merge with Mill A.

(d) At all times gives an advantage to the customers in Mill A's area, with the results: (1) that Mill A's outlets increase disproportionately more than Mill B's outlets; and (2) that new customers tend to locate in Mill A's area.

(e) At all times gives the impression that Mill B is a "high cost" producer and that only the great base mill has the "technological efficiency" to do business "under modern conditions."

All of these effects serve to perpetuate Base Mill A's advantage in the national market areas, although at the public's expense; and to enhance A's investment in productive capacity, although to the detriment of B's investment. And finally, these effects lead A to further expansions at its old location, even though the previous capacity there may have been misplaced from the standpoint of economic location.

On the matter of location it may be noted that a variant of the "protection" argument is that the outlying non-base mills are "subsidized" under the basing point system. The "subsidy" which such mills receive, according to this argument, is supposed to flow from the fact that the markets for steel are highly concentrated while the demand for steel in the outlying region may be insufficient to support a mill of minimum size for technological efficiency. Thus, it is claimed, the basing point system creates a pricing arrangement whereby the outlying mill can take full advantage of its location in pricing to its local customers
(“subsidy”) and yet attain volume production by shipping to the concentrated markets at the lower prices prevailing there. The conclusion which is drawn from this argument is that this arrangement permits the location of mills in outlying areas where outlets are not sufficiently developed to attract, of themselves, the resources required to establish a mill. While this argument recognizes the circular nature of the problem of regional industrialization—that the region cannot attract a steel mill until it has attracted customers and, in turn, cannot attract customers until it produced low-priced steel—it overlooks two other facts. These are: (1) that while the markets for steel are highly concentrated, the production of steel is still more concentrated in these same areas—that is, these areas ship more steel to the outlying areas than the outlying areas ship back; and (2), the peculiar pricing arrangement from which the subsidy is supposed to flow retards development of consuming enterprises in the non-base mill’s natural territory.

In any case it becomes clear why Base Mill A has a fondness for a system which permits Non-base Mill B to sell to customers in its territory while Mill A, in turn, sells to customers in B’s territory. In the first instance Non-base Mill B is committed to a pricing system under which it enjoys two peculiarly distinguished restrictions. The first is that it is bound to sell at prices which are so arranged as to allow Mill A to share its market without Mill A’s having to reduce its rate of return in order to do so. The second is that it can sell in Mill A’s market—if at all—only at a drastically decreasing rate of return.6 This commitment of Non-base Mill B has its origins in historical times and “Pittsburgh Plus,” and it has continued in force under the multiple basing point system.

But even if we prefer to believe that Mill A is unaware of the advantages he gains from the basing point system, then we can conclude that these advantages are operative nonetheless. In any case the “protection” B enjoys under this arrangement amounts to a market with a fence across it—but the fence has a gate in it, and that opens only in.

6 While the more western customers are perpetually discriminated against in terms of price, they nevertheless receive preferential treatment in times of steel shortages. Since non-base Mill B’s more easterly customers offer the smallest net return, it will, in such times, tend to withhold supplies from them in favor of its nearby customers. These deserted customers will not, moreover, be attractive to Base Mill A, as it will prefer to supply its old customers, or to drop some of its nearby customers in favor of customers it might gain in B’s market.
Relationships Between Base-Mill and Base-Mill

The question which immediately arises as a result of the preceding analysis is why, since all of the advantages accrue to the base mills, have not the outlying non-base mills reduced their prices—why have they not established themselves as base mills? The answer to this question will appear by reference to Chart III.

CHART III

Here is described the case where the former non-base Mill B announces itself as a base mill, and Mill A automatically "absorbs freight" to offer delivered prices in B's natural market area identical with those offered from Mill B. The customers in B's area do not shift suppliers, and since Mill B is not able to gain any nearby customers as a result of its price reduction, it also "absorbs freight" to match A's delivered prices in A's territory. The result is that none of the customers change suppliers, the crosshauling continues, and reciprocal matching of delivered prices and reciprocal freight absorption begins. And, further, a matching of income losses comes about relative to the customers in the western half of the market area.

Now it may be noted that in the case illustrated there is a symmetrical arrangement and an even division of the customers, and therefore the income loss to the two mills is even. In such a case the contest between the two mills is even, and the result would be, if such a division of the market ever existed, a more or less gradual reciprocal withdrawal of the mills from the other's market area. But it has been concluded previously that no such symmetrical and even division of the customers
is likely to have come about under conditions where one mill sells as a non-base and the other as a base mill. On the contrary, where the freight cost between the two mills is important, the non-base mill's customers, though scattered, must necessarily be concentrated toward the western end of the market area. Since this is true, then, the matching of income losses must necessarily reduce Mill B's income proportionately more than A's income.

It follows, moreover, that the smaller B is, relative to A, the greater will be its relative income loss. If Mill B has only one-tenth the profits of Mill A, a 100 percent loss of its profits may mean only a ten percent reduction in Mill A's profits. In such a case, if Mill B should decide to sell at cost, in its attempt to drive Mill A out of its territory, the decision may cause Mill A but little inconvenience.

It is apparent, therefore, why small mills located at an important distance from large mills cannot establish themselves as base mills against the wishes of the large producers. When such an outlying mill does reduce its price in its local market, and its delivered prices are met by the distant producers, it has no profit incentive except to raise its prices again and return to its non-base status.

But it is not always possible to do this, as the small mill may find that his distant competitor is slow to recognize his desire to raise prices again. Thus, for example, the Trial Examiner's Report in the Cement Case records the story of a small cement mill which attempted to establish itself as a base mill, only to find that a large distant competitor adopted its base price rather permanently. In this case it is easy to see that the small mill could not again raise its price in its local market, while the distant competitor continued to offer to sell the customers at the new low price. An excerpt from the report is as follows:

"During the latter part of 1927 the Warrior Cement Company, which operated a plant at Spocari, Ala., made some prices which were lower than the prevailing prices in their territory based on Birmingham, Ala. Lone Star then quoted in the Spocari territory prices based on Warrior's mill, using the mill net of the latter's cut price as the new base price at Spocari. This had the effect of preventing Warrior from ever receiving a greater mill net than it had from the offending cut price. Lone Star kept this low base at Spocari until May 1928, when it acquired the Warrior mill. This mill was especially favored as to easily workable stone and low transportation rates. The Spocari mill was regarded as an outlaw mill. The Spocari plant was underselling to the extent of giving customers a freight advantage which it deducted from open quotations based on North Birmingham. This base was put in December 5, 1927, and the mill was acquired by Lone Star on April 28, 1928."

Here it may be noted that although the small producer was “especially favored as to easily workable stone and low transportation rates,” Warrior sold out to its competitor in somewhat less than 5 months after the competitor began absorbing freight to meet its local delivered prices. While the Trial Examiner’s report does not enlighten us on the terms of the sale, it is not difficult to imagine that the producer’s decision to sell may have been influenced by the plight he found himself in as a result of reducing his prices in his local market.

Another way of approaching this matter is to consider the case where the two mills are both selling at the same base price without absorbing freight, and then the larger mill decides to put the smaller mill out of business by absorbing freight to meet its delivered price. The principle is illustrated in chart 4.

CHART IV

In stage #1, Mill A has 4 customers in its area while Mill B has 2 customers in its area. We will assume that the customers are all of equal size, each customer taking 1 unit. We will assume, further, that the freight cost from mill to customer location is $1, and that the freight cost between Mill B and Mill A is $9. And finally, we will assume that
the two mills are of equal technological efficiency, and that production costs are $53 per unit.

Therefore, Mill B's income is $2(\$57) = \$114, while its costs are $2(\$53) = \$106, and its freight bill is $2(\$1) = \$2. That is, Mill B's total income is \$114 and its total payments are \$108, leaving a profit of \$6.

Similarly, Mill A's income is \$228, its production costs are \$212, and its freight bill is \$4, leaving a profit of \$12.

In stage 2, Mill A has absorbed freight to take Mill B's customer at location 3; and in order to make up the loss, Mill B has absorbed freight to take one of Mill A's customers at location 2. Mill A's income and production costs are the same as previously, while by absorbing \$7 of freight to location 3 its profits are now reduced to \$5.

On the other hand, Mill B has, by absorbing \$7 of freight charges, incurred total costs greater than its total income. It is now losing \$1 on the total business.

Now it may be noted that if Mill B were in some type of business in which fixed costs are low and variable costs high, in relation to the average value of its product, it might be able to reduce output and stay in business on a reduced scale. But where fixed costs are a large fraction of the average cost of the mill's product, such an inroad upon its volume will quickly put it out of business. Once Mill B is out of business, then it is no longer necessary for Mill A to absorb freight in order to sell to the customers in B's area. Such discriminations in mill price constitute a competition which has nothing to do with efficiency—it is a competition of size. It is a means by which large producers force small distant producers to keep their prices up, or conversely, put such producers out of business.

Now we have said—relative to our illustration—that Mill A intended to put Mill B out of business when it absorbed freight to meet Mill B's lower delivered price in Mill B's area. This is not necessarily the case; when A first decided to absorb freight to B's area, it may have been simply a matter of Mill A's thinking that by gaining an additional customer the increased volume of business would reduce his costs and justify the freight absorption—that, as Justice Burton has put it, "by distributing his fixed charges over the resultingy increased volume of business, he could absorb the freight differential without loss of profit to his business as a whole and without raising any charges to his other customers."\footnote{FTC v. Cement Institute et al., 333 U. S. 683, 739 (1948).}
It may be of interest to consider an illustrative situation in which it seems plausible that Mill A would absorb freight to meet Mill B’s delivered prices without any predatory intent. Let us consider, then, the arrangement in chart V.

Here we have two mills of unequal size, but of equal efficiency—the average production cost for each is $53 per unit. Both sell for $56 per unit, getting a margin of $3. Base Mill B sells to 6 customers, 2 at each location #9, #8 and #7; and Base Mill A sells to 12 customers, 2 at each location #1 through #6. The freight cost is $1 between each two successive locations in the model, except between locations #7 and Base Mill A, where it is $3. At its present margin of $3, Base Mill B cannot ship to the nearest customer in A’s market area, since the freight cost there would be $6, of which B would have to absorb $5.

Base Mill A might, however, consider shipping to B’s customers at locations #7 and #8. It has only to offer them the same delivered prices and services as does B, and eventually about half of these customers will buy. What are the considerations? If A ships to one customer at #7, the freight will be $3, of which it will have to absorb $1, thus leaving a mill net of $55 on the shipment. This is a lesser price than is charged the other customers in the home market, but it looks like “good business,” as it leaves a margin of $2.

Now if A ships to one customer at #8, the freight will be $4, of which it will have to absorb $3. This will leave a mill net of $53, the same as average costs were before the additional business was obtained. It
may be that this marginal business at #8 would push A's plant beyond the point of optimum efficiency, and that average costs would be raised somewhat—in which case A might not want this business. On the other hand, let us suppose that with the increased business and the further spreading of fixed costs, A's average costs are lowered somewhat, so that it would gain a small margin by shipping to #8. Then A ships to #8.

Chart VI illustrates the effects of A's shipping to B's 2 customers at #7 and #8, either through inadvertent "good business" or with predatory intent. In any case, B is sorely injured. It has lost a third of its sales, one-third of its productive capacity has become unused, and its average costs have gone up ruinously. Now what is the sequence of events? First, B will lower prices to try to retake the customers. But these are now A's customers, so A is free, in any case, to lower his prices "to meet competition." Now, if A and B were about equally matched—if A had only 4, 6, or perhaps 8, instead of 12 customers paying full prices safely back in its own market area—the matter would adjust itself before very long, since A could not afford the losses required to stay in B's market much better than B could afford having it stay there. But A can afford the loss, so B's only hope is to raise its price high enough to try to break even on its 4 remaining customers. At this higher level, however, A can now afford to meet B's prices at location #9. So, A offers identical prices there, and takes another fourth of B's remaining customers. If B has not already gone out of business, it will probably do so now.
Now it will have been noticed that the customer arrangement illustrated is asymmetrical, and that Mill B was at a disadvantage at the outset.

This kind of disadvantage may come about in reality in several ways, some of which are:

1. When the customers are asymmetrically located, in some such way as illustrated. (Yet production costs at the two mills may be equal).

2. When the customers are more symmetrically located, and the production costs at B are higher than at A. (Yet when total costs—including freight costs—are considered, Mill B may be as efficient as Mill A. That is, total resource use may be more efficient with the existence of two mills than with one).

3. When Mill A receives preferential freight rates.

Finally, we have shown Mill A as only twice as large as Mill B. When Mill A is several times as large as Mill B—a not unusual situation—Mill B is at a disadvantage in swapping customers, no matter what the customer locations and relative efficiencies of the two mills.

Summary

On the basis of the hypothesis that the so-called "principle of indifference" operates in the manner stated—namely, that where buyers are offered from alternative sources goods and services which are undifferentiated as to kind and quality and are offered such goods and services at delivered prices which differ insignificantly among alternative sellers, buyers are about as likely to buy from a distant producer as from one nearby—there have been demonstrated several mechanical ways in which the geographic price discriminations inherent in the basing point system operate to restrict localization of industry in the newer industrial regions. The following conclusions may be itemized:

1. Where the small producer is located at such a distance from the large producer that the small producer's marginal profit equates with freight costs at a point between the two producers, the small producer is put to several mechanical disadvantages:

   (a) If the small producer operates as a non-base mill, its local territory will be shared fully by the base mill, while it—in turn—will share the base mill's local territory only partially, if at all.

   (b) If the small producer operates as a non-base mill, a price reduction initiated at the base mill results in a proportionate income loss to both mills, but restricts the non-base mill to a smaller territory, while widening the base mill's exclusive territory.
(c) If the small producer operates as a non-base mill he may find it very hazardous to attempt becoming a base mill. Where such a producer does lower prices in his local market area, the base-mill producer may, through the automatic workings of the system, absorb freight to match the lower delivered prices, in which case the small mill is engaged in an unequal contest of matching income losses. The small producer may then find it impossible to raise his prices again, particularly if the large producer chooses to continue the contest.

(d) Whether the small producer operates as a base mill or as a non-base mill, if the size of two mills is greatly unequal, the small producer is restrained from lowering prices in his local territory by the action of the large producer in absorbing freight to match such lower prices.

(e) The large base-mill producer gains both short term and long term advantages by forcing the small producer to keep its delivered prices high in its local territory. The short term is that the small producer’s territory is kept open to the large producer. The long terms are (1) the short term advantage is perpetuated and (2) the customers tend to localize around the mill with the lower mill price.

2. In many hypothetical situations the disadvantages listed under 1, above, would accrue to the small mill which is located at an important distance from the large mill, although the small mill’s marginal profit may not equate with freight costs at a point between the two mills (although in the case of two more or less isolated market areas, very great distances between them tend to compensate for inequalities in size of mills).

3. Where freight costs are large in relation to the average profit on a commodity, and the production facilities can be relocated only at great expense, it is not always necessary that a large producer “undercut” the local prices of a distant small producer in order to put him out of business—it may be necessary only that he “meet” the delivered prices of such a small producer. Moreover, a large producer may put a small producer out of business in this way although the efficiencies of the large and small are equal; and the action may be either by predatory intent or by inadvertence.
THE CONCEPT OF UNLAWFUL DISCRIMINATION AS IT APPLIES TO GEOGRAPHIC PRICE DIFFERENCES

WALTER B. WOODEN*

PROBABLY no other aspect of delivered price systems has caused as much debate and difference of opinion as that embodied in the subject of this article. Oddly enough, the debate did not attain anything like its present dimensions until after the concept was held by the Supreme Court in April 1948 to be applicable to a price fixing conspiracy involving geographic price differences in the Cement Institute case. However, the Court had applied the concept to such price differences in 1945 where no price fixing conspiracy was alleged and without creating any unusual amount of discussion. In 1924 the Federal Trade Commission had ordered the U. S. Steel Corporation and certain subsidiaries in the Pittsburgh Plus case to cease and desist from discriminating in price among their customers on a geographic basis and the companies reported that they would comply with the order “insofar as practicable”.

In all these cases the geographic price differences were those which inhered in the operation of a basing point system of delivered prices. In the Cement case the requisite injury to competition was found only in the elimination of price competition among sellers. In the Glucose cases the requisite competitive injury was found in the damage to competition among the customers of a single seller. In the Pittsburgh Plus case the requisite injury was found in the field of competition among both the sellers and buyers of steel products. All of these cases involved charges of unlawful price discrimination in violation of the Clayton Act or of the Robinson-Patman Act which amended it. In the Rigid

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3 8 F. T. C. 1 (1924).
Steel Conduit case, decided by the U. S. Court of Appeals in May 1948, the concept of geographic price discrimination was judicially integrated with the concept of unfair methods of competition under the Federal Trade Commission Act, on the authority of the Cement Institute case. In October 1948 the U. S. Court of Appeals entered its decree affirming the Commission’s 1924 order in the Pittsburgh Plus case and commanded obedience thereto pursuant to stipulation between counsel for the Commission and the U. S. Steel Corporation. Thus in the short space of three and one-half years the concept of unlawful price discrimination in the form of geographic price differences has been applied by the courts to pricing practices and price structures widely used in American industry. Prior to 1945 the only authority for application of the concept was that expressed in the administrative decisions of the Federal Trade Commission.

The Legal Foundation for the Concept

The legal concept of geographic price discrimination as a practice injurious to competition between the discriminator and his competitors goes back to the early part of the century when the old Standard Oil Company used such discrimination either to drive out competitors or to dominate them through fear of it. Such discrimination, sometimes known as local price cutting, was alleged to be and the Supreme Court mentioned it as one of the unfair methods by which the Standard Oil Company has acquired and maintained its dominant monopolistic position. The decree of the Court in 1911 assumed that dissolution would be an adequate remedy under the Sherman Act but there is no doubt that the revelations of geographic price discrimination in that case were powerful factors in the 1914 legislative proscription of unfair methods of competition in the Federal Trade Commission Act and of price discrimination in the Clayton Act.

While the Standard Oil case was on its way through the courts some of the States were legislating against geographic price discrimination as a monopolistic practice. For example, the State of South Dakota in 1907 passed a statute making it a criminal offense for sellers of commodities in general use to destroy or prevent competition by discriminating in price between purchasers at different towns within the state after “equalizing the distance from the point of production”. The constitutionality of the statute was sustained by the Supreme Court in 1912.

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4 Triangle Conduit & Cable Co., et al. v. FTC, 168 F. 2d 175 (C. C. A. 7th 1948).
5 Standard Oil Company of New Jersey v. United States, 221 U. S. 1, 43, 78 (1911).
Minnesota enacted a similar statute in 1909 covering the purchase of milk, cream and butterfat after "making due allowance for the difference, if any, in the actual cost of transportation". When the statute was amended so as to make such discrimination unlawful without regard to intent the Supreme Court with Justices Holmes, Brandeis and Stone dissenting, held it unconstitutional in 1926.\(^7\)

In *State v. Fairmont Creamery Co. of Nebraska*,\(^8\) the Supreme Court of Iowa had upheld a statute quite similar to that declared unconstitutional in the *Minnesota* case and that case was cited by the Supreme Court of the United States in upholding the South Dakota statute in the *Central Lumber Company* case. The Iowa Supreme Court made the following pertinent observations concerning the economic objectives of the Iowa statute:

> "The particular methods which are condemned by the legislative act under consideration are set forth therein. It is quite manifest that a company sufficiently large in its capital and in the scope of its business could obtain a monopoly for itself in whatever territory it chose, by adopting the methods which are enumerated and prohibited in the statute. The temporary maintenance of artificial prices for the sole purpose of destroying a weaker competitor and creating a monopoly is one of the modern evil inventions. All that is required for its sure success is that there be great inequality of financial resources in favor of the offending party. A multitude of people buy milk and cream for immediate consumption. Comparatively few buy milk and cream 'for the purpose of manufacture.' To the multitude who buy for immediate consumption, a monopoly would be quite impossible, and its attempt quite absurd. But those who buy milk and cream 'for the purpose of manufacture' sustain a distinctly different relation to the trade and to the community in which they operate. The magnitude of their operations is limited only by the magnitude of their resources. The motive to monopolize is present as well as the ability to reap its fruits when acquired. In the nature of the case, the discriminations which are condemned in the legislative act are practicable as a practice only to those who engage in the business on a large scale. We are impressed, therefore, that the classification adopted is one which arises quite naturally, and that it rests upon a substantial and practical distinction. Substantially the same reasoning is applicable to those persons who 'buy poultry, eggs, and grain for storage.' The argument may require modification in its detailed application to the latter class; but we will not dwell longer upon it."\(^9\)

Some of the background out of which there emerged the Clayton Act's condemnation of price discrimination in 1914 appears in a report of the Commissioner of Corporations to the President in 1907 criticizing

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\(^7\) *Fairmont Creamery Co. v. Minnesota*, 274 U. S. 1 (1927).

\(^8\) *153 Iowa* 702, 133 N. W. 895 (1911).

\(^9\) *Id.* at 710, 711, 133 N. W. at 898, 899.
the old Standard Oil Company for "startling discriminations in price". He pointed out that Standard charged "a price which is proportionate to the extent of its monopoly in a given place and reduces prices in proportion to the degree of competition which it may meet" and that the prices at different cities had a range of more than 100% after allowing for freight. The evidence of such discrimination was put into the record of the Standard Oil dissolution suit as evidence of unfair methods and the practice was characterized as unfair by the Supreme Court.

Louis D. Brandeis, before his appointment to the Supreme Court, in testifying at hearings on a bill to prevent discrimination in prices in the 63rd Congress characterized this discrimination as the most powerful of all weapons used by Standard except railroad rebates. He said it "would cut the price in the districts where a competitor established himself, and thus destroy him, meanwhile reimbursing himself for the cut in that region by charging high prices elsewhere."

The application of the Clayton Act passed by Congress in 1914 to geographic price discrimination is shown not only by its legislative and pre-legislative history but by the fact it provided that nothing contained in it should prevent discrimination that made "only due allowance for difference in the cost of ... transportation". Thus it is clear that the concept of geographic price discrimination was the original basic concept in the evolution of both federal and state statutes which were enacted to deal with the problem. Accordingly there is not the slightest warrant for any inference that when the Commission and the Courts challenged geographic price discrimination they were applying the Clayton Act as amended to a form of price discrimination not contemplated by Congress.

The historical background of both State and Federal legislation against price discrimination in the sale of commodities is contemporaneous and consistent with the great mass of legislation aimed at the elimination of railroad rate discriminations. It was widely believed that through discrimination the railroads had exercised the power of economic life or death over various communities and large sections of the country and over the development of industry therein. The efforts to relieve such discrimination has led to increasing governmental regu-

11 Standard Oil Co. of New Jersey v. United States, 221 U. S. 1, 43 (1911).
12 Hearings before House Committee on Interstate and Foreign Commerce, on H. R. 13305, pp. 4, 5, 63rd Cong. 2d and 3rd sessions (1914).
lation through the Interstate Commerce Commission. But the problem of railroad discrimination has persisted and is still far from solution as illustrated by the decision of the Supreme Court in May 1947 on the so-called interregional rate discrimination cases.12* Basically the problem of geographic discrimination which is so obvious when seen in railroad freight rates is quite similar to the problem of geographic price discrimination in the sale of commodities transported by railroad when the seller of such commodities undertakes to make of himself a wholesaler of such transportation as well as a merchandiser of his own commodity. This is true even with regard to the effect upon the location and development of local enterprise in the industry of which the seller is a part.

It is hardly necessary to say that the statute contains its own measure of what discriminations are unlawful and that other considerations of an economic or social character cannot override the statutory terms. That is not to say, however, that such considerations are of no value in determining whether those terms should be given a strict narrow construction or a broad liberal one consistent with the public policy contemplated by Congress in the whole body of legislation on the subject of monopoly. Economic theory may be of distinct value for such purposes.

THE ECONOMIC FOUNDATION FOR THE CONCEPT

The classical centralized market and the economic explanation of the manner in which competitive forces operated in such a market did not concern themselves with the matter of transporting goods from the market after sales and purchases were consummated at the market price. In other words, it was a freightless market. It was also an open market in which each seller and each buyer knew what prices were being received and paid for a given commodity at any given time, and each made his contribution through bid or offer to the formulation of price. Under those conditions and assuming a homogeneous commodity of equal quality discrimination in price could not occur. A seller would not be permitted by his competitors or by his own customers to discriminate in price. Nor would he see any advantage to himself in taking less for his goods per unit from some customers than from others when each unit was of equal value to him. This is sometimes referred to as the principle of indifference.

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Authorities in the field of economic theory have expounded these principles. In an article entitled "Objective Tests of Competitive Price" Dr. Jacob Viner, professor of economics at the University of Chicago said:

It is as true of domestic as of foreign trade that systematic regional price discrimination is inconceivable under free and active competition.

Dr. Viner pointed out in that same article the close resemblance between "dumping" in foreign trade with its implication of monopoly and the practice of domestic manufacturers imposing higher net prices in the "home market" near their plants than upon other domestic customers in markets at a distance.

Likewise Dr. F. W. Taussig, professor of economics at Harvard University, stated that monopoly presents the possibility that "different installments of the supply may be sold at varying prices" and that by contrast "under competition, one price prevails throughout the market; no one seller is allowed by the others to get a higher price." Taussig also stated that continuous and steady "dumping" is explicable only on the ground of monopoly.

It would seem that these economic principles found some judicial recognition in the dissenting opinion of Judge Hamilton of the United States Court of Appeals for the Sixth Circuit when he said in the Goodyear case:

Monopolistic prices are always possible when a seller is able to deal differently with the same classes of buyers of the same product or to manage in some other way to sell his goods in virtually separate markets. Recognizing this practice and in order to suppress monopolies at their inception, the Congress penalized sales of the same article to different customers at different prices.

The expert economic witnesses who testified in the Cement Institute case in support of the complaint confirmed these principles as a matter of economic theory and held them applicable to the facts of record in that case. Dr. Viner testified in the Cement case to the same effect as above quoted from his writings concerning the significance of systematic dumping in violation of the principle of indifference. The soundness of the economic principle of indifference was not disputed by the

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13 Taussig, PRINCIPLES OF ECONOMICS 204 (1921).
14 33 J. POL. ECON. 110 (1925).
15 TAUSSIG, SOME ASPECTS OF THE TARIFF QUESTION 208 (1931).
expert economists who testified for the respondents in the Cement case, although they stressed only that half of the principle which favored their theory of the case, namely, that under competitive conditions buyers will not pay more to one seller for a homogeneous product than they will to another seller at a given time and place. But these same economists admitted on cross examination that the principle was equally applicable to sellers, i.e., under competitive conditions sellers will not sell such a product for less to some buyers than to others.\(^\text{17}\) The testimony of economists on both sides therefore supported the finding of the Commission in the Cement case that "there is a well recognized principle of economics that in the sale of units of equal desirability the seller will not accept less from one buyer than from another".\(^\text{18}\) Likewise in the Pittsburgh Plus case the undisputed testimony of the expert economists was to the effect that systematic dumping which is the equivalent of systematic freight absorption could not be reconciled with the existence of a free competitive market. In that case the Commission so found and also that under free competition Chicago mills would not have shared their high net return territory with eastern mills, instead of dumping their surpluses into competitors' territory knowing just what they could get for it under the basing point system.\(^\text{19}\) As U. S. Steel itself said in its brief filed in the United States Court of Appeals.\(^\text{20}\)

Each expert stated that a Chicago producer, if moved by no influence other than the motives underlying the law of supply and demand, would attempt to sell his steel to his Chicago customers at a moderate reduction from the Pittsburgh Plus price there, before he would be willing to sell it at a substantially greater reduction in Pittsburgh, or at any place between the two cities.

There seem to be three schools of economic thought on the concept of price discrimination in geographic pricing systems. The orthodox school may be said to be that represented in the Commission's findings in the Cement and Pittsburgh Plus cases and based on the undisputed expert testimony in the record of those cases. The single expert who represented the Cement industry in the old Cement case decided by the Supreme Court in 1925\(^\text{21}\) did not challenge the orthodox economic prin-

\(^{17}\) The Cement Institute v. FTC, Record pp. 14026, 14039, 14372, 14403 (C. C. A. 7th 1946).

\(^{18}\) Findings par. 22 (c).

\(^{19}\) 8 F. T. C. 1, 42-44 (1924).

\(^{20}\) Page 23.

principles but successfully attempted to rationalize the pricing practices of the industry as coming within those principles. The same attempt was unsuccessfully made by a number of experts in the Cement case decided by the Supreme Court in 1948. The issue of discrimination between the economists in the recent Cement case did not turn on the existence or non-existence of such economic concepts as the principle of indifference and its relation to dumping but upon their applicability to the record facts.

Nevertheless, most of the economic experts who represented the Cement Institute were adherents of what may be called the rationalistic school of economic thought and which they regard as a realistic school. As an offset to the concept of perfect competition against which the orthodox school measures a pricing practice or a price structure the rationalistic school has set up the concept of "imperfect competition". It would judge a pricing practice or price structure by a standard of the alleged or apparent needs of business as it is actually conducted under modern conditions. A tendency to rationalize the status quo would seem inevitable in the application of such a standard.

A third school of economic thought on the subject may be termed the iconoclastic school. It is critical of the alleged "ivory tower" concepts of perfect competition by which the orthodox school tests a price or a price structure, and particularly is critical of the principle of indifference, apparently considering price discrimination a more or less normal expression of competition. In this it seems to lean toward the rationalistic school of imperfect competition. But it vigorously rejects any complete rationalization of monopoly and monopolistic pricing under the concept of imperfect competition. It would condemn monopoly and monopolistic pricing by objective tests such as price rigidity and uniformity but would not accept the principle of indifference as of any value in reaching an economic judgment. By so doing this school would seem to be rendering itself incompetent to give any assistance in judging the significance of price discrimination as involving a monopolistic condition or practice. Emphasis on price rigidity and uniformity is no more than the unexpert intelligent mind would give, which raises the question just what special contribution the iconoclasts as a school of economic thought can make to the problem of discrimination. Neither the rationalistic nor the iconoclastic school is able to refute the fact that in the still existing areas of our economic life where competition is

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admittedly the rule, there is no discrimination in price. Thus in the *Cement Institute* case two experts in agricultural economics testified without contradiction that a producer of agricultural products "did not parcel out the commodity so as to net different prices simultaneously for shipment to a number of delivery points", and that nothing similar to a basing point system existed in the marketing of agricultural products.23

Dr. E. T. Grether, one of the economists testifying for the Cement industry, seems to admit that his school of economic thought can provide no aid in determining whether the basing point pricing method is collusive or competitive in character or whether geographic discrimination is of any significance in that connection. He testified that "from an economic standpoint you have no answer [as to the existence of collusion] unless it is clear cut and that there is no other answer, you see. That is not an economic problem".24 He had previously published a statement that "the courts and legislators in connection with the regulation of trade practices gain little or no assistance from an examination of the deductive principles of formal economic theory derived from the assumptions of pure competition" and testified "that is exactly what I have been saying here the whole time".25 This economist, however, recognized that imperfect competition is the equivalent of monopolistic competition and that this is a hybrid concept partaking of some of the characteristics of pure competition and of pure monopoly. Dr. Grether also had written that "the misfortune of economics and law from the standpoint of their union in the development of standards of evaluation is that the free and open competition posited by the latter is the monopolistic competition of the former".26 Professor E. H. Chamberlain of Harvard had warned of the dangerous confusion of ideas inhering in such terms, stating that "to consider the theory of monopolistic competition vaguely as a theory of imperfect competition is to confuse the issues".27

It would seem difficult for the members of the iconoclastic school to avoid being pushed into the ranks of either the orthodox or the rationalistic school if they are to have anything to say as economic experts on the problem of price discrimination as such.

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24 *Id.* at 14536, 14537.
25 *Id.* at 14531, 14532.
26 *Id.* at 14532.
27 *Id.* at 14530.
There was a most palpable relation between the use of geographic price discrimination by a dominant concern such as the old Standard Oil Company and the effort to crush its competitors and increase its monopolistic power. An obvious alternative, however, was that competitors thus attacked might be allowed to survive on condition that they adopt and maintain the prices which the dominant concern or concerns in an industry might decide upon. Under such alternative, price leadership would take the place of cut throat discrimination, reciprocal interpenetration of each competitor's freight advantage territory would emerge, and reciprocal absorption of freight would become the vehicle for matched delivered prices reflecting what the price leader desired to realize in net prices at its producing or shipping point. So long as these conditions are observed monopoly in the form of increasingly unified ownership would yield for the time being to the monopoly of a tacit understanding that the price leader's prices are to be respected in his freight advantage territory. But the method utilized to produce such a result would be the general industry-wide use of geographic price discrimination such as was used in the old Standard Oil and Pittsburgh Plus cases. There is a not inconsiderable degree of correspondence between this reasoning and the actual evolution of a number of industries.

These rationalizations of a complex evolution which probably varies from industry to industry are illustrated by some of the evidence in the Cement Institute case. It illustrates how the reciprocal form of geographic discrimination may revert to the predatory form when that reciprocity is no longer observed. One of the "Big Five" cement producers was the Lone Star Cement Co. All of its mills were basing points and this made it a price leader whose base prices were supposed to be followed. It described its base prices as those which would be effective in all markets "if we had no competition" and of course there were wide areas in which those non-competitive base prices were effective. It reduced its base price through freight absorption in the areas where the base prices of other mills were effective. In so doing it would seem to have done what the Commissioner of Corporations stated was done by the old Standard Oil Company; i.e., charges "a price which is proportionate to the extent of its monopoly in a given place and reduces prices in proportion to the degree of competition which it may meet" in other places. The same is true of any other base price. When the Marquette

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27a See note 10, supra.
Cement Company under the pressure of declining demand cut the delivered prices determined by the formula of base price plus freight, Lone Star and another base mill company whose prices were being cut, retaliated by establishing lower and lower base prices at Marquette's mill location. This quickly brought Marquette to its knees and to renewed observance of the regular formula. The significant point is that just as reciprocal geographic discrimination was the vehicle that made the base mills' price leadership effective, so their predatory punitive geographic discrimination was a weapon that reverted to the tactics of the old Standard Oil Company. In other words, geographic price discrimination may be used either as the embodiment of reciprocity between price leaders and their followers or as a deadly weapon of aggression, the mere threat of which is ordinarily as effective as its actual employment. Nevertheless, although the membership of three districts of the Cement Institute voted that such predatory and punitive geographic discrimination should be formally declared an act of unfair competition, the Institute did not see fit to adopt any such declaration.

It is also worth noting that geographic discrimination by a dominant price leader for disciplinary purposes characteristically involves as did the discriminations of the old Standard Oil Company, freight absorption and not phantom freight. The phantom freight of non-base mills may be regarded as a bonus for good price behavior on their part. Reciprocity in freight absorption may be regarded as the sine qua non of a competitive truce or armistice between the dominant price leader and his followers. Whether there is or can be some intermediate form and degree of geographic price discrimination that is neither predatory nor reciprocal is a much discussed question. Legally there can be no doubt that this is possible since the statute does not outlaw all price discrimination as per se unlawful, nor have the courts or the Commission so construed it. However, it was presumably the practical commercial difficulty of finding, defining, and adhering to such a middle course that induced U. S. Steel to decide it would adopt the f.o.b. mill method of quotation in July 1948. A choice had to be made between some form and degree of price discrimination that would not involve constantly and systematically getting more money from some customers than from others and a wholly non-discriminatory method of pricing. The commercial advantages of such inconstant and unsystematic discriminations still permissible under the law were apparently not substantial enough to warrant the risk involved in retaining them.

28 Findings of Fact, par. 10 (f).
29 Findings of Fact, par. 10 (g).
The Measure of Discrimination in Delivered Prices

If one concedes that discrimination in delivered prices has no different status or greater immunity under the statute than discrimination in f.o.b. mill prices, the question arises as to how the existence of geographic price discrimination can be determined and its amount measured. All the statutes on the subject, federal and state, recognize the necessity of making due allowance for differences in the cost of transportation to the various points between which discrimination may exist. Even though the statutes did not require this, common sense and equity would compel the courts to recognize it. Otherwise a seller would have to underwrite all discriminations by the common carrier in delivering his product. And even legitimate differences in the carrier’s rates would create differences in a seller’s delivered prices which he could not account for on any other basis. So it may be said that where common carriers are used it is impossible to ascertain the existence of geographic price discrimination or to measure its amount without making due allowance for the differences in cost of common carrier transportation to the points or areas affected by the discrimination.

With reference to the heavy commodities in which geographic price discrimination typically occurs, transportation by other than common carrier and other than by rail may be ignored for the purposes of this discussion. The statute of course makes no distinction between discriminations caused by failure to make due allowance for differences in cost of delivery by common carrier and discriminations caused by failure to make due allowance for differences in cost of delivery by other means. But in the area where the adverse competitive effect is found in the matching of sellers’ delivered prices on heavy standardized goods it is delivery by common carrier that is of prime importance. Obviously if due allowance is made there will be no difference in the mill net or f.o.b. factory prices applying to the various destinations involved. To whatever extent due allowance is not made it will reflect itself in varying mill net prices and the amount of the variation would be the amount of the discrimination. Where a seller’s delivered prices are different at different points depending on a varying cost of common carrier transportation from a given point it is impossible to ascertain and measure geographic price discrimination in any other way. That was the method employed by the Commission and followed by the Supreme Court in the Glucose cases. It was the method employed by the Bureau of Corporations in presenting the evidence of geographic discrimination by the old Standard Oil Company.
If the geographic discrimination condemned by the statute and public policy is to be effectively dealt with, there are persuasive reasons why a seller should not be allowed to deprive the buyer of his common law right of access to common carrier transportation. The seller's only motive for such deprivations is in order to make effective the seller's geographic price discriminations and to withhold from buyers the knowledge that he is constantly getting more money from some customers than from others through a process in which the seller assumes to become a wholesaler of common carrier transportation, reselling some of it at varying losses through freight absorption or some of it at varying profits through phantom freight. Moreover there is great cogency in the fact that the real consideration in the seller's mind for parting with title to his goods is the amount he nets for his goods at the factory or shipping point. For that is the only amount out of which the seller can realize a profit, if any.

The suggestion has been made that the word "price" in the statute be defined as whatever the seller and buyer might agree upon. One can readily envision what that would mean in the so-called "administered price" industries where the seller's wish would be law. The seller would become not only the fixer of the price as he now is, but the fixer of the meaning of the word. The latter function would no longer be performed as an administrative and judicial one based on the circumstances of the case. We may be sure that the seller would define price in such a way as to relieve him from liability for discrimination whether geographic or otherwise.

It may be logically contended that the proviso which justifies discriminations that make only due allowance for differences in cost of delivery requires a concept of price which can be applied to all forms of delivered pricing. There should be no form of delivered pricing which is exempt from the statute by private definition. The logic of the statutory concept that delivered prices which fail to make due allowance for differences in cost of delivery cannot be justified is the same logic as the concept that unless delivered prices make such allowance they are discriminatory. At any rate, it would appear to coincide with the Supreme Court's declaration in the Staley case that a non-discriminatory price system is one "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."380 Even discounting

380 324 U. S. 746, 757 (1945).
that as dictum, the question persists as to how there can be geographic price discrimination at all without involving reversal of that principle and applying the contrary principle of lower prices to those not having the natural advantage of proximity to the plant. Geographic price discrimination would seem to be inextricably entwined with the failure to make due allowance for differences in cost of delivery just as it was in the discriminations of the old Standard Oil Company.

The question whether a single delivered price within a wide area or over the entire country may be discriminatory has not been adjudicated, although it is involved in several cases pending before the Commission. There has been no judicial reaction to the question other than the Supreme Court's dictum in the Staley case that there would be no discrimination in such a zone price so far as it reflected only freight absorption. As is so common in dicta, however, the Court overlooked the fact that a zone delivered price system also contains phantom freight to many customers and that far more than a basing point system it runs counter to the principle stated also in the Staley case that relative proximity to the plant should be the measure of the price advantages variously located customers should be entitled to. A basing point system at least may make due allowance for differences in cost of delivery from the basing point. A zone system makes no pretense of making such allowance from any point to any other point and the larger the zone the less can it conform to the making of such allowance. To whatever extent geographic price discrimination is the equivalent of failure to make due allowance for differences in cost of delivery, the zone system contains the greatest amount of such discrimination. One should hesitate to accept any definition of price which would exempt from the terms of the statute the systems of geographic pricing which most completely disregard the principle of due allowance for differences in cost of delivery. It would be futile to discuss the competitive aspects of zone systems which would be lawful or unlawful depending on the facts of a particular case. But it seems safe to conclude that if zone systems are immune from the charge of discrimination in violation of the statute while basing point systems cannot avoid such a charge, there would be an increasing tendency to shift to the former. Once established and in operation throughout an industry a zone system requires less cooperative attention to keep it going than a basing point system.
Phantom freight and Freight Absorption

Phantom freight is the increment to a seller's net realized price which results when the freight factor in his delivered price is greater than the actual cost of transportation. Freight absorption is the shrinkage in his net realized price which results when the freight factor in his delivered price is exceeded by the actual cost of transportation. For some more or less obscure reason there was a general disposition to abandon the effort to justify phantom freight after the Glucose cases were decided by the Supreme Court in 1945. Even the U. S. Circuit Court of Appeals when it decided the Cement Institute case in 1946 condemned the practice of phantom freight while approving the practice of freight absorption. In reversing that Court's decision, however, the Supreme Court held that freight absorption as well as phantom freight involved price discrimination, reiterated that it had so held in the Glucose cases and again said that both were unlawful when they had the adverse effect on competition specified in the statute. It also held that neither practice could be defended as meeting the equally low price of a competitor in good faith where the effect was to eliminate price competition among the various sellers.

The attempt to distinguish between discrimination in the form of phantom freight and in the form of freight absorption is untenable. So far as the effect on price competition among the sellers is concerned, it is obvious that a system with freight absorption from basing points located at every point of production and shipment, thus eliminating all phantom freight, will produce identity of delivered prices as readily as a system that includes both phantom freight and freight absorption. So far as injury to competition among the customers of a single seller is concerned, the discrimination reflected by the varying mill nets of freight absorption may hurt a customer just as much as an equal amount of discrimination taking the form of phantom freight. In the Staley case only half of the maximum discrimination was phantom freight. It is impossible to say that the other half consisting of freight absorption was any less harmful to competition among Staley's customers. The impact of price discrimination is mathematical rather than ideological. And as recognized by the Supreme Court in the Staley case, it would be a simple matter for a seller who previously charged phantom freight to establish his highest mill net (including phantom freight) as a base price and then absorb freight in all directions without changing the substance of the situation. It characterized this as a subterfuge which
could not be regarded as a good faith effort to meet the equally low price of competitors. When the Supreme Court said in the Cement case that the single and multiple basing point systems functioned in the same way and produced "the same consequences—identity of prices and diversity of net returns", and when it said the difference between the two were "therefore differences of degree only", that was equivalent to saying that the difference between freight absorption and phantom freight was only a difference of degree because those two factors function in the same way and produce the same consequences.

Moreover, freight absorption is ordinarily calculated and applied in terms of rail freight and in the precise amounts necessary to match the delivered prices of competitors more advantageously located for rail delivery. But the Circuit Court of Appeals in the Cement Institute case said that phantom freight was involved when delivered prices were figured in terms of rail freight and delivery was actually made by truck or boat at lower rates. So in order to keep phantom freight from intruding into a system of pure freight absorption it would be necessary to see that imputed delivery costs do not exceed the actual cost. That could be done only by proscribing the physical use of cheaper modes of transportation than by rail.

In the last analysis phantom freight and freight absorption are both merely different degrees of departure from the principle of due allowance for differences in cost of delivery. Both are merely different degrees of geographic price discrimination.

**Conclusion**

The definite inferences which the foregoing exposition will either support or permit are as follows:

1. That the concept of geographic price discrimination and its destructive effect on competition with the discriminator was basic in all the remedies that have been provided by State and Federal statutes.

2. That while each such statute carries its own definition of discrimination and of the circumstances under which it is unlawful, all of them can be interpreted to advantage in the light of economic principles accepted by the majority of economists and consequently in the light of the common law background upon which those principles were formulated.

3. That geographic discrimination lends itself either to the domi-

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31 157 F. 2d 533, f. n. 562 (C. C. A. 7th 1946).
tion of competitors by ruinous local price cutting from powerful rivals or to a suspension of competitive forces through reciprocal interpene-
tration of each other's home territory on the basis of mutually adjusted local price cutting through systematic freight absorption resulting in matched delivered prices.

4. That geographic price discrimination is at odds with the prin-
ciple of making due allowance for differences in cost of delivery and exists by virtue of a failure to make such allowance.

5. That Congress and the courts should be slow to accept any con-
cept of price which would assume that geographic discrimination can be avoided by the expedient of disregarding the principle of making due allowance for differences in cost of delivery.

6. That the difference between the phantom freight and freight absorption forms of geographic discrimination is one of degree and not of kind, that price competition among sellers can be as effectively suppressed by the latter as by the former, and that competition among the customers of a single seller can be injured as readily by one as by the other.

7. That the anti-discrimination statutes are a vital part of the anti-
trust laws without regard to the existence of conspiracy to violate them.
THE LEGAL AND FACTUAL CONTENT OF RECENT GEOGRAPHIC PRICING CASES

JOSEPH E. SHEEHY*

FEW court decisions in recent years have given rise to as much dis-
sussion and comment as have those in the Federal Trade Commis-
sion cases involving geographic pricing practices. A casual reading of
some of the many interpretive articles which have appeared on this sub-
ject indicates the existence of a high degree of confusion as to the prac-
tices involved and the remedies which the Federal Trade Commission
sought and obtained in its efforts to terminate those practices. An appreci-
ation of these fundamentals is essential to an understanding of the legal
status of geographic pricing practices.

A chronological treatment of the cases would necessarily start with
United States Steel Corporation et al.,¹ and continue through the Glucose
cases,² The Cement Institute, et al.,³ and Triangle Conduit & Cable Co.,
Inc., et al.,⁴ with digressions along the way to include such matters as
United States Malsters Association, et al.,⁵ Fort Howard Paper Co., et al.,⁶
and The Milk and Ice Cream Can Institute, et al.⁷ It appears, how-
ever, that the problem received little consideration from the business
world until the Supreme Court handed down its decision directing en-
forcement of the Commission’s order in the Cement case. It is appro-
riate, therefore, that it be given primary consideration in any discussion
of the cases on this subject.

In 1937 the Federal Trade Commission issued a complaint against
The Cement Institute, 74 corporate members and 21 individuals asso-
ciated with it. This complaint was in two counts. Count I, Paragraph
Four, contained the following allegation.⁸

¹ 8 F.T.C. 1 (1924).
² Corn Products Refining Co. v. FTC, 324 U. S. 726 (1945), and FTC v. A. E. Staley Mfg.
Co., 324 U. S. 746 (1945).
⁴ Triangle Conduit & Cable Co., et al. v. FTC, 168 F. 2d 175 (C. C. A. 7th, 1948).
⁶ Fort Howard Paper Co., et al. v. FTC, 156 F. 2d 899 (C. C. A. 7th, 1946).
⁷ FTC v. Milk and Ice Cream Can Institute, et al., 152 F. 2d 478 (C. C. A. 7th, 1946).
⁸ 37 F.T.C. 102.
“For more than 8 years last past, respondents have maintained and now have in effect a combination among themselves to hinder, lessen, restrict, and restrain competition in price, among producing respondents in the course of their aforesaid commerce among the States. The said combination is made effective by mutual understanding or agreement to employ, and by the actual employment of, the methods and practices set forth in Paragraphs 5 to 7 inclusive, of this count.”

Paragraph Five contained a description of the basing point system in use in the cement industry, and subparagraph (d) thereof summed up the effect of its use as follows:9

“The result is the quoting of a delivered price by every producing respondent identical with the delivered price quoted by all other respondents which seek business at any given destination point in the United States.”

Clearly, therefore, Count I of the Cement complaint was concerned solely with the combination to restrict and restrain price competition. In other words it involved an old-fashioned price fixing conspiracy of the type which the courts have uniformly condemned whether the action was brought under the Sherman Act or under Section 5 of the Federal Trade Commission Act.

Count II of the Cement complaint contains elements of novelty and much of the discussion and criticism leveled at the Commission’s action have been directed toward this count. The violations of law alleged in Count II were prefaced by the charge that they were carried on by the respondents pursuant to a combination among themselves to restrict and restrain competition. Thus the old-fashioned conspiracy charged in Count I is carried over into Count II. Its novelty arises from the fact that the Commission selected a specific practice, namely price discrimination, under Section 2 of the Clayton Act, as amended by the Robinson-Patman Act, and charged that there existed a combination or conspiracy to violate that statute. There appears to be no serious contention that the Commission would be powerless to proceed against such a conspiracy. Criticism that has been directed toward the proceeding under this Count seems to be based primarily upon the method employed by the Commission in identifying the price difference upon which the charge of discrimination was based. It was alleged that respondents discriminated in price among their customers when they established delivered prices made up of elements other than the net price at the mill plus actual transportation costs to each point of delivery. In other

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9 Id. at 103.
words, the variations in prices actually received by the seller, frequently designated as mill nets, were the measure of price difference upon which the discrimination was based. It is important to remember, however, that regardless of the standard used in determining price difference, the charge would stand or fall upon the proof that there existed a combination or conspiracy to violate the statute.

The final record consisted of nearly 100,000 pages of testimony and exhibits. The findings are in much greater detail than is customary and contain extensive quotations from the evidence and exhibits. This insured that there would be squarely before the court not only the findings in their summary form as is customary but also pertinent excerpts from the actual evidence on which the findings were based. A perusal of the findings as thus written would seem to leave little doubt as to the existence of a combination or conspirarcy. The majority of the United States Circuit Court of Appeals for the Seventh Circuit, however, concluded that the Commission had failed to establish the existence of the unlawful conspiracy charged.

The Supreme Court summed up succinctly the issues involved in this case when it stated:10

"The core of the charge was that the respondents had restrained and hindered competition in the sale and distribution of cement by means of a combination among themselves made effective through mutual understanding or agreement to employ a multiple basing point system of pricing. It was alleged that this system resulted in the quotation of identical terms of sale and identical prices for cement by the respondents at any given point in the United States. This system had worked so successfully, it was further charged, that for many years prior to the filing of the complaint, all cement buyers throughout the nation, with rare exceptions, had been unable to purchase cement for delivery in any given locality from any one of the respondents at a lower price or on more favorable terms than from any of the other respondents.

"The second count of the complaint, resting chiefly on the same allegations of fact set out in Count I, charged that the multiple basing point system of sales resulted in systematic price discriminations between the customers of each respondent. These discriminations were made, it was alleged, with the purpose of destroying competition in price between the various respondents. . . ."

The Court, after giving consideration to and disposing of various contentions raised by the respondents with regard to such matters as jurisdiction, alleged bias of the Commission, alleged error in connection with the introduction of evidence, and others of a like nature, came to

10 333 U. S. 683, 688 (1948).
the consideration of the findings of fact upon which the Commission’s order was based. With regard to these, it said: 11

“The Commission’s findings of fact set out at great length and with pains-taking detail numerous concerted activities carried on in order to make the multiple basing point system work in such way that competition in quality, price and terms of sale of cement would be non-existent, and that uniform prices, job contracts, discounts, and terms of sale would be continuously maintained. The Commission found that many of these activities were carried on by the Cement Institute, the industry’s unincorporated trade association, and that in other instances the activities were under the immediate control of groups of respondents. Among the collective methods used to accomplish these purposes, according to the findings, were boycotts; discharge of uncooperative employees; organized opposition to the erection of new cement plants; selling cement in a recalcitrant price cutter’s sales territory at a price so low that the recalcitrant was forced to adhere to the established basing point prices; discouraging the shipment of cement by truck or barge; and preparing and distributing freight rate books which provided respondents with similar figures to use as actual or ‘phantom’ freight factors, thus guaranteeing that their delivered prices (base prices plus freight factors) would be identical on all sales whether made to individual purchasers under open bids or to governmental agencies under sealed bids. These are but a few of the many activities of respondents which the Commission found to have been done in combination to reduce or destroy price competition in cement.”

These excerpts from the Court’s opinion show clearly that in so far as this case involved a violation of Section 5 of the Federal Trade Commission Act, both the Commission and the Supreme Court recognized one simple, basic fact—namely, that the respondents had engaged in a conspiracy to fix prices and that such a conspiracy was in violation of the law. There was nothing novel or startling in a decision of this nature since practices of the kind found by the Commission and the courts to have existed have been defined by statute for more than 50 years as unlawful.

Much of the criticism of the Cement decision appears to be directed toward the Commission’s determination as to what constituted price in the cement industry. The Commission charged in effect that in that particular case, to arrive at the true price received by respondents, the price actually paid to the carrier for transportation of the cement to the buyer must be deducted from the delivered price. The Commission found that purchasers of cement generally and customarily paid the freight charges directly to the common carrier and paid to the seller

11 Id. at 709.
only the amount of the invoice after deducting the amount of the freight paid to the carrier. The Commission further found that the accounting practices of the respondents showed clearly that they recognized the net amount received at the mill as the price of their product. Title passed at the mill, and in so far as the seller was concerned, responsibility for the transaction terminated there. Having concluded that in so far as the cement industry was concerned the true price was the net amount received at the mill, the Commission then logically concluded that the variations in this true price resulting from the system which produced matched prices at all delivered points were the measure of price differences. It further found that the effect of the discriminations in price established by the evidence had been substantially to lessen competition and tend to create a monopoly in the sale and distribution of cement.

In connection with this phase of the case, efforts were made, before the Supreme Court, to distinguish it from previous decisions by showing that in some instances use of the system involved neither phantom freight nor freight absorption. The second point urged most strongly by the respondents was that such price differences as occurred in the mill net realizations were the result of good faith efforts to meet competition and, consequently, were permissible under Section 2 (b) of the Clayton Act, as amended. The Court, however, failed to find any substantial difference between the basing point practices it had previously condemned in the Staley and Corn Products cases and those shown to have existed in the Cement case. With regard to the alleged good faith meeting of an equally low price of a competitor, the Court said: 12

"But this does not mean that § 2 (b) permits a seller to use a sales system which constantly results in his getting more money for like goods from some customers than he does from others. We held to the contrary in the Staley case. There we said that the Act 'speaks only of the seller's "Lower" price and of that only to the extent that it is made "in good faith to meet an equally low price of a competitor." The Act thus places emphasis on individual competitive situations, rather than upon a general system of competition.' Federal Trade Commission v. Staley, supra at 753. Each of the respondents, whether all its mills were basing points or not, sold some cement at prices determined by the basing point formula and governed by other base mills. Thus, all respondents to this extent adopted a discriminatory pricing system condemned by § 2. As this in itself was evidence of the employment of the multiple basing point system by the respondents as a practice rather than as a good faith effort to meet 'individual competitive situations,' we think the Federal Trade Commission correctly concluded that the use of this cement basing point system vio-

12 Id. at 725.
lated the Act. Nor can we discern under these circumstances any distinction between the 'good faith' proviso as applied to a situation involving only phantom freight and one involving only freight absorption. Neither comes within its terms.

"We hold that the Commission properly concluded that respondents' pricing system results in price discriminations. Its finding that the discriminations substantially lessened competition between respondents and that they were not made in good faith to meet a competitor's price are supported by evidence. Accordingly, the Commission was justified in issuing a cease and desist order against a continuation of the unlawful discriminatory pricing system."

Briefly, then, the Court in deciding the Cement case found that the respondents had engaged in a price fixing conspiracy in violation of Section 5 of the Federal Trade Commission Act. It further found on the basis of the facts in the record that price in the cement industry was recognized by that industry as being the amount realized at the mill; that the basing point system resulted in discriminations in that price; that these discriminations did not come within the scope of price variations permitted under Section 2 of the Clayton Act as amended and, consequently, they were unlawful within the terms of that section; and that the Commission was warranted in issuing a cease and desist order against a continuation of the unlawful, discriminatory pricing system. Stripped to its essentials, the decision of the Court holds that in this industry there existed a price fixing conspiracy and a conspiracy to discriminate in prices which produced adverse competitive effects, both conspiracies carried on through the medium of a multiple basing point system.

Three years before the Supreme Court decided that the Commission was justified in issuing a cease and desist order against the continuation of the unlawful discriminatory multiple basing point system employed in the cement industry, it had decided that the use of a single basing point system by an individual company producing glucose and related products resulted in unlawful price discrimination. This seems important since the emphasis placed upon this phase of the Cement case at times indicates that the position taken by the Supreme Court was novel and without judicial precedent. In 1939 the Commission issued complaints against Corn Products Refining Co., et al., and A. E. Staley Manufacturing Co., et al. Each of these companies was charged with discriminating in price among its customers in violation of Section 2(a) of the Act.

13 34 F.T.C. 850 (1942).
14 34 F.T.C. 1362 (1942).
With regard to Corn Products Refining Company, it was alleged that
the company maintained two manufacturing plants, one at Chicago and
one at Kansas City; that in the course of its sales it discriminated in
price between purchasers of its commodities and that the results of such
discrimination were to lessen competition and tend toward creation of
a monopoly. In its findings the Commission set forth in detail the
precise manner in which respondents' basing point system was operated
and the measure of price differences on shipments to a number of cities
in the West and Southwest. It found that respondent sold its bulk glu-
cose at delivered prices which were calculated upon the basis of the
price in Chicago plus the railroad freight rate from Chicago to the desti-
nation of the purchaser.

In Paragraph 4(d) of the findings15 the Commission summed up the
effects of this company's use of its basing point system, particularly
with regard to shipments made from its Kansas City plant. The United
States Circuit Court of Appeals in deciding this phase of the case stated:16

"In so far as the delivery price includes for freight more than the actual
cost of transportation it measures a definite discrimination forbidden by statute.
Upon the principle of equality, the Act forbids any difference in charges to
different competitive customers not based upon actual differences in service or
delivery. If a difference is to be justified because of presence of the latter
element, it must have some reasonable relationship to actual cost and may not
be of such character or quality as to work an unjust discrimination. Western
Union Telegraph Co. v. Call Publishing Company, 181 U. S. 92, 100. The
inclusion of a fictional cost of delivery, having no justification in fact, in itself
suggests, upon the part of the manufacturer, arbitrary fixation of prices dis-
criminating illegally as between competitive customers. Systematic price dis-
crimination is irreconcilable with free, active competition. It is not the kind
of price competition found in a truly competitive market. Thus in U. S. v.
Sugar Institute, D. C., 15 F. Supp. 817, 908, the court condemned and en-
joined defendants from 'determining transportation charges or freight, appli-
cations to be collected from customers, or limiting freight absorptions' and
'selling only on delivered prices or on any system of delivered prices, including
zone prices or refusing to sell f.o.b. refinery.' Upon appeal defendants waived
their assignments of error as to each of these. The Supreme Court modified
the decree in other particulars, not pertinent here, and affirmed in all other
respects. Sugar Institute v. U. S., 297 U. S. 553, 591, 605. Thus defendants
were finally enjoined from selling at prices including artificial or fictional
items of freight and the court adhered to the reasoning of Western Union
Telegraph Co. v. Call Publishing Co., 181 U. S. 92, forbidding 'any difference
in charge not based upon difference in service.'"

15 Note 13, supra, at 861.
16 144 F. 2d 211, 215 (C. C. A. 7th, 1944).
The Supreme Court likewise appears to have encountered no difficulty in determining that the system of pricing used by this respondent was violative of Section 2(a) of the Clayton Act, as amended. The following pertinent quotation is from its decision:

"Petitioners' pricing system results inevitably in systematic price discriminations, since the prices they receive upon deliveries from Kansas City bear relation to factors other than actual costs of production or delivery. As in the case of the twelve cities selected by the Commission for illustrative purposes, the freight actually paid by petitioners in making deliveries usually varies from the freight factor from Chicago, used in computing the delivered price. When the actual freight is the lesser of the two, petitioners charge and collect unearned or phantom freight; when it is the greater, petitioners absorb the excess freight, which they pay, but do not include in the computation of their delivered price.

"In either event, on shipments from Kansas City, the delivered price to the purchaser depends not only on the base price plus the actual freight from Kansas City, but also upon the difference between the actual freight paid and the freight rate from Chicago which is included in the delivered price. This difference also results in varying net prices to petitioners at their factory at Kansas City, according to the destination of the glucose. The factory net varies according as petitioners collect phantom freight or absorb freight, and in each case in the amount of this freight differential. The price discriminations resulting from this systematic inclusion of the freight differential in computing the delivered price are not specifically permitted by the statute. Hence they are unlawful, unless, as petitioners argue, there is an implicit exception to the statute for such a basing point system."

The argument of the petitioners as to alleged exception of the basing point system from the operation of the statute was based primarily upon the failure of Congress to include a provision in the Robinson-Patman Act which in effect would have made the use of basing point systems unlawful per se. It was urged that Congress by rejecting this provision had indicated its intention to sanction all basing point systems. The Court in disposing of this argument stated:

"We think this legislative history indicates only that Congress was unwilling to require f.o.b. factory pricing, and thus to make all uniform delivered price systems and all basing point system illegal per se. On the contrary we think that it left the legality of such systems to be determined accordingly as they might be within the reach of § 2(a), as enacted, and its more restricted prohibitions of discriminations in delivered prices."

The above quoted statement acquires added significance in the light

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17 324 U. S. 726, 732 (1945).
18 Id. at 737.
of increasing insistence that advanced determinations be made as to the legality or illegality of basing point systems of whatever kind, in whatever industry used and without regard to variations that may exist as to competitive conditions therein. The Court clearly recognized that the legality of such systems could be determined only by viewing them and their effects in the light of the competitive picture existing in the industry at such time as the practices might be challenged.

In this particular industry the Commission found that respondent's customers, the candy manufacturers located in Chicago, through the operation of the system received prices more favorable than those of any of respondent's customers located outside of the Chicago area. It was further shown that glucose was the principle ingredient in the manufacture of low-priced candy, a field in which competition was keen and the differences of small fractions of a cent in the sale price were enough to divert business from one manufacturer to another. In the opinion of the Court the findings of the Commission with regard to the discriminatory nature of the pricing practices and their adverse effect upon competition were supported by substantial evidence and, consequently, the decision of the lower court, affirming and enforcing the Commission's order, was affirmed.

In FTC v. A. E. Staley Manufacturing Company,19 decided by the Supreme Court on the same day as the Corn Products Refining case, the issues were in many respects similar. That company, however, had only one plant, which was located at Decatur, Illinois. It had adopted Chicago as its base point, thus making the delivered price the base price plus delivery from Chicago. Deliveries from the Decatur plant to customers located in Decatur were made at a price which included the charge of phantom freight from Chicago to Decatur although of course there was no such movement of merchandise. The same situation prevailed as to all destinations which were closer, freightwise, to Decatur than to Chicago. It was the contention of this respondent that, when it entered the field, it found Corn Products Refining Company established and doing business on a Chicago base and that it adopted this method of selling in good faith to meet the price of a competitor. The Court explained that the pricing system of the Corn Products Refining Company, the competitor whose price allegedly had been met in good faith, involved unlawful price discriminations. It stated:20

19 324 U. S. 746 (1945).
20 Id. at 753.
Thus it is the contention that a seller may justify a basing point delivered price system, which is otherwise outlawed by § 2, because other competitors are in part violating the law by maintaining a like system. If respondents' argument is sound, it would seem to follow that even if the competitor's pricing system were wholly in violation of § 2 of the Clayton Act, respondents could adopt and follow it with impunity.

This startling conclusion is admissible only upon the assumption that the statute permits a seller to maintain an otherwise unlawful system of discriminatory prices, merely because he had adopted it in its entirety, as a means of securing the benefits of a like unlawful system maintained by his competitors. But § 2 (b) does not concern itself with pricing systems or even with all the seller's discriminatory prices to buyers. It speaks only of the seller's 'lower' price and of that only to the extent that it is made 'in good faith to meet an equally low price of a competitor.' The Act thus places emphasis on individual competitive situations, rather than upon a general system of competition. Respondents are here seeking to justify delivered prices which discriminate in favor of buyers in Chicago and at points nearer, freightwise, to Chicago than to Decatur, by a pricing system involving phantom freight and freight absorption. We think the conclusion is inadmissible, in view of the clear Congressional purpose not to sanction by § 2 (b) the excuse that the person charged with a violation of the law was merely adopting a similarly unlawful practice of another.'

There is little room for arguing that the language used by the Court in the Corn Products and Staley cases lacks clarity with regard to the price discriminations inherent in the basing point systems used by those companies. Each had a single basing point, and in adhering thereto each collected money for transportation services which were never furnished, or as it is commonly termed, "phantom freight", and each absorbed freight charges in whole or in part when under its system such action was necessary. There was no charge in these cases that the system was adopted or maintained as a result of agreement or conspiracy between the companies involved. The issue was clear and simple as to whether or not the price variations resulting from the operation of such a system constituted discriminations in price within the meaning of the Clayton Act as amended. The Court on the basis of the findings concluded that in so far as the operations of those particular businesses were concerned, the existence of such discrimination had been established. Three years later, when the Cement case came before it, the elements of the Glucose cases were present plus two additional factors: (a) the industry used many basing points instead of the single point method used in the sale of glucose, and (b) the system was used pursuant to a combination or conspiracy among the manufacturers. As previously shown herein, the Court found no legal significance in the difference between a single
basing point system which results in price discrimination and a multiple basing point system which produces the same results. With regard to the conspiracy phase of the case, it would seem unrealistic to urge that the maintenance of illegal price discriminations by means of agreements is in any different legal category than the fixing of prices in the first instance by agreements.

In 1941 the Commission issued a formal complaint against the Rigid Steel Conduit Association and its officers and members in which it was charged that they were engaged in carrying out an unlawful understanding, agreement, combination or conspiracy for the purpose and with the effect of substantially restricting, suppressing and eliminating price competition in the sale and distribution of steel conduit. In Count II of this complaint it was charged that each respondent acting with the knowledge that the other respondents simultaneously do likewise used the various methods and practices which it was charged in Count I were employed through agreement or conspiracy. Both counts charged violation of Section 5 of the Federal Trade Commission Act. There was no charge as to violation of Section 2 of the Clayton Act in the Conduit case. Count I encompassed a conspiracy similar in its legal implications to the conspiracy charged in Count I of the Cement complaint. Count II obviously departed from Count II of the Cement complaint in that it contained no charge of price discrimination but instead a charge of violation of Section 5 of the Federal Trade Commission Act. This Count, unlike Count I, was not based upon a specific charge of agreement or combination but instead upon the charge that each seller, knowing that the other sellers were using the same basing point system and knowing further that the use of the system would result in the elimination of price competition among them, had engaged in an unfair method of competition. The charges differed from the familiar pattern of conspiracy to violate the antitrust laws. They covered practices destructive of price competition with clearly defined monopolistic tendencies.

In the Commission’s findings it was shown that as in the case of many other steel products, conduit was originally sold only on a Pittsburgh base. Changes were made through the years down to 1934 when two basing points were selected, Pittsburgh and Chicago. The Chicago base price was fixed at a figure approximately $4.00 per ton above the Pittsburgh base.

Responsive to Count I of the complaint the Commission found that the respondents had maintained a combination and conspiracy which
had the capacity, tendency and effect to hinder, lessen, restrain and suppress competition in the sale of conduit. As to Count II of the complaint, the Commission found:21

"... that the capacity, tendency, and effect of the use by each respondent named therein of the basing-point, delivered-price formula to determine price quotations and prices which will be made to conduit purchasers at any given destination concurrently with similar use of the same pricing formula by other of the said respondents has been, and is, to hinder, lessen, and restrain competition in price in the sale and distribution of conduit; to deprive purchasers of the benefits of competition in price; to unfairly discriminate among purchasers; and to create in each of said respondents a dangerous tendency toward a monopolistic control over price in the sale and distribution of conduit."

Counsel for the Commission based his argument in support of Count II on two distinct grounds: (a) that upon the facts of record in that case, the individual, concurrent use of the basing point system as there employed was an unfair method of competition in violation of Section 5 of the Federal Trade Commission Act, and (b) that an order based upon this count was a necessary form of relief from the price fixing combination established under Count I.

In support of the contention that even in the absence of a conspiracy respondent’s practices constituted an unfair method of competition, it was urged by Commission’s counsel that when individual companies, who in the aggregate controlled more than 93% of the output of the industry, concurrently adopted pricing practices, each with knowledge that the others were doing likewise and knowledge that the results of such action would be the elimination of price competition, that such acts were unfair methods of competition. It was contended that they fell into the same class as the practices condemned in FTC v. Beechmut Packing Company22 in which, although there likewise was no charge of conspiracy, the Court said that the system there employed “necessarily constitutes a scheme which restrains the natural flow of commerce and the freedom of competition in the channels of interstate trade which it has been the purpose of all the antitrust acts to maintain.”23

The second reason urged by the Commission’s counsel for prohibiting the concurrent use of the basing point system as employed in this industry was that such action was a necessary form of relief from a price fixing combination. It was believed that an order merely prohibiting the

21 Rigid Steel Conduit Ass’n, 38 F.T.C. 534, 593 (1944).
22 257 U.S. 441 (1922).
23 Id. at 454.
Continuance of the conspiracy would be ineffective. Machinery for price fixing was in full operation and it could be kept in operation indefinitely in an industry where each, with knowledge of the procedure and its effects, continued the concurrent use of the plan. In other words, this contention was based upon a need for a practical, effective means of enforcement which would insure the restoration of competitive prices to the industry.

There has been much speculation as to the significance of Count II and the portion of the order dealing with it. It is frequently described as prohibiting all forms of geographic pricing, all freight absorption and in fact limiting sellers to f.o.b. pricing. It has been contended that the Commission in effect has laid down a general regulation to this effect that is applicable to all industries under all circumstances and without regard to the competitive picture existing in each. The fact is, of course, that the Commission has no statutory authority to promulgate any such general rule. It may issue a formal complaint only in individual cases when it has reason to believe that such action may be warranted in the public interest. In this instance it had reason to believe that a price fixing conspiracy existed and so charged in Count I of its complaint. It of course had all of that information before it when Count II was drawn. The charges therein, while not based upon an express agreement, were drawn against that background. There was also present the price rigidity which the Commission from its experience has learned to associate with the absence of effective competition. There is no basis for the assumption that in the absence of such a background the Commission could or would find reason to believe that the statute was being violated.

The United States Circuit Court of Appeals for the Seventh Circuit encountered no difficulty in connection with Count I. The Court expressed the opinion that there was direct proof of conspiracy in the record but that whether there was or not the evidence in the record justified the Commission in drawing the inference that respondents acted in concert in a price fixing conspiracy.

With regard to Count II, the Court appears to have been impressed with the Commission's argument as to the existence of an unfair method of competition even though it might fall short of the elements necessary to establish violation of the Sherman Act. In fact the decision seems to have been based on this phase of the argument since no reference has been made therein to the necessity for granting the type of relief urged in order to effectively break up the price fixing combination. The
Court measured the practices in the light of the Cement case and decided that it could not say\textsuperscript{24} "that the Commission was wrong in concluding that the individual use of the basing point method as here used does constitute an unfair method of competition." The words, "as here used", are important words of limitation. It must be borne in mind that the existence of a conspiracy in this industry had been established and, that neither the Commission nor the Court could eliminate that fact from among all other facts established on the record when consideration was given to the concurrent action of each respondent. It is difficult, therefore, to see how anyone could seriously contend that under this decision the use by individual companies of basing point methods of selling or freight absorption is \textit{per se} unlawful. It would seem that to reach such a conclusion one would first be obliged to concede that a basing point system cannot be maintained successfully in the absence of a conspiracy.

Another basing point complaint was that issued against United States Steel Corporation and 11 of its subsidiaries in 1921, and subsequently amended. It was based upon the so-called Pittsburgh Plus method of selling. At that time rolled steel was sold at a base price plus the railroad rate of freight from Pittsburgh to destination regardless of the actual point of shipment. An exception was made as to steel manufactured in or near Birmingham, Alabama. The Birmingham price was made up of the Pittsburgh base plus an arbitrary differential of $5.00 per ton. The Commission charged that through the observance of this pricing practice, the respondents discriminated in price among the different purchasers in violation of Section 2 of the Clayton Act (prior to its Robinson-Patman Amendment) and were using an unfair method of competition in violation of Section 5 of the Federal Trade Commission Act. The latter charge was similar to the one then at issue in the Beechmut case and also to that contained in Count II of the Conduit case which issued many years later.

The Commission found that the respondents produced about 50% of the total rolled steel production in the United States and that their use of the Pittsburgh Plus system of sale with the slight variations therefrom that then existed resulted in discriminatory prices which substantially lessened competition among steel users, between respondents and their own customers and among steel producers. It found further that the system as used was an unfair method of competition. This phase

\textsuperscript{24} Note 4, \textit{supra}, at 185.
of the *Pittsburgh Plus* case, like Count II of the *Conduit* case, is sometimes made the basis for assertions that the Commission has prohibited the use of basing point selling regardless of the manner in which the practice may be used and the presence or absence of collusion.

It is true that there was no charge of conspiracy in the *Pittsburgh Plus* case. The Commission’s findings, however, leave no doubt as to the collusive background existing in this industry. Clearly, there was a definite understanding among the steel producers, respondents and non-respondents, concerning the adoption of the basing point system and as to certain branches of the industry it is shown in the findings that the manufacturers, including the respondents, agreed upon the Pittsburgh Plus system as a means of fixing and maintaining prices. When consideration is given to these findings, it seems idle to argue, as is so frequently done, that there was no collusion or conspiracy in the *Pittsburgh Plus* case. The Commission elected to proceed against a single company and its subsidiaries, but the existence of a combination in restraint of trade was clearly established on the record.

The order entered in that case prohibited respondents from quoting or selling steel products at Pittsburgh Plus prices or from using other basing points of a like nature. It was explained that the term “Pittsburgh Plus” referred to respondents’ systematic practice of quoting and selling products manufactured and shipped from points outside of Pittsburgh at their f.o.b. Pittsburgh prices plus rail freight charges from Pittsburgh to destination. It also prohibited sales in interstate commerce without showing clearly on the contract or invoice the amount actually charged for the products at the shipping point and the actual transportation charge from there to destination. There was a further prohibition in the order against discriminating in price between different purchasers where the effect of such discrimination may be substantially to lessen competition. The following is quoted from the price discrimination paragraph of that order: 25

“...The use by respondents in the course of such interstate commerce of the system of Pittsburgh Plus prices for their said steel products, manufactured at and shipped from points outside of Pittsburgh—which prices are their f.o.b. Pittsburgh prices plus amounts equivalent to what the railroad freight charges on such products would be from Pittsburgh to each different destination if such products were actually shipped from Pittsburgh—shall be deemed to constitute a violation of this order.”

25 8 F.T.C. 1, 60 (1924).
From that portion of the Pittsburgh Plus order quoted above the conclusion is sometimes drawn that the Commission has prohibited all forms of selling or price quotation other than f.o.b. point of manufacture or shipment. Here again full consideration must be given to the proved facts of record with regard to the industry involved. As of the time this order was written, the steel industry was dominated by a single company, the respondent in the case. Through agreements and collusion it had been instrumental in having a system adopted which precluded the possibility of price competition anywhere. The Commission was charged with drawing an order that would make possible the restoration of competition. Acting in accordance with the statutory duties delegated to it by the Congress, it concluded that this type of order was necessary to obtain effective relief.

After the 1938 amendment of the Federal Trade Commission Act, which provided for Commission orders becoming final through lapse of time, the respondent in this case filed a petition to review and set aside the order. The Commission filed a cross-petition for enforcement. In July, 1948, respondents adopted a method of pricing their products which was deemed to be not in conflict with the requirements of the order, and subsequently both parties consented to the entry of a decree of affirmance and enforcement, which was entered by the United States Circuit Court of Appeals for the Third Circuit on October 5, 1948.

Several other Federal Trade Commission cases involving the legality of geographic pricing practices have been decided by the Circuit Court. There are no novel features involved, and consequently, they have been the subject of relatively little comment. In the Fort Howard Paper Company case the manufacturers of crepe paper and their association were charged with entering into agreements to fix prices. The mechanics used included price filing covering both current and future prices, the establishment of zones which produced substantially identical delivered prices and the standardization of trade practices the uncontrolled use of which might otherwise have resulted in price variations. The zoning systems used in this case is of interest since it presents a deviation from the single or multiple basing point systems previously considered. As to its use in this particular setting, the Court stated:26

"We think the artificiality and arbitrariness of the zone structure is so apparent it cannot withstand the inference of agreement. The Commission evidently could not believe that Wisconsin companies would deprive themselves of the

26 Note 6, supra.
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."

In Milk and Ice Cream Can Institute, et al. v. FTC\textsuperscript{27} the Court sustained an order of the Commission directed against a conspiracy in that industry in which respondents were prohibited from quoting or selling metal milk or ice cream cans in accordance with a plan or system involving equalization of freight with competitors, which resulted in the establishment or maintenance by respondent members or any two or more of them of uniform delivered prices to any given destination.

In United States Malsters Association, et al. v. FTC\textsuperscript{28} the Commission also found the existence of a price fixing conspiracy which was implemented by the use of a single basing point at Chicago.

The Commission's orders and court decisions thereon show clearly that the use of a basing point or other geographic pricing system has been condemned by the Commission as an unfair method of competition under Section 5 of the Federal Trade Commission Act only when found to exist in conjunction with a conspiracy to fix prices or otherwise restrain trade. The actions taken in the Pittsburgh Plus case and Count II of the Conduit case obviously go somewhat beyond the concept of a simple conspiracy in that they seek to reach unfair methods of competition not predicated directly upon the conspiracy. It must be borne in mind, however, that in each of these cases the Commission found that a conspiracy did exist in the industry involved. There has been no geographic pricing case in which the Commission has predicated an order solely upon facts comparable with those alleged in Count II of the Conduit case.

Price discriminations in violation of Section 2 of the Clayton Act, as amended, are customarily practiced by individual companies seeking an unfair competitive advantage. It seems significant, therefore, that in the geographic pricing cases wherein the Commission has charged price discrimination there has always been a background of price fixing con-
restraint of trade in that industry. In June, 1947, the Commission issued a complaint\textsuperscript{29} in which it was charged that the industry was engaged in a combination and conspiracy to fix and maintain prices.

It is always dangerous to generalize but there appears to be a strong probability that geographic pricing systems will not function successfully in the absence of unlawful conspiracies. In any event it may be stated with certainty that the Federal Trade Commission has issued no order against the use of such practices in any industry where there was a complete absence of price fixing. This fact makes it impossible to understand the reasoning of those who profess opposition to any weakening of the antitrust laws but insist upon action, legislative or otherwise that will detract from the remedies obtained by the Commission in the cases discussed above. These remedies were necessary effectively to reach the particular violations of the antitrust laws involved in the circumstances of those cases. Different circumstances will require different remedies, but any infringement upon the scope of the decisions discussed here must inevitably result in a weakening of the antitrust laws by providing loopholes for evasion.

\textsuperscript{29} Corn Products Refining Co., F.T.C. Docket 5502 (1947).
COLLUSION AND PARALLEL ACTION IN DELIVERED PRICE SYSTEMS

JOSEPH S. WRIGHT*

THE success of the Federal Trade Commission in persuading the courts that a number of geographic pricing methods have been the central mechanism of price fixing conspiracies has resulted in a veritable uproar in the business community, and to a lesser degree in the Bar. The central theme of the critics of the decisions seems to be that while no one could quarrel with the proposition that conspiracies to fix prices are illegal, the effect of the decisions is to outlaw any method of pricing except so-called uniform f.o.b. mill prices with the addition of full transportation costs to the customer. It is urged that “freight absorption” is no longer possible and that no seller can “meet the competition” of another seller in areas where he does not have a freight rate advantage without either violating Section 2 of the Clayton Act or putting himself in a situation where conspiracy may be implied if competitors follow a similar course.

Out of the welter comes a plea that a business man should know to a certainty just what practices he may engage in and the exact location of the fence between the sheep and the goats.

Without the slightest hope of reducing this confusion over the extent to which delivered price systems are questionable, this paper will be devoted to the collusive aspects of the delivered pricing systems heretofore questioned and will seek to avoid assiduously the related questions arising under Section 2 of the Clayton Act.

It is particularly difficult to deal with this subject since so many of the terms and expressions necessary to the discussion have lost any exact meaning and become inflammatory rather than lucid. The word “competition” is an example—it may suggest entirely opposite situations to an attorney in a Government agency and to a business executive. The unfortunate present necessity of using such dull tools as “monopoly”, “competition”, “meeting competition”, and “matching prices”, makes it unlikely that anyone can ever make a satisfactory dissection of the problem.

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Types of Systems

The delivered pricing systems fall into two rough categories—basing point systems and zone systems. Basing point systems are those in which delivered prices are quoted, made up of a base price at one or more geographical points plus a transportation factor to the buyer's destination. They range in complexity from single basing point systems, such as "Pittsburgh Plus" in steel and "Chicago Plus" in corn syrup and malt syrup, to those which may be known as "freight equalization" systems wherein every producing point is a basing point.

The zone systems are generally considered to include methods wherein an identical price is quoted to all customers within a certain geographical area, regardless of differing transportation costs from sellers' shipping points. These systems, as the basing point systems, range in complexity from the so-called "universal delivered price", wherein the entire country is a single zone, to complex geographical divisions of the country into several score of price zones.¹

The Cases Involving Zone Systems

From its very inception the Federal Trade Commission has proceeded in cases of cooperative price fixing under the broad provisions of Section 5 of its Act. The first proceeding in this field resulted in the fifth order entered by the new Commission, involving the Bureau of Statistics of the Book Paper Manufacturers and more than a score of book paper manufacturing concerns.² In this first case the respondents signed a stipulation agreeing to the entry of an order against any concerted movement:

"(1) to enhance prices of book-print paper, or
(2) to maintain such enhanced prices, or
(3) to bring about substantial uniformity of such prices, or
(4) to effect or maintain such enhancement of such uniformity of prices through the medium of telephone communication, or by correspondence,

¹ These categories are not all precise and many variants may be found. In Docket 4320, Salt Producers Ass'n, et al, 36 F.T.C. 1110 (1943), the industry admitted a conspiracy to use a "zone" system, which was really a combination of both basing point and zone systems, in that as to certain products a "universal delivered price" is quoted and as to others the zone price was based upon a freight calculation from a producing point. 1 Temporary National Economic Committee Monograph 296 (1940). In the Cement case, the Commission found a combination of the two systems employed by certain West Coast producers. 37 F.T.C. 87, 156 (1943).

or by personal meetings, or through other communications, or in any other manner whatsoever."

Over the more than 30 years from its first order in this field, the Commission has considered formal records in several hundred cases where it has been required to determine whether restraints on competition were the result of agreements or understandings. In the same period the Commission has doubtless considered several times this number of similar matters on informal investigational records.¹

Analysis of the Commission's price fixing orders indicates a distinct trend away from such broad and sweeping injunctive language as in the Book Paper case, supra, and a more detailed and realistic approach to the mechanics of the price fixing devices condemned.

The Commission apparently found the prohibitions of its 1917 order so broad and general as to be ineffective, and was put to the necessity of starting all over with a new proceeding nearly thirty years after the original Book Paper case. A new order was entered in 1945⁴ involving some sixty respondents comprising the present book paper industry, requiring them to cease and desist from a price fixing conspiracy; from exchanging and relaying prices, discounts, terms and conditions of sale through a central clearing agency; from agreed differentials in price for variations in color, weight, size, trim, backing, type or quantity of paper; from an elaborate zone system of quoting identical delivered prices; and from a uniform or standard form of sales contract. This later order of the Commission was affirmed on June 11, 1948, and the Court stated:⁵

"Here the petitioners are proved to have agreed upon these factors: uniform quantity discounts, uniform finishing differentials, uniform base prices, and a uniform zoning system with uniform zone differentials, all without regard to a particular petitioner's costs of production and distribution. The pattern clearly provides a means of fixing uniform prices. The petitioners' temporary departure from their system or temporary inability to carry through their purpose does not affect its illegality. The petitioners' degree of success in stifling price competition is not the measure of their liability."

A comparison of these two proceedings, involving the same industry and the same subject matter, demonstrates that the earlier type of order to cease and desist, directed broadly to conspiracy and agreement as such, has little realism or practical effect, and that the Commission has

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¹ Figures on cases closed after investigation and before issuance of complaint are not published in such form that any analysis can be made.
⁵ Allied Paper Mills v. FTC, 168 F. 2d 600, 608 (C. C. A. 7th 1948).
found it necessary to prohibit the mechanics by which price fixing has been accomplished, including the geographical pricing formulas, if it is to make its orders effective.

One of the first price fixing conspiracy orders in which the Commission sought a more detailed prohibition against the mechanics of price fixing was its Docket No. 934, *Pacific States Paper Trade Association, et al.*, in which the order prohibited allocations of territory between competitors, discussion of prices and terms of sale by four trade associations, rigid classifications of customers and agreed price differentials between the classes, and intimidation and coercion of customers. The findings as to division of territories and setting of prices for each territory suggest the present zone systems of pricing, hence this case is probably the "grandfather" of the zone price system cases. On petition for review, this order was reversed in the Circuit Court of Appeals as to those paragraphs which specified the mechanics by which the price system device was carried out.7

The Supreme Court reversed the lower Court and restored the questioned portions of the order, stating:8

"The members of the associations dominate the paper trade in question. They are organized to further common purposes. They limit competition in intrastate trade by adherence to uniform prices fixed by agreements through combination. The facts admitted show a strong purpose and much diligence to that end. And some of their activities are for like purpose and have the same effect in the field of interstate commerce. Suggested prices for Idaho and Montana were sent out with the Spokane lists. There was an understanding that such prices would be followed. Mill shipments, whether shipped from within or from without the State, are subject to the agreed prices. From the standpoint of respondents, restraint upon price competition in their interstate commerce is as desirable as in their business local to the States. In both classes of business, they are stimulated by the same motive to lessen competition. All the salesmen while in intrastate territory are required to sell at prices fixed by agreement. And, when across the State line in interstate territories, they use the agreed lists in quoting prices and making sales. It does not appear whether the prices so fixed are adhered to in interstate business. The fact that there is no established rule that the lists shall be followed in taking orders for interstate shipments or that the quoting of lower prices is an infraction for

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6 Pacific States Paper Trade Ass'n, 7 F. T. C. 155 (1923).
which complaint may be made is not controlling in favor of respondents. An understanding, express or tacit that the agreed prices will be followed is enough to constitute a transgression of the law. No provision to compel adherence is necessary. . . ."

The first Commission proceeding in which a geographical pricing formula, of basing point or zone system, was spelled out as a central mechanism of conspiracy is Docket 2565, National Electrical Manufacturers Association, et al. Here the principal manufacturers of power cable and wire for electrical transmission admitted a conspiracy to set up a system of uniform delivered pricing, combining both a "universal delivered price" and varying geographical zones. There were further findings of adoption of uniform terms of sale, uniform discounts, uniform methods of calculating prices on goods which differed from standard grades and specifications, a central price reporting system, a method of investigating and punishing price cutting, and a combination to fix the price of one type of wire through a patent licensing arrangement.

From 1936 to 1938 the Commission entered orders in seven more cases where conspiracy to fix prices through a zone system had been found, involving water works valves and fittings, butter tubs, snow fence, wood and paper food dishes, calcium chloride, corn cribs and silos, and liquid chlorine. In each of these cases the parties either admitted the allegations of the complaint or executed a stipulation of facts and consented to the entry of an order. In none of them was there any petition for court review.

The first Commission order against a zone system as a part of a price fixing conspiracy which was contested before the Commission and on

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9 National Electrical Manufacturers Ass'n, 24 F.T.C. 306 (1936).
10 It is interesting to note that this is the only geographical pricing system case in which a civil penalty action has been brought under Section 5(1) of the Federal Trade Commission Act. A settlement of $38,000 was obtained in U.S. v. American Steel and Wire Company of New Jersey, et al, on April 25 and April 30, 1947. 1947 Annual Report of Federal Trade Commission at page 62.
Butter tubs—D. 2650, Menasha Wooden Ware Corporation, 25 F.T.C. 57 (1937).
Snow fence—D. 3305, United Fence Manufacturers Ass'n, 27 F.T.C. 377 (1938).
Calcium chloride—D. 3519, Columbia Alkali Corporation, 27 F.T.C. 1354 (1938).
review is Docket 3092, Scientific Apparatus Makers of America, et al.\textsuperscript{12} The Commission found, among other things, that the producers of blue print paper and related articles had agreed to follow a price list prepared and circulated among them by Eugene Dietzgen Company in 1932, which list divided the United States into a number of territories and specified prices for each. The Court of Appeals fully supported the Commission's findings as to conspiracy on review of order in Eugene Dietzgen Company v. FTC.\textsuperscript{18} While neither the Commission nor the Court found it necessary to rely on inferences to establish the origin of the conspiracy in the Dietzgen case, on the question of liability of two of the petitioners who had not participated in the original agreement but had later adopted the pricing, the Court followed the "implied conspiracy" rule of the Interstate Circuit case\textsuperscript{14} and held:\textsuperscript{15}

"We must look to the substance and not to the form of the conspirators' conduct. We do not think that affirmative, positive, express agreement to maintain prices is essential to establish unfair trade practices. If the parties clearly and intentionally maintain the prices, even though without express agreement, they are liable. In such a situation their action may fall within the prohibition of the Federal Trade Commission Act. An artificial price level not related to the supply and demand in a given commodity, may evidence concerted action of sellers operating to restrain commerce. That is what the evidence here shows."

The "zone system" case which has probably received the most attention is the Commission's Docket 4606, National Crepe Paper Association of America, et al,\textsuperscript{16} in which the order was affirmed by the Seventh Circuit Court of Appeals on July 12, 1946.\textsuperscript{17} In this case the Court made the following pertinent observation about the existence of the conspiracy and the nature of the pricing system involved:\textsuperscript{18}

"As we have already observed, we have here a finding of the existence of an agreement to suppress competition. This finding of the Commission was made upon all the evidence, including the conditions existing in the industry. It was not a finding based simply on inference. It was a finding of fact based on actualities. The existence of substantial similarity in delivered prices to

\textsuperscript{12} Scientific Apparatus Makers of America, 33 F.T.C. 1130 (1941).
\textsuperscript{13} Eugene Dietzgen Company v. FTC 142 F. 2d 321 (C.C.A. 7th 1944).
\textsuperscript{15} Note 13, supra, at 331.
\textsuperscript{16} National Crepe Paper Ass'n of America, 38 F.T.C. 282 (1944).
\textsuperscript{17} Ft. Howard Paper Company v. FTC, 156 F. 2d 899 (C.C.A. 7th 1946).
\textsuperscript{18} Id. at 906.
zoned territories having identical zone price differentials, by six manufacturers located at different places, was not a happenstance. Nor, looking at the situation objectively, was it the inevitable and unescapable result of keen competition in a standard product of invariable qualities. To be sure, a keen competitor strives to meet a lowered price of a competitor immediately upon becoming aware of it, but he does not strive to and invariably match a price which is higher than that at which he needs profitably to sell, unless by express, or tacit agreement, all manufacturers have found existence to be less strenuous for all concerned by merely setting a price for three zones in the whole United States, and except for such (identical) zone differentials, discarding and ignoring the substantial item of freight. We are unable to comprehend a manufacturer's disdain of a natural advantage utilizing the same to gain local business, unless he were indoctrinated with the belief (or forced by superior economic competitors to align himself to concerted action of identical delivered prices) that elimination of all competition was economically preferable.

"True, convenience of the use of zones is not to be denied, but mere convenience does not induce competitors approximately one-third of the nation's width apart to consider themselves concentric in mapping of zones. One glance at the three zone map for bulk crepe will show the artificiality of the zone structure and intention to obviate any natural advantage of location from price determination. Two of the companies are located in Wisconsin, and the western limits of the zone run merely to the Mississippi River while the eastern boundary runs to the Atlantic Ocean. Zone I is obviously drawn to include all manufacturers and put them on a par. The unfairness of this is shown by the fact that a purchaser in the adjacent states of Minnesota and Iowa would pay the additional fixed price differential to that paid by purchasers in the remote New England states. The zoning system here employed is an enormous exaggeration of the basing point system, having nineteen states as the focal basing point. The packaged crepe zone system split the nation (but not into equal halves) into two parts."

The most recent zone delivered pricing orders of the Commission are those in the glazed facing tile and sand-struck brick industries, where orders were entered May 8, 1948.\(^{19}\) In both of these cases, the conspiracy was found to have been effectuated through common selling agencies, a factor which does not appear in the other cases.

It is interesting to note that of the seventeen principal cases involving zone systems, beginning with the \textit{NEMA} case in December 29, 1936,\(^{20}\) conspiracy was admitted by the parties in thirteen, and denied only in the three paper cases\(^{21}\) and in Docket 4613, \textit{Acme Asbestos Covering and Flooring Company, et al.}\(^{22}\)

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\(^{18}\) FTC Dockets 5467 and 5468, Structural Clay Products Incorporated, et al.

\(^{19}\) Note 9, \textit{supra}.

\(^{20}\) Notes 12, 13 and 16, \textit{supra}.

The Cases Involving Basing Point Systems

In the basing point cases, on the other hand, the proportion of contested proceedings to settlements is much higher. The first conspiracy case in which the findings and order spelled out a basing point system as the central mechanism of price fixing appears to have been Docket 3868, *Southern Vitrified Pipe Association, et al.* Here the respondents admitted the conspiracy to sell only at delivered prices; to employ a uniform table of weights to be used in calculating delivered prices; to exchange prices prior to submission of sealed bids to Government agencies; to police compliance with the system by examination of books and records of suspected deviators; to discourage use of trucks by refusing to deliver by trucks or by adding penalty charges for such delivery; to establish customer classification and differentials; and to restrict production and sales of vitrified clay sewer pipe.

Following the vitrified clay sewer pipe decision, orders were entered against basing point conspiracies in the industries producing lime, hardwood lumber, cement, malt, milk and ice cream cans, rigid steel conduit, raw porcelain enamel, refractory products, and bottle crowns.

The case against *United States Maltsters Association and others* was the first of the basing point cases to be decided by the court on review. In this case the Commission found that the firm of Stevenson, Jordan & Harrison, had been employed to assist in the operation of the plan and that the industry had met and agreed upon a method of price reporting; upon a compilation of freight rates to be applied in arriving at delivered prices.

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23 Southern Vitrified Pipe Ass'n, 30 F.T.C. 1347 (1940).
24 Lime—D. 3591, Pine Hill Lime & Stone Company, 33 F.T.C. 427 (1941);
Hardwood lumber—D. 3418, The Hardwood Institute, 34 F.T.C. 661 (1942);
Malt—D. 3555, United States Maltsters Ass'n, 35 F.T.C. 797 (1942)—modified 37 F.T.C. 342 (1943);
Milk and ice cream cans—D. 4551, The Milk and Ice Cream Can Institute, 37 F.T.C. 419 (1943);
Rigid steel—D. 4452, Rigid Steel Conduit Ass'n, 38 F.T.C. 534 (1944);
Raw porcelain enamel—D. 5155, Ferro Enamel Corporation, 42 F.T.C. 36 (1946);
Refractory products—D. 4900, American Refractories Institute, April 13, 1948;
25 United States Maltsters Ass'n, 35 F.T.C. 797 (1942).
26 This firm has figured in the price fixing program of four of the delivered price cases, including D. 3556, *American Veneer Package Ass'n, Inc.*, 30 F.T.C. 665 (1940), D. 4320, *Salt Producers Ass'n*, 34 F.T.C. 38 (1941)—modified 37 F.T.C. 339 (1943); and D. 5155, *Ferro Enamel Corporation*, 42 F.T.C. 36 (1946).
Delivered Price Systems

price quotations; upon a system of selling malt only at delivered prices; and upon uniform contracts with buyers to which no riders or special provisions could be attached.

The reviewing court had this to say about the plan: 27

"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. Especially is this so when it is considered that petitioners' plants are located in four different states and that the barley from which the malt is manufactured is procured from eight or nine different states. Of further significance is the uniformity by which prices were increased and decreased. When a member announced an increase in price, that information was flashed by telegram to every other member and they immediately announced a like increase. When a member announced a decrease in price, such announcement was likewise flashed to all other members and they at once proceeded to announce a similar decrease. It may be true, as pointed out by petitioners, that a decrease in price by all members is necessary when such decrease is announced by any one member in order to meet competition. It certainly cannot be claimed, however, that it is necessary that all members increase their price upon announcement of an increase by one member in order to meet competition."

The next important basing point case involved the Milk and Ice Cream Can Institute and its members 28 and a so-called "freight equalization" system wherein each seller announced plant prices and offered to equalize transportation charges with each of the others. The Commission entered its order in 1943, shortly after the Cement Institute case, 29 finding that the industry had adopted a "publicity plan" under which every producer was required to report all contracts in force and all orders received at the end of each business day. The daily reports required information as to customer's name and address; complete description of product; unit price, including extras, deductions and discounts; "freight rate per hundred-weight added to delivery"; "freight rate per hundred-weight allowed to equalize with (give point) destination of shipment". It was found that the industry had met to discuss errors in computing freight rates and that as a result of the discussions of variations in freight rate calculations it was agreed to employ freight rate books procured from Climax Traffic Bureau for the purpose of computing delivered prices.

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27 United States Maltsters Ass'n v. FTC, 152 F. 2d 161, 164 (C.C.A. 7th 1945).
28 The Milk and Ice Cream Can Institute, 37 F.T.C. 419 (1943).
29 The Cement Institute, 37 F.T.C. 87 (1943).
Further joint activity was conducted to standardize the products of the different manufacturers and to establish uniform price differentials between them. The industry was likewise found to have agreed upon a uniform method of designating products as "firsts" and "seconds" and of reporting allowances to customers for the purpose of preventing price differentials.

The net effect of the system was found by the Commission to have been uniform delivered prices wherein no buyer could find any advantage in dealing with any of the sellers.

In sustaining the Commission's order, the Court made the following observation:

"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. In fact, the Commission recognizes that this freight equalization plan was used by petitioners prior to the organization of the Institute. 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. Any doubt in this respect, however, is removed by reference to the minutes of the Institute and other evidence found in the record."

The Cement Institute case was the next basing point matter to reach the Court on review. In its findings the Commission had spelled out in great detail the cooperative activities of the Cement Institute and the various cement producers. The Circuit Court of Appeals set aside the Commission's order, Judge Major writing the Court's opinion as he did in the Maltsters case, supra, and with Judge Evans dissenting. The Court found, among other things, that the Commission had not alleged that the acts were done pursuant to a conspiracy and, further, that no conspiracy had been proved. This decision was reversed and the Commission's order affirmed by the Supreme Court on April 26, 1948, Justice Burton dissenting on grounds similar to those in the decision of the Court below. It is apparent from the Court's opinion that the various activities of the cement industry to support and make effective the multiple basing point system of delivered prices constituted a conspiracy to employ the basing point system as a price fixing device.

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30 Milk and Ice Cream Can Institute v. FTC, 152 F. 2d 478, 481 (C. C. A. 7th 1946).
31 Note 29, supra.
33 FTC v. Cement Institute, 333 U. S. 683 (1948).
A large portion of the more than 100 pages of findings of fact by the Commission in the Cement case is devoted to the details of the activities to support and make the basing point system work. In this industry, particularly, any variation in delivered price, even of a fraction of a cent per barrel, was sufficient to swing business from one seller to another, and numerous factors in the pricing system required continuous concerted supervision. One of the most troublesome was the necessity for arriving at common transportation factors in calculating delivered prices. For many years the cement industry employed common rate books to eliminate the possibility of error which resulted from independent calculation of the rates by the different producers. These rate books also included an arbitrary conversion factor by which fractions of a cent could be uniformly dropped at a certain point when converting freight rates into prices per barrel of 380 pounds. It was found that the industry quoted prices based only on the rates shown in the official rate books even though it might be known that such rates were different from actual shipping rates.

The Commission also found that the industry had cooperated to eliminate “diversion in transit”, a practice which is capable of breaking down any multiple basing point system. Under the basing point system there is a delivered price for each destination in the country and when any seller is shipping into the area governed by a distant base, where he “absorbs freight”, the shipment may pass through one or more way points which carry a higher delivered price quotation. The extreme example of this would be a shipment by a seller at basing point A to a buyer located at basing point B. Every way point on the rail line between these two basing points will carry a higher delivered price than that at the buyer’s destination. If the buyer stops such a shipment in transit, he obtains the goods at the stopping point at a cost which may be considerably less than the formula price. The Commission found that the industry had acted collectively to prevent this practice in order to support the pricing system.

The Commission further found that the industry had concertededly refused to permit buyers to take delivery of cement at the mill, even though so-called “mill prices” were used in the basing point formula. Since that formula depended upon the arbitrary all-rail rates in the Institute’s freight rate books, if a buyer could obtain delivery at the mill and ship by truck or barge to a distant destination, he would “beat the system” by the amount by which the truck or water transportation was
lower than the all-rail freight rate.34

A further collusive factor in the basing point system was found to be the ease with which it lent itself in the cement industry to punishment of recalcitrant sellers and of localizing any price competition which developed. The Commission found that in a number of instances cement producers had imposed involuntary or punitive bases. In one instance, Lone Star imposed a base price at Spocari, Alabama, the location of a small non-base producer, and explained its actions by stating:35

"Spocari producer was found to be passing to buyers, secret rebates (representing freight advantage) deducted from open quotation calculated on N. Birmingham base."

The Commission found that in many instances price cutting, through departures from the formula in particular transactions, was dealt with by this means of "involuntary punitive bases". A representative of one of the large producers explained one such punitive base as being the result of variance from day to day and job to job of the prices of the producer located at that point.

The most recent basing point case is that of Rigid Steel Conduit Association, et al,36 in which the Commission's order was affirmed by the Seventh Circuit Court of Appeals on May 12, 1948.37 A principal element of collusion in the Rigid Steel Conduit case was the compilation of freight

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34 The Commission found that explanations of the various producers for either refusing to deliver to trucks or penalizing truck delivery included the following:

"The manufacturer, striving to figure his prices on indeterminate and fluctuating trucking rates and to meet the equally fluctuating and indeterminate rates from his competitor's plant, quickly found himself engaged in blind, reckless and destructive competition."

"We could not control the deliveries and the many trucking prices disrupted our entire marketing and price structure."

"Unsatisfactory marketing conditions due to indiscriminatory trucking * * * To protect our rail markets in the trucking zone from possible arbitrary rail price established by distant competing mills to meet this truck competition."

"Because of uncertainty of price at destination when delivery was made to buyer's trucks at mill, whereas carload prices at destination were determinable."

"* * * therefore we had no control of the delivered price at destination and could not prevent the disruption of marketing practices at destination."

"Our business has been built on a delivered price basis and when we were selling to buyer's trucks at the mill our whole price structure within a trucking radius of the mill was jeopardized." 37 F.T.C. 87, 192 (1943).

35 Note 29, supra, at page 180.

36 Rigid Steel Conduit Ass'n, 38 F.T.C. 534 (1944).

37 Triangle Conduit & Cable Company, Inc. v. FTC, 168 F. 2d 175 (C.C.A. 7th 1948).
“adders” employed to prevent any differences in delivered price quotations. Of them the Circuit Court of Appeals stated:88

“There was testimony that the system thus used was an effective means of matching bids and price quotations, and that the quotations made by each conduit seller, irrespective of whether it had a manufacturing plant located at or near Pittsburgh or Chicago, enabled them to match their price quotations. It also appears that at times it was difficult to exactly determine the railroad tariff rate and that mistakes by some conduit sellers in the selection of a particular tariff rate to be used in a particular instance were a fruitful source of differences in the delivered prices quoted, thereby preventing a matching of such quotations. To prevent such errors, petitioners, acting through Rigid Steel Conduit Association, employed one Donley, who prepared a compilation of freight rate applicators containing the freight factor applicable from Pittsburgh to various destinations in the United States and, on a differential of $4 per ton above the Pittsburgh base price, the freight applicable from Chicago. These compilations became important adjuncts to petitioners’ plans and methods in matching delivered price quotations. They were intended by petitioners to be used as their common price factors.”

The Commission found as well that the industry had acted collectively to classify customers and establish differentials between them; to determine and control the use of warehouses; and to adopt uniform contracts with buyers, as well as to enforce the terms of such contracts through investigations. On the question of whether the findings of conspiracy were wholly inferential, the Court stated:89

“The argument is that there is no direct evidence of any conspiracy; that if the Commission made such a finding, it is based upon a series of inferences; and that the general use of the basing point method of pricing and the uniformity of prices does not justify an inference of conspiracy. We think there was direct proof of the conspiracy, but whether there was or was not, in determining if such a finding is supported, it is not necessary that there be direct proof of an agreement. Such an agreement may be shown by circumstantial evidence. *Milk and Ice Cream Can Institute v. Federal Trade Commission, supra, 152 F. 2d at page 480.*”

The really controversial portion of the *Rigid Steel Conduit* case arises in Count II where the Commission charged, separately from the allegations of conspiracy that the conscious parallelism involved in the use by each of the industry members of the basing point system constituted an unfair method of competition and ordered each seller to cease using such system:

88 Id. at 177.
89 Id. at 179.
"for the purpose or with the effect of systematically matching delivered-price quotations with other of said respondents or producing the equivalent of such matched delivered prices through systematic discriminations in the mill nets received on sales to different purchasers . . ."

Of this portion of the order the Court stated: 40

"As already noted, each conduit seller knows that each of the other sellers is using the basing point formula; each knows that by using it he will be able to quote identical delivered prices and thus present a condition of matched prices under which purchasers are isolated and deprived of choice among sellers so far as price advantage is concerned. Each seller must systematically increase or decrease his mill net price for customers at numerous destinations in order to match the delivered prices of his competitors. Each seller consciously intends not to attempt the exclusion of any competition from his natural freight advantage territory by reducing the price, and in effect invites the others to share the available business at matched prices in his natural market in return for a reciprocal invitation."

Relying upon the decision of the Supreme Court in the Cement case, the Court went on:

"In the light of that opinion, we cannot say that the Commission was wrong in concluding that the individual use of the basing point method as here used does constitute an unfair method of competition."

CONCLUSION

While generalizing in this field is most dangerous, it seems plain that any arbitrary industry-wide system or method of arriving at continued identity of delivered price quotations is suspect under the recent Federal Trade Commission cases. This is particularly apparent as to basing point systems, which seem necessarily to require collusion, either in outright form or in "parallel action" of a sort which will not withstand the inference of collusion. The necessity for identical transportation factors, for refusing to permit delivery to trucks or water carriers, for preventing "diversion in transit", and for unified action in every other respect in which a price advantage can be created for any seller, makes it unlikely that such a system can be made to produce continued identity of prices without leaving a trail of evidence sufficient to condemn the venture.

The same mechanical difficulties do not seem to be present in the zone cases, and it would appear possible, on a "follow the leader" basis, to achieve identical delivered prices without regard to differing transportation rates and other similar troublesome features of basing point

40 Id. at 181.
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systems. Under a zone system there is no problem of diversion in transit in shipments within a zone, since the delivered price at the destination is the same at all way points. Buyers can find no advantage in taking delivery at the mill in most instances, and form of transportation involved is of importance only to the seller.

As a practical matter, however, it would seem difficult to switch over to a zone system without an understanding of some sort. In all of the zone cases so far decided, there has been evidence of agreement to establish the system in the first instance. Further, in the heavy-goods industries, where transportation costs are an important element in price, extremely large zones might prove impractical, and require elaborate territorial divisions and differentials between them, and this could entail mechanical difficulties in settling "boundary disputes" as between zones. Furthermore, any elaborate zone system which might be justified by average transportation costs from one producing point might be completely unrelated to transportation costs from other producing points, raising the question of the competitive good faith of sellers at such points emphasized by the Court in the Fort Howard case.41

On the other hand, while habitual quotation of identical delivered prices has figured in every one of the geographical pricing system cases, in no case has this been considered as the sole factor in the decision, and it is doubtful that a case could be sustained on this theory and without direct evidence of agreement unless the Commission and the court could be convinced that such continued identity was achieved in a setting and against a background of facts which made impossible any other conclusion than that an agreement or understanding existed for this purpose.

Criticism has been voiced that the Commission's approach to these cases has required as a practical matter that everyone sell uniformly at f.o.b. plant prices, and refrain from absorbing freight to meet competition except in sporadic instances.42

The writer is unable to understand how any of the decisions, including Count II of the Rigid Steel Conduit case, can have such restrictive interpretation. As the Court said in commenting on similar arguments against the form of the order in the Cement case:43

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41 Note 17, supra.
43 Note 33, supra.
"Most of the objections to the order appear to rest on the premise that its terms will bar an individual cement producer from selling cement at delivered prices such that its net return from one customer will be less than from another, even if the particular sale be made in good faith to meet the lower price of a competitor. The Commission disclaims that the order can possibly be so understood. Nor do we so understand it. As we read the order, all of its separate prohibiting paragraphs and sub-paragraphs, which need not here be set out, are modified and limited by a preamble. This preamble directs that all of the respondents 'do forthwith cease and desist from entering into, continuing, cooperating in, or carrying out any planned common course of action, understanding or agreement, combination or conspiracy, between and among any two or more of said respondents, or between any one or more of said respondents and others not parties hereto, to do or perform any of the following things. . . .' Then follow the prohibitory sentences. It is thus apparent that the order by its terms is directed solely at concerted, not individual activity on the part of the respondents.

* * * *

"One other specific objection to the order will be noted. Paragraph 1 prohibits respondents from 'quoting or selling cement pursuant to or in accordance with any other plan or system which results in identical price quotations or prices for cement at points of quotation or sale or to particular purchasers by respondents using such plan or system, or which prevents purchasers from finding any advantage in price in dealing with one or more of the respondents against any or the other respondents.' This paragraph like all the others in the order is limited by the preamble which refers to concerted conduct in accordance with agreement or planned common course of action. The paragraph is merely designed to forbid respondents from acting in harmony to bring about national uniformity in whatever fashion they may seek by collective action to achieve that result. We think that no one would find ambiguity in this language who concluded in good faith to abandon the old practices. . . ."

In more than half the delivered price cases, the parties have admitted the conspiracies charged against them, and in all the contested cases the Commission's findings of conspiracy have been fully supported on court review. Those who say that these decisions go farther than to make more difficult the continuation of organized price fixing are peering nervously into the future and predicting that in cases not now in existence and involving new and startling concepts of law and economics, the Commission may apply some of the language of the court decisions to wholly different factual situations. It is submitted that these fears are not warranted by the facts.
DEFENSES AVAILABLE IN CASES OF GEOGRAPHIC PRICE DISCRIMINATIONS

ROBERT B. DAWKINS*

IN A proceeding brought by the Federal Trade Commission for alleged unlawful price discrimination, the requirements of the Commission's case in chief consist of showing (1) a price difference; (2) in the sale of commodities of like grade and quality; (3) with at least one leg of the discrimination in interstate commerce; (4) that the commodities are for use, consumption, or resale within the jurisdiction of the United States; and (5) that the effect of the discrimination upon competition "may be" that specified in the statute. The party charged may prevail by establishing the absence of any one or more of these elements. However, the defenses to be considered here are those resulting from statutory provisions by which the party charged may excuse or justify an otherwise unlawful price discrimination and thus defeat a prima facie case made out by the Commission.

The area to be considered is further narrowed by limitation to price discriminations resulting from geographic pricing practices. To permit examination within a reasonable compass only the geographical pricing practices more commonly used in the distribution of industrial goods are included. These are: f.o.b. mill pricing, and its counterpart of delivered prices determined by adding actual delivery costs to a uniform mill price; f.o.b. mill, full freight allowed, and its counterpart of uniform delivered prices at all points, sometimes called a single-zone uniform delivered price; multiple-zone pricing (with uniform delivered prices within each zone but differing as among zones); single basing-point pricing; multiple basing-point pricing; and pricing f.o.b. mill, freight equalized. It is assumed that the reader has a working knowledge of the operation of these pricing methods. In considering them, the fact that there may be occasional departures from a method is ignored. The variations which may be produced by departures are so numerous and unrelated to the questions raised by adherence as not to warrant consideration here.

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In a further effort toward definition, the word "price," when unqualified, is used in the same meaning as it is used in Section 2 (a) of the Clayton Act as amended—that is, whatever the circumstances of the transaction make it. This is not unrealistic, despite the frequency with which reference is made to the Cement Institute case\(^1\) as authority for the proposition that the Federal Trade Commission has defined price as "mill net" and received judicial sanction for that definition. Such references depend upon the fact that in that case the Court said:

The Commission held that the varying mill nets received by respondents on sales between customers in different localities constituted a "discrimination in price between different purchasers" within the prohibition of § 2 (a), . . .

and after discussing the defenses interposed, stated:

We hold that the Commission properly concluded that respondents' pricing system results in price discriminations.

This holding must be considered in the light of the fact that the Commission's complaint alleged that respondents' mill nets were the true prices, as well as the further fact that in its findings as to the facts\(^2\) the Commission set out in elaborate detail the factual basis for its holding that in the circumstances of this case "mill net" was the true price. The findings on this point included the fact that "... purchasers of cement generally and customarily paid the freight charges thereon directly to the common carrier and paid to the seller only the amount of the invoice after deducting the amount of freight paid to the carrier"; that "respondents sought, by concert of action among themselves, to avoid the risks and responsibilities of ownership of cement in transit to the purchaser and by contract to impose such risks and responsibilities on the purchaser"; and that "These and other actions of respondents have signified their intention to pass title to cement sold to the purchaser at the time of delivery to the common carrier and at the mill nets applicable to purchasers at particular destinations." It should also be observed that in its notice to its staff of October 12, 1948, on "Commission Policy Toward Geographic Pricing Practices" it was stated:

The Commission's past use of methods of exposition which treated mill net realizations as prices took place in a context in which determination of the legality or illegality of the practices charged did not depend upon the question of whether price differences were to be regarded as differences in mill nets or in delivered prices.

\(^1\) FTC v. Cement Institute, et al., 333 U. S. 683, 722, 725 (1948).

\(^2\) 37 F. T. C. 87, 255 (1943). (Subparagraph (c) of Paragraph Twenty-four.)
This same fact was recognized in the Commission's findings as to the facts in the *Cement Institute* case.\(^3\) There is also the interpretation of legislative intent concerning "price" in the opinion of the Court in the *Corn Products* case,\(^4\) which shows that "price" and "mill net" are not synonymous.

The discriminations in price which may result from use of any of the pricing methods mentioned above are due to so-called "freight absorption" on the one hand, or the charging of unearned or "phantom freight" on the other. The available ways of excusing or justifying an otherwise unlawful price discrimination arising from these causes are confined to the proviso of Section 2 (a):

\[\ldots\text{That nothing herein contained shall prevent differentials which make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered.}\ldots\]

and the proviso of Section 2 (b):

\[\ldots\text{That nothing herein contained shall prevent a seller rebutting the prima-facie case thus made by showing that his lower price or the furnishing of services or facilities to any purchaser or purchasers was made in good faith to meet an equally low price of a competitor, or the services or facilities furnished by a competitor.}\]

In the case of uniform f.o.b. mill pricing, since no price differences result, there are no discriminations in price to excuse or justify. Its counterpart of delivered prices determined by adding to a uniform mill price the actual cost of delivery involves price differences, but the differ-

\[^3\text{"In the circumstances of this case, whether price be considered as delivered price under respondents' pricing system or as mill net, there are price discriminations which cannot be explained or justified by differences in cost of delivery and which reflect nothing but respondents' plan and effort to make their delivered prices identical at each destination." Id. at 256. (Subparagraph (e) of Paragraph Twenty-four.)}\]

\[^4\text{In discussing the striking from the Robinson-Patman bill of a provision which would have had the effect of defining price as mill net, the court said: "Such a drastic change in existing pricing systems as would have been effected by the proposed amendment engendered opposition, which finally led to the withdrawal of the provision by the House Committee on the Judiciary, 80 Cong. Rec. 8102, 8140, 8224. We think this legislative history indicates only that Congress was unwilling to require f.o.b. factory pricing, and thus to make all uniform delivered price systems and all basing point systems illegal per se. On the contrary we think that it left the legality of such systems to be determined accordingly as they might be within the reach of § 2 (a), as enacted, and its more restricted prohibitions of discriminations in delivered prices." Corn Products Refining Co., et al. v. FTC, 324 U. S. 726, 737 (1945).}\]
ences "make only due allowance for differences in the cost of . . . delivery." There is a theoretical question as to whether these differences in costs of delivery result from the "differing methods or quantities in which such commodities are . . . delivered." However, it has never been seriously urged that differing costs of delivery of the same quantities by the same methods should not be accepted in justification of corresponding price differences. The several decisions in which indirect reference to such justification have occurred consistently appear to accept the view that differences in quantity or method are unnecessary.

Uniform delivered prices at all points are presumably nondiscriminatory, for a price discrimination without a price difference would be a contradiction in terms. In order to term a uniform delivered price "discriminatory," it is necessary to read into the term "discriminate in price" an obligation upon the part of the seller to recognize and make allowance in his delivered prices for disparate situations among his customers or to recognize undefined rights which may be imputed to them—for example, a right to the benefit of location in terms of allowance in the delivered price for lower costs of delivery. If one imputed right be recognized, logically it is difficult to see where a stopping place can be found short of giving to each purchaser the exact benefits of differences in cost of manufacture and sale, as well as delivery, arising in the seller's transactions with him as compared with other purchasers. This runs counter to a clearly expressed legislative intent. There is also the dictum in the Staley case that there is no discrimination in price in a uniform delivered price at all points.

It is hardly necessary to mention the fact that the language of Section 2 (a) itself indicates that the term "price" includes delivered prices, for otherwise the inclusion in the cost-justification proviso of costs of

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6 Assumed to be true delivered prices in the sense that the parties intend delivered prices and that title to the goods, with the accompanying rights and liabilities, remains in the seller until actual delivery is made to the purchaser.

6 "The bill neither requires nor compels the granting of discriminations or differentials of any sort. It leaves any who wish to do so entirely free to sell to all at the same price regardless of differences in cost, or to grant any differentials not in excess of such differences. It does not require the differential, if granted, to be the arithmetical equivalent of the difference. It is sufficient that it does not exceed it." SEN. REP. No. 1502, 74th Cong., 2d Sess. 5 (1936).

7 "But it does not follow that respondents may never absorb freight when their factory price plus actual freight is higher than their competitors' price, or that sellers, by so doing, may not maintain a uniform delivered price at all points of delivery, for in that event there is no discrimination in price." FTC v. A. E. Staley Manufacturing Co., et al., 324 U. S. 746, 757 (1945).
delivery would be meaningless. This, however, leaves the contention sometimes made that the "make only due allowance" phrase in the cost-justification proviso opens a uniform delivered price to attack because such prices in some instances include unearned freight and in others include less than the actual freight. Such a contention seems to presuppose that uniform delivered prices are not "price" and that there are price differences in a uniform delivered price which require justification.

Though varying in some details from uniform delivered pricing, f.o.b. mill, full-freight-allowed pricing results in uniform delivered costs to purchasers and varying mill nets to the seller, just as in the case of the uniform delivered price. If the f.o.b. price is treated as "price," it is uniform; if mill net is treated as "price," the differences in nets are exactly equalled by the differing delivery allowances. It would seem improbable that the courts will hold either of these types of pricing is unlawfully discriminatory in the event the issue is presented.

Multiple-zone pricing involves uniform delivered prices within a single zone and differing delivered prices as among zones. The same considerations apply to the uniform delivered prices within a single zone, as in the case of a universal uniform delivered price. It should be noted here, however, that in two proceedings pending before the Federal Trade Commission the complaints challenge uniform zone delivered prices as violative of Section 2 (a). These complaints allege broad price-fixing conspiracies, including as one part of the conspiracy charged agreements to establish price differentials between zones and to maintain uniform delivered prices within each zone. In the portion of the complaints charging violation of Section 2 (a) it is alleged that respondents discriminate for the purpose and with the effect of suppressing price competition among themselves through employment of a price structure which does not reflect their transportation costs and which results in varying mill nets. Neither of these proceedings has yet come before the Commission for decision upon the merits. In one the recommended decision of the trial examiner holds the uniform delivered prices within a zone are not unlawfully discriminatory, and in the other the recommended decision of the trial examiner takes the contrary position on this point.

The remaining aspects of multiple-zone pricing present questions so

* FTC Dockets No 4877, Chain Institute, et al.; and No. 5253, National Lead Company, et al.
similar to those arising in single and multiple basing-point pricing and the f.o.b. mill, freight equalized system that all of these will be examined jointly. Users of the single basing-point system located at the base point and users of the multiple basing-point method, on sales within the territory in which their base price plus freight is lowest, each have differences in their delivered prices, but these differences merely reflect differing delivery costs. Each user of the f.o.b. mill, freight equalized system has uniform f.o.b. mill prices on sales in his freight-advantage territory and, consequently, no price differences among such sales.

In multiple-zone pricing the price differences between zones bear no direct relationship to the cost of delivery and are not susceptible of defense under the cost-justification proviso. The same is true of the price differences arising in the case of all sales by users of either single or multiple basing-point systems not located at a base point, all sales by users of the multiple basing-point method outside the territory controlled by their own base, and all sales by users of the f.o.b. mill, freight equalized system outside their own freight-advantage territory. Theoretically, at least in the case of a sufficiently individualistic and nonhomogeneous product, a single seller might use a multiple-zone or f.o.b. mill, freight equalized method of selling when all his competitors used other and different pricing methods. In such a case, however, mere adherence to the method would eliminate any defense under the proviso of Section 2 (b), for there would be no meeting of "an equally low price of a competitor" save by sheer accident. To be used at all, the single and multiple basing-point methods of pricing must be adhered to by a number of sellers. As a matter of fact, any of this group of four pricing methods, when used, is customarily used by all or substantially all competing sellers in a given industry. In the case of homogeneous or very similar products, continued adherence to any one of these methods is not practicable if any important factor in, or substantial segment of, the industry uses a different pricing method. These matters should be kept in mind in seeking to apply the proviso of Section 2 (b).

The nature and effectiveness of the defense of meeting "an equally low price of a competitor" depends in part upon the construction given Section 2 (b). This proviso refers to "the prima-facie case thus made" and the body of the section characterizes a prima facie case as "proof . . . that there has been discrimination in price." In the Moss case the

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9 "The Commission's position was that, having proved this, § 2 (b) . . . put upon the petitioner the burden of justifying the discrimination; and warranted the order, if it failed to do so. The petitioner did not prove affirmatively that the discrimination did
Second Circuit held, so far as pertinent here, that the showing of a discrimination in price constituted a prima facie case. It also appears to hold that, if established, a defense under the proviso of Section 2 (b) is absolute.\(^\text{10}\)

A remarkable feature of the Moss case is that, although it would not be suspected from a reading of the decision, the Commission proved not only "discrimination" in price, but it also offered substantial evidence of injury to competition resulting from the discriminations shown, including proof that one competitor was actually driven out of business by them. The Commission did not even contend before the Second Circuit that the respondent had failed to "justify" his discriminations by showing that they did not injure competition. On the contrary, it was vigorously contended in the Commission's brief that the finding that the seller's price discriminations substantially injured competitors "was supported by an abundance of substantial and undisputed evidence." Actually, the court appears to have decided nonexistent issues. Petition for writ of certiorari was denied, but the effect to be given this should be weighed with knowledge that the brief of the Acting Solicitor General, on behalf of the Commission, in opposition to the petition, in effect disclaimed the basis for the decision by the circuit court. It was stated in this brief:

> The court below apparently interpreted the Act as meaning that upon mere proof by the Federal Trade Commission that a respondent before the Commission had sold to two customers at different prices, he has the burden of affirmatively proving that the discrimination did not lessen competition or tend to injure or prevent it. . . . the Commission has always construed the Act to require it as part of its affirmative case to present evidence that a discrimination may lessen or tend to injure competition.

The brief continued that the court below apparently misunderstood the Commission's position, but that nevertheless "the decision below is not lessen competition or tend to prevent it; nor did it prove that its lower prices were only 'to meet an equally low price of a competitor.'" Samuel H. Moss, Inc., v. FTC, 148 F. 2d 378, 379 (C. C. A. 2d 1945).

\(^{10}\) "If he can prove that the lower price did not prevent or tend to prevent anyone from taking away the business, he will succeed, for the accuser will not then have brought him within the statute at all. Nevertheless he may succeed even though he fails to establish such a negative; for, although it will then appear that he has lessened, or prevented, competition, the proviso of § 2 (b) will still excuse him, if he can show that his lower price did not undercut his competitors, but merely 'met' their 'equally low price.' In short, that is a defence to the violation of § 2 (a). This is as we interpret § 2 (a) and § 2 (b), when read together." *Ibid.*
clearly right for the reasons advanced by the Commission”, and, further, that:

Since the result reached by the court below is right under the construction of the statute urged by petitioner and applied by the Commission, there is no occasion for further review in order to determine what in this case is an academic question. A judgment will not be disturbed because “the lower court relied upon a wrong ground or gave a wrong reason.”

At this point it should be noted that the Commission has used a partly similar and partly varying construction in one proceeding, presumably as a step toward settling by judicial decision the meaning of Section 2 (b) and its proviso. The position taken in this proceeding is set out in some detail in the Commission’s findings as to the facts:

A prima facie case of a violation of section 2 (a) may be established by proving (1) jurisdiction, (2) goods of like grade and quality, and (3) discrimination in price. Discrimination in price here was shown by proving a difference in the prices charged competing customers. Based upon the prima facie case thus shown the Commission may draw from such prima facie case a rebuttable presumption that the effect of such discrimination may be to substantially lessen competition or tend to create a monopoly or to injure, destroy or prevent competition. The burden then shifts to the respondent. In rebuttal of the prima facie case the respondent under section 2 (b) may show that the respondent’s lower price was made in good faith to meet an equally low price of a competitor. However, such a showing is not an absolute defense to a charge of unlawful discrimination and proof of meeting a competitor’s equally low price can be availed of only to the extent it may rebut the prima facie case. The meeting of an equally low price of a competitor in good faith is not a defense to a charge of price discrimination where competitive injury is affirmatively shown and so replaces the rebuttable presumption of the prima facie case. This results from the difference between such a case and the prima facie case referred to in section 2 (b). Section 2 (b) defines a prima facie case as “... proof ... that there has been discrimination in price. ...” This definition must be compared with the prohibitions of section 2 (a) which makes such a discrimination unlawful only in the event it injuriously affects competition. If proof of good faith in meeting an equally low price of a competitor is made, the Commission could no longer rely upon its prima facie case, but must show by additional and affirmative evidence that the effect of the discrimination may be to substantially lessen competition or tend to create a monopoly or to injure, destroy or prevent competition between respondent and its competitors or between customers of the respondent or with the customers of such customers. Where such injurious effect on competition is affirmatively proved, the proof made as to meeting an equally low price of a competitor under the proviso of section 2 (b) does not constitute a substantive justification or defense.

11 FTC Docket No. 4386, Standard Oil Company, now pending in the Seventh Circuit on petition for review.
There are a number of speculative possibilities, none of which is without grounds for objection. The word "discrimination" in Section 2 (b) can hardly be said to have a different meaning when used in Section 2 (a). As applied to price, it is usually thought of as signifying a price difference when abstract justice would indicate there should be none—for example, a price difference between competing purchasers. If in fact Section 2 (b) shifts to the person charged the burden of proving that his discriminations did not injure competition, this construction has an unusual result. Under Section 2 (a) the Commission is apparently required not only to plead discriminations, but also that the discriminations injure competition. But under such construction of Section 2 (b) it may never be required to establish injury to competition, for the mere failure of the person charged to prove the negative would authorize the issuance of an order. While it is not an uncommon legislative device to shift the burden of proof as an aid to effective law enforcement, such shifts have customarily been with respect to matters peculiarly within the knowledge or control of the person charged. Whether or not price discriminations result in injury to competition is a factual matter, with the facts equally, if not more likely to be, in the possession of others than of the person charged. It should be observed that giving to the term "discriminate in price" a meaning which overlaps the injury-to-competition provisions of Section 2 (a) may result in the showing of "discrimination" being sufficient to support an inference of injury to competition. To illustrate, if you add to a showing of price difference between competing purchasers of a commodity, a showing that price competition between the purchasers is keen and that in the competitive conditions which exist the amount of the price difference, if reflected in resale prices, is sufficient to divert trade, there is a supportable inference that the effect "may be" to injure competition. However, logic appears to compel a supporter of the view under discussion to be willing to rely upon no more than the bare bones of "discriminate in price."

Such a construction of Section 2 (b) requires proving a negative under circumstances that may be well-nigh impossible. Or it may result in prolonging hearings indefinitely through the numbers of discriminations shown. For example, in the Muller case12 the Commission offered evidence of some 1,100 transactions with purchasers scattered from coast to coast. The burden of trying to show that none of these injured competition would have been interminable had that case been tried on the construction of Section 2 (b) under discussion.

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Coupling the view that the party accused must negative injury with the view that the proviso of Section 2 (b) is not a substantive defense creates another unusual result. Section 11 of the Clayton Act requires that before the issuance of a complaint charging violation of Section 2 (a) "... the commission ... shall have reason to believe" that its provisions have been or are being violated by the person charged. One element of an unlawful price discrimination is injury to competition. Without more than knowledge of a "discrimination" in the sense of a price difference between competing purchasers the Commission would not have reason to believe there was violation of Section 2 (a). Assuming the Commission has knowledge of facts which prima facie show, directly or by reasonable inference, injury to competition, there would seem to be little reason for refraining from putting in proof concerning them. Failure to do so would merely drag out the proceeding by requiring the person charged to try to negative the existence of injury, and if the showing thus made required it the Commission would then put in its proof respecting injury. If the result should then be in doubt, presumably the person charged would thereafter put in proof to show that he did no more than meet the equally low price of a competitor in good faith, but this would be useless if the Commission succeeded in establishing injury to competition.

Another approach to the contention that the proviso of Section 2 (b) is not a substantive defense shows a resulting incongruity. This proviso includes discriminations in services or facilities granted in good faith to meet "the services or facilities furnished by a competitor" as well as the meeting of an equally low price of a competitor. The "services or facilities" phrase makes the proviso applicable to charges brought under Section 2 (e) of the Act, under which evidence as to injury or lack of injury to competition is irrelevant. Under a charge of price discrimination, therefore, the Commission might overcome a defense of meeting an equally low price of a competitor by affirmatively showing injury to competition. Under a Section 2 (e) charge, however, since injury to competition is irrelevant, there would be no rebuttal of a defense of meeting the services or facilities of a competitor in good faith.

Apparently any interpretation of Section 2 (b) in some manner produces inconsistencies or else overrides the ordinary meaning of some of the words used in the statute. It would seem that the least violence to the language of the section results from reading it as though the word "discrimination" were preceded by the word "unlawful" and the burden of justification applies to the provisos of the section. With the single
except previously mentioned, this has been the course followed by the Commission, and this appears consistent with the legislative history as construed in the *Staley* case.\textsuperscript{18}

Some of the limitations of the proviso of Section 2 (b) as a defense by an individual seller using the single basing-point pricing method or by all producers in an industry using multiple basing-point pricing clearly appear in the *Glucose* cases\textsuperscript{14} and the *Cement Institute* case. In considering the grounds given by the Court in rejecting the defense made under Section 2 (b) in the *Staley* case, it should be kept in mind that the injury to competition alleged and found was among customers of the seller. Among the factors mentioned by the Court in reaching its conclusion are these: The seller adopted in its entirety a pricing system found to be in use by others and which produced exact identity of prices by all sellers at any given location; that this system as used by his competitors produced unlawful discriminations and that Section 2 (b) does not excuse the adoption of a similarly unlawful practice; that the seller never attempted to establish a nondiscriminatory price system; that the seller met the higher as well as the lower prices of his competitors; and that Section 2 (b) deals with individual competitive situations and not with a general system of competition.\textsuperscript{15}

In the *Cement Institute* case the multiple basing-point pricing method was involved, and the injury to competition was among the sellers themselves. In discussing the defense under Section 2 (b) in this case, the Court remarked that practically all the arguments presented were considered and rejected in the *Glucose* cases, and said in part:\textsuperscript{18}

Thus the combined effect of the two cases was to forbid the adoption for sales purposes of any basing point pricing system. It is true that the Commis-

\textsuperscript{18} "It will be noted that the defense that the price discriminations were made in order to meet competition, is under the statute a matter of 'rebutting' the Commission's prima facie case.' Prior to the Robinson-Patman amendments, § 2 of the Clayton Act provided that nothing contained in it 'shall prevent' discriminations in price 'made in good faith to meet competition.' The change in language of this exception was for the purpose of making the defense a matter of evidence in each case, raising a question of fact as to whether the competition justified the discrimination. See the Conference Report, H. R. Rep. No. 2951, 74th Cong., 2d Sess., pp. 6-7; see also the statement of Representative Utterback, the Chairman of the House Conference Committee, 80 Cong. Rec. 9418." Federal Trade Commission v. A. E. Staley Manufacturing Co., et al., 324 U. S. 746, 752, 753 (1945).


\textsuperscript{15} FTC v. A. E. Staley Manufacturing Co., et al., 324 U. S. 746, 751-757 (1945).

\textsuperscript{18} FTC v. Cement Institute, et al., 333 U. S. 683, 723-725 (1948).
sion's complaint in the *Corn Products* and *Staley* cases simply charged the individual respondents with discrimination in price through use of a basing point price system, and did not, as here, allege a conspiracy or combination to use that system. But the holdings in those two cases that § 2 forbids a basing point price system are equally controlling here, where the use of such a system is found to have been the result of a combination.

... Section 2 (b) permits a single company to sell one customer at a lower price than it sells to another if the price is "made in good faith to meet an equally low price of a competitor." But this does not mean that § 2 (b) permits a seller to use a sales system which constantly results in his getting more money for like goods from some customers than he does from others. We held to the contrary in the *Staley* case. There we said that the Act "speaks only of the seller's 'lower' price and of that only to the extent that it is made 'in good faith to meet an equally low price of a competitor.'" The Act thus places emphasis on individual competitive situations, rather than upon a general system of competition." ... Each of the respondents, whether all its mills were basing points or not, sold some cement at prices determined by the basing point formula and governed by other base mills. Thus, all respondents to this extent adopted a discriminatory pricing system condemned by § 2. As this in itself was evidence of the employment of the multiple basing point system by the respondents as a practice rather than as a good faith effort to meet "individual competitive situations," we think the Federal Trade Commission correctly concluded that the use of this cement basing point system violated the Act. Nor can we discern under these circumstances any distinction between the "good faith" proviso as applied to a situation involving only phantom freight and one involving only freight absorption. Neither comes within its terms.

It seems plain beyond the necessity of discussion that a basing-point system, whether single or multiple, may not be successfully defended under the proviso of Section 2 (b). The reasons for this failure are inherent in the pricing systems themselves and the elimination of the reasons would simultaneously destroy the systems. That is to say, the changes necessary to permit defense under Section 2 (b) would result in pricing which would not be recognizable as single or multiple basing-point pricing.

When a multiple-zone pricing method is in general use in an industry, if the zone lines follow natural trade boundaries and the differences between zone prices are relatively small, there is limited probability of injury to competition among purchasers resulting. If, however, such injury did result, and if it were used as a basis for proceedings against one or more individual sellers under Section 2 (a), the reasoning in the decided basing-point cases indicates a strong likelihood that successful defense under Section 2 (b) could not be interposed. Similarly, in the case of an f.o.b. mill, freight equalized system in general use in an indus-
try, the probability of injury to competition among buyers is even more remote, but if it did occur, defense under Section 2 (b) would have a serious handicap, in that presumably injury would also be present from the prices which were being met and the discriminations would be in accordance with a general method of competition, rather than being tailored to fit individual situations.

In either multiple-zone or f.o.b. mill, freight equalized pricing systems in industry-wide use, injury to competition among the discriminations could hardly occur unless there were sustained, general, and precise adherence by all users. It is probably impossible for such conditions to occur in the absence of a conspiracy in restraint of trade which includes the pricing method. This is due to the fact that the natural forces of competition cause departures from time to time, and means for discouraging departures in the first instance and bringing them to a conclusion when they do occur must be provided, else sustained observance is unlikely. Likewise, precision of performance in the sense of producing identical prices by all sellers at any given location, particularly when delivery cost calculations are necessary in determining price, is improbable in the absence of cooperative action. Price differences result from differences in shipping weights, errors in freight calculations, availability of more than one method of delivery, and similar matters, unless detailed methods to prevent such differences are agreed upon and used. If it is shown that the pricing system is carried on or implemented by conspiracy, obviously a defense under Section 2 (b) would fail for lack of "good faith."

Conversely, if there were not sustained, general, and precise observance, and if the pricing method were sufficiently loose in the joints to afford purchasers some choice upon a price basis, the likelihood of elimination of competition among sellers would be so remote as to leave little possibility of the need for a defense. At the same time such variety would improve the possibilities of successfully using Section 2 (b) if a defense became necessary.

Defining the precise boundaries of "good faith" in meeting competitors' prices is as fruitless a task as would be an attempt to state the exact limits of many other phrases frequently found in statutes. In

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17 Some of the reasons for this appear in this extract from the Commission's statement of October 12, 1948, of policy toward geographic pricing practices: "In these circumstances competition between purchasers paying significantly different prices may occur in quite limited areas or only along the fringes of trade territories. Seeming advantages in price may be materially affected by disadvantages of location."
almost evenly balanced circumstances there is no surety as to what constitutes "reasonable care" or "due diligence." The Sherman Act has been in effect for nearly sixty years, yet it would be difficult to find a lawyer who would attempt to say with certainty in all cases what constitutes a monopoly. In all such matters there are areas which are clearly white or clearly black, but with a band of gray between. These bands of gray will continue to exist, because of the utter impossibility of defining all conceivable combinations of circumstances which may violate the general policy of the statute.

So it is in the matter of meeting a competitor's prices "in good faith." The business man who is engaged in striving exactly to match the prices of his competitors at all times and places and striving to avoid any differences in price cannot fail to be aware of what he is doing. He should not be surprised when a claim of meeting the equally low prices of competitors in good faith receives scant sympathy. On the other hand, the business man who is individually and genuinely engaged in competitive endeavor has little need to concern himself with the intricacies of "in good faith" if he deals fairly among his customers. In its statement of policy of October 12, 1948, respecting geographic price discriminations, the Commission said:

In approaching these questions, the Commission sees no public interest and has no legal authority to proceed against the practices of a single seller except where probable or actual injury to competition appears in that seller's pricing practices. Accordingly, it will not question such differences in the prices of a single enterprise as are merely designed to meet the readily foreseeable competition of a competitor where such differences involve no tendency to create a monopoly or eliminate price competition, nor will it question reciprocal price reductions similarly designed where their scope is not such as to preclude variety of delivered prices and raise the problem of collusion. It will challenge discriminatory price reductions which are made to meet nonexistent competition or which involve reciprocal relationships so comprehensive that through them price competition in the industry disappears.

These statements no doubt mark the extreme beyond which the meeting or matching of competitors' prices by means of a pricing system appears likely to be regarded by the Federal Trade Commissions as of doubtful good faith.
ADMINISTRATIVE LAW

MASS PICKETING UNDER THE TAFT-HARTLEY ACT

IN ITS first decision on Section 8(b)(1)(A)\(^1\) of the Taft-Hartley Act, the National Labor Relations Board determined that an incident of "mass picketing" was restraint and coercion of the employees in exercise of their right to refrain from any or all concerted activity as guaranteed them by Section 7\(^2\) of the statute. This ruling in the case of *International Longshoremen's and Warehousemen's Union v. Sunset Line and Twine Company*,\(^3\) merits an investigation not only because it is the initial ruling on Section 8(b)(1)(A) of the statute but also it immediately raises the question—is mass picketing made illegal per se by the Taft-Hartley Law?

Stated briefly, the following factual situation was presented by this case. The Sunset Line and Twine Company, a California corporation, was engaged in the manufacture of fishing line in a small community north of San Francisco. Representatives of the company were negotiating a new contract with Local 6\(^4\) when relations were terminated and Local 6 went on strike. The mass picketing incident complained of, as set out in the Board's findings of fact, involved the picketing by 20 or 30 pickets carrying placards near the company driveway and a gathering of a crowd of pickets, strikers and fellow members of Local 6, numbering between 200 and 300, in the sidewalk area near the company driveway. As the nonstriking workers arrived to go to work, the crowd blocked the driveway and forcibly attempted to prevent the non-strikers from entering the company parking lot.\(^5\)

The Trial Examiner found that the large assembly of people was caused by the presence of all the police who had been called by the company, but the Board held that this conclusion was not supported by the preponderance of evidence\(^6\) and overruled the Trial Examiner's decision,

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1 "Sec. 8(b) It shall be an unfair labor practice for a labor organization or its agents—"(1) to restrain or coerce (A) employees in exercise of the rights guaranteed in Section 7: . . . ; 61 Stat. 141 (1947), 29 U. S. C. § 158 (b) (Supp. 1948).

2 "Sec. 7 Employees . . . shall also have the right to refrain from any or all of such activities . . . ; 61 Stat. 140 (1947), 29 U. S. C. § 157 (Supp. 1948).

3 79 N. L. R. B. No. 207 (1948).

4 *International Longshoremen's and Warehousemen's Union, Sonoma County Division, C.I.O.*

5 See note 1 *supra*.

holding that the crowd was composed of pickets, strikers and fellow members of Local 6. The Board held that this mass picketing "patently involved restraint and coercion of the employees attempting to go to work" and enjoined such further action by a cease and desist order. Its conclusion was that mass picketing designed to prevent the non-striking employees from driving their cars into the company parking lot was activity constituting restraint and coercion of the employees who were attempting to exercise their right to refrain from any or all concerted activity.8

This interpretation is, of course, subject to judicial review under the provision of the Taft Hartley Act that persons aggrieved by a final order of the Board may obtain a review in a circuit court of appeals of the United States.9 However, there is a limitation placed on the courts in judicial review. When a circuit court of appeals is reviewing a Board order, the findings of the Board, regarding questions of fact, if supported by substantial evidence on the record considered as a whole, shall be taken as conclusive.10 Although the Taft-Hartley Act has changed the Wagner Act's11 provision relating to evidence which read, "the findings of the Board as to the facts, if supported by the evidence shall be conclusive" to read, "if supported by substantial evidence on the record considered as a whole, shall be conclusive," it is doubtful if the re-wording of the section will change the prior procedure.12 Therefore, an examination of cases where courts have reviewed Board decisions under the Wagner Act will reveal the weight given to an administrative ruling such as this, in a judicial review.

"In reviewing the Board's ultimate conclusions, it is not the court's function to substitute its own inferences of fact for the Board's, when the latter have support in the record... Undoubtedly questions of statutory interpretation, especially when arising in the first instance in judicial proceedings, are for the courts to resolve, giving appropriate weight to the judgment of those whose special duty is to administer the questioned statute... But where the question is one of specific application of a broad statutory term in a proceeding in which the agency ad-

7 Ibid.
8 Ibid.
ministering the statute must determine it initially, the reviewing court's function is limited."

An excellent summarization of the problem of judicial review of NRLB decisions was given by Chief Justice Stone in the Medo Photo Supply Corporation case. He stated, "It has now long been settled that findings of the Board, as with those of other administrative agencies, are conclusive upon reviewing courts when supported by evidence, that the weighing of conflicting evidence is for the Board and not for the courts, that the inferences from the evidence are to be drawn by the Board and not by the courts, save only as questions of law are raised and that upon such questions of law, the experienced judgment of the Board is entitled to great weight."

In the Sunset Line and Twine Company case here under study, it has for the first time been expressly stated that mass picketing by a labor organization is an activity forbidden by a Federal statute. Prior to this time mass picketing rulings in both State and Federal jurisdictions have varied from case to case.

**HISTORICAL BACKGROUND**

American picketing law prior to the year 1921 involved mainly the problem of determining whether the picketing was or was not illegal. In a few cases prior to this time the courts have made references to the effect of picketing in larger numbers but the courts have been chiefly concerned with picketing itself and the manner in which it was conducted.

In 1921 the death knell to mass picketing was effectively sounded by the United States Supreme Court in American Steel Foundries v. Tri City Central Trades Council. Chief Justice Taft in writing the opinion said, "the name 'picket' indicates a militant purpose, inconsistent with peaceable persuasion." Although he did not expressly rule out picketing,

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18 257 U.S. 184 (1921).
he limited the number of pickets to "one representative for each point of ingress and egress." From the tenor of the opinion, it is deductible that Chief Justice Taft felt that each case should stand or fall on its merits because he expressly stated, "this is not laid down as a rigid rule, but only as one which should apply to these cases under the circumstances disclosed by the evidence and may be varied in other cases."

Since the *American Steel Foundries* decision, picketing has been recognized as legal if peaceable and if the number of pickets was reasonable under the circumstances of the case. What constitutes a reasonable number of pickets is not easily ascertainable; it necessarily varies according to the circumstances. Some cases have held that there must not be more than three pickets to a group; in another case the court said, there will be no mass picketing but the court will permit the presence of not more than ten pickets, while still another court refers to the presence of four pickets as mass picketing. Although the courts have varied in their determination of what is a reasonable number of pickets they have consistently ruled if the unions picket in such numbers as to obstruct the ingress or egress of the establishment being picketed, such action will be enjoined.

Recently there has been an increasing tendency by a number of courts to hold mass picketing illegal per se. This trend has been supplemented by statutes which have been enacted in a number of states expressly forbidding mass picketing. In a recently enacted Texas stat-

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19 "Since the Tri City case . . . it is almost universal practise carefully to limit the number of pickets." Hellerstien, *Picketing Legislation and the Courts*, 10 N. C. L. Rev. 158, 183 (1932).
20 *International Pocketbook Workers v. Orlove*, 158 Md. 496, 148 Atl. 826 (1930); *La France Electrical Construction & Supply Co. v. International Brotherhood of Electrical Workers*, 108 Ohio St. 61, 140 N.E. 899, 904 (1929).
22 *Evans v. Cooper*, 5 CCH Lab. Cas. 62495 (1941).
23 *Gevas v. Greek Restaurant Workers' Club*, 89 N.J. Eq. 770, 134 Atl. 309, 313 (1926) (This court held that picketing which is intimidating is not peaceful and intimidation does not depend on numbers).
24 *Westinghouse Electric Corp. v. United Electric & Machine Workers*, 139 N.J. Eq. 97, 49 A. 2d 896 (1946); *United States Steel Workers of America v. Fortner*, 42 S.E. 2d 734 (Ga. 1947) (In this case the court enjoined the mass picketing and limited the strikers to two pickets at each entrance).
26 Va. Laws c. 229 § 1-5 (1946); S. D. Laws c. 93 § 1-7 (1947); Tex. Laws c. 138 § 1-7 (1947); Dela. Laws c. 196 § 10 (1947) (This law authorizes the court of chancery to regulate mass picketing).
ute, mass picketing is defined in terms of any picketing by more than two pickets spread 50 feet apart or picketing which impedes access to the picketed premises; while a statute in South Dakota condemning mass picketing defines the prohibited picketing to be the picketing by a greater number than 3 per cent of the first 100 striking or locked out employees of the picketed employer and 1 per cent of the excess of the hundred.

The Board's conclusion in the Sunset Line and Twine case is consistent with the developing trend of judicial precedent on mass picketing, but two questions remain to be considered: (1) Did the Board interpret Section 8(b)(1)(A) in keeping with the legislative intent and (2) if the interpretation was accurate, did the Board predicate the ruling on the conduct of pickets who were picketing en masse or did the Board determine that this section of the Taft-Hartley Law made mass picketing illegal per se? To determine both the status of mass picketing under the statute and legislative intent of Section 8(b)(1)(A), it is necessary to examine the legislative history of the law.

LEGISLATIVE HISTORY OF MASS PICKETING UNDER TAFT-HARTLEY LAW

There is no reference made to mass picketing in the text of the Taft-Hartley Law, although in the reports on the bill and debates prior to the passage of the statute mass picketing and picketing in numbers was discussed.

When Representative Hartley reported House Bill 3020 out of the Committee on Education and Labor, he discussed mass picketing in connection with Section 12(a)(1) of the bill, stating:

"This section forbids force, violence, physical obstruction or threats thereof in a labor dispute, and forbids picketing in numbers or in ways other than those reasonably necessary to give notice of the existence of a labor dispute at the place being picketed. This clause preserves the right of free speech but forbids exercising it by engaging in mass picketing and by intimidation."

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28 S. D. Laws c. 93 § 5 (1947).
29 See note 2 supra.
31 1 Legislative History of the Labor Management Relations Act 335 (1948).
In the Minority Report\(^{32}\) on the same section of the bill there was another reference made to mass picketing. The Minority stated:

“This bill would, moreover, outlaw many activities which are primarily a concern of the local authorities such as violence, mass picketing, and picketing the homes of individuals, thus extending Federal police authority into areas where it has no business.”

Representative Hartley brought out the mass picketing point again in the ensuing debate prior to the passage of his bill, where he said:

“This bill also outlaws mass picketing . . . designed to prevent individuals from entering or leaving a place of business. . . . This provision barring mass picketing by the use of force and violence in the conduct of a strike is based on this premise: We do not want to interfere with the legitimate right to strike, but the Committee holds that there is an equally fundamental right, and that is that any person has the right to go to work if he wants to work, and that he has that right free from molestation on the part of anyone, be it union or anyone else.”\(^{33}\)

In the final draft of the bill\(^{34}\) which was passed in the House of Representatives, there is no reference to mass picketing, but “picketing an employer’s place of business in numbers” is set out as “unlawful concerted activity”; while in the Senate version of the bill\(^{35}\) there is no such provision, nor did the original Senate bill\(^{36}\) have any reference to mass picketing or picketing in numbers. Even in the analysis of S. 1126 by Senator Taft when he reported\(^{37}\) the bill out of the Committee on Labor and Public Welfare he made no reference, as such, to mass picketing.

However, in the debates following the presentation of this bill in the Senate, Senator Ball introduced an amendment\(^{38}\) which made it an unfair labor practice for a union to “coerce” employees in exercise of their rights guaranteed by Section 7 of S. 1126.\(^{39}\) Just what practices by unions that were to be forbidden is not clear but in the following debate\(^{40}\) on the amendment Senator Ball indicated how he thought mass picketing was affected by his amendment:

\(^{32}\) Id. at 386.
\(^{33}\) Id. at 614.
\(^{34}\) Id. at 158.
\(^{35}\) Id. at 226.
\(^{36}\) Id. at 99.
\(^{37}\) 2 LEGISLATIVE HISTORY OF THE LABOR MANAGEMENT RELATIONS ACT 1000 (1948).
\(^{38}\) Id. at 1217.
\(^{39}\) 1 LEGISLATIVE HISTORY OF THE LABOR MANAGEMENT RELATIONS ACT 109 (1948).
\(^{40}\) 2 LEGISLATIVE HISTORY OF THE LABOR MANAGEMENT RELATIONS ACT 1202 (1948).
"Mr. Ball. What we are talking about is threats of violence or of reprisal. . . . A mass picket line certainly would be coercion and restraint in this picture."

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"Mr. Ives. Is it the Senator's idea that machinery would be established under the National Labor Relations Board to stop mass picketing?

Mr. Ball. No, of course not.

Mr. Ives. The Senator's idea is to have the police power of the Federal Government exercised?

Mr. Ball. No. But I think that a mass picket line would be an unfair labor practice. . . ."

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"Mr. Morse. I understand the Senator to say that he thinks it is possible to bring within the meaning of the amendment, as an unfair labor practice, mass picketing. . . .

Mr. Ball. . . . The mass picketing situation is not a major objective. What we are trying to reach here, it seems to me, is the coercive activity in which some unions and their agents indulge in organizational and election campaigns; . . ."

Also, the meaning of the word coercion as used in connection with the amendment was not defined but Senator Ball said41 that it had been interpreted by the courts.

"Mr. Saltonstall. . . . I should like to ask . . . whether there have been any court interpretations of the words "coerce" or "restrain" in connection with this section?

Mr. Ball. I think there have been many interpretations of the words in the present Sec. 8(1)42 by the courts, because many unfair labor practice charges have been upheld in the courts against employers on the grounds that they were coercing employees in the exercise of their rights. . . ."

The Ball amendment was passed in the Senate43 and became a part of S. 1126. This bill and the House bill were submitted to conference, out of which came the Taft-Hartley bill. The Ball amendment was retained intact and is now part of the Taft-Hartley Law as Section 8(b)(1)(A).44 It was on the interpretation of this section that the Board determined mass picketing to be an unfair labor practice in the Sunset Line and Twine case.

From an examination of the legislative history of the Taft-Hartley Law it is apparent that the meaning of Section 8(b)(1)(A) depends on the meaning of the word coercion. If the mass picketing in the

41 Id. at 1203.
42 See note 11 supra.
43 2 LEGISLATIVE HISTORY OF THE LABOR MANAGEMENT RELATIONS ACT 1217 (1948).
44 See note 2 supra.
Sunset Line and Twine case was forbidden by Section 8(b)(1)(A), the mass picketing would have to constitute coercion; also, if Section 8(b)(1)(A) forbids all mass picketing then mass picketing would have to be coercive per se. Therefore, it is necessary to determine just what is judicially established as coercive activity by a labor organization. This examination of what activity amounts to coercion must also include an examination of intimidating activity for coercion denotes intimidation.45

"Interference, restraint and coercion are not acts themselves but are the description and are the results of acts."46 "What amounts to coercion, intimidation . . . must necessarily depend upon the facts of each particular case."47 "A strike may be such as to constitute intimidation though there is no use of force or physical violence. . . . To intimidate is to inspire with fear, to overawe, or make afraid. Fear may be inspired without physical violence or spoken threats, and moral intimidation may be accomplished by a menacing attitude and a display of force which may coerce the will as effectively as actual physical violence. . . . The term "picket" indicates a militant purpose inconsistent with peaceable persuasion. . . . Picketing which has for its purpose the backing up of persuasion with a show of physical force almost inevitably tends to intimidation and violence. . . . "48 "Intimidation is not limited to threats of violence or of physical injury to person or property. It has a broader significance and there may be moral intimidation which is illegal."49 Intimidation of workers by strikers may consist in numbers alone without any actual notice."50 "Do not cross the picket line" has been held not to be intimidating,51 but the forcible stopping of automobiles and intimidating occupants by gathering in large numbers constitutes forcible intimidation.52

What type of picketing does not constitute "coercion" or "intimidation"? Unions contend that "peaceful picketing is lawful under any and

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51 Simon v. Schwachman, 301 Mass. 573, 18 N. E. 2d 1, 3 (1938).
52 Ex parte Bell, 19 Cal. 488, 122 P. 2d 32 (1942).
every condition; that it is merely a form of publicity; that it is a right inherent in labor in the nature of modern industrial enterprise. The Supreme Court has held that peaceful picketing is a right of free speech guaranteed by the Constitution. A California court has held that peaceful picketing sanctioned by the guarantees of "due process of law" involves besetting the premises of another, and the fact that to some extent compulsion, coercion and intimidation are employed does not detract from its peaceful nature so long as the means constitute only economic, moral or social pressure and not the pressure of violence. In the same case, however, the court said that the forcible stopping of automobiles and intimidating occupants by gathering in large numbers exceeds the bounds of peaceful picketing.

CONCLUSION

The issues presented by the Board's decision in the Sunset Line and Twine case are: (1) Is this initial interpretation of Section 8(b)(1)(A) of the Taft-Hartley Law correct and (2) Does this section of the statute make mass picketing illegal per se.

The use of force and the acts of physical violence committed by the members of Local 6 were certainly coercive activities and therefore the conduct was an unfair labor practice within the meaning of Section 8(b)(1)(A) and was properly enjoined by the Board. It is deducible that the Board predicated its decision in this case on the conduct of the pickets and not on the number of pickets present. Since there were coercive acts committed by the mass picketers other than just picketing en masse, it was not necessary for the Board to determine whether mass picketing of itself was or was not forbidden.

To say that mass picketing is of itself illegal, it is necessary to draw hairline distinctions. First, peaceful picketing is a constitutionally guaranteed right of free speech. Independent of various state statutory definitions, mass picketing is the picketing by a large number of pickets concentrated in one area. Just when picketing ceases to be plain picketing and becomes mass picketing cannot be stated except by a determina-
tion of the factual circumstances involved. Given a specific factual situation with an arbitrary number of peaceful pickets, you have a union exercising a constitutional right of free speech. If the number of pickets were doubled and they were still peaceably picketing but their numbers were such as to be called "mass pickets", it does not necessarily follow that this picketing by the very virtue of the numbers would be unpeaceful picketing. Therefore, mass picketing can be peaceful picketing and if this is so then mass picketing is a guaranteed right of free speech. Secondly, if mass picketing is forbidden by Section 8(b)(1)(A) of the Taft-Hartley Law, mass picketing would have to be coercive, but the mere presence of a large number of pickets is not of itself coercive. Prudence compels admission that as the number of strikers is increased, the effect of their activity is magnified, but the relationship cannot be formularized for the increased effectiveness is a variable established by the circumstances involved. Therefore, mass picketing is not coercive per se—hence it is not forbidden by Section 8(b)(1)(A) of the Taft-Hartley Law.

ROBERT R. DICKEY
FEDERAL LEGISLATION
EMPLOYEE STOCK OPTIONS UNDER H.R. 6712
(The 1948 REVENUE REVISION BILL)

When a corporation finds itself short of cash, in a shaky financial condition, and lacking competent executive employees, how may it most feasibly attract skilled administrators to enter its employ? A method often used in the past has been to offer the potential employee a relatively low salary coupled with an option to buy shares in the company at a price approximately equal to the market price at the time the option is given. If the executive is successful in putting the company back on its feet and thereby raising the value of the stock, he stands to make a large profit by the exercise of his option to buy shares, yet the corporation has been spared expensive salary payments at a time when it could ill afford to make them. While this situation provides what is probably the most appropriate occasion for the use of employee stock options, they have been used in many other cases and for a variety of reasons. They have been given to reward past achievement, to provide incentive for greater efforts in the corporate behalf, to induce employees to remain in the service of the corporation, and to secure greater participation by employees in the ownership of the business. Less commendable use of stock options has been in connection with attempts to conceal from the public or from other stock-holders the magnitude of the compensation paid certain employees, and to provide compensation in a way which it is hoped will avoid or reduce taxes to the recipient. It has been concluded that employee stock options are not generally desirable from the viewpoint of the corporation unless they serve some legitimate purpose not readily accomplished by direct compensation, as in the situations first mentioned above.

Provisions regulating and considerably modifying the method of taxing employee stock options have been included in H.R. 6712, hopefully entitled the “Revenue Revision Act of 1948”, which passed the House on June 19, 1948, but which failed to come to a vote in the Senate prior to adjournment of that body. As this bill was intended to “remove inequities, eliminate uncertainties for both taxpayers and tax

1 H.R. 6712, 80th Cong., 2d Sess. (1948).
2 Washington, Corporate Executives’ Compensation 82 (1942).
administrators, prevent tax avoidance, simplify the tax system, moderate certain harsh provisions and provide increased incentives to management and venture capital\(^5\) and since it was largely based on recommendations of the Treasury,\(^6\) it is probable that most of its provisions will be enacted into law by the next Congress despite shift in party control. The section dealing with stock options\(^7\) departs in several significant respects from the Treasury recommendation\(^8\) so there may be somewhat more question as to its adoption.

**THE TAX PROBLEM**

Taxation of stock options has been confused in the past because of a conflict between two basic notions with regard to taxation:\(^9\) first, that any economic benefit received by an employee as compensation from his employer is income;\(^10\) and second, that when a bargain purchase is made, no income is realized until there has been a sale of the property and an actual receipt of profit.\(^11\) If an employee is given an option in one year to buy at $10 per share stock which has a market value at that time of $11, if he exercises his option in a later year when the market price is $20 per share, and if he sells the stock in a still later year for $25 per share, he has unquestionably made a profit of $15 per share, yet how and when should he be taxed for it? He has received some economic benefit from his employer in the year when the option was granted, the amount of this benefit has increased by the time when he exercised the option and has become fixed by his acquisition of the stock, yet no cash income is received until the year when the stock is sold. Under the current Treasury Regulations,\(^12\) he is taxed not at all in the year when he received the option, he reports $10 per share as ordinary income in the

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\(^7\) H.R. 6712, 80th Cong., 2d Sess. § 137 (1948).

\(^8\) See note 32 infra.

\(^9\) For a discussion of this difficulty see Delbert B. Geeseman, 38 B. T. A. 258, 262 (1938); Bastedo, *Taxing Employees on Stock Purchases*, 41 Col. L. Rev. 239 (1941).


\(^11\) Palmer v. Comm'r, 302 U. S. 63, 69 (1937); Comm'r v. Van Vorst, 59 F. 2d 677 (1932); Rose v. Trust Co. of Georgia, 28 F. 2d 767 (C. C. A. 5th 1928).

\(^12\) U. S. Treas. Reg. 111, § 29.22 (a)-1 (1946).
year when he exercised it, and he reports $5 per share as a capital gain in the year when the stock is sold.

Under the proposed law, there are several possibilities, depending on factors which will be discussed below. If the option agreement falls within the definition given in the bill of a “restricted stock option” and if the stock is held for at least three years, then the employee in the example given will pay no tax at all until the year when the stock is sold, at which time he will report the entire $15 as a capital gain. The advantage to the employee is obvious, for not only will the amount of his tax be lower but he will also have received cash income with which to pay the tax. It should be borne in mind that under either scheme the entire $15 profit is taxed at one time or another, and this has been true under each of the various methods of taxing options which has been in effect during the last quarter century. The distinction between the two schemes and the problem lies in whether the profit will be taxed as ordinary income or as a capital gain, and in whether there should be a tax levied when the option is given, when it is exercised, or when the stock is sold, or at more than one of those times.

TREATMENT BEFORE THE SMITH CASE

The subject has never been dealt with specifically by statute. For many years the Treasury Regulations provided that when property is transferred from an employer to an employee for an amount substantially less than the fair market value, the difference between the amount paid and the fair market value is includible in the employee’s gross income.13 Though this provision seems sufficiently inclusive to cover every case where an employee stock option is exercised at a time when the market price exceeds the option price, a much more limited construction was put on it by the courts. It was consistently held that taxable income resulted at the time of exercising the option only when the option was given the employee as compensation for past or future services.14 This excluded options given as incentives to future efforts, which were classed as giving rise to “bargain purchases”.15 The intent of the employer was

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13 This provision first appeared as T.D. 3435, II-1 CUM. BULL. 50 (1923).
considered controlling, and this was gathered from all the circumstances of the particular case. In some instances, the former Board of Tax Appeals went so far as to find a non-taxable bargain purchase even though the option agreement expressly mentioned that the option was given as consideration for the future services of the employee. In 1939, the Treasury amended its regulations to conform to this line of decision and to require inclusion in gross income of the spread between market value and option price only when the option was given as compensation.

Although this scheme of taxation seemed fair enough in theory, it had the drawback that neither the employee nor the corporation nor the Revenue agent could assert with much confidence that a given option was compensation or was a bargain purchase. At one point it appeared that a simple criterion had been found. In the case of Palmer v. Commissioner, involving the analogous taxability of stock warrants given to stockholders, one of the factors tending to show that no taxable income resulted from exercise of warrants was that at the time the warrants were declared there was no significant spread between the warrant price and the market price and that consequently no distribution was intended by the corporation. While this was only one of the factors considered in this case, the subsequent case of Choate v. Commissioner used the Palmer case as authority for the rule that if there were no spread when the warrant was given, then no taxable income resulted at the time of its exercise, even though by then a substantial spread had developed.

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16 Hawke v. Comm'r, 109 F. 2d 946 (C. C. A. 9th 1940), cert. den. 311 U. S. 657 (1940). This intent is not necessarily the same as the interpretation which the employer may place on the transaction.

17 Clarence L. Landen, Memo. TC, Dkt. 105984, Jan. 14, 1943; Herbert H. Springford, 41 B. T. A. 1001 (1940); Gordon M. Evans, 38 B. T. A. 1406 (1938). The Treasury acquiesced in the Springford and Evans decisions!

18 T.D. 4879, 1939-1 Cum. Bull. 159. As before, the courts continued to take a liberal view as to what was compensation and what was a bargain purchase. The latter was found in the Landen and Springford cases, note 17 supra, and in Charles E. Adams, 39 B. T. A. 387 (1939).

19 302 U. S. 63 (1937).

20 129 F. 2d 684 (C. C. A. 2d 1942).

21 In employee stock option cases, this had regularly been a prominent factor in determining whether the option represented compensation or a bargain purchase. The fact that only a small bargain was obtained was taken as indicating that there was no intent to compensate. Rossheim v. Comm'r, 92 F. 2d 247 (C. C. A. 3d 1937); Mehrengood Corp. v. Helvering, 89 F. 2d 972 (App. D. C. 1937). Conversely, the ability to sell immediately at a substantial profit indicates compensation. W. M. Ritter Lumber Co., 30 B. T. A. 231, 274 (1934).
THE SMITH CASE AND TD-5507

It was with this background that *Commissioner v. Smith*\(^{22}\) was decided. In this case, defendant had been given the option to buy shares in a subsidiary of his employer corporation at a price which was at that time at least as high as the market value. The option was given "in consideration of services rendered,"\(^{23}\) and Smith testified that it was intended as compensation. Nevertheless it was argued that since no spread existed at the time when the option was given this was actually a bargain purchase, not taxable until the stock was sold. This contention was overruled by the Supreme Court, which announced that "Section 22(a) of the Revenue Act is broad enough to include in taxable income any economic or financial benefit conferred on the employee as compensation, whatever the form or mode by which it is effected.\(^{24}\) Since the option was given as compensation and had no market value at the time it was given, the compensation intended must have been that obtainable by exercise of the option at some later date. When this exercise took place, taxable income resulted.

The *Smith* case established that the mere lack of market value of an option when given did not conclusively make its subsequent exercise a non-taxable bargain purchase. It did not go on to hold that an employer could *never* give an option to an employee under such circumstances that its exercise would be a non-taxable bargain purchase.\(^{25}\) This question was not at issue, it being conceded in the *Smith* case that the option was given as compensation. The decision had a curiously stimulating effect on the Treasury rule-makers, however. About a year later and in apparent reliance on the *Smith* case, a new regulation appeared\(^{26}\) which flatly declared any transfer of stock by an employer to an employee at a price less than the market value to be in the nature of compensation, and so taxable at the time of the transfer. This differed from the

\(^{22}\) 324 U.S. 177 (1934); see Ferrall, *Employee Stock Options and the Smith Case*, 1 Tax L. Rev. 225 (1946).

\(^{23}\) Comm'r v. Smith, 324 U.S. 177, 179 (1945).

\(^{24}\) *Id.* at 181.

\(^{25}\) In the case of James M. Lamond, TC Memo, Dkt. 6026, Jan. 31, 1946, decided after the *Smith* case but before the subsequent change in the Treasury Regulations, the Tax Court found such circumstances to exist, and held that no taxable income resulted from exercise of the option.

former regulation\textsuperscript{27} in calling for a tax when \textit{any} spread existed at the time of purchase rather than a "substantial" spread, and in taking the position that the option always represented compensation.\textsuperscript{28} Neither of these changes was required by the \textit{Smith} decision.\textsuperscript{29} Apparently the position of the Treasury was that since the former principal test of taxability (spread at the time the option was given) was no longer to be recognized as controlling, there was no point in permitting an inquiry into whether the option was given with intent to compensate. Whatever the rationale of the new rule, there is no question but that this treatment of purchases under stock options makes for greater certainty than did previous regulations. The duties of the Bureau of Internal Revenue are simplified whenever the question of intent drops out of the application of any tax. The taxpayer also benefits (though somewhat negatively) by knowing more definitely in advance the tax consequences of his acts.

Although the present regulations have the twin virtues of certainty and simplicity, they have also the effect of greatly reducing the attractiveness of employee stock options to the employee, and consequently the usefulness of option agreements to the corporation. In order to exercise his option, the employee must be prepared to put out money for the price of the stock and for the tax as well before any cash income is received. With a given amount of capital, fewer shares can be purchased and less profit can be expected.

H.R. 6712\textsuperscript{30}

This bill includes a large number of generally unrelated sections designed to smooth out various rough spots in the tax system without any very significant effect on the flow of the revenues. Section 137, dealing with employee stock options, is an attempt to provide for the first time a specific statutory tax treatment for such options.\textsuperscript{31} In general, the scheme

\textsuperscript{27} T. D. 4879, 1939-1 \textit{CUM. BULL.} 159.

\textsuperscript{28} The courts had previously recognized a rebuttable presumption to the effect that any payments or other benefits conferred by an employer on an employee were in the nature of compensation. \textit{Willkie v. Comm’r}, 127 F. 2d 953 (C. C. A. 6th 1942), \textit{cert. den.} 317 U. S. 659 (1942); \textit{Walker v. Comm’r}, 88 F. 2d 61 (C. C. A. 1st 1937).

\textsuperscript{29} See \textit{Ross, Tax Consequences of Employees’ Stock Option Plans}, 26 \textit{TAXES} 137 (1948).

\textsuperscript{30} H. R. 6712, 80th Cong., 2d Sess. (1948).

\textsuperscript{31} This section stems from the Treasury recommendations contained in the letter from A. L. M. Wiggins, Under Secretary of the Treasury, to Hon. Harold Knutson, Chairman, House Ways and Means Committee, Feb. 26, 1948, but differs in a number of respects therefrom. The Treasury recommended in essence that:
is to encourage the use of stock options when given as incentives by relieving the employee from any tax until the stock is finally sold. If the option is obviously given as present compensation, if the employee fails to hold the stock for an appreciable period or if the option agreement fails to meet the incentive requirements set up in the bill, the tax consequences to the employee are less favorable.

Under the bill, "restricted stock options" are given special and preferential tax treatment. Options not qualifying under this classification are taxed exactly as they would be according to the existing Treasury Regulation, i.e., the employee is taxed at the time of exercising the option on the spread between the market price and the option price at that time, as ordinary income. No inquiry will be made as to the intent with which the option was given. It is immaterial whether the option amounted to compensation or was a bargain purchase, so long as the option is given "for any reason connected with the employment of such person."

"Restricted stock options" are those given to buy stock in the employer or a parent corporation, where the option expires in less than ten years, is not alienable and lapses if the employee leaves the company, is approved or ratified by the stockholders, and is given to an individual who does not already own more than 10% of the voting stock of the company, directly or indirectly.

If the option qualifies under this definition, its tax treatment will depend on whether or not it has been given as an incentive device or as present compensation. The test used is simple and arbitrary. If the option price at the time the option is given is at least 90% of the market price, it is assumed that no present compensation is intended and no income results when the option is exercised. If on the other hand the option price is less than 90% of the market price when the option is given, it is treated as though it were compensation and taxable income results at the time the option is exercised. The amount of this income is the difference between the option price and the market price at the time the

1. The grant of the option should be taxed if a substantial spread (between market and option price) exists at that time.
2. Any spread at the time the option is exercised, in excess of that at the time of grant, should be taxed as ordinary income, but this tax would be deferred until the stock is sold.
3. If the option is held more than three years, the income could be spread over those years.
4. The employer could take a deduction in the year the option is exercised, to the extent of the spread at that time.

option was granted or at the time it was exercised, whichever is smaller. Income from this source may be disregarded if it is less than $200.

If the stock purchased through exercise of the option is held for at least three years, any profit resulting at the time it is sold is taxed as a long-term capital gain. The basis used in computing the gain will be the option price actually paid plus any taxable income reported at the time of purchase (because of the 90% rule). If the stock is sold within three years of the time of purchase, part or all of the profit is taxed as ordinary income. If the market value is lower when the stock is sold than when it was purchased, all the profit is taxed as ordinary income; if the stock has appreciated in value during the holding period, this appreciation is taxed as a capital gain, while the difference between the option price and the market price at the time of purchase is taxed as ordinary income. These provisions are designed to encourage the employee to retain his stock and consequently his incentive to make the company prosper.

The preferential treatment given to restricted stock options is not extended to the personal representative when the option is exercised after the death of the employee. Any spread between option price and market price is taxed to the estate as ordinary income at the time of purchase.

Under this bill, the employer corporation may take a deduction for salary payments by way of stock options whenever the employee at the time of exercising the option is required to pay a tax. Thus the employer may take a deduction when the option is exercised if it was not a "restricted stock option" or if the option price was less than 90% of the market price when given, but it may not take the deduction upon the exercise of a restricted stock option given at a price not less than 90% of the market value. The right to a deduction is not affected by the length of time that the employee holds the stock.

The effect of this bill is illustrated by a consideration of the treatment which would be accorded under it to the option involved in the recent case of Van Dusen v. Commissioner.33 In this case, the president of the employer corporation gave an option to buy at $5 per share stock of which the market quotation at that time was approximately 9. The market price ranged from 15 to 30 at the times when the option was exercised. The court found that despite the fact that the option was transferred by the president personally rather than by the corporation, the option was given as compensation and the spread between market

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33 166 F. 2d 647 (C. C. A. 9th 1948).
and option price at the time of purchase was taxable as ordinary income. H.R. 6712 covers such an option, since it applies to any "granted by an employer (or any other person) to an individual, for any reason connected with the employment of such individual." The option would apparently not be a restricted option, however, as such options must have been "granted by a corporation to an individual [employee]." Hence under the bill, the entire spread at the time of purchase would be taxed as ordinary income, just as the court held under the earlier Treasury Regulations.\textsuperscript{34} If the Van Dusen option were considered a restricted stock option, then approximately $4 per share (the spread between option price and market price at the time the option was given) would be taxed as ordinary income in the year when the purchases were made. No further profit would be taxed until the stock was sold. If the stock were held at least three years and then sold, all profit over the resulting $9 per share basis would be a long-term capital gain. If the stock were sold within the three year period, the difference between $9 per share and the purchase price would be ordinary income, while the difference between the purchase price and the selling price would be a capital gain.

CONCLUSION

The provisions of H.R. 6712 seem well adapted to encourage the use of stock options as legitimate incentive devices and at the same time to prevent their use as a means of tax avoidance. Although the provisions are somewhat complicated, all persons concerned may readily determine the tax consequences flowing from them. It will be apparent at the time the option is granted whether or not it is a restricted stock option. This will also be true as to whether or not the option price is at least 90\% of the market price, unless there is no market for the stock or its value is unknown. If the option is restricted and if the 90\% test is satisfied, the corporation takes no deduction and has no further tax concern in the transaction. The only uncertainty confronting the corporation occurs when the option is not properly restricted or when the 90\% rule is not satisfied. In either case, the time for taking the deduction will depend on when the employee chooses to exercise the option. From the viewpoint of the employee, the only uncertainties (except when market value is unknown) are dependent on his own acts, \emph{i.e.}, the time when he exercises the option and the time when he sells the stock. He is therefore

\textsuperscript{34} U.S. Treas. Reg. 103, \textsection 19.22 (a)-1 (1939) was in effect at the time of the Van Dusen purchases.
in complete control of the time when the tax will be due and of the particular tax scheme which will be applied. Troublesome questions of intent are avoided entirely.

The 90% rule and the provision that restricted stock options cannot be given to person owning 10% or more of the company stock, directly or indirectly, should prevent the use of option plans to avoid taxes on any significant scale. The provisions denying transferability of the option and encouraging the employee to retain the stock more than three years tend to make the employee less apt to treat the option as a pure speculation. A curb is put on manipulation by management in the requirement that the option be approved or ratified by the stockholders prior to its exercise.

Technically and administratively this bill seems to be a fair and desirable solution to the problem of how to tax stock options. The question still remains whether options should be encouraged by preferential tax treatment or whether corporations should be induced to use other less speculative means of providing incentive to their employees such as higher salaries, profit-sharing plans, deferred bonus payments and the like. This is purely a question of policy, as there is no doubt that Congress could adopt the scheme now in effect under the Treasury Regulations, and could consider the exercise of options in every case as a form of deferred compensation (as in Commissioner v. Smith). For that matter, it appears that a tax could be imposed at the time the option is granted, though administrative difficulties and the questionable amount of revenue obtained have prevented the Treasury from ever attempting this. Stock option plans have their greatest usefulness in the case of small, relatively unstable businesses and may represent in some instances the only method available to such corporations to attract competent executive personnel. In view of this and considering the safeguards contained in H.R. 6712, it seems that on the whole its provisions relating to employee stock options. are generally useful and desirable and should be enacted into law.

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35 Advantages of the bill are available without restriction on the amount of stock owned by the employee after exercising the option. Thus an employee owning 8% of the stock could be given an option to buy an additional 43%, and would still qualify for preferential treatments, if the other requirements are met. The objectives of the bill might better be effected by the addition of a top limit.

36 Taxing the grant of the option was contemplated in the Treasury recommendations for 1948, however. See note 32 supra.
THE EXTENSION OF ADMIRALTY JURISDICTION
TO INCLUDE AMPHIBIOUS TORTS

By the enactment into law of a little more than 200 words, the Eightieth Congress overturned a precedent of eighty-three years standing in the field of admiralty law. The operation also removed a potential thorn from the side of many a litigant who, in the future, will be seeking redress for wrongs originating on the water but consummated on land. At the same time, it adopted for American law in this field a rule that has long prevailed in British and in most European courts.

Specifically, the act provides for the extension of admiralty and maritime jurisdiction to "all cases of damage or injury, to person or property, caused by a vessel on navigable water, notwithstanding that such damage or injury was consummated on land." In addition, the act permits suits to "be brought in rem or in personam according to the principles of law and the rules of practice obtaining in cases where the injury or damage had been done and consummated on navigable water." Two limiting provisos, one restricting suits against the United States in this category to the Public Vessels Act or the Suits in Admiralty Act and the other requiring that claims against the United States be presented to the Federal agency concerned prior to suit, are discussed below.

Passage of the act marked the successful culmination of nearly twenty years of effort toward that end by the American Bar Association and the Maritime Law Association of the United States. Bills similar to the new law had been introduced as early as 1899 and in each Congress since the Seventy-fifth. Its enactment warrants a limited exposition of the circumstances which necessitated such a law, and also a discussion of whether the law will meet the test of constitutionality if and when a case involving its principles is brought before the Supreme Court of the United States.

THE HISTORY OF AMPHIBIOUS TORTS

The phrase "amphibious torts" is often used to describe the kinds of action which will be most directly affected by this recent extension of admiralty jurisdiction. This expression was apparently first used by Mr. Justice Henry B. Brown for want of a better term to single out those

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3 Jurisdiction of the Admiralty in Cases of Tort, 9 Col. L. Rev. 1, 9.
cases where damage was caused by a vessel on navigable water to something which was a part of the land. This basic distinction between land and navigable water has been all important for, since the decision of the United States Supreme Court in *The Plymouth*, the locality test respecting maritime torts has determined the jurisdiction of the admiralty courts. This interpretation has led to judicial hair-splitting of a caliber seldom rivaled in any branch of the law.

The rule of the *Plymouth* case, which prohibited recovery in an action in personam against the shipowner for damages to a warehouse and dock which resulted from the spread of a fire originating by negligence aboard a vessel alongside, was followed without substantial modification for nearly forty years. Then, in 1904, the Supreme Court did allow an admiralty action in the case of *The Blackheath* for damages to a beacon which was built on piles but firmly attached to the land 12 or 15 feet below the surface of the water. The court in handing down this decision was careful to distinguish it from *The Plymouth*, and to indicate its support of the major premise, but a minority of the court, while concurring with the result, felt that *The Plymouth* case should have been specifically overruled at the same time. The result of *The Blackheath* opinion was a rash of test cases to try and extend the admiralty jurisdiction to similar fact patterns involving land structures, but the court stood firm in its position largely on the ground that beacons were an aid to navigation. If there were any doubts about *The Blackheath*, these were removed when in 1916 the Supreme Court allowed recovery in admiralty by a construction company for damages to an incompletely built beacon.

In another series of cases involving the denial or availability of admiralty jurisdiction, the distinction between land and matters relating to navigable waters has been equally foggy. These have been referred to as the "cable cases." In one, *Postal Telegraph Cable Co. v. P. Sanford Ross, Inc.*, the court held that a submarine telegraph cable, crossing a tideland navigable channel and resting on the bottom, although connected to the shore with land wires, is not a structure on the land and affixed thereto as an extension of the shore. It therefore accepted juris-

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4 3 Wall. 20 (U.S. 1865).
5 195 U.S. 361 (1904).
6 Cleveland Terminal Company v. Steamship Company, 208 U.S. 316 (1908); The Troy, 208 U.S. 321 (1908); Martin v. West, 222 U.S. 191 (1911).
7 The Raithmoor, 241 U.S. 166 (1916).
9 221 Fed. 105 (E. D. N. Y. 1915).
diction in admiralty. This can be contrasted to other similar cases in which jurisdiction was denied, such as *Nippon Yusen Kabushiki Kaisa* *v. Great Western Power Co.*10 Here the apparent distinction was the fact that a power cable was involved instead of one for communication purposes which might be carrying messages related to maritime matters!

The denial of admiralty jurisdiction in cases where the injury has occurred on land has made it extremely difficult, and in some instances impossible, to obtain adequate redress for certain types of injuries. When a vessel collides with a bridge through mutual fault and both are damaged, under the law as it existed prior to passage of the present Act, the owner of the bridge, being denied a remedy in admiralty, is barred by contributory negligence from any recovery in an action at law. But the owner of the vessel may, by a suit in admiralty, recover half damages from the bridge, contributory negligence operating merely to reduce the recovery. Further, where a collision between a vessel and a land structure is caused by the fault of a compulsory pilot, the owner of the land structure is without remedy for his injuries since at law a compulsory pilot is not deemed the servant of the vessel’s master or owner.11 But if the vessel sheers off the land structure to collide with another vessel in the vicinity, the owner of the second vessel, by an in rem proceeding in admiralty may recover full damages.12 It is inequities of this type which the new legislation was designed specifically to correct.

**RELATION TO THE TORT CLAIMS ACT**

The House and Senate committee reports, and correspondence from the Navy, Maritime Commission, and the Department of Justice included in these reports emphasize the fact that the act will not increase materially the possibility of added claims against the Government. Passage of the Tort Claims Act, 1946,13 removed what had probably been an important obstacle to the passage of legislation to extend the admiralty jurisdiction. Prior to that act, as a result of judicial interpretation, there was no basis for recovery in admiralty for damages caused by a Government vessel to land structures in spite of the Public Vessels Act, 1925,14 which covered, without exception, all "damages caused by a public

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12 The *China*, 7 Wall. 53, 68 (U.S. 1868).
vessel." The courts had held in *State of Maine v. United States*\(^5\) that admiralty jurisdiction under the Public Vessels Act was limited to cases where private admiralty proceedings could be maintained. As the House committee report pointed out, "It was thought undesirable, while the United States was at war and operating many vessels, both through the War Shipping Administration and in the military and naval service, to impose additional liabilities on the United States for injuries caused by its vessels.\(^6\)

The Federal Tort Claims Act has resolved any questions of jurisdiction on those cases which had been found by judicial decision to be outside the scope of the Public Vessels Act. As the House report continues, "Moreover in peacetime Government vessels are seldom in charge of a compulsory pilot. It therefore seems unlikely that the bill can materially increase the liability of the United States for injuries caused by its vessels. On the other hand, so far as regards the right of the United States to recover for injuries done to Government-owned submarine cables and shore installations through the negligence of compulsory pilots in charge of private vessels, the enactment of the bill will be of substantial advantage to the United States.\(^7\)

**CREATE NO NEW CAUSES OF ACTION**

The new law does not create any new causes of action; it merely directs the courts to exercise the admiralty and maritime jurisdiction of the United States already conferred by Article III, Section 2, of the Constitution, "The judicial power shall extend . . . to all cases of admiralty and maritime jurisdictions. . . ." The law provides that "for damages or injury done or consummated on land by a vessel on navigable waters, the Public Vessels Act or Suits in Admiralty Act, as appropriate shall constitute the exclusive remedy for all causes of action arising after the date of the passage of this Act." This wording, suggested by the Acting Secretary of Navy,\(^8\) was designed to avoid any possible duplication of remedies. Section 421 of the Federal Tort Claims Act excludes any action arising under either the Public Vessels Act\(^9\) or the Suits in Ad-

\(^{15}\) 45 F. Supp. 35 (Me. 1942), aff'd 134 F. (2d) 574 (C. C. A. 1st 1943), *cert. denied* 319 U.S. 772 (1943).


\(^{17}\) *Id.* at 2, 3.

\(^{18}\) *Id.* at 4.

\(^{19}\) See note 14 *supra.*
miralty Act\textsuperscript{20} which relate to claims or suits in admiralty against the United States. The effect of the exclusive jurisdiction is, of course, to rule out the possibility of a suit at law for damages caused by public vessels to land structures.

The law also provides for the exclusive jurisdiction of admiralty "for all causes of action where suit has not been hitherto filed under the Federal Tort Claims Act." Inasmuch as the Federal Tort Claims Act extends back to January 1, 1945 and the Public Vessels Act has a 2-year limitation, the overlapping of these time periods is an effective bar to the opening up of new causes of action.

One further provision which was also suggested by the Navy Department\textsuperscript{21} and which ultimately became part of the statute, was the creation of a "grace" period between the filing of a claim against one of the Government departments and the initiation of legal proceedings. The Act states, "That no suit shall be filed against the United States until there shall have expired a period of six months after the claim has been presented in writing to the Federal agency owning or operating the vessel causing the injury or damage." This provision is similar in purpose to one included in the Federal Tort Claims Act,\textsuperscript{22} and gives a Federal agency an opportunity to adjust the claim and perhaps in this way avoid the necessity for litigation. In most cases of this kind, the responsibility for liability is clear, and there is a decided advantage in having an opportunity to settle the claim before it reaches the courts.

It should be noted that as to claims between private litigants, there will still remain the right to a common law remedy where the common law is competent to give it. This right is expressly saved to claimants under Section 24 of the Judicial Code.\textsuperscript{23}

CONSTITUTIONAL ASPECTS OF THE NEW LAW

No small part of the reason for the long period of gestation for this legislation was the fact that for a time at least many legal minds questioned the authority of Congress to extend the admiralty jurisdiction in this manner. In the report of the Standing Committee on Admiralty and Maritime Law of the American Bar Association in 1930,\textsuperscript{24} after careful study of the case law, the committee concluded that "These cases leave

\textsuperscript{21} See note 16 supra, at 4.
\textsuperscript{22} See note 14 supra.
\textsuperscript{23} 28 U.S.C. \S 41 (3) (1946).
\textsuperscript{24} 55 A.B.A. Rep. 303, 307 (1930).
no doubt that Congress has no authority to extend the Admiralty jurisdiction beyond torts committed on navigable waters." Yet at the same time the committee pointed out, "there is real need to correct the present unfortunate condition of the law, if that can be done" and "such a situation seems so anomalous that it seems there must be some way to remedy it."25 The question was whether the Congress would be able to skirt the reefs presented by the Supreme Court in *The Plymouth*, and in the line of cases following that decision.

The same committee in the following year, and after further study of the question, reported: "The decisions of the Supreme Court . . . seem to indicate a clear view that admiralty jurisdiction does not and cannot be made to extend to land structures, even by act of Congress for the court has stated that Congress cannot enlarge the constitutional grant of power."26 In the opinion of this committee, the only hope apparently lay in a court reversal of doctrine of *The Plymouth* case in the manner advocated by the minority of the court in *The Blackheath.*27

By way of contrast, Mr. George R. Farnum, a member of this committee, writing a short time later, said "There is nothing inherently incongruous, either in logic or tradition, in treating torts originating on a vessel on navigable waters as possessing essential characteristics of a maritime transaction, though the damage is consummated on land. On the other hand, there is every reason, if the law is to find its justification in the measure in which it satisfies business needs and promotes public convenience and equity, to bring this field of wrongs within the cognizance of the admiralty courts."28 "Conditions call for," he said, "a decisive operation that will remove the very root of the difficulty. It is believed that this can be accomplished by "legislation, simple in its formulation and complete in its effectiveness. Should the attempt fail through constitutional frustration, it will be time to think of compromising with the evils that are the reproach of the existing state of the law."29

There is valid precedent for the extension of admiralty jurisdiction through legislation both in this country and in England. In a series of acts beginning in 1840, the British redefined the jurisdiction of admiralty courts. The English Admiralty Court Jurisdiction Act of 186130 extended it to include "any claim for damages by any ship."

25 *Id.* at 305.
27 See note 5 *supra*.
28 *Admiralty Jurisdiction and Amphibious Torts*, 43 YALE L. J. 34, 36 (1933).
29 *Id.* at 45.
30 24 & 25 Vict. c. 10, § 7 (1861)
Admittedly the powers of Parliament in respect to legislative matters are free from the constitutional limitations imposed upon the American Congress. However, passage of the Ship Mortgage Act in 1920 by Congress is a specific example, which has been upheld by the Supreme Court, of an extension of admiralty jurisdiction into a field where it had heretofore been excluded by judicial determination. By its decision in the John Jay handed down in 1854, the Supreme Court denied admiralty jurisdiction in the field of ship mortgages by saying that "Such a (ship) mortgage has nothing in it analogous to those contracts which are the subjects of admiralty jurisdiction. . . . There cannot be, then, anything maritime in it. A failure to perform such a contract cannot make it maritime." In its closing paragraph the court pointed the way to a solution in the following statement: "It is true that the policy of commerce and its exigencies in England have given to its admiralty courts a more ample jurisdiction . . . but this enlarged cognizance of mortgages of ships has been given there by statute. . . . Until that shall be done in the United States, by Congress, the rule, in this particular, must continue. . . ."

As stated previously, Congress did not get around to including ship mortgages within the province of admiralty jurisdiction until 1920, and it was 14 years later before a test of the constitutionality of the law reached the Supreme Court although cases involving its provisions at least indirectly had been up several times. Mr. Chief Justice Hughes, in delivering the opinion of the court in The Thomas Barlum and discussing the validity of the grant of jurisdiction, presented an excellent summary of the law on this subject as follows:

"The Congress rested its authority upon the constitutional provisions extending the judicial power 'to all cases of admiralty and maritime jurisdiction' and conferring upon the Congress the power to make all laws 'which shall be necessary and proper' for carrying into execution all powers 'vested by this Constitution in the government of the United States, or in any department or officer thereof.' Art. III, § 2; Art. I, § 8, par. 18. This authority was not confined to the cases of admiralty and maritime jurisdiction in England when the Constitution was adopted. Waring v. Clarke, 5 How. 441, 457, 458. The limitations which had been imposed upon the high court of admiralty in the course of its controversy with the courts of common law were not read into the grant. But the grant presupposed a 'general system of maritime law' which was familiar to the

32 17 How. 399 (U.S. 1854).
33 Id. at 402, 403 (italics added).
34 293 U.S. 21, 42 (1934).
lawyers and statesmen of the country, and contemplated a body of law with uniform operation. The Lottawanna, 21 Wall. 558, 574, 575. The Constitution did not undertake to define the precise limits of that body of law or to lay down a criterion for drawing the boundary between maritime law and local law. Id. Boundaries were to be determined in the exercise of the judicial power in recognition of the purpose of the grant. "No state law can enlarge it, nor can an act of Congress or rule of court make it broader than the judicial power may determine to be its true limits." The St. Lawrence, 1 Black 522, 527. The framers of the Constitution did not contemplate that the maritime law should remain unalterable. The purpose was to place the entire subject, including its substantive as well as its procedural features, under national control. . . . The Congress thus "has paramount power to determine the maritime law which shall prevail throughout the country. The Lottawanna, supra, p. 577; Butler v. Boston & Savannah S.S. Co., 130 U.S. 527, 557; In re Garnet, 141 U.S. 1, 13; Southern Pacific Co. v. Jensen, 244 U.S. 205, 215; Crowell v. Benson, 285 U.S. 22, 39; United States v. Flores, 289 U.S. 137, 148, 149. But in amending and revising the maritime law, the Congress necessarily acts within a sphere restricted by the concept of the admiralty and maritime jurisdiction. The Belfast, 7 Wall. 624, 641; Panama Railroad Co. v. Johnson, supra; Crowell v. Benson, supra, p. 55."

In closing his decision, Mr. Chief Justice Hughes remarked that "We have had abundant reason to realize that our experience and new conditions give rise to new conceptions of maritime concerns. These may require that former criteria of jurisdiction be abandoned, as, for example, they were abandoned in discarding the doctrine that the admiralty jurisdiction was limited to tidewaters."85

CONCLUSION

Extension of admiralty jurisdiction to include all cases of damage or injury, to person or property, caused by a vessel on navigable water by the Eightieth Congress should do much to clarify the field of admiralty law and dispel the foggy distinctions which the prior status of the law often necessitated. It places the American law on the subject on a par with the English and most European jurisdiction. It equalizes the position of plaintiff and defendant in those cases where the wrong originated on the water, but the injury was received on land, yet at the same time it maintains the remedies available under the common law at the election of the injured party.

The new law meets with the approval of the legal profession, which has long advocated such a change, and likewise with the approbation of the Government departments most likely to be affected.

The only hurdle to its complete acceptance is the possibility of its

85 Id. at 52.
failure to meet the test of constitutionality. Even here the Supreme Court has on several occasions indicated its recognition of the authority of Congress to determine the maritime law which should prevail throughout the country and of the fact that it was not the intention of the framers of the Constitution that such law should remain unaltered. It seems unlikely that, as in the case of the Ship Mortgage Act, there will be a period of 14 years before the law will meet head-on the challenge of constitutionality. In view of the present liberal trend of the Supreme Court, the decision might well be, and should be, to uphold the will of Congress in this matter. Such a decision would be met with wide approval.

Clarke L. Fauver
RECENT DECISIONS

ADMINISTRATIVE LAW—Failure of a Quasi-Judicial Tribunal to Give Counsel an Opportunity to Present Oral Argument on Every Question of Law Including Questions on Demurrer or As If On Demurrer Is a Denial Of Due Process Under the Fifth Amendment.

On August 22, 1946, Federal Communications Commission granted without hearing the application of a Tarboro, North Carolina, radio station, known as the Coastal Plains Broadcasting Company, for a broadcasting permit to construct a radio station. Coastal Plains was permitted to operate during the day on the same frequency as WJR, a Detroit, Michigan, station. WJR is a Class 1-A Clear Channel Station, that is, one which has only a limited daytime interference-free area, but an unlimited nighttime interference-free area. Fearing that the Coastal Plains station would interfere with the reception of WJR in its present daytime protected area, WJR petitioned the Federal Communications Commission: (1) To reconsider the application granted to Coastal Plains, and/or; (2) To postpone action on the application until a hearing relative to granting more kilowatt power to Class 1-A Clear Channel Stations of WJR type was concluded. Coastal Plains, in answer to the petition of WJR, filed with the Commission an “opposition.” The opposition was in the form of a demurrer, or, as in modern practice, a motion to dismiss. This opposition, therefore, raised the question of whether the allegations in the petition of WJR stated a claim for relief. This question the Commission decided without giving WJR or the Coastal Plains Company an opportunity to argue orally. The Commission decided the question ex parte in favor of Coastal Plains. WJR appealed this decision to the United States Court of Appeals for the District of Columbia. Held, Due Process under the Fifth Amendment requires a hearing, including an opportunity to make oral argument, in a quasi-judicial proceeding on every question of law raised before quasi-judicial administrative tribunal, including questions on demurrer, or as if on demurrer, except such questions of law as may be raised in interlocutory orders such as, proceedings pendente lite, temporary injunctions and the like. WJR, The Goodwill Station, Inc. v. Federal Communications Commission, No. 9464, App. D. C., Oct. 7, 1948.

The instant case represents one of the most recent interpretations of the Constitutional requirements of due process under the Fifth Amendment in quasi-judicial administrative proceedings. The question of what constitutes due process in administrative proceedings has had a long and turbulent history. Carrow, Background of Administrative Law, p. 27, (1948). The general rule is that procedural due process requires a fair and open hearing which is one of the rudiments of fair play secured every litigant by the Federal Constitution. Ohio Bell Telephone Co. v. Public Utilities Commission, 301 U. S. 292 (1937). But, the Constitution guarantees no particular form of procedure; it protects
substantial rights. National Labor Relations Board v. MacKay Radio Co., 304 U. S. 351 (1938). This Constitutional requirement of fair play was recognized early by Congress and the term “full hearing” appeared in many statutes creating administrative agencies. 1 Vom Bauer, Federal Administrative Law, § 281 (1942). Among such statutes was the Packers and Stockyards Act. 42 Stat. 166 (1921), 7 U. S. C. § 211 (1946). The interpretation of this phrase became the occasion for the Morgan cases, which laid down certain broad general standards with reference to procedural due process. Though the Morgan cases dealt, technically, with the meaning of “full hearing” in the Packers and Stockyards Act, it seems clear that the same requirements would be considered essential to due process. Hart, An Introduction to Administrative Law, p. 307 (1940).

In the first Morgan case, Morgan v. United States, 298 U. S. 468 (1936), the question of whether the Secretary of Agriculture, Mr. Henry Wallace, had accorded certain market agencies a full hearing before making rates was before the court. In considering this question it laid down the now famous rule: “The one who decides must hear”. First Morgan case, supra, at p. 481. It said that a full hearing was a hearing of the evidence and argument, that “the argument may be oral or written”. [Emphasis supplied]. First Morgan case, supra, at p. 481. After defining what constituted a full hearing it remanded the case to the Missouri District Court to determine if the Secretary had accorded the agencies a full hearing. The District Court allowed interrogatories to be addressed to the Secretary and in answering them he said that: “He did not hear the oral argument. The bulky record was placed upon his desk and he dipped into it from time to time.” Second Morgan case, infra, at p. 17. The District Court decided that a full hearing had been accorded the agencies. “The Supreme Court has not said that it was the duty of the Secretary of Agriculture to hear or read all of the evidence and in addition to hear the oral arguments, and to read and consider the briefs. If the Supreme Court had said that it would have meant that the . . . Act cannot be administered.” [Emphasis supplied]. Morgan v. United States, 23 F. Supp. 383 (W. D. Mo. 1937). The market agencies again appealed to the Supreme Court and in the second Morgan case, Morgan v. United States, 304 U. S. 1 (1938), the Court agreed with the District Court that a full hearing had been accorded the agencies, notwithstanding the fact that the Secretary had not heard the oral argument. “We agree with the Government’s contention that it was not the function of the court to probe the mental processes of the Secretary in reaching his conclusion if he gave the hearing required by law.” Second Morgan case, supra, at p. 4. On the point of whether a full hearing was accorded the agencies the Court held, in effect: He who decides must decide on the basis of evidence presented and read by him. The Court then proceeded to remand the case on a procedural point: Parties to a quasi-judicial administrative proceeding have a right to know the issues and have a right to an opportunity to meet them. Note, 27 Geo. L. J. 360 (1938). The third Morgan case dealt with the
disposition of a fund paid into the District Court pending the outcome of the litigation. In this decision, Morgan v. United States, 307 U. S. 183 (1939), the Court, through Justice Stone, took occasion to remind the parties that courts and administrative agencies "should not in this day repeat the mistake made by courts of law when equity was struggling for recognition; neither can rightly be regarded by the other as an alien intruder." Third Morgan case, supra, at p. 191. Once again the case was remanded. The Secretary issued new market rates, these the market agencies attacked on the ground that the Secretary was biased against them. This District Court summoned the Secretary as a witness. He testified substantially the same as he had done in answering the interrogatories addressed to him in the second Morgan case. The case again went up on appeal and in the fourth Morgan case, Morgan v. United States, 313 U. S. 409 (1941) the court held: (1) That the Secretary was not biased; (2) That it was error to call the Secretary as a witness. An administrative officer cannot be cross-examined as to how he reached a decision any more than a judge can be cross-examined as to how he reached a decision. The court then ended with the caveat: "Agency and court are to be deemed collaborative instrumentalities of justice and the appropriate independence of each should be respected by the other." Fourth Morgan case, supra, at p. 422.

Summarizing the Morgan cases in the light of the problem in the instant case it would appear: (1) That oral argument is not a sine qua non in quasi-judicial proceedings; (2) That written argument may satisfy procedural due process requirements; (3) That judicial deference to the judgment of administrative agencies is a guiding principle. So much for general constitutional standards.

With regard to the specific constitutional problem involved in the instant case, that is, whether oral argument must be accorded on demurrer, or as if on demurrer, the cases fall into two categories: (1) Where the statute gives petitioner the right to oral argument in the alternative; (2) Where the statute is silent as to the right to oral argument but requires a full hearing. Before taking up these cases in detail, brief mention should be made that the instant situation is quasi-judicial in nature and not quasi-legislative. It is a proceeding wherein the petitioner has such a right (a radio license) as entitles him to a fair hearing if that right be modified or revoked. Federal Communications Commission v. National Broadcasting Co. (KOA), 319 U. S. 239 (1943). All the cases hereinafter cited are either quasi-judicial in character or are based on statutes which utilize the forms and language of adjudication. Sen. Rep. No. 8, 77th Cong., 1st Sess. 101-102 (1941).

In three cases courts have had an opportunity to construe statutes which make the right to oral argument discretionary with the administrative agency and provide for the submission of written arguments and briefs in their stead. In two of those cases the court disposed of them upon other grounds than due process. Thus, in Yakus v. United States, 321 U. S. 436 (1944), the Court said: "In advance of application to the Administrator for such a [full oral] hearing
we cannot well say whether its denial in any particular case would be a denial of due process.” And in *Levers v. Anderson*, 326 U. S. 219 (1945) the Court held that the petitioner need not request an administrative rehearing in order to secure judicial review of an adverse decision, although “a rehearing, if granted, would have afforded petitioner for the first time an opportunity . . . to present oral argument to the officer who made the order.” In the third case, however, the Court held that denial of an oral hearing was not an abuse of discretion. “Complainant claims it was injured by the refusal of the Administrator to grant an oral hearing of its case. This court will only interfere with a decision of the Administrator in the matter of granting or refusing an oral hearing where it plainly appears that there has been an abuse of discretion. We find no such abuse in this case. Apparently all relevant facts in support of complainants case may be fully submitted in written form.” *Mortgage Underwriting Co. v. Bowles*, 150 F. 2d 414 (E. C. A. 1945).

In the second line of cases, where the statute is silent as to the right to oral argument but requires a hearing, courts have held: (1) Where the agency has a rule providing for oral argument on request, oral argument need not be accorded petitioner if not requested. *Consolidated Edison Co. v. National Labor Relations Board*, 305 U. S. 197 (1938). (2) Where the petitioner was heard by a trial examiner he cannot complain he was not heard orally by the Commission if he has not requested oral argument. *Federal Radio Commission v. Nelson Bros. Bond and Mortgage Co.*, 289 U. S. 266 (1933). (3) Where petitioner was heard by a trial examiner he cannot complain if the Commission refused to grant his request for oral argument. *Woodmen of the World Life Ins. Co. v. Federal Radio Commission*, 65 F. 2d 484 (App. D. C. 1933). (4) Where petitioner’s oral argument was heard by only one of three members of the Board who decided his case he cannot complain there was no continuity of personnel. *Eastland Co. v. Federal Communications Commission*, 92 F. 2d 467 (App. D. C. 1937).

The instant case does not fall into either of the two categories of cases cited. The *Mortgage Underwriting case*, supra, is not controlling for the reason that in that case the statute made the granting of an oral hearing discretionary. Here the statute merely specifies that a hearing is required before an existing license can be modified, a licensed facility changed or an application for modification of a license denied. 48 Stat. 1089-90 (1934), 47 U. S. C. § 312 (b), 303 (f), 309 (a) (1946). The cases in the second category are also not controlling. The *Edison case*, supra, does not apply because here the petitioner requested a hearing. The *Federal Radio Commission*, the *Woodmen*, and *Eastland cases*, supra, do not apply because in those cases petitioner was accorded an oral hearing before either a trial examiner, or one of the members of the board. The *Morgan cases*, supra, can also be distinguished from the instant case upon the same grounds. The market agencies had been accorded an oral hearing before subordinate administrative officers, though not by the one who decided. In short, there is no case which decides the question we are concerned with here.
The dissenting minority in support of its contention that oral argument is not a constitutional guarantee pointed to Rule 78 of the Federal Rules of Civil Procedure which provides for the substitution of written briefs for oral argument on motions in order to expedite the business of the court. They also cited the fact that most rules of administrative agencies do not provide for oral hearing on demurrer. They argued that the denial of an oral hearing in both court and agency rules was significant, though not controlling. Can it be that the rules are the result of the simple conclusion that the denial of oral argument does not violate the rudiments of fair play? The minority also pointed out that local rules of court put a time limit on oral argument of motions. If the right to oral argument is a constitutional requirement such a rule would have to be phrased in terms of adequacy of presentation, and could not be limited arbitrarily to ten minutes. They viewed the rule limiting time on motions as a rule of court convenience having no basis in constitutional necessity.

The instant case enunciates a new interpretation of procedural due process requirements mainly by its insistence that in quasi-judicial proceedings a petitioner has the universal right to oral argument, as such. The right to be heard, the court believes, is the right to be heard orally. There is no demonstration that in an administrative proceeding, where a petitioner has such a right as entitles him to a fair hearing, written argument on demurrer would not satisfy the requirements of process as well as oral argument. There is no recognition that the denial of oral argument in some situations, as in the Mortgage Underwriting case, supra, would not constitute an abuse of discretion. The decision also seems to ignore the reality that as a matter of administrative convenience, where voluminous written arguments and briefs are submitted to the board, the board in deciding a case oftentimes adopts the written argument and brief of a subordinate administrative officer. For these reasons, together with the broad principle of judicial deference to administrative experience, as exemplified by the fourth Morgan case, supra, it is submitted that the decision in the instant case is unsound.

The decision is most important to administrative agencies because, as has been said before, many agencies do not have rules providing for oral argument in the instant situation. The acceptance by higher authority of the doctrine that oral argument is a *sine qua non* on demurrer would necessitate extended revisions of these rules.¹

¹ In a subsequent case the doctrine of the instant case was again applied, serving notice that it is not confined solely to proceedings before the Federal Communications Commission. *Philadelphia Co. v. Securities Exchange Commission*, No. 9513, App. D. C., Oct. 18, 1948.
CITIZENS—Written Renunciations of American Citizenship by Native Born
Persons of Japanese Ancestry Involuntarily Obtained Are Invalid and Will
Be Cancelled.

Proceedings in equity were brought by Tadayasu Abo and approximately
2300 other native born persons of Japanese ancestry to obtain a decree rescinding
their written renunciations of American citizenship made in 1945 while
interned and imprisoned at Tule Lake Relocation Center in Modoc, California.
The Center was surrounded by a manproof fence reinforced with armed guards,
internal pro-Japanese organizations were permitted to and did exert strong pres-
sure on the internees to renounce their citizenship, and a condition of mass
nervosis and community-wide hysteria and continual fear of "forced relocation"
and compulsory draft were prevalent during the renunciation period. Held,
that the renunciations were not freely and voluntarily executed; were accepted
by the Attorney General with full knowledge of the purpose for and conditions
under which they were obtained; and in equity and justice should be cancelled
and the plaintiffs declared to be citizens of the United States. Tadayasu Abo
et al. v. Clark et al., 77 F. Supp. 806 (N. D. Cal. 1948).

At common law no citizen had the power of throwing off his allegiance with-
out the sovereign's consent, Shanks et al. v. Dupont et al., 3 Pet. 242 (U. S.
1830). Congress in 1868 passed a law establishing the right of expatriation,
the doctrine of consent, Ex parte Griffin, 237 Fed. 445 (N. D. N. Y. 1916),
and treated expatriation as a natural and inherent right, the consent, if neces-
sary, being inferred from the Act of 1868, supra, Reynolds v. Haskins, 8 F. 2d
473 (C. C. A. 8th 1925). The right is now recognized both as to renunciation
of foreign allegiance in favor of the United States, In re Loop Tin Sing, 21 Fed.
905 (C. C. D. Cal. 1884), and as to the abdication of United States citizenship
However, in the exercise of this natural right, the government is an interested
party, and the manner and form of expatriation are proper subjects of govern-
ment regulation. Mackenzie v. Hare, 239 U. S. 299 (1915). The courts have
consistently upheld the power of Congress to create additional modes for the
renunciation of United States citizenship. United States ex rel Wrona v. Kar-
nuth, 14 F. Supp. 770 (W. D. N. Y. 1936); Ex parte (Ng) Fung Sing, 6 F. 2d
670 (W. D. Wash. 1925). The Nationality Act of 1940, 54 Stat. 1137, 8
U. S. C. § 907 (1940) revised and codified the nationality laws of the United
States, and in 1944 it was amended by adding to Section 401 a new subsection
(i) to permit a national in time of war to surrender his nationality by making
a written renunciation in prescribed form approved by the Attorney General,
58 Stat. 677 (1944), 8 U. S. C. § 801 (i) (1946). This is the first case involving
the validity of mass renunciations, but individual renunciations under sub-
section (i) came into question in Yuyichi Inouye v. Clark, 73 F. Supp. 1000 (S.
D. Cal. 1947), where the court held that renunciations by loyal native American
citizens of Japanese ancestry who had married Japanese aliens and renounced American citizenship while illegally confined in relocation centers under the desire to remain with their husbands and in fear of assault by disloyal co-prisoners were voidable as made under duress and coercion. In proposing the amendment to Section 401 by the addition of subsection(i), the Attorney General was of the opinion that the Tule Lake internees who elected to abandon their United States nationality could then be presumed to be nationals of Japan and thus dealt with as alien enemies, but in *Ex Parte Tadayasu Abo et al.*, 76 F. Supp. 664 (N. D. Cal. 1947), the same court that decided the principal case rejected the theory of dual nationality of native born resident Americans as judicially unsound and held that there must have been a voluntary departure from the United States to convert to an alien status. This, of course, vitiated the primary purpose of subsection(i). The decision in the principal case, while leaving the door open for the government to show that individual renunciations were voluntary, for the first time holds renunciations voidable *en masse* in a class proceeding. By way of dicta it condemns the objective of subsection(i), without passing on its constitutionality, as an ill chosen effort to give some color of constitutionality to the continued incarceration of native born American citizens. It illustrates the concept that during a period of actual hostilities governmental restraints on individual liberties are more likely to be sanctioned as a proper exercise of the War Powers, but after the war is over, the rights of the individual tend to predominate. This method of expatriation became inactive on July 25, 1947, Congress having fixed that date as the end of the war for this purpose, 61 Stat. 451 (1947), 8 U. S. C. § 801 (Supp. 1948), but in the event of United States participation in a future war, it would be re-activated, and inasmuch as it is not limited by its terms to persons of Japanese ancestry (to which it was directed), it would still offer a general means for the voluntary renunciation of American citizenship. On the basis of the holding in the present case it may be said with added emphasis that American citizenship is a priceless heritage that will not be lightly regarded by the courts, and the renunciation of that citizenship is a serious act which will be surrounded by judicial safeguards.

JOHN W. SIPES

CONSTITUTIONAL LAW—The Fourteenth Amendment to the Federal Constitution Does Not Require a State, Contrary to Its Own Practice, to Furnish Counsel for a Defendant in a Non-Capital Offense.

The defendant was indicted upon a warrant issued on December 28, 1946, charging him with the crime of highway robbery, a non-capital offense. On January 6, 1947, the regular Superior Court of Washington County was convened, and the bill of indictment returned by the grand jury. Defendant pleaded not guilty, was asked by the court if he had counsel, and upon his nega-
tive reply the court proceeded to trial. The jury returned a verdict of guilty, and the defendant was sentenced to the State Prison for a term of not less than nine or more than ten years. On a writ of habeas corpus dated July 9, 1947, the Superior Court commanded that he be produced in open court. Defendant's counsel made a delayed motion that the conviction and sentence be set aside and declared void, and that a new trial be granted. Counsel based his argument on the grounds of the alleged denial of the defendant's rights, in the expediency of the trial, in the lack of counsel for defendant, and upon the general ignorance of the defendant of his rights. Held, upon the facts disclosing that defendant made no request for counsel, and that the trial was in the general course of practice of the courts having jurisdiction, the denial of defendant's motion was without error. State v. Chesson, 228 N. C. 259, 45 S. E. 2d 563 (1947).

In Federal Courts, it is a sacred principle that a man accused of a crime is entitled to a defense by counsel both upon the law and the facts, U. S. Const. Amend. VI, and that no person shall be deprived of life, liberty or property without due process of law, U. S. Const. Amend. V. It is well settled that these amendments are limitations on the powers of the Federal government alone, and do not in any way limit the powers of the state governments. Barron v. Baltimore, 7 Pet. 242, 247 (U. S. 1833). The Fourteenth Amendment is a limitation of the powers of the state governments, and includes those rights set forth in the Bill of Rights of the United States Constitution which are considered fundamental. Betts v. Brady, 316 U. S. 455, 462 (1942).

The state of North Carolina adopted the provisions of the Fourteenth Amendment in its own constitution, N. C. Const. Art. I § 11, State v. Farrell, 223 N. C. 321, 322, 26 S. E. 2d 322, 325 (1943), and by a statute insuring the right to counsel. N. C. Code § 4515 (1935). Although the United States Constitution guarantees the right to counsel, it makes no provision for appointment thereof. The Supreme Court has not remained silent on this subject, making the following statement in Powell v. Alabama, 287 U. S. 45, 71 (1932), see note 84 A. L. R. 527 (1933): “All that it is necessary now to decide, as we do decide, is that in a capital case, where the defendant is unable to employ counsel, and is incapable adequately of making his own defense, because of ignorance, feeble-mindedness, illiteracy or the like, it is the duty of the court, whether requested or not, to assign counsel for him as a necessary requisite of due process of law...” According to this decision, under the above conditions, state courts must, in a capital case, appoint counsel for the accused. The Supreme Court does not decide that counsel must be appointed for non-capital cases, nor under other circumstances for capital cases, stating in Powell v. Alabama, supra at 71, “Whether this would be so in other criminal prosecutions, or under other circumstances, we need not determine.”

Although the Powell case does not decide that counsel must be appointed for indigent defendants in other than capital cases, a minority of four Supreme Court justices would hold otherwise. Led by Mr. Justice Black, their vigorous dissents in Carter v. Illinois, 329 U. S. 173 (1946) and Foster v. Illinois, 332
U. S. 134 (1947), would indicate that the present rule might very well be changed in the near future. For a treatment of this aspect, see Bute v. Illinois, 333 U. S. 640 (1948), 37 Geo. L. J. 109.

All of the states save Virginia, have constitutional provisions for the assistance of counsel in criminal trials. These provisions vary. Some state constitutions practically embody the guarantee of the Sixth Amendment. In a second group, the guarantee of the right to counsel has been held to require the appointment in all cases where the accused has not been able to obtain counsel. In a third group, these provisions have been interpreted as not to require the appointment of counsel for indigent defendants. In a fourth group, the provisions have not been held to require appointment of counsel, since their courts have made such appointment discretionary or obligatory only in the case of capital offenses or felonies. In a fifth group, the provisions have been construed as not to require appointment of counsel, because statutes call for such appointment only in capital cases or felonies, or refer the matter to the court's discretion, Betts v. Brady, supra, at 467-470, and statutory and case material cited therein. Statutory provisions in some states now require their courts to appoint counsel in all cases where the accused cannot procure counsel, and these statutes have been modified in some instances to require such appointment only for certain offenses. Other states require that indigent defendants in non-capital as well as capital cases be provided with counsel on request, some by statute and some by judicial decision or established practice judicially approved. Some states however, have definitely rejected the requirement to appoint counsel in non-capital cases, see Betts v. Brady, supra, at 470, 471, and appendix, at 477-480, and statutory and case material cited therein. Mr. Justice Roberts summed up the situation very succinctly in Betts v. Brady, supra, at 471, 472, when he said: "... in the great majority of the states, it has been the considered judgment of the people, their representatives and their courts that appointment of counsel is not a fundamental right, essential to a fair trial. On the contrary, the matter has generally been deemed one of legislative policy. In the light of this evidence, we are unable to say that the concept of due process incorporated in the Fourteenth Amendment obligates the states, whatever may be their own views, to furnish counsel in every such case. Every court has power, if it deems proper, to appoint counsel where that course seems to be required in the interests of fairness."

The State of North Carolina, then, has adopted the Fourteenth Amendment in its own state constitution, and has a statute guaranteeing the right to counsel, which however, does not provide for appointment thereof. By numerous decisions, its courts are committed to the appointment of counsel in cases of capital felonies. State v. Collins, 70 N. C. 241 (1874); State v. Hardy, 189 N. C. 799, 128 S. E. 152 (1925); State v. Farrell, supra. Since it involves a non-capital felony, the instant case does not fall under the above classifications, and the court is relegated to the exercise of its discretionary power.

At first blush, the North Carolina court's refusal to extend the doctrine of the
Powell case to non-capital cases, would seem to be harsh and tantamount to a deprivation of due process. It must be remembered however, that it is within the discretion of the court to appoint counsel where it thinks that such action is required to secure due process. The Court of Appeals of Maryland, for instance, a jurisdiction which has affirmatively rejected the requirement that counsel should be appointed in non-capital cases, Betts v. Brady, supra, appendix at 480, recently reversed a conviction because it thought that on the record, an accused had been handicapped in his defense for lack of counsel. Coates v. State, 180 Md. 502, 25 A. 2d 676 (1942).

The decision of the instant case repudiates the thesis of the Supreme Court minority, that due process can only be assured through the representation of counsel, and adheres to the language of Mr. Justice Roberts, regarding the Fourteenth Amendment: "... we cannot say that the Amendment embodies an inexorable command that no trial for any offense or in any court, can be fairly conducted and justice accorded a defendant who is not represented by counsel."

Betts v. Brady, supra, at 473.

CONSTITUTIONAL LAW—Seizure upon Search without Warrant where Warrant Might have been Obtained, Is Unlawful though Incident to Lawful Arrest.

In January 1946, certain of the petitioners sought to lease part of a farm belonging to one Kell, who, believing they were going to set up and operate a still, reported his suspicions to proper federal authority. As a result of this report, Kell was told to enter into the lease but to do nothing to entice the prospective lessees to complete their plans. One agent was placed on the farm and subsequently was hired as a "mash man". He reported at frequent intervals to his superiors, and on one occasion a truckload of alcohol was seized within an hour after it had left the farm. After three months of continuous observation the federal agents planned a raid; Kell, cooperating fully, drove the agents to his farm. Near the barn where the still was located, the odor of fermenting mash was apparent and the sound of a gasoline motor was heard. One of the petitioners was seen bending over the machinery; an arrest was made, and the illegal distillery "seized". The federal agents did not act under any authority of warrant for the arrest or search.

The District Court of New Jersey held the seizure to be reasonable as incident to lawful arrest, United States v. Trupiano et al., 70 F. Supp. 764 (1947), which opinion was affirmed by the Circuit Court of Appeals for the Third Circuit, 163 F. 2d 828 (1947); on writ of certiorari, held: reversed; when the facts and circumstances show a lack of need for summary seizure, it is not justifiable as an incident of lawful arrest, the precise location of the arrestee having no relation to the foreseeability or necessity of the seizure. Trupiano et al. v. United States, 334 U. S. 699 (1948).
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Since the provision against unreasonable search and seizure as contained in the 4th Amendment of the federal Constitution makes no attempt at definition, the law on the subject has been decided by the federal judiciary. That this determination is a judicial question decided from the facts and circumstances presented by each case, has long been settled. *United States v. Vatune*, 292 F. 497 (N. D. Cal. 1923); *Agnello v. United States*, 269 U. S. 20 (1925); *Go-Bart Importing Co. v. United States*, 282 U. S. 344 (1931). It has been said that the Constitutional provision in question must be construed in the light of what was deemed an unreasonable search and seizure when it was adopted, and in a manner which will conserve public as well as individual rights. *Carroll v. United States*, 267 U. S. 132 (1925).

Several general rules have been developed by the federal courts in interpreting the 4th Amendment. Foremost among these is the right to search and seize as an incident of lawful arrest. *Agnello v. United States*, *supra*; *Carroll v. United States*, *supra*. In the *Agnello* case it was said that "the right without a search warrant contemporaneously to search persons lawfully arrested while committing crime and to search the place where the arrest is made . . . is not to be doubted." See also *United States v. Lee*, 274 U. S. 559 (1927); *Gouled v. United States*, 255 U. S. 298 (1921); *Weeks v. United States*, 232 U. S. 383 (1914).

Practicability and necessity make it mandatory that if the peace officer has authority to arrest without a warrant then he also has the authority to search and seize without a warrant, "in order to find things connected with the crime, as its fruits or as the means by which it was committed, as well as weapons and other things to effect an escape from custody". *Agnello v. United States*, *supra*. This rule is in conformity with the common law. *Vachina v. United States*, 283 F. 35 (C. C. A. 9th 1922); *Carroll v. United States*, *supra*.

Since a lawful arrest can be made without authority of warrant either for a past felony upon probable cause, or because a crime is being committed in the officer's presence, it has heretofore followed that the search incident to such arrest is valid, conditioned only by the lawfulness of the arrest. The weight of authority is decidedly to the effect that to justify arrest and subsequent search and seizure without authority of warrant, the officer must have direct personal knowledge, through his own senses, of the commission of the crime by the accused. *Elrod v. Moss*, 278 F. 123 (C. C. A. 4th 1921); *Hester v. United States*, 265 U. S. 57 (1924); *United States v. Solomon*, 33 F. 2d 193 (D. C. Mass. 1929); *United States v. Lindsly*, 7 F. 2d 247 (E. D. La. 1925); *Benton v. United States*, 28 F. 2d 695 (C. C. A. 4th 1928); *Worthington v. United States*, 166 F. 2d 557 (C. C. A. 6th. 1948). When contraband goods, such as intoxicating liquors, are exposed to the view of officers, no authority of warrant is necessary. *Vachina v. United States*, *supra*; *United States v. Borkowski*, et al., 268 F. 408 (S. D. Ohio 1920); *United States v. Camarota*, 278 F. 388 (S. D. Cal. 1922).

After-acquired knowledge will not legalize a search that was unlawful when
made, *Raniele v. United States*, 34 F. 2d 877 (C. A. 8th 1929); nor will the development of subsequent events justify an unlawful search after it has been initiated. *United States v. O'Connell*, 43 F. 2d 1005 (S. D. N. Y. 1930); *Byars v. United States*, 273 U. S. 28 (1927). General exploratory searches are forbidden; *United States v. Rembert*, 284 F. 996 (S. D. Tex. 1922); *Marron v. United States*, 275 U. S. 192 (1927); *Carroll v. United States*, *supra*; and this protection extends to the innocent and guilty alike, *Kroska v. United States*, 51 F. 2d 330 (C. A. 8th 1931); but the federal Constitutional provision extends protection to the accused from federal employees, not from state authorities, *Marron v. United States*, *supra*.

It cannot be said, however, that warning was not given for the reported decision, for the courts, when discussing searches and seizures without authority of warrant, but upon a showing of probable cause, have been careful to point out that in cases where the obtaining of a warrant is reasonably practical, it should be required as a prerequisite to the authority to search. *Carroll v. United States*, *supra*; *Husty v. United States*, 282 U. S. 694 (1931) (by implication); *Taylor v. United States*, 286 U. S. 1 (1932); *Walker v. United States*, 125 F. 2d 395 (C. C. A. 5th 1942).

The *Taylor* case, *supra*, formed the foundation of the majority (5-4) opinion in the reported decision. In that case, prohibition agents broke and entered petitioner’s garage, suspecting that the numerous cartons seen therein contained illegal whiskey. Petitioner was not arrested until one half hour later when he came to the garage. The court enunciated the doctrine that seizure was unreasonable, however well founded the suspicions of federal agents, when there was ample time and opportunity to obtain a search warrant; the decision pointing out that the time element and the foreseeability of the need for a search and seizure made the warrant essential. See also *Hart v. United States*, 162 F. 2d 74 (C. C. A. 10th 1947); *United States v. Di Corvo*, 37 F. 2d 124 (D. Conn. 1927).

The opposite view is taken in *United States v. Esposito*, 45 F. Supp. 39 (E. D. Pa. 1942). The court here said, that “to throw a shield over these men who had themselves made the interior of their building a place of suspicion, and to envelop them in a panoply of constitutional protection . . . is a misapplication of a provision that was embodied in the Constitution to insure the privacy of a man’s person and dwelling from illegal inquiry”. In *United States v. Solomon*, 33 F. 2d 193, 194 (D. Mass. 1929) the court denied defendant’s contention of illegal search and seizure on grounds of the feasibility of obtaining a search warrant, inferring by way of dicta that such is not the test of reasonableness.

The reported decision reflects the desire of a bare majority of the present Supreme Court to go to almost any lengths to prevent the slightest depreciation of the rights secured by the 4th Amendment, without regard to practicability. In *Johnson v. United States*, 333 U. S. 10 (1948), where officers were in possession of evidence which a magistrate might have found to be probable cause for issuing a search warrant (presence of odors to affiant qualified to know the
odor), the same majority held the conviction unlawful even though the obtaining of a warrant could contribute nothing towards the preservation of the rights protected by the 4th Amendment. See also the dissenting opinion of three of the majority justices of the reported case in *Harris v. United States*, 331 U. S. 145 (1946).

It cannot be said that the *Trupiano* decision is in conflict with that part of the law bottomed on the intent and purpose of the 4th Amendment, but it does mark the first time that a search and seizure, incident to lawful arrest has been "branded" as illegal. For such summary seizure to be conditioned by an *ex post facto* judicial judgment seems highly unreasonable in itself.

FRANK P. BARKER.

DOMESTIC RELATIONS—A foreign divorce based on constructive service is no defense to an action by the wife in the "home" state for arrears on a pre-existing support order.

The parties were married in 1937 and resided in New York until 1942 when the defendant husband left his wife. In October 1943 the wife was granted a separation decree and awarded permanent alimony, the husband appearing generally to defend. In January 1944 the husband moved to Nevada and in April 1945 sued for divorce there. It was granted in May 1945, the wife being notified by constructive service but not defending. The Nevada decree was silent on the subject of alimony. After obtaining the Nevada decree, the husband ceased payments for alimony as provided in the New York decree. The wife brought suit for the arrears in unpaid alimony in New York and the husband put in the Nevada decree as a defense. *Held* New York has the power to rule that the pre-existing support order survives the "ex parte" Nevada divorce. *Estin v. Estin*, 334 U. S. 540 (1948).


A divorce is seen to consist of two distinct sections—marital capacity and economic rights—and their inherent dissimilarity evokes different considerations in the eyes of the Supreme Court. A state is necessarily interested in its domiciliaries, and in preventing bigamy and bastardy. Thus its pronouncements on marital capacity are necessarily entitled to full faith and credit. *Williams v. North Carolina supra*. On the other hand, "the state where the deserted wife is domiciled has a deep concern in the welfare of the family deserted by the head of the household." *Eserewein v. Commonwealth of Pennsylvania*, 325 U. S. 279 (1945). The two interests are conflicting under the orthodox theory of a divorce *a vinculo matrimonii* being a total divorce of husband and wife, dissolving the marriage tie and releasing the parties wholly from
their matrimonial obligations. 1 Bl. Comm. 440. Under the new theory of Divisible Divorce, they are easily reconcilable, "restricting each state to the matters of her dominant concern." Estin v. Estin supra p. 549.

What then are the wife's rights for support under this new doctrine? If she appears generally to contest the foreign action and the foreign court was competent to litigate the matter of alimony, its decision would bind all other courts as being res judicata. Davis v. Davis, 305 U. S. 32 (1938), Sherrer v. Sherrer, 68 Sup. Ct. 1087 (1948). The same reasoning applies where the wife herself is the plaintiff in the foreign suit for divorce and her endeavors there, though a failure, preclude her from later asserting a demand for support in her "home" state. Staub v. Staub, 170 Md. 202, 183 Atl. 605 (1936) held that even if the foreign court not adjudicate concerning alimony, the wife's action barred her later claim.

The wife whose problem is reached in the instant case is in a different category. She has not appeared to defend; she has not been personally served; she has been notified only constructively by service by publication. The foreign court has no power to litigate her rights in personam. i.e., her right to support. Mr. Justice Douglas' opinion contemplates two possibilities in this situation. First, the "home" state may consider that the divorce a vinculo cuts off the duty of the husband to support and thus the foreign decree is given efficacy as to both parts of the Divisible Divorce. Herrick v. Herrick, 55 Nev. 59, 25 P. 2d 378 (1933). "The dissolution of the marriage relation extinguishes the subject matter which forms the basis of an action or proceeding for separate maintenance." Bushnell v. Cooper, 289 Ill. 260, 124 N. E. 521 (1919). It should be noted that this view is not incompatible with the wife's right to support under a support order issued prior to the foreign decree. Glaston v. Glaston, 160 P. 2d 45 (Cal. 1945). An example of the same result obtained through comity is State v. Lynch, 42 Del. 95, 28 A. 2d 163 (1942), where a Maryland divorce was held a good defense to criminal proceedings for failure to abide by a support order of a Delaware court.

Second, the "home" state can hold that an ex parte divorce decree against a wife constructively served only affects the marital capacity of the parties. "It... certainly has no effect to release the defendant there and everywhere else from his liability to the decree made against him in the State of New York, upon that decree being carried into judgment in a court of another state of the Union, or in a court of the United States, where the defendant may be found or where he may have acquired a new domicile different from that which he had in New York, when the decree was made there against him." Barber v. Barber, 21 U. S. 582 (1858). This was the rationale of the Estin case in the lower courts as well as in Bassett v. Bassett, 141 F. 2d 954 (C. C. A. 9th 1944). Cf. Security Trust Co. v. Woodward, 73 F. Supp. 667 (D. C. N. Y. 1947). Two states expressly provide by statute for alimony after divorce has been granted outside the state, Mass. Gen. Laws (1932) C. 208, Sec. 34; N. J. Rev. Stat. (1937) Sec. 2:50-37, and the rights conferred thereby are in line with the Estin
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The dissenting opinions of Mr. Justices Frankfurter and Jackson are based upon a belief that New York has not decided prior to this case which of the two aforementioned roads she will travel. "The crucial issue," says Mr. Justice Frankfurter, "is whether New York has held that no ex parte divorce could terminate a prior New York separate maintenance decree, or whether it had decided merely that no ex parte divorce decree of another state could." The majority, however, considers the New York law to be clear on this point and would take up the discrimination problems posed by the dissents when "a state makes that its policy."

Mr. Justice Jackson dissents for the further reason that he does not feel "constructive service divorces based on short residence" need be given full faith and credit. But this is written upon the false assumption that the defendant sued for the Nevada divorce after a residence there of only three months. The record shows that the complaint was filed in Nevada April 17, 1945, some fifteen months after he left New York. Record, pp. 26, 28, 46, 76. Thus this contention is unfounded.

As can be seen by the foregoing, the Estin case resolves the problem into one which each state can solve as it desires. Mr. Justice Douglas aptly describes the effect of the rule as follows: "An absolutist might quarrel with the result and demand a rule that once a divorce is granted, the whole of the marriage relation is dissolved, leaving no roots or tendrils of any kind. But there are few areas of the law in black and white. The greys are dominant and even among them the shades are innumerable. For the eternal problem of the law is one of making accommodations between conflicting interests. This is why most legal problems end as questions of degree."

MICHAEL A. SCHUCHAT

NEGLIGENCE—Doctrine of Res Ipsa Loquitur Applied to Accident Involving Aircraft Operating as a Common Carrier

Action to recover for wrongful death was brought by Evelyn C. Smith, individually and as executrix of the estate of Courtney M. Smith, deceased, against the Pennsylvania Central Airlines Corp. The deceased was killed while traveling as a passenger for hire in an airplane owned and operated by the airline. The plane crashed into a mountain in West Virginia. The complaint relied in part on the doctrine of res ipsa loquitur to establish negligence by the defendant. A motion to strike, based on the contention that such doctrine was not applicable to aircraft accidents, was made by the defendant. Held, that
the doctrine of res ipsa loquitur should be deemed applicable to accidents involving airplanes operating as common carriers. The motion to strike was denied. Smith v. Pennsylvania Central Airlines Corp., 76 F. Supp. 940 (D. D. C. 1948).

This case represents a new application of the doctrine of res ipsa loquitur in the District of Columbia. The court stated that this doctrine lies in the field of substantive law and, according to the local rule as to conflicts of law, the law of West Virginia must be determinative of the question of applicability of the doctrine; therefore it became the duty of the court to ascertain the law of West Virginia on this point as a matter of principle and with the aid of such persuasive authorities as are available, inasmuch as the precise question had not been determined in that state. The court further stated that West Virginia has adopted substantially the same view of the doctrine of res ipsa loquitur as that existing in the District of Columbia. It therefore appears that the decision of the court would have been the same had the accident occurred in the District of Columbia.

The number of reported cases involving the applicability of this doctrine to aircraft accidents is small. The bone of contention is embodied in the question: Is the accident one which ordinarily does not occur in the absence of someone's negligence? The defense in this case contended that the novelty of air navigation should preclude the application of the rule of res ipsa loquitur to aircraft accidents in view of the fact that they may be due to mysterious and unknown causes. The court replied that this doctrine was applied to railroads as early as 1844 in Carpue v. London and Brighton Ry., 5 Q. B. 747, 114 Eng. Rep. 1431, when that mode of transportation was in its infancy, and also, supra at 945, the court said:

“The progress of aviation has been rapid. . . . Those responsible for the remarkable and swift growth and development of aviation can justifiably boast of a superb record of unparalleled and rapid achievement and success. Accomplishment must be accompanied by responsibility. No reason is discernible why the principles that govern the liability of other common carriers, such as railroads, should not be equally applicable to trans- port airlines operating as common carriers.”

The court further stated that the majority of reported cases in this country, England, and Canada have reached the conclusion that the rule of res ipsa loquitur is applicable to accidents occurring on airplanes operated as common carriers and cited Smith v. O'Donnell, 215 Cal. 714, 12 P. 2d 933 (1932); Genero v. Ewing, 176 Wash. 78, 28 P. 2d 116 (1934); Smith v. Pacific Alaska Airways, 89 F. 2d 253 (C. C. A. 9th 1937), cert. denied, 302 U. S. 700 (1937); Seaman v. Curtiss Flying Service, 231 App. Div. 867, 247 N. Y. Supp. 251 (2d Dep't 1930); Fosbrooke-Hobbes v. Airwork, Ltd., 1 All E. R. 108 (1937); Malone v. Trans-Canada Airlines, 1 Avi. 1028 (Ontario 1942); McLennery v. McDougall, 47 Manitoba 119, 1 Avi. 718 (1937); Galer v. Wings, 47 Manitoba 281, 1 Avi. 778 (1938).
In *Smith v. O'Donnell*, supra, the accident involved was a midair collision of two aircraft. The court said, "If the proper degree of care is used, a collision in midair does not ordinarily occur, and for that reason the doctrine was properly submitted to the jury."

In *Smith v. Pacific-Alaska Airways*, supra, there is no discussion of the doctrine in the opinion although it is apparent that it was considered applicable inasmuch as a verdict for the defendant was reversed for retrial, the court stating that the retrial was necessary because the jury had not been instructed adequately on the doctrine of res ipsa loquitur.

In *Seaman v. Curtiss Flying Service*, supra, an airplane crashed on takeoff, and one of the reasons for reversing a verdict for defendant was the failure of the lower court to instruct the jury on the doctrine of res ipsa loquitur, which the court held applicable without discussion.

In *Goodheart v. American Airlines*, 252 App. Div. 660, 1 N. Y. S. 2d 288 (2d Dep't 1937), the facts were similar to those of the principal case. A plane en route to Buffalo crashed into a mountain, killing plaintiff's intestate, a passenger. The appellate court held the trial court in error for instructing on the doctrine of res ipsa loquitur, but only because the plaintiff had alleged and introduced evidence of specific negligence. In the instant case the allegation of specific negligence was held not to affect the applicability of the doctrine.

In the present case, the opinion also cited the following cases which refused to apply the doctrine: *Morrison v. LeTourneau*, 138 F. 2d 339 (C. C. A. 5th 1943); *Cohn v. United Air Lines Transfer Corp.*, 17 F. Supp. 865 (D. C. Wyo. 1937); *Herdon v. Gregory*, 190 Ark. 702, 81 S. W. 2d 849, 82 S. W. 2d 244 (1935); *Wilson v. Colonial Air Transport, Inc.*, 278 Mass. 420, 180 N. E. 212 83 A. L. R. 329 (1932); *Smith v. Whitley*, 223 N. C. 534, 27 N. E. 2d 442 (1943); *Boulineaux v. City of Knoxville*, 20 Tenn. App. 404, 99 S. W. 2d 557 (1935); *Budgett v. Soo Sky Ways*, 64 S. D. 243, 266 N. W. 253 (1936). As pointed out in the opinion, however, none of these cases involved a common carrier with the exception of *Smith v. Whitley*, supra, in which it does not appear whether the plane was a common or private carrier. The others involved either a private plane or an aircraft on a test flight.

In *Morrison v. LeTourneau*, supra, the plane was a small, two-place, dual-controlled cub aircraft. Both occupants were killed in the crash. There was no evidence of how or why Morrison, plaintiff's intestate, accompanied Le-Tourneau on the flight. The only witnesses testified merely that the plane appeared from out of the fog, clouds and mist, and crashed into the ground. In refusing to apply the doctrine of res ipsa loquitur, the court held that such accidents could happen to the most skilled pilots without negligence. The court obviously could have refused to apply the doctrine because of lack of any evidence of exclusive control by the defendant.

In *Cohn v. United Air Lines*, supra, plaintiff's intestate went along on a test flight at the invitation of the pilot-employee of defendant. The complaint relied entirely on the doctrine of res ipsa loquitur. The court sustained a de-
murrer to the complaint on the grounds that any one of a number of causes for which defendant was not responsible might have caused the accident. The opinion cited *Wilson v. Colonial Air Transport, supra*, to the effect that the doctrine should not be applied where there is any other reasonable or probable cause from which it might be inferred that there was no negligence at all. Although the *Wilson* case did make such a statement, it is apparent that the holding therein was based on the fact that there was no such evidence presented as to care and inspection of the aircraft as would establish exclusive control on the part of the defendant. The decision in the *Cohn* case was based also on Department of Commerce statistics for 1935 concluding that the number of accidents resulting from negligence was small as compared with the number resulting from other causes.

In *Budgett v. Soo Sky Ways, supra*, the doctrine was held inapplicable because dual controls in the aircraft ruled out the possibility of exclusive control by the defendant.

The doctrine of res ipsa loquitur was held inapplicable where a plane privately owned by defendant crashed into a transmission tower owned by the plaintiff corporation while the pilot was attempting to make a forced landing at a nearby airport after the engine failed. *Rochester Gas and Electric Corp. v. Dunlop*, 148 Misc. 849, 266 N. Y. Supp. 469 (Monroe County Ct. 1933). At 266 N. Y. Supp. 472 the court quoted with approval from *Robinson v. Consolidated Gas Co.*, 194 N. Y. 37, 40, 86 N. E. 805, 807 (1909) as follows:

“The *res* of that maxim, which is sometimes misused, is not simply an accident resulting in an injury, but the accident and surrounding circumstances, necessarily shown by proving how the accident occurred, or in other words the occurrence as it appears by proof of the accident.”

The effect of the application of the doctrine of res ipsa loquitur is not the same in all courts of this country. In the principal case the court pointed out that the effect of the application in some jurisdictions is to give rise to a presumption of negligence, in others to shift the burden of proof. In the District of Columbia, however, it merely permits an inference of negligence which the jury may, but it is not compelled, to accept. It does not shift the burden of proof. When all the evidence is in, the question for the jury still is whether the preponderance is with the plaintiff. It would therefore seem to be a reasonable supposition that the effect of the application of the doctrine, the extent of the burden cast on the defendant, might well act at least as a make-weight to the court in deciding in border line cases whether or not the doctrine is applicable.

From the small number of reported cases in which this question of the applicability of the doctrine to aircraft accidents has been decided, either for aircraft operated as common carriers or for those operated privately, it is impossible, to state a true majority rule. It does seem, however, that the decision in the principal case is in line with the trend as regards accidents involving aircraft operated as common carriers. The courts recognize a requirement for a
high degree of care by the common carrier for the safety of his passengers. To
this is added the fact that in no other mode of transportation is the fate of the
passenger so completely entrusted to the carrier who has exclusive control of the
aircraft, and the probability that the carrier is in a better position than the
plaintiff to adduce an explanation as to why and how the accident happened.
Adding to these the improved mechanical knowledge and technique of the
aircraft industry, improved communications, navigational aids, and electronic
aids to navigation and to instrument flying problems, it appears probable that
the instant case will indeed express the view of the majority.

EUGENE B. SISK, JR.

TORTS—Assault and Battery—Consent to Illegal Combat Bars Recovery for
Damages Inflicted.

Appellant, a minor, brought action for personal injuries against appellee, Craft Shows, promoter of an unlawful prize fight wherein appellant participated
with his consent and for which he was paid. It was not alleged that the combat
was in anger, or that force in excess of that to be normally anticipated in such
a combat was used. Held, voluntary consent to such an invasion prevents the
invasion from being tortious and therefore actionable; since a tort action cannot
be maintained against the other contestant, it cannot be maintained against

Consent to an invasion of a legally protected interest will ordinarily negative
the existence of any tort; volenti non fit injuria—he who consents cannot receive
an injury; but authority is divided in the application of this fundamental
principle to those cases in which the invasion assented to constitutes a crime.
Colby v. McClendon, 206 P. 207, 85 Okla. 293 (1922).

The majority of the American decisions follow the rule that consent will not
avail as a defense in a case of illegal combat. Stout v. Wren, 8 N. C. (1 Hawks)
420, 9 Am. Dec. 653 (1821); Barholt v. Wright, 45 Ohio St. 177, 12 N. E. 185
(1887); Morris v. Miller, 83 Neb. 218, 119 N. W. 458 (1909); Teolis v.
Moscatelli, 119 A. 161 (R. I. 1923). But this rule does not, in the absence of
deliberate malice, apply to friendly combat or lawful games. McNeil v. Mullin,
70 Kan. 634, 79 P. 168, 170 (1905). The non-conformity of the majority view
is grounded upon the importance which the law attaches to breaches of the
peace, and, while the state did have a direct interest in the action of trespass
at the time of Matthew v. Ollerton, Comb. 218, 90 Eng. Reprint 438 (1689),
to which the majority rule has been ascribed, the criminal nature of the action
was destroyed with the Statute of 5 and 6 William and Mary c. 12 (1694),
abolishing the fine payable to the Crown. Bohlen, “Consent as Affecting Civil
Liability for Breaches of the Peace”, 24 Col. L. Rev. 819 (1924). Notwith-
standing this separation of the civil and criminal functions of trespass, “The
majority rule carries into a civil action, where one party sues the other for
damages for something which has been done in violation of positive law, the principle applied in criminal prosecutions by the state to the effect that the consent of one or both of the parties does not prevent such a prosecution.” Hart v. Geysel, 159 Wash. 632, 294 P. 570 (1930). The fact that the complaining party challenged the defendant to combat is no justification. Lizana v. Lang, 90 Miss. 469, 473, 43 S. 477 (1907); Chapman v. Lamp, 189 Iowa 771, 179 N. W. 50 (1920). Although consent is not permitted as a defense, it has been held that it may be shown in mitigation of damages. Barkolt v. Wright, supra; Grotton v. Glidden, 84 Me. 589, 24 A. 1008 (1892). In addition to cases of mutual combat, the exception recognized by the majority has also been extended to cases of abortion. Martin v. Hardesty, 91 Ind. App. 239, 163 N. E. 610 (1928), cf. Goldnamer v. O’Brien, 98 Ky. 569, 33 S. W. 831 (1896), and Nash v. Myer, 54 Idaho 283, 31 P. 2d 273 (1934).

A minority of the jurisdictions hold a contrary view. In Galbraith v. Fleming, 60 Mich. 403, 27 N. W. 581 (1886), the court said, “While the voluntary act on the part of the plaintiff would not preclude the state from punishing him or the defendant for a breach of the peace, it nevertheless prevents him from bringing a civil action to recover compensation for injuries received by his own seeking and in violation of law.” See also Smith v. Simon, 69 Mich. 481, 37 N. W. 548 (1888); Lykins v. Hamrick, 144 Ky. 80, 137 S. W. 852 (1911); Wright v. Starr, 42 Nev. 441, 179 P. 877 (1919); McNeil v. Choate, 197 Ky. 682, 247 S. W. 955 (1923). These courts have denied recovery, in the absence of excessive force, adhering to the basic rules that one who has consented to a particular invasion has no right to complain, and that no one should be permitted to profit by his own wrongdoing. Hart v. Geysel, supra. The Restatement, Torts (1934) sec. 60, has adopted the minority view.

There is only one case in the United States, Teeters v. Frost, 145 Okla. 273, 292 P. 356, 357 (1930), wherein a situation precisely similar to that presented by the instant case was decided. In the Teeters case a minor engaged in an illegal prize fight, and the injuries he received resulted in his death. Suit was brought against the promoter of the contest, and the Oklahoma court, relying chiefly upon McNeil v. Mullin, supra, followed the majority rule and allowed recovery. The Supreme Court of Kansas, however, in Wood v. McKeever, 141 Kan. 323, 41 P. 2d, 989, 991 (1935), stated that while the earlier cases support the rule that mutual combatants are liable to each other, present day legal opinion has largely discarded it, though this observation was not directly applicable to the facts of the instant case, since the Kansas case involved a shooting rather than mutual combat, it is an indication that Kansas today would accept the Restatement as the correct rule. The case of Hart v. Geysel, supra, decided a few months after the Teeters case, also involved an illegal boxing match. Here the suit was between the two contestants and while the court did not expressly declare either the majority or minority rule, recovery was denied.
The results of the cases in point have been less affected by the disparity in the respective rules than would be expected. In many of the cases which declare the majority rule, the facts indicate that the defendant used excessive force, e.g. Adams v. Waggoner, 33 Ind. 531, 5 Am. Rep. 230 (1870), (stabbing), Shay v. Thompson, 59 Wis. 540, 18 N. W. 473 (1884), (gouging), Grotten v. Glidden, supra, (severe kicking), and it would appear that the actual difference in the two rules is chiefly confined to those cases wherein serious injury is inflicted without the use of excessive force. Colby v. McClendon, supra.

As stated in Bohlen, supra, there is an element of absurdity in the consequences of applying the majority rule to prize fights regulated by State commissions. If the managers and promoters of the fight comply with the rules and regulations, there can be no action, but if valid authority is not obtained, each fighter would have an action against the other.

The holding of the California court in the instant case is exemplary of the modern trend indicated by the court in Wood v. McKeever, supra, and is in keeping with basic tort law which permits one to dispose of his legally protected rights as he pleases.

EDWIN E. DONNELLY, JR.

TRUSTS—A Savings Bank Tentative Trust Created by a Deposit in Trust for Beneficiary Is Converted into an Irrevocable Trust by Delivery of Bank Deposit Book by Depositor to Beneficiary.

A depositor opened a savings account in her own name in trust for a beneficiary, to whom she later handed a sealed envelope containing the bank deposit book. At the same time, she requested the beneficiary to hold it for her. Later, the depositor is adjudicated an incompetent. The beneficiary petitions for payment of the funds in the savings account and asserts that an irrevocable trust exists in her favor. This is contested by the special guardian for the incompetent depositor who alleges that the trust remained tentative and revocable. Held, that the delivery of the bank deposit book by the depositor to the beneficiary created an irrevocable trust. In re Farrell, 81 N. E. 2d 51 (N. Y. 1948).

Savings bank trusts are now recognized in practically all jurisdictions. Originally, several states rejected these trusts on the ground that the depositor intended to retain control over the deposits, thereby making the disposition incomplete prior to his death and therefore not valid. Thus, the beneficiary would not be entitled to the deposits upon the death of the depositor, even though the trust had not been revoked. However, this view does not find favor to-day and has been abrogated in most of these states.

Savings bank trusts are frequently called “Totten Trusts” after the leading case of In re Totten, 179 N. Y. 112, 71 N. E. 748 (1904) which stated the rule that “A deposit by one person of his own money in his own name as trustee for another, standing alone, does not establish an irrevocable trust dur-
ing the lifetime of the depositor. It is a tentative trust merely, revocable at will, until the depositor dies or completes the gift in his lifetime by some unequivocal act or declaration, such as delivery of the pass book. . . ." This rule has been adopted generally. The delivery of the bank book to the beneficiary is evidence which may be admitted to show that the depositor intended an irrevocable trust. Restatement, Trusts, Sec. 58 (a) (1935).

The Court in the instant case interpreted the pass book delivery required by the Totten case to convert a tentative trust into an irrevocable trust to mean merely placing the pass book in the hands of the beneficiary even if for the purpose of safekeeping with an intent, clearly expressed, that it was to be held for the depositor. The Court did not seek any facts beyond the mere physical handing over of the pass book and relied upon the Totten case, supra, and Imperatrice v. Imperatrice, 81 N. E. 2d 95 (N. Y. 1948), decided same court, same date. However, as pointed out in the dissenting opinion in the instant case, in the Totten case, there was no delivery of the bank deposit book to the beneficiaries during the lifetime of the depositor and it was actually his death which completed the gift and created the irrevocable trust. And, in the Imperatrice case, the delivery of the bank deposit book was accompanied by a statement expressing the intention of the depositor that the funds were to be considered the property of the beneficiary and it was actually this statement which completed the gift and created the irrevocable trust. In the instant case, we have neither a death of the depositor nor any such statement and the cases are distinguishable.

Authorities do not appear to interpret a "delivery" in such all-inclusive terms as applied by the Court in the instant case. A mere delivery of possession without intention to pass title does not prove a gift; a bailment may have been intended. Brown, Personal Property, Par. 48 (1936). The delivery of the bank deposit book to the beneficiary is not conclusive of an irrevocable trust. The delivery may be so qualified as to show merely an intent to have the beneficiary hold the book as a bailee. Bogert, Trusts, Par. 47 (1935). It may be shown that the bank deposit book was delivered to the beneficiary only for safekeeping and not with the intention of making the trust irrevocable. Scott on Trusts, Par. 58.1 (1939). Prior decisions of the jurisdiction of the instant case follow the line set forth by these authorities. Where the deposit book is delivered to the beneficiary for safekeeping, the deposit remains a revocable trust. Matthews v. Brooklyn Savings Bank, 208 N. Y. 508, 102 N. E. 520 (1913). Matter of Halligan's Estate, 82 Misc. Rep. 30, 143 N. Y. Supp. 676 (1913). A gift in the form of a savings bank trust always involves the intention of the depositor. Hemmerich v. Union Dime Savings Bank, 205 N. Y. 366, 98 N. E. 499 (1912). Beaver v. Beaver, 117 N. Y. 420, 22 N. E. 940 (1899). Other jurisdictions also follow the cited authorities. Where the beneficiary holds the bank book as a servant or agent, the funds in the savings account remained the property of the depositor. Nutt v. Morse, 142 Mass. 1, 6 N. E. 763 (1886). Possession of the bank book is not, of itself, sufficient to establish intention

The holding of the instant case would appear to be a definite departure from the accepted doctrine that delivery of the bank deposit book may be so qualified by the intention of the depositor as to prevent the creation of an irrevocable trust. Bearing in mind that the very purpose of these Totten Trusts is to enable the depositor to control the funds during his lifetime and to permit the beneficiary to assume control thereafter, it would seem that the doctrine that possession of the bank book carries with it control of the funds frustrates such purpose and destroys the efficacy of such trusts.

ALEXANDER T. KARDOS
BOOK REVIEWS


This book, "Being An American", is a reprint of twenty-eight addresses, plus one lecture and one law paper, by Mr. Justice Douglas of the United States Supreme Court, during the years 1940 to 1948 after his appointment to the Court. All of the material was selected and arranged by Richard J. Walsh who, as editor, says that "responsibility for the idea of this book, for its title, and for the choice, order, and slight editing of the contents, rests wholly upon me".

Naturally, in a publication of this nature—brief statements and expositions of political, economic, and social ideals, addressed to different groups of people on different occasions over a period of nine years—there is considerable repetition, both in the thoughts expressed and in the manner of expression.

Part One of the publication, covering eight addresses made at various colleges and public gatherings in 1941, 1942, 1943 and 1947, is entitled "The American Idea" and the topics presented are: The Liberal Tradition, The Jefferson Philosophy, The Tradition of Equality, Freedom, The Consent of the Governed, A Nation of Minorities, Citizenship, and The Genius of America. "The Liberal Tradition"—the introductory topic in the book—is a tribute to John Peter Altgeld, a governor of Illinois in the eighteen nineties at a time of great industrial disturbance and strife. Although unknown to most Americans, he is extolled as a great trail blazer of reforms in an era of social injustices, seeking "to apply the philosophy of Jefferson to the workaday world of the nineties", and to place human rights above the dollar. His philosophy was that the powers of government should be directed to protect the poor in their efforts to survive and to share the fruits of freedom. That philosophy, said Mr. Justice Douglas, in support of the common people of the world, the protection of the civil liberties of the people and the cause of the victims of ignorance, prejudice or passion, should be carried into the solution of the problems that confront us to-day. His championship of this philosophy is the essence of much of the thought set forth in this book. The validity of our Bill of Rights must be preserved.

The second part of this book is entitled "The Public Service". The first topic under that heading "The Lawyer" is an appeal to the lawyers of the country to turn part of their energies to the public service and to
assume a new constructive leadership in the agencies of government. This would, the author says, create a forward looking attitude of mind and new constructive leadership by members of the bar, rather than an attitude of doubt and distrust of government. "Then the lawyers as leaders of thought would be planning for the future rather than casting longing looks backward".

The other topics under the heading "The Public Service" are addresses devoted to the lives and memories of George W. Norris, Louis D. Brandeis, former Chief Justice Stone, Franklin Roosevelt and Eleanor Roosevelt. Outstanding among these, and recurring frequently throughout the book, are expressions of the highest praise of, and devotion to the democratic ideals of former Justice Brandeis and President Franklin Roosevelt. Justice Brandeis' writings are frequently quoted. Of him, Mr. Douglas says: "He knew that the secret of success in the democratic way of life lay beyond good will and good intentions. It was the practical ability of men of good will to meet and master the problems of each day, to reduce progressively the areas of oppression and injustice". "He saw the necessity for the development of new social techniques for handling the intricate problems that pressed for solution. He summoned not only the law, but arithmetic, accounting, and the vast lore of the social sciences to his aid. He saw that reform was not the product of an occasional sporadic effort. He knew that liberalism too often won a battle but lost a war. He knew that it was not sufficient that a law be passed, but that victory was achieved only by superb administration". The public life of Franklin Roosevelt is extolled in the highest terms by Mr. Douglas in addresses devoted to Mr. Roosevelt, in two of which, at Hyde Park, New York, beautiful tribute is paid to his memory.

In the third part of this volume, the "Problems of Our Times" are discussed in eight addresses delivered in various cities during the years 1943 to 1947. These problems are dealt with much more specifically than most of the other topics presented. The functions and the duties of the courts and of the police in preserving civil liberties under procedures are emphasized and given practical consideration. Right of counsel is given special emphasis. The achievements of the Federal Bureau of Investigation "have been illustrious", says the author.

In speaking of "Justice For All", Mr. Douglas develops in a paragraph a thought which has deep significance in the present and for the future: "We in America do not apologize for the ideal of justice that is written into our fundamental law. It is our greatest inheritance, and we cherish it. But we in America must be careful in distinguishing our performance
from the ideal. Before the world we can stand on performance alone. We cannot maintain a position of moral leadership in the world if our deeds belie our professions. We must start with tolerance and justice at home. If they are absent from our national life, neither the peoples of Asia and Europe, nor the minorities among us, will have abiding confidence in our course”.

In one of the topics under the head of “Problems of Our Times,” the author, in an address at the Conference on the Scientific Spirit and Democratic Faith, in New York in 1946, discusses “The Ethical Principle”. The topic naturally lends itself to broad and vague generalities and the twelve pages of the text may well be so described, although the spirit that runs through them is of course on a high moral plane.

The concluding part four of the book is given to discussions of post-war horizons. There are two brief but excellent discussions of two topics — “To Make the Peace” and “Security”. They are, in their nature and in their treatment here, closely related. They also give a wholesome and illuminating background to a most interesting and instructive discussion which follows. That is on the subject of “The Communists” and their theories and practices, in contrast and comparison with democracy as we know and practice it. It would be well if this illuminating presentation of communism, as it is, could be brought to the attention of all Americans, young and old. It would be particularly good and wholesome reading for those whose sympathies may lean toward communism.

In conclusion, it may well be emphasized that Mr. Douglas stresses throughout his presentation of ideals, the thought that there will be many changes in our future. The full development of industrial America is still, he believes, in the future. “The future”, he says, “will be strange to us. Its problems will be new. They will be more difficult than any we have had”. But, in looking into the years of trial and struggle ahead, he expresses a thoughtful assurance when he says: “But of one thing I am sure: What we make will not be a denial of our past. America will reverence freedom as it always has. We shall not surrender or compromise our ideals of liberty and freedom for the individual. We shall not lose the basic civil liberties guaranteed at the birth of our country in the Bill of Rights and supplemented during the years of our growth by Congress and the courts. Those rights are the touchstone of what we must demand from the future. As long as our citizens are free to think, to write, to speak, to vote as they please, we can never fear to compete with any nation for a position of moral leadership in the world.” A truer picture of American life and American ideals would have been presented
by Mr. Douglas in these addresses if he had laid some stress upon our sense of individual responsibility and duty along with the emphasis placed upon personal liberty and private rights.

ROBERT A. MAURER*

PRISONERS OF WAR—Institute of World Polity, School of Foreign Service, Georgetown University, Washington, D. C., 1948, pp. v, 98. $1.50.

As far as this reviewer knows, this relatively slender volume represents the first attempt on the part of people with actual, first-hand experience, to discuss the practical and legal problems concerning ways and means of improving the future treatment of prisoners of war. Under the leadership and direction of Dr. Ernst H. Feilchenfeld, Director of Research of the Institute of World Polity, a study group of thirty students of the Georgetown School of Foreign Service—formerly prisoners of war or with experience in handling prisoners of war—began meeting in March 1946. The comments and suggestions formulated by the group were circulated amongst the membership of the Institute of World Polity, which includes such notable figures as Rev. Edmund A. Walsh, S.J., Regent of the School of Foreign Service (Chairman of the Institute), Professor Joseph P. Chamberlain of Columbia, Professor Manley O. Hudson of the Harvard Law School, Professor Philip C. Jessup of Columbia (Deputy United States Representative in the United Nations Security Council), Professor Edwin Borchard of the Yale Law School, Dean Pitman B. Potter of American University, Professor Quincy Wright of the University of Chicago, and many others. The comments of some of these Members of the Institute, together with the collective study of the student group over a period of approximately two years, make up this profoundly important book.

No academic fences are straddled in a conspicuous effort to present in lucid, simple, and non-technical language suggested revisions of the present rules, and a new Convention, governing such questions as Status, Capture, Care, Labor, Self-government in Camps, Atrocities, Discipline and Delinquencies, Repatriation and Liberation, and Protective Agencies. Profound historical changes call for profound structural and substantive changes in the legal documents which must deal with them: this is the

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1 For definition, under present rules, of prisoner of war, see 6 Hackworth, Digest of International Law 273-6 (1943).
keynote sounded by “Prisoners of War”. Existing rules on prisoners of war are inadequate in modern warfare. A discussion of improvements must start from the conditions which now exist, the study reminds us, not from those which prevailed, or were thought to prevail when the rules now in force were adopted. Since 1910, total warfare, or virtually total warfare, has become institutional. Under existing rules, the captor state is obliged to remove prisoners of war to safe zones behind the front. Since the development of aerial bombardment there is no longer a safety zone; there are merely regions which are less exposed to destruction than others. The use of atomic bombs and bacteriological warfare will aggravate this situation further, as has been so realistically described in the proposed civil defense plan against enemy attack recently made public by the National Military Establishment. If any remedies are to be found, they must therefore be of a novel kind. Another historical change emphasized by the book—more profound than the first change—is the total mobilization of all manpower and the internment of civilians. Prison camp problems are no longer confined to military personnel. In future wars, care for prisoners may mean care for populations totaling millions of human beings. The magnitude of numbers raises new problems, particularly for a captor state with inadequate supplies even for its own population. As one student member of the study group remarked, these facts cause captor nations to lower their standards in the treatment of prisoners of war and create the temptation to exterminate the weaker prisoners who are less useful as slave labor. The Axis atrocities during World War II remind us, however, that more than a temptation was created. Under the established rules, neither an occupied population nor prisoners of war must be forced to do any work directed against their own country. Total war, however, tends to produce the very opposite trend. This is another significant historical change ignored by the regulations adopted between World War I and World War II.

This reviewer recently came across the story of a noted Czech who quipped, “If there’s ever a war between the United States and Russia, I’m going to fight on the side of the Russians”. When asked why, he replied, “Oh, I’d much rather be captured by the Americans”! The Czech was undoubtedly cognizant of the fact that in World War I and in World War II the United States has admittedly had the comparatively best record in the treatment of enemy prisoners. The Geneva Convention provides that prisoners of war shall receive the same type of food as is issued to the base troops of the capturing power. This puts American prisoners of war at an immediate disadvantage against
prisoners captured by the United States. Not only that, but American authorities have shown respect for the dietary habits of prisoners of war and allowed differential cooking for various nationalities among prisoners.

In the Chapter on "Discipline and Delinquencies", a variety of vexing legal questions affecting a prisoner of war escapee were posed. What should an escapee do when he is shot at? Should he be able to plead self-defense? Even if the plea is permitted, difficult borderline questions will arise. What if an escapee shoots a would-be captor who is about to shoot him? What if a starving escapee levels a pistol at a farmer who refuses to give him food? What if he shoots at a little girl who sees him and is likely to report him at once to the authorities? What if the escapee shoots indiscriminately, as a matter of precaution, at everybody he runs across?

The most significant practical proposals made for the revision of the present rules include the following:

(1) replacement of the International Red Cross by a new international organization;
(2) prompt repatriation of prisoners of war;
(3) a labor code for prisoners which would go beyond some futile generalities;
(4) more definite regulations on shelter;
(5) the specification of definite minimum calories, enough to live on, with proper allowance not only for the dietary habits of prisoners but also for the climate in which they are forced to live;
(6) the recognition of prisoner of war status for paratroopers;
(7) classification of types of crime and punishment in connection with escape;
(8) a clear definition of who is and who is not entitled to protection;
(9) regulations in greater detail and in a special way governing the increased shipment of parcels and other supplies from home and the difficult problems of transportation and distribution;
(10) there should be, from now on, pre-existing international tribunals; if that is not feasible, in view of the suspension of international organization which major wars tend to bring about, a new convention should at least contain definite provisions for future international procedure. Also, and on this point there
was equal agreement, whatever international tribunals and procedures are adopted should deal equally with victors and vanquished; and

(11) the adoption of an over-all legislative technique (not usually followed in past conventions) that would utilize the methods of a general charter embodying systematically all needed principles, detailed paragraphs dealing with as many problems and contingencies as can be covered, and the inclusion of a saving clause, referring specifically to all paragraphs concerned, which excludes an interpretation to the effect that everything not mentioned is excluded.

It is interesting to note that several of these suggestions were substantially supported by the United States at the Seventeenth International Red Cross Conference which took place at Stockholm, August 20-30, 1948, in which 49 Governments and 51 national Red Cross societies participated. The United States position had been formulated by the Interdepartmental Prisoners of War Committee, in whose work the representatives of the Departments of State, Army, Navy, Air Force, Justice, Treasury, Post Office, and the American Red Cross had participated in preparation for the Conference. Foremost among the revisions supported by the United States which were concurred in by the conference were the following: (1) a complete rewording of the article concerning food which, in essence, provides that the food ration of prisoners of war shall be sufficient in quantity, quality, and variety to keep prisoners in good health, and prevent loss of weight or the development of nutritional deficiencies; (2) a new and simplified formula regarding the employment of prisoners of war which among other things prohibits their use for mine clearance and disposal work; (3) prompt repatriation of prisoners of war after the cessation of hostilities; (4) a provision permitting transfers of prisoners of war among allies provided the receiving government is a party to the convention, and placing on both governments involved in the transfer equal responsibility in seeing that the treatment received by prisoners of war following their transfer is in accordance with the terms of the convention; (5) the extension of the application of the prisoners of war and civilian conventions to civil wars provided the dissident party agrees for its part reciprocally to apply the terms of those conventions; and (6) definition of the conditions which must be met by partisan forces if they are to be accorded treatment as prisoners of war and entitled to protection of that convention. The Conference represents a stepping
stone toward the ultimate objective envisaged by “Prisoners of War”: the formal signing by Governments of a new Convention. However, it is one of the fundamental ideas of this book that it is dangerous to rely exclusively on signatures, ratifications and observance, and that main reliance should be placed on an absolute American policy of kindness and the effect this policy may produce in other countries.

In conclusion, the study sponsored by the Institute of World Polity and embodied in this book is a contribution to a field of international law which should be the subject of interest to everyone. The violence of war is not soon dissipated. But the student group which participated in the study, the Institute of World Polity, and Dr. Feilchenfeld are to be commended for producing what may turn out to be a guide for future intergovernmental conferences on prisoners of war, which it is earnestly hoped will pave the way for improving the lot of helpless human beings.

SHELDON Z. KAPLAN*


A complex business civilization, such as ours, breeds problems of taxation which cannot be solved by a revenue act so simple that he who runs may read it. Since simplicity is to a degree irreconcilable with precision, the Federal income tax statute has consistently grown in complexity to a point where its study is regarded by the average general practitioner as a black art. Nonetheless, the lawyer in general practice has come to realize that in the most everyday legal transaction he is likely to be confronted with an unknown tax equation, and with the rate structure pyramided to its present height he can no longer afford to shut his eyes to tax law.

In sympathy with this uncomfortable predicament, Mrs. Stanley and Mr. Kilcullen have written this book with the laudable and difficult objective of making income tax law “easier to understand”. They have succeeded to an admirable degree.

The book is not a treatise on income tax law in comparison with such

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standard works as those of Mertens and Montgomery. It is, in the words of the subtitle, a "guide" to the provisions of the statute and regulations. Perhaps a more apt, if longer, description is that this book constitutes the study of a statute, section by section, in numerical order. It leaves to the more detailed treatises the commoner approach of topical consideration. As a result one receives from this book what might well be called a "bird's-eye view" of income tax law, and herein lies its unique value to the profession, including the law student, both neophyte and seasoned practitioner, and, indeed, the tax expert himself. No less an authority than Randolph E. Paul, in his preface to the book, recommends it to the tax expert who, in constant study of detail, often tends to become so immersed in the vast forest of tax law that the general pattern becomes obscured. No earnest tax lawyer should overlook a convenient vehicle for refreshment of his basic understanding of the statute as a whole, and this book provides him that welcome opportunity in condensed and simplified form.

For the law student, viewing with some trepidation his first class in taxation, Mrs. Stanley and Mr. Kilcullen have provided a friend in need, a preliminary aid which should help much to alleviate that "feel of missing something" which gnaws at an average student in the notorious "mystery hour". What he is missing, of course, is the pattern of statutory concepts at work, a pattern which even the most excellent casebooks by their very nature can provide only gradually and then in nebulous outline. It is by no means implied that this book in any way should supplant the study and analysis of case development. However, with a firm grasp of the statutory pattern available from a preliminary reading of this book, the student should be able to think actively, instead of listening passively, as court and professor wrestle with the "applications". "The Federal Income Tax", with its high degree of accuracy coupled with engaging simplicity, is a major contribution to the student's problem of background acquisition.

To ease the inarticulate pain of incomprehension so frequently felt by the general practitioner when confronted with a tax question, this book offers a powerful anodyne. It will not make him a tax expert, nor, indeed, will it provide him specific answers to specific problems. What it does do is much more important and useful to the general practitioner; it gives him familiarity with the basic income tax provisions of the Internal Revenue Code, the regulations thereunder, and a sampling of leading cases—only 64 were chosen—from which he can obtain sufficient background to see a tax problem when one exists. He will add to his tech-
nical vocabulary such esoteric phrases as "adjusted basis", "90-day letter", "personal holding company", "Clifford trust", "involuntary conversion", "continuity of interest", and many others. He will note, not without some dismay, how frequently the locally "ironclad" assignment, partnership agreement, and family trust are held ineffectual to shift the incidence of taxation. This basic insight, this familiarization with background, will mean much to the busy practitioner who must, on occasion, do original research in taxation. His reading will be faster, his eye for the significant keener, his technique less blurred. Such an opportunity for time saving can hardly be ignored in this busy age.

It is pleasant to save the best for the last. This book about a statute composed of "monsters of syntactical correctness" is itself graphic and readable. The simple, yet accurate, illustrations of typical situations at which a particular provision is aimed are mnemonic aids for the difficult-to-remember statutory words. Helpful to understanding, also, are the brief historical discussions by which the authors demonstrate how some of the incredibly difficult provisions of the Code grew in complexity out of the perennial conflict between the imperious need of the Government for revenue and the fertility of invention displayed by taxpayers and their counsel in minimizing tax liability. Not overlooked is the desirability of acquainting the reader with the materials and working tools of the tax practitioner, as well as some of his more common procedural problems.

In short, the profession should consider itself fortunate that two such gifted writers have felt the need of making income tax law easier to understand.

LLOYD FLETCHER, JR.†


This is the first volume in a new series, planned on the style of Notable British Trials, dealing with trials arising out of World War II. Each volume will have a separate editor and will be based upon authentic shorthand notes of the trial. The "Peleus" trial took place before a British War Crimes Court at Hamburg. The captain and four officers

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of a German submarine were charged with the killing of some surviving members of the crew of a Greek merchantman after it had been torpedoed and sunk. The essential facts were supported by affidavits from three survivors of the "Peleus" and the oral testimony of five members of the crew of the submarine. The evidence proved to the satisfaction of the court that an attempt was made to exterminate the survivors while struggling for their lives in the sea by firing upon them with machine-guns and pistols and by the throwing of hand grenades. The commander's defense was "operational necessity" and the others pleaded superior orders. All defendants were convicted. The commander and two of his officers were sentenced to death. One defendant was given life imprisonment and the fifth a term of fifteen years. The acts charged were all conventional war crimes and no novel issues were raised, except the attempt of the German counsel to argue that the foundations of international law have been gravely undermined by extreme nationalistic jurisprudence, which he traced back to the Austinian concept of force in law. Such a totalitarian argument could not, of course, be supported from any respectable modern source of authority. Appendices include the texts of pertinent documents such as the Royal Warrant prescribing Regulations for the Trial of War Criminals. Fourteen additional volumes of cases are announced as in preparation. The series should prove interesting to the layman as well as the professional reader interested in the development of the sanctions of international law.

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BOOKS RECEIVED


