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Meeting Competition Exception to Sales Below Cost Prohibition

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the realities of labor disputes as clearly today as it did in 1932. Perhaps its application should be less vigorous.[58]

In view of the foregoing arguments, it is perhaps surprising that a majority of the Supreme Court justices did not vote to reverse the decision in the principal case. The answer may lie in its peculiar facts. The terminal company was run as a cooperative with the primary employer holding one quarter interest jointly with other railroads who were joined as plaintiffs,[59] and the union professed only to picket the primary employer's trains and services in the terminal.[60] If NLRB standards of what constitutes a secondary boycott are used, the union's activities might not have been so characterized.[61] Thus it may be that in a future case where these mitigating factors are absent, a majority of the Court will find Norris-LaGuardia inapplicable to railroad secondary boycotts regardless of RLA procedures.

MEETING COMPETITION EXCEPTION TO SALES BELOW COST PROHIBITION

On August 14, 1963, defendant's officials determined that they would advertise and sell fryer chickens at twenty-nine cents per pound during the upcoming Labor Day weekend. Defendant's invoice cost was thirty and one half cents per pound. Competing stores had sold at twenty-nine cents on July 24, August 14 and August 16. Before it established the Labor Day weekend selling price, defendant made no investigation to determine the legality of its competitors' prices, but

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58 See Northwest Airlines, Inc. v. Transport Workers Union, 190 F. Supp. 495 (W.D. Wash. 1961) (dictum); Gregory, *op. cit. supra* note 11, at 551; Gregory, *The Law of the Collective Agreement*, 57 MICH. L. REV. 635, 645-46 n.39 (1959); Loeb, *Accommodation of the Norris-LaGuardia Act to Other Federal Statutes*, 11 LAB. L.J. 473 (1960); Stewart, *No-Strike Clauses in the Federal Courts*, 59 MICH. L. REV. 673, 677-78 (1961); Note, *Accommodation of the Norris-LaGuardia Act to Other Federal Statutes*, 72 HARV. L. REV. 354, 363 (1958), views the *Chicago River* case as an indication of this trend.

59 Brief for Respondent, pp. 12-15. The Court did not hesitate to disregard form for substance in Butte, A. & Pac. Ry. v. Brotherhood of Locomotive Firemen, 268 F.2d 54, 59, *cert. denied*, 361 U.S. 864 (1959), saying:

> [T]he carrier is the wholly-owned subsidiary of the shipper—Anaconda. The two have common principal officers and the unified purpose of serving the ultimate best interests of the shipper. Under these circumstances, the act of Anaconda ... must be regarded as the act of the carrier.

60 Brief for Respondent, pp. 19-20, 65-67.

61 See United Steelworkers v. NLRB, 376 U.S. 492, 498 (1964). Of course, the only reason to apply NLRB standards is to make use of "national labor policy" regarding secondary boycotts. The RLA provides no standard at all.

assumed their twenty-nine cent prices were legal because no action had been brought to enjoin or prosecute competitors. The state brought action to enjoin defendant's sales of fryer chickens below cost under the Unfair Practices Act.[1] The trial court found that defendant had not violated the act, because the sales below cost were made in good faith to meet competitors' prices. On appeal, the Washington Supreme Court affirmed with a 5-4 decision. *Held:* The good faith defense provided in Washington's Unfair Practices Act may be invoked when below cost selling prices have been established in advance of selling date without specific knowledge of competitors' future prices, and without investigation to determine whether competitors' prices are legal. *State ex. rel. O'Connell v. Albertson's, Inc.*, 68 Wash. Dec. 2d 254, 412 P.2d 755 (1966).

The Washington Unfair Practices Act is one of many state statutes adopted in the late 1930's prohibiting sales below cost and loss leaders.[2] The act provides for certain exceptions to an otherwise prohibited sale,[3] including a sale "made in good faith to meet the legal prices of a competitor."[4] Courts that have construed the good faith exception to the Unfair Practices Acts have seldom considered the specific issues of the degree of knowledge required of competitors' future prices and the legality of expected prices.[5]

By sustaining the good faith exception upon the facts of the principal case, the majority held that actual knowledge of a competitor's future prices is not a prerequisite to establishing good faith. The dissent, however, argued that the good faith exception clause should be construed narrowly, and, under a strict construction, defendant could not establish a below cost selling price in good faith without

[1] WASH. REV. CODE ch. 19.90 (1959). Section 19.90.040 prohibits sales below cost and loss leaders.

[2] Thirty-one states have laws of general application. See, *e.g.*, CAL. BUS. & PROF. CODE §§ 17000 to 17101 (Deering 1954); COLO. REV. STAT. ANN. §§ 55-2-1 to 55-2-17 (1953); IDAHO CODE ANN. §§ 48-101 to -412 (Supp. 1965); MINN. STAT. §§ 325.01-.07 (1961); ORE. REV. STAT. §§ 646.100-.180, 646.990 (1963); VA. CODE ANN. §§ 59-9 to -19 (1950) 2 TRADE REG. REP. ¶ 6623 lists all states with sales below cost statutes, with citations to text. 2 TRADE REG. REP. ¶ 6571 outlines the scope of the acts. Thirty-two states have statutes that apply to particular industries or products. See, *e.g.*, CAL. AGRIC. CODE § 730.2 (Deering 1954) (agricultural and dairy products); WASH. REV. CODE § 19.91.020 (1959) (cigarettes). 2 TRADE REG. REP. ¶ 6625 contains a complete compilation.

[3] WASH. REV. CODE § 19.90.070 (1959). Exceptions include close out sales and sales of seasonal, perishable or damaged goods.

[4] WASH. REV. CODE § 19.90.070(4) (1959).

[5] The good faith exception to the Washington act has been construed only once by the Washington Supreme Court. State v. Sears, 4 Wn. 2d 200, 103 P.2d 337 (1940). The court was presented with the question of whether the provision was unconstitutionally vague.

having actual knowledge of its competitors' future prices. The majority further concluded that the requirement that defendant act in good faith to meet the *legal* prices of competitors was met because (1) a state's witness had testified that competitors' sales at twenty-nine cents "could be legal," and (2) defendant was entitled to a presumption that its competitors' prices were legal since these prices existed on the market without action being taken to enjoin or prosecute under the Unfair Practices Act.

The few state courts that have considered the question of *when* a seller may establish a below cost price and maintain that he acted "in good faith to meet competition" have, as the court did in the principal case, merely stated that there either was or was not sufficient evidence of good faith without providing any standard more specific than "good faith."[6] The federal courts, presented with a similar question under the good faith proviso in section 2(b) of the Robinson-Patman Act,[7] have held that a defendant must produce "facts which would lead a reasonable and prudent man to believe that the granting of a lower price would in fact meet the equally low price of a competitor."[8] The dissent in the principal case argued that defendant must know the identity of those whose prices he intends to meet and the specific prices at which they will be selling in order to establish good faith. The dissent's requirement would go beyond that imposed by federal courts under section 2(b) of the Robinson-Patman Act,[9] and would be undesirable from both a legal and economic viewpoint.

Prices must necessarily be set for the future. A seller, when deciding whether to sell below cost to meet expected competition, could meet with his competitors and ask what prices they intend to charge.

[6] In Northern Cal. Food Dealer's Inc. v. Farmer's Market Inc., Trade Reg. Rep. (1956 Trade Cas.) ¶ 68402, at 71723 (Super. Ct. Cal. 1956), the court held that under a "liberal construction" of the California act, a sale below cost made six weeks after competitor's sales did not evidence bad faith. In State *ex rel.* Anderson v. Commercial Candy Co., 166 Kan. 432, 201 P.2d 1034 (1949), the court reversed a trial court's finding that defendant did not act in good faith when evidence showed that competitors had sold below defendant's price immediately before and after defendant's sales below cost. Defendant's below cost sales for months after competitors had discontinued similar prices negatived any possible inference of good faith. People v. Pay Less Drug Store, 25 Cal. 2d 108, 153 P.2d 9 (1944).

[7] Section 2(b) provides "nothing herein contained shall prevent a seller rebutting the prima facie case thus made by showing that his lower price . . . was made in good faith to meet an equally low price of a competitor. . . ." 49 Stat. 1526 (1936). 15 U.S.C. § 13 (1964).

[8] FTC v. A.E. Staley Mfg. Co., 324 U.S. 746, 760 (1945).

[9] In Forster Mfg. Co. v. FTC, 335 F.2d 47, 55 (1st Cir. 1964), the court reversed a FTC holding that before prices can be cut a seller must have "proof positive" of the amount of competitive offers and the name of bidders who made them. Section 2(b) requires only a good faith belief that granting a lower price would in fact meet equally low prices of competitors.

Assuming competitors would divulge such information, where would this leave defendant with respect to the Sherman Act,[10] Federal Trade Commission Act,[11] or, in Washington, the Consumer Protection Act?[12] Exchange of future price information could indicate a combination or conspiracy to fix prices or an unfair method of competition.[13] The Unfair Practices Act should not be construed to encourage price fixing; such a construction is contrary to the act's stated purpose to "foster and encourage competition."[14]

It is submitted that competition will best be encouraged by applying a liberal standard which allows a seller to meet prices he reasonably anticipates, based upon competitors' past prices and expected market conditions. Admittedly, this rule may encourage below cost selling that could be curbed stringently by a narrow construction of the good faith exception. However, below cost selling is not necessarily detrimental to consumers, competitors, or competition. The idea that sales below cost must be prohibited to protect small businessmen and preserve competition is of doubtful validity. The Unfair Practices Acts are most frequently applied to retailing—one of the most competitive parts of the economy. It is almost impossible for a firm to gain and maintain a monopoly position in a retail market because of the relative ease of entry into the field. A firm that begins to develop a monopoly position and raises prices is threatened immediately by new competition.[15] Market changes in the past thirty years have generated the large chain store and admittedly, the small independent is threatened. However, the large chains do not have to sell below cost to underprice

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[10] 26 Stat. 209 (1890), 15 U.S.C. §§ 1,2 (1964).

[11] 38 Stat. 717 (1914), 15 U.S.C. § 45 (1964).

[12] WASH. REV. CODE ch. 19.86 (1961).

[13] Conspiring to fix prices is prohibited by section 1 of the Sherman Act, and dissemination of price information may evidence a conspiracy. United States v. Ward Baking Co., 224 F. Supp. 66 (E.D. Pa. 1963); C-O-Two Fire Equipment Co. v. United States, 197 F.2d 489 (9th Cir. 1952). In United States v. Washington Wholesale Grocer's Ass'n, Trade Reg. Rep. (1940-43 Trade Cas.) ¶ 56230, at 820 (1943), defendants were enjoined from holding any meeting or conference for the purpose of discussing prices. See generally 1 Trade Reg. Rep. ¶ 4730.

Discussions and meetings to fix prices may constitute a violation of section 5 of the Federal Trade Commission Act which prohibits unfair methods of competition. National Lead Co. v. FTC, 352 U.S. 419 (1956); Bond Crown and Cork Co. v. FTC, 176 F.2d 974 (4th Cir. 1949).

The Washington Consumer Protection Act was designed to complement the federal antitrust laws and the Washington courts are to be guided by federal cases in construing the state act. WASH. REV. CODE § 19.86.920 (1961); Dewell & Bittinger, *The Washington Antitrust Laws,* 36 WASH. L. REV. 239, 242 (1961).

[14] WASH. REV. CODE § 19.90.910 (1959).

[15] See testimony by Dean Grether, University of California School of Business Administration, in Restrictive Trade Practices Commission, Department of Justice, Ottawa, *Report of an Inquiry into Loss Leader Selling* 110 (1955) [hereinafter cited as *Commission Report*].

the corner drug and neighborhood grocery. The share of market between large and small retailers is determined by factors other than price considerations alone, such as locality convenience.[16] Another argument frequently advanced in favor of restricting below cost selling is that an item will be used as a "loss leader" to lure the consumer into the store, while prices on other items are hiked above normal markup. This contention assumes a gullible consumer who does not make price comparisons on his purchases—an assumption lacking empirical support.[17] This contention also assumes that prices on other products will have to be raised to carry the unprofitable one—overlooking the possibility that increased volume on other items at normal markup will fully cover the loss leader.[18]

The court's construction of the term "legal" in the good faith provision leaves some doubt as to what rule was established by the majority opinion. The state's contention, as stated by the court, was that defendant had not shown that its competitors' prices were legal, therefore the good faith defense could not be sustained. In discussing the issue, the court first quoted testimony of an Attorney General staff investigator that the competitors' twenty-nine cent prices "could be legal." This statement, said the court, amounted to an admission by the state that the competitors' prices were legal in fact. The case could have been disposed of at this point—if the prices were in fact legal, defendant obviously came within the exception.[19] However, the majority opinion went on to cite with approval the trial judge's opinion that a defendant need not investigate a competitor's price but may assume that a price existing on the market is legal. The court then cited a rule developed in a previous case that the good faith exception does not require that a competitor's price be legal in fact; a defendant need only believe in good faith that it is legal.[20] The court concluded

[16] See BRIGGS, LEGAL BARRIERS TO COMPETITION IN MONTANA STATE AND LOCAL LAW 58 (1964).

[17] Dean Grether concluded that "My final reaction is that the confusion here would not be as great as the harm if price-cutting could not be employed widely and competitively in the distributive trades." *Commission Report* 91.

[18] *Id.* at 96.

[19] In the principal case, it was found that defendant at all times believed its competitor's prices were legal. A case could arise in which a competitor's price was legal, but defendant believed it was illegal when he established his below cost price. Assuming that defendant's belief could be proven, it could negate good faith.

[20] State v. Sears, 4 Wn. 2d 300, 103 P.2d 337 (1940). Most courts construing the term "legal" in the good faith exception of other state acts have reached a similar result. See State v. Wolkoff, 250 Minn. 504, 85 N.W.2d 401, 406 (1957) and cases cited therein.

A statute requiring a price to be legal in fact has been held unconstitutional. Commonwelath v. Zasloff, 338 Pa. 457, 13 A.2d 67 (1940).

that the trial court's finding that "defendant at all times considered competitors' prices legal" could be sustained upon the facts.

A desirable rule which can be drawn from the principal case is that a defendant need not investigate the legality of a competitor's price before he sells below cost to meet that price.[21] Good faith belief in the legality of a price may normally be presumed when the state fails to bring an action enjoining a competitor's sales.[22] For one to make his own determination of whether a competitor's price is legal would require (1) finding whether the price is below cost, and (2) determining whether, if the price is below cost, the other requisites of a statutory violation are present.

Resolution of the first question requires knowledge of the wholesale prices at which the competitor has been purchasing or, in the case of a competing manufacturer, his production costs. In addition, some acceptable method of valuation must be selected: the firm with large inventories will seldom identify invoice or production costs with each particular unit of inventory. Any of several generally accepted accounting methods of cost identification might be applicable.[23] Also

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[21] At least one court has held that failure to investigate a competitor's price does not negate good faith. In State *ex rel.* Anderson v. Commercial Candy Co., 166 Kan. 432, 201 P.2d 1034 (1949), the court reversed a trial court's finding that defendant did not act in good faith to meet the price of a competitor. The court stated, 201 P.2d at 1039: "As a practical proposition, how could the defendants have ascertained whether or not the price ... was below cost ... unless resort be made to the books and records of such competitor." In McIntire v. Borofsky, 95 N.H. 144, 59 A.2d 471, 474 (1948), the court, holding the sales below cost statute constitutional noted that if the good faith exception "required the retailer to examine his competitor's books to ascertain whether the competition was legal, it would be of doubtful validity."

[22] In State v. Wolkoff, 250 Minn. 504, 85 N.W.2d 401, 407 (1957), the court stated: "The very fact that a competitor advertises a certain price on a given article over a long period of time without being challenged, and apparently without adverse economic effects, may warrant a merchant in assuming that such price is a legal one."

Plaintiff may, of course, show that defendant knew or had reason to know that a competitor's price was illegal. In Minnesota v. Robnau and Minnesota v. Shopper's City, Trade Reg. Rep. (1960 Trade Cas.) ¶ 69809, at 77165 (Dist. Ct. Minn. 1960), defendant Robnau had received telegrams from the state informing him that competitors' sales were illegal, and defendant Shoppers City failed to obtain readily available price information from the Department of Business. Proof that defendant knew or had reason to know a competitor's price was below cost does not necessarily establish that defendant knew the price was illegal. Defendant must still ascertain whether the other statutory requisites are present. See text accompanying notes 26-28 *infra.*

[23] The most common methods of inventory cost selection are: (1) first in, first out—a procedure which assumes a procession of cost through the business based on the proposition that the oldest goods are sold before newer stock is sold; (2) last in, first out, based on the assumption that the last items acquired are the first items sold; and (3) weighted average, based on the assumption that all goods available for sale during a period are comingled and no particular batch of goods is retained or sold. See MEIGS, JOHNSON & KELLER, INTERMEDIATE ACCOUNTING 369-78 (1963).

As an alternative to invoice price, the definition of "cost" in WASH. REV. CODE § 19.90.010 (1959) provides that replacement cost may be used, if lower than invoice. The accountant's definition generally refers to replacement cost as the price an item under the statute, the distributor's "cost of doing business" must be added to his invoice or replacement cost.[24] It is yet uncertain what expenses are to be included in the "cost of doing business," how these costs are to be allocated to specific units, and what period of time is to be used for measuring costs.[25]

Even if a seller could determine that a competitor is selling below cost, the question of whether the price is legal is by no means resolved. Because of the paucity of decisions interpreting the Washington provision prohibiting loss leaders and sales below cost, there is considerable uncertainty as to what constitutes a statutory violation. The court has yet to decide whether intent is a required element of a violation and, if it is, whether a general or specific intent must be shown.[26] There are a number of economically legitimate reasons why a firm might initiate below cost sales,[27] which may or may not negate a

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will bring in the wholesale market, and may include incidental acquisition costs, such as freight, handling, and storage. As applied to manufactured inventories, replacement cost refers to the prevailing price for materials, labor, and factory overhead. MEIGS, JOHNSON & KELLER, *op. cit. supra* at 391-92.

[24] WASH. REV. CODE § 19.90.120 (1959).

[25] For a suggested method of allocation, see University of Washington Bureau of Business Research, *Regulation of Retail Competition in Washington* 36-37 (1963) [hereinafter cited as *Regulation of Competition*]. The authors submit that all costs (exclusive of purchases of goods) including salaries, rent, depreciation, taxes, insurance and selling expenses incurred during an accounting period be applied to units of inventory by first determining the ratio of the total of these costs to inventory purchases, then applying that ratio to the inventory cost of specific units.

[26] The dissent in the principal case argued that no intent should be required. WASH. REV. CODE § 19.90.040 (1959), which prohibits sales below cost, loss leaders, and other price cutting practices, is a maze of phrases and clauses; within the maze appears the phrase, "for the purpose of injuring competitors or destroying competition," but it is uncertain to what prohibited practices the phrase refers.

Even under statutes that expressly provide that intent is a required element of violation, courts have had considerable difficulty determining what constitutes a wrongful intent. See Clark, *Statutory Restrictions on Selling Below Cost*, 11 VAND. L. REV. 105, 113-19 (1957); Henderson, *Selling Below Cost in Wyoming*, 1 LAND AND WATER L. REV. 235, 245-49 (1966).

[27] In the long run, the businessman will typically sell at prices which fully cover costs and provide a profit. Prices in the short run, however, are governed primarily by demand factors. In a short run period of slack demand on a particular item, it may be more desirable to sell below cost and cover the loss with profitable items rather than discontinue the unprofitable product. "The idea of freezing prices at the level of cost prevents the market from performing its chief social function—guiding the allocation of resources according to criteria of productivity and consumer demand." Comment, *Sales Below Cost Prohibitions*, 57 YALE L.J. 391, 397 (1948).

Retailers who practice "full line pricing" will carry some items at little or no markup in order to offer a complete line of products, or merely to accomodate a few good customers and promote good will. A new enterprise seeking to break into a market, or an existing firm entering a new market, or a firm trying to develop by-products may be compelled to sell at a loss in the short run. Similarly, a firm may experience a temporary shutdown in operations, incur excessive spoilage and waste, or otherwise face temporary rises in operating costs; in each case, the loss must be carried on every unit sold and the market may not allow the increased cost to be passed on to the consumer through higher prices. See *Regulation of Competition* 33; BRIGGS, *op. cit. supra* note 16, at 49; Letters From Phillip A. Ray, "purpose or intent to injure competitors or destroy competition." Even if one could ascertain his competitor's intent, or lack of it, he could not be certain whether the competitor was violating the act. Aside from the intent element, it is also questionable whether the Washington act requires an adverse *effect* upon competition; if an adverse effect is required, a seller must determine whether his competitor's sales below cost are "destroying or tending to destroy competition."[28]

It is submitted that the court should be hesitant to issue injunctions restraining a defendant from selling below cost to meet competition, and should liberally construe the good faith exception as it did in the principal case. Once an injunction is issued, especially if it is phrased in the broad terms of the statutory provisions against loss leaders and sales below cost as was done in a California case,[29] the defendant is significantly restrained in his future pricing policy. He acts at the risk of subjecting himself to a contempt citation whenever he makes a sale which might be found to violate an ambiguous statute.

WATER RESOURCES PLANNING ACT OF 1965—AN EXPERIMENT IN CREATIVE FEDERALISM

The concept of "creative federalism"[1] is as elusive as it is new. As a descriptive term, "creative federalism" describes not what federal-state relations presently are but what they ought to be. In order to

Under Secretary of Commerce, in *Hearings Before a Subcommittee of the House Committee on Interstate and Foreign Commerce,* 86th Cong., 2d Sess. 5 (1960), and From D. Beryl Manischewitz, National Association of Manufacturers, *Id.* at 154. The subcommittee was considering an amendment to the Federal Trade Commission Act which would have prohibited sales below cost.

[28] WASH. REV. CODE § 19.90.040 (1959) ends with the words "whereby a sale below cost is effected, to the injury of a competitor, and where the same destroys or tends to destroy competition." In Martin v. Alienikoff, 63 Wn. 2d 842, 389 P.2d 422 (1964), defendant was charged with violating the portion of § 19.90.040 which prohibits rebates and selective extension of special services. Defendant argued that the required elements of violation included (1) a sale below cost, (2) injury to competitors, and (3) destruction or tendency to destroy competition. Plaintiff contended that only the act of granting rebates or services needed to be shown, because the three elements listed above appear in clauses disconnected from the prohibitive clauses. The court accepted defendant's construction, except that no mention was made of element (3) in the court's holding.

If destruction or tendency to destroy competition is required, what adverse economic effect would meet the requirement? In the principal case, the alleged injury to competition was spoilage of competitors' unsold chickens. This may have been injury to competitors within the meaning of the act, but it is certainly arguable that there was no destruction nor tendency to destroy competition.

[29] People v. Pay Less Drug Store, 25 Cal. 2d 108, 153 P.2d 9, 15 (1944).

[1] The phrase appeared in Ways, *Creative Federalism and the Great Society,* Fortune, Jan. 1966, p. 121. President Johnson reportedly used the term to refer to the Appalachian Regional Development Act, N.Y. Times, Jan. 24, 1966, p. 17. The cre-