Opinion No. 8.

Unfair Trade Practices—Unfair Practices Act—Sales Below Cost—Trading Stamps—Intent to Injure and Destroy Competition — Montana Trade Commission, Duties of.

HELD: 1. A sale at cost, plus the "minimum markup" fixed by the Trade Commission, upon which a trading stamp is given, is not necessarily a sale below "cost" as that term is defined in the Unfair Practices Act. The fact whether or not such a sale is a sale below cost must be determined upon the facts of the individual case, taking into account the cost accounting system of the individual merchant.

2. If a sale is found to be below cost, that fact alone does not constitute a violation of Section 51-103, R. C. M., 1947; it must also be proven that the sale was made with intent to injure and destroy competition, and the sale, in and of itself, does not constitute proof of such intent.

3. The provisions of Section 51-105, R. C. M., 1947, do not establish the "cost" survey as an absolute standard by which all merchants must establish their prices. Any reasonable system of allocating costs may be followed in establishing prices by the merchant. Section 51-105, supra, merely permits the introduction into evidence of the cost survey, for the use of the trier of fact in determining whether the merchant's method of allocating costs is reasonable.

4. It is the duty of the Montana Trade Commission to determine upon the facts of individual cases, whether the giving of trading stamps constitutes a reduction in the selling price of an article; whether this reduction brings the sale below "cost" as that term is defined in the Unfair Practices Act; and whether such sale was made with the intent to injure and destroy competition.

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March 10, 1953.

Mr. Patrick Hooks, Secretary-Counsel
Montana Trade Commission
P. O. Box 198
Helena, Montana

Dear Mr. Hooks:

You have asked my opinion upon the following question:

> "If a grocery store is selling certain items at a price which represents the invoice cost of the items plus the minimum markup established by a cost survey for the area, does the giving of a trading stamp, representing a cash discount of approximately two per cent, with the item make the transaction a 'sale below cost' as that term is defined in Section 51-103, R. C. M., 1947?"

You have stated in your letter of request that you are concerned only with the legality of sales in which the price of the item less the redemptive value of the stamp is less than the minimum markup established by the cost survey, and do not question the

legality of the stamps generally. It is further my understanding that the figure which you refer to as "minimum markup" is the amount defined in Section 51-103, supra, as "cost of doing business" or "overhead expense" which must be added to the invoice or replacement cost of the article in arriving at the "cost," below which goods may not legally be sold.

These further facts which you have furnished are also necessary for an adequate consideration of this question: In a typical stamp plan the customer is given a stamp for each 10c of merchandise purchased. The stamps are not immediately redeemable, but must be accumulated until a specified number is reached, when they may be redeemed either in merchandise or cash. The merchant himself does not furnish the cash or merchandise—these are supplied by the licensor of the stamp plan. The merchant, however, buys the stamps from the stamp-plan company at a flat rate per thousand stamps.

Chapter 1 of Title 51, R. C. M., 1947, embraces Sections 51-101 through 51-118, and is known as the Unfair Practices Act. Section 51-103, supra, as amended by Section 1, Chapter 129, Laws of 1949, prohibits sales at less than cost. It provides:

"Sales at Less Than Cost Forbidden—'Cost' Defined. It shall be unlawful for any person, partnership, firm, corporation, joint stock company, or other association engaged in business within this state, to sell, offer for sale or advertise for sale any article or product, or service, or output of a service trade, at less than the cost thereof to such vendor, or give, offer to give or advertise the intent to give away any article or product, or service or output of a service trade for the purpose of injuring competitors and destroying competition, and he or it shall also be guilty of a misdemeanor, and on conviction thereof shall be subject to the penalties set out in Section 11 (51-112) of this Act for any such act.

"The term 'cost' as applied to production is hereby defined as including the cost of raw materials, labor and all overhead expenses of the producer, and as applied to distribution, 'cost' shall mean the invoice or replacement cost within ninety (90) days prior to the date of sale and the quantity last purchased, whichever is lower, of the article or product, to the distributor and vendor, less all trade discounts, except customary cash discounts, plus the cost of doing business by said distributor and vendor.

"The term 'customary cash discounts' means any allowance not exceeding two per cent (2%), whether a part of a larger discount or not, made to the wholesale or retail vendor, where the wholesale or retail vendor pays for merchandise within a limited or specified time.

"The 'cost of doing business' or 'overhead expense' is defined as all costs of doing business incurred in the conduct of such business and must include, without limitation the following items of expense: labor (including salaries of executives and officers), rent, interest on borrowed capital, depreciation, selling cost, maintenance of equipment, delivery costs, credit losses, all types of licenses, taxes, insurance and advertising."

Section 51-105, R. C. M., 1947, provides that an "established cost survey for the locality and vicinity in which the offense is committed" shall be deemed competent evidence in proving the costs of the persons complained against within the provisions of the Act.

Section 51-114, R. C. M., 1947, par. (2) provides that the Montana Trade Commission shall fix the "cost of doing business" or "overhead expense" . . . "stated in percentage or percentages of invoice or replacement cost which would probably be incurred by the most efficient person, firm or corporation within such retail trade or business within such area."

Section 51-113, R. C. M., 1947, places the administration of the Act in the hands of the Montana Trade Commission, and gives it a wide grant of power to "prevent any person, firm or corporation from violating any of the provisions of this Chapter." Among the powers so conferred are the powers to make complaints against any

person, firm or corporation believed by the commission to be violating the provisions of the Chapter, to hold hearings upon such complaint, to make findings of fact, and to issue orders requiring such person, firm or corporation to cease and desist from the conduct complained of. It is further provided (Sec. 51-113, R. C. M., 1947, par. 3) that the findings of the commission as to the facts, if supported by sufficient evidence, shall be conclusive.

The effect of these sections, in summary, is to prohibit sales below cost, as that term is defined in the Act, when such sales are made for the purpose of injuring and destroying competition, to empower the Montana Trade Commission to take action when it feels that the Act is being violated, and to set up a theoretical yardstick, by means of the cost survey, which may be introduced in evidence to dispute the validity of the cost figures produced by the defendant.

It should be noted that the "customary cash discount" defined in Section 51-103, supra, as amended, refers to cash discounts allowed to a wholesaler or retailer, and has no application to cash discounts allowed by a retailer to his customers.

This portion of the statute was not intended to indicate that the legislature does not consider a cash discount a reduction in price. Rather, it is a relief measure to allow the merchant who buys on credit equal opportunity with the merchant who buys his supplies for cash. If the merchant who buys for cash were allowed to deduct the cash discount he receives from his suppliers in computing his selling price to his customers, his cost, as defined by the Act, would be lower than that of another merchant who bought his supplies for credit. The credit merchant would then be forced to meet that price and sell at a loss, or lose his customers by being undersold.

A question of considerable importance, upon which no Montana court has rendered a decision, should be settled before the decisive question of liability can be considered. That question is whether the giving of a trading stamp as a cash discount constitutes a reduction of the purchase price. It has been the subject of disagreement among the courts of other states.

One line of decisions maintains that a trading stamp scheme is not a reduction in price. This question was raised, but not decided, in the case of Food and Grocery Bureau of Southern California vs. Garfield, 20 Cal. (2d) 228, 125 P. (2d) 3. That case arose under the California Unfair Practices Act, but no proof was offered that the giving of the trading stamps was a sale below cost. In this connection the court said:

> "But the association does not assert that the appellant's issuance of trading stamps resulted in the sale of any commodities below cost, and the affidavits filed by it do not include any facts indicating that sales below cost were accomplished by the use of stamps. Of interest in this connection, is the written opinion of the trial judge, presented in the respondent's brief, which discloses beyond question that the order granting the preliminary injunction was based solely upon the theory that the stamp plan constituted the making of a gift of a product with the intent to destroy competition."

The court then held that the plan did not constitute the making of a gift within the meaning of the Act, saying:

> "It must be concluded, therefore, that the trading stamp plan adopted by the appellant does not constitute the making of a gift of $1.00 in cash or $1.25 in merchandise but is a discount given the customer in consideration of his paying cash."

In the case of Bristol-Myers Co. vs. Lit Bros., 336 Pa. 81, 6 A. (2d) 843, which arose under the Pennsylvania Fair Trade Act of 1935, the court held that the giving of a cash discount by means of a trading stamp did not constitute "selling (of) any commodity at less than the price stipulated" It held that the trading stamp was "not a price cutting device, but a means of inducing a customer to return to the

store to make additional purchases," and was analagous to other customer services. The court said:

"If, for example, merchant A provides orchestral music for his customers at a certain hour of the day, or maintains in his store a salon where works of art are exhibited, or a nursery where children are fed and otherwise cared for while their mothers are shopping in the store, or if he provides his customers free bus service to and from his store, merchant B has no grounds for complaint which the law will heed. Yet all these things confer benefits on the customer and some of these benefits are susceptible of pecuniary measurement. It follows, therefore, that for a merchant to confer pecuniary benefits upon his customers, which benefits some competing merchant does not confer, does not amount to such unfair competition as the Fair Trade Act forbids. Merchant A can extend his customers 30 or 60 days credit on the purchase of a commodity while merchant B refuses to extend any credit on the purchase of the same article. A is not thereby violating the Fair Trade Act. A may allow a discount of 1% on all bills paid within ten days after being rendered. B may allow no such discount. A is not thereby violating the Fair Trade Act.

"It is clear to us that the practice indulged in by Lit Brothers, of issuing trading stamps with the sales of its merchandise falls within the sphere of legitimate competition and does not constitute a 'selling (of) any commodity at less than the price stipulated" and that it is not 'unfair competition' within the meaning of the Act appellant invokes To come within the prohibitions of the Act. Lit Brothers would have to either (1) cut directly the price of the commodities within the Act's protection, or (2) accomplish the same result in respect to the commodities by a device which was a palpable subterfuge resorted to for the purpose of circumventing the law."

Another California case, also involving a Fair Trade Act, was Weco Products Co. vs. Mid City Cut Rate Drug Stores, 55 Cal. App. (2d) 684, 131 P. (2d) 856. There the court reviewed the foregoing cases and held:

"The matter has not been passed upon by the appellate courts of this state However, aside from the consideration of the Fair Trade Act, the status of trading stamps is definitely fixed in this state as being a discount for 'the immediate payment of cash.' This pronouncement finds its latest expression in the case of Food and Grocery Bureau v. Garfield, 20 Cal. 2d 228, 125 P. 2d 3, 5, decided April 28, 1942 where the defendant is the same as in the instant case and where the very trading stamps here involved were under consideration. It is true that the Food and Grocery Bureau case involved a different statute, the Unfair Practices Act rather than the Fair Trade Act, but the ruling of the court must be regarded as conclusive of the status of the trading stamp in commercial retail business."

Another point of view has been taken by the Court of Appeals of New York in the case of Bristol Myers vs. Picker, 302 N. Y. 61, 96 N. E. (2d) 177, also a Fair Trade Act case. That court considered and rejected the reasoning of the cases previously mentioned and said:

"These other types of service have no direct relation to the article purchased or the price paid They are completely separated and too remote from the pricing element to come within the statute's prohibition. Here the benefit to the customer is directly, proportionately, inseparably and specifically related to the article purchased and its price . . . No matter how one puts it, the consumer who is accorded a cash discount in reality pays that much less for the article which he purchases, and this none the less true because the return is by way of merchandise rather than coin which may purchase merchandise. . . ."

The reasoning of this case is that the merchant, in giving that trading stamp, gives an article of value for which he has paid, and which has a definite cash value in the hands of the

customer. This cash value, they hold, reduces the stated selling price by an amount equal to the redemptive value of the stamp.

Because this question has never been adjudicated in Montana, and also because it has been the subject of such a great divergence of learned judicial opinion elsewhere, I deem it of extreme importance that the point be given full consideration by an agency qualified and empowered to rule upon the facts.

The Trade Commission is such an agency and is directed by Section 51-113, supra, sub. 2, to hear facts and rule upon such acts and conduct.

The immediate question presented is whether a sale at a price less than the total of replacement cost, or invoice cost, plus "cost of doing business" as determined by the cost survey is necessarily a sale below cost. In other words is a sale at a price less than that fixed by the Trade Commission according to the cost survey always a sale below cost? That question was before our Supreme Court in the case of Associated Merchants of Montana vs. Ormesher, 107 Mont. 530, 86 P. (2d) 1031. The Court held that the seller is privileged to fix his prices according to any reasonable standard he may adopt, and that a cost survey is not necessarily determinative of the costs in the particular area. Justice Angstman, discussing the admissibility of cost surveys as evidence, said:

> "This statute, it should be noted, simply establishes the admissibility of such evidence. It does not purport to prescribe the weight or credibility to be given to the evidence . . . If a defendant's business is, because of peculiar circumstances, not fairly to be governed by the cost survey, he is privileged so to show."

The effect of the cost survey provision of the statute was summarized by Justice Angstman as follows:

> "Hence, in the absence of provisions to the contrary, we must presume that the legislature did not intend to prescribe that the cost must be absolutely exact, and that it must be based upon the precise method of accounting which any one merchant might adopt, but meant, by 'cost,' what business men generally mean, namely, the approximate cost arrived at by a reasonable rule. Hence, if a particular method adopted by a merchant cannot, under the facts disclosed be said to be unreasonable, and does not disclose an intentional evasion of the law, the method so adopted should be accepted as correct. In other words, all that a man is required to do under the statute is to act in good faith."

Under this decision, the fact which must be established in any action for violation of the Unfair Practices Act is not that the sale was below the figure established by the area cost survey, but that the method of allocating cost used by the particular merchant is unreasonable and does not accurately reflect his real cost of doing business. To prove this fact the cost survey may be introduced, but the fact to be ultimately proved is that the merchant has not acted in good faith, and has not allocated his costs upon a reasonable basis.

To fix a single figure and say that it shall represent the cost of every merchant in the area upon a particular item would result in arbitrarily fixing of the price of every commodity, without regard to the economic considerations which affect individual merchants. The declared purpose of the Act is "to safeguard the public against the creation or perpetuation of monopolies and to foster and encourage competition . . ." (Sec. 51-117, R. C. M., 1947.) This purpose would be completely nullified if every merchant were forced to observe a fixed schedule of prices. Furthermore, it would violate the principles of free competition upon which the United States and this State are founded and which have been written into the Constitution of this State (see Mont. Const. Art. XV, Sec. 20). Our Supreme Court has held that the Unfair Practices Act was not intended as a price-fixing statute, (Associated Merchants v. Ormesher, supra). The statute requires only that the individual merchant follow some reasonable system of allocating his costs to the individual items he sells.

This opinion does not mean, and should not be construed as meaning, that all discounts from the selling price of any commodity by the use of trading stamps are legal under the Unfair Practices Act. Even if the reduction in price to the consumer accomplished by the stamps is slight, it must be shown, by some reasonable method of keeping accounts, that the reduction does not reduce the selling price below the merchant's cost. This is the rule of the Ormesher case, and the law of this state.

In your letter of request you also state that you believe that when articles are sold at the minimum figure established by the invoice price and the cost survey figure, and a trading stamp given with the sale, it is a sale below cost, **and done with the intent of injuring competitors and destroying competition.** This intent is one of the indispensable requirements of a violation of the Act. Unless it is present, a sale actually and admittedly below cost is not a violation of the Act.

Our Supreme Court has held that a showing of the prohibited intent is the keystone of the Act. In the Ormesher case, supra, the court said:

> "The statute here considered is not a price-fixing statute. Its aim and object is to prevent unfair competition in business. As a means to that end the Act prohibits sales of commodities below cost when done 'for the purpose of injuring competitors and destroying competition.' It fixes the minimum price only, leaving in the seller the discretion to sell at whatever price above that he chooses. The minimum price is fixed not as an end in itself, but to prevent ruinous price cutting injuring or destroying competitors."

In the case of Board of Railroad Commissioners vs. Sawyer's Stores, 114 Mont. 562, 138 P. (2d) 964, the court said:

> "Proof of sales at less than cost, if that had been established by the evidence, would not in itself be proof of the unlawful purpose to injure competitors and destroy competition. No presumption of such purpose arises from the mere fact of such sale being made."

The penalties provided by the Act are severe; a violation may bring a fine of a thousand dollars, imprisonment for six months, or forfeiture of a corporate charter for the third offense, (see Secs. 51-111 and 51-109). The above decisions are a recognition by our Supreme Court that the intent to commit the offense should be clearly made out before such penalties are inflicted.

There is a distinct danger that the due process clauses of the State and Federal Constitutions would be violated if this strict intent requirement were not rigidly adhered to. (In the cases of Commission vs. Lasloll, 338 Pa. 457, 13 A. (2d) 67, 128 A. L. R. 1120; and, State vs. Packard Bomberger & Co., 16 N. J. Misc. 479, 2 A. (2d) 291, statutes forbidding sales below cost without intent to injure competition were found to be unconstitutional.)

It is plain from the wording of the Act that something more than ordinary price competition is meant. The act must be done "for the purpose of injuring competitors **and** destroying competition." (The Califorina Act, from which ours was taken, has since changed the wording of its Act to "intent to injure competitors **or** destroy competition." However, even **under** this reduced requirement, the California Court has said:

> "It must be borne in mind that this statute does not regulate the selling of commodities—**it is the predatory trade practice of selling below cost with intent to injure competitors** which the legislature on reasonable grounds has determined is vicious and unfair that is prohibited." (Wholesale Tobacco Dealers vs. National Grocery Dealers Bureau, (1938), 11 Cal. (2d) 634, 82 P. 2d) 3, 118 A. L. R. 486.)

It is aimed at the deliberate use of price cutting to injure **and** destroy a competitor. This does not mean intent to maintain ordinary price competition

which might cause competitors to lose profits they might have had if they were allowed to maintain higher prices. (See 11 Montana Law Review 21, page 39.) The Ormesher and Sawyer cases make it abundantly clear that the Act is directed only **toward "ruinous price cutting done with intent to injure and destroy competitors."**

In this respect the economic power of the offender should be an important consideration. The prohibited intent is to injure **and** destroy competition. A small, competitively insignificant merchant could hardly intend, by means of the minute amount refunded on trading stamps, to injure **and** destroy a powerful individual or group of merchants. On the other hand, an even smaller refund by a powerful merchant or group might be sufficient to destroy a number of small independents. (See 11 Montana Law Review 21, page 39.)

The Supreme Court has not attempted to fix, in advance, a standard by which the necessary intent may be measured. This is necessarily a question of fact which must be decided by the trier of fact in the individual case. Such matters of fact are within the scope of the Montana Trade Commission's fact finding powers, under Section 51-113, R. C. M., 1947. This section provides that the Montana Trade Commission shall have not merely the right but the **duty** to hold hearings and determine the facts whenever they have reason to believe that any person, firm or corporation is violating the law. The power is exclusively in the Commission. This case is exactly the sort of situation which the Trade Commission has been empowered by the legislature to inquire into and remedy, if need be. No other administrative agency or official can assume this fact-finding function. The Trade Commission in performance of its statutory duty should inquire into and determine the facts in any situation where it believes the law is being violated.

It is therefore my opinion that:

1. A sale at cost, plus the "minimum markup" fixed by the Trade Commission, upon which a trading stamp is given, is **not necessarily** a sale below "cost" as that term is defined in the Unfair Practices Act. The fact whether or not such a sale is a sale below cost must be determined upon the facts of the individual case, taking into account the cost accounting system of the individual merchant.

2. If a sale is found to be below cost, that fact alone does not constitute a violation of Section 51-103, R. C. M., 1947; it must also be proven that the sale was made with intent to injure **and** destroy competition, and the sale, in and of itself, does not constitute proof of such intent.

3. The provisions of Section 51-105, R. C. M., 1947, do not establish the "cost" survey as an absolute standard by which all merchants must establish their prices. Any reasonable system of allocating costs may be followed in establishing prices by the merchant. Section 51-105, supra, merely permits the introduction into evidence of the cost survey, for the use of the trier of fact in determining whether the merchant's method of allocating costs is reasonable.

4. It is the duty of the Montana Trade Commission to determine upon the facts of individual cases, whether the giving of trading stamps constitutes a reduction in the selling price of an article; whether this reduction brings the sale below "cost" as that term is defined in the Unfair Practices Act; and whether such sale was made with the intent to injure **and** destroy competition.

I call to your attention that any possible constitutional questions have not been raised or considered. However, for your considerations see 11 Montana Law Review 21, by Professor Francis E. Coad.