

THE BACKGROUND AND OPERATION OF THE PENNSYLVANIA  
FAIR TRADE LAW IN THE DRUG TRADE.\*BY STEPHEN WILSON.<sup>1</sup>

In any study of the present situation regarding the Fair Trade Laws it is of interest to consider their legal development. While the primary interest in the Fair Trade Law is economic and commercial, the economic and legal developments are so interrelated, each having influenced the other, that a consideration of their legal development is a practical necessity. Prior to the twentieth century manufacturers had the full and unquestioned right to stipulate the resale prices of the articles they manufactured. This was clearly upheld in 1889 by the Supreme Court decision in the case of *Fowle vs. Park*, 131 U. S. 88. In this decision, the Court did not doubt that this control of resale prices by the manufacturer was in restraint of trade but held that this restraint was quite reasonable in that the merchandise was controlled by a patent and that to limit that control would be equivalent to infringement of the patent rights.

Since the beginning of the twentieth century, however, contrary to all other industrial nations of the world, the United States has departed from its former position. Manufacturers have been denied the right to exercise control over their patented, copyrighted and secretly processed goods to a large extent. The progress of this development can be divided into two stages: *first*, the denial of the right to control resale prices, which was accomplished by 1911; and *second*, the restriction of all attempts to accomplish the same purpose by various means not previously declared illegal. A third stage began with the passage of the Fair Trade Legislation of recent years.

Considering only Supreme Court decisions, the denial of the manufacturer's right to control resale prices may be briefly reviewed as follows. In 1908 in the cases *Bobbs Merrill vs. Straus* 210 U. S. 330 and *Scribner vs. Straus* 210 U. S. 352, the Court held that the sale of books at a price lower than that stipulated by the publisher did not constitute an infringement of the copyright. In this case, however, contracts were not involved as the publishers had stipulated their prices by means of notices only.

In 1911, in the case of *Miles Medical Co. vs. Park* 220 U. S. 373, the Court rendered a decision holding the stipulation of resale prices by contract to be in restraint of trade and void. While this decision held that the use of contracts was contrary to the Sherman Anti Trust Act, it applied only to secretly processed goods and not to patented articles. Since secretly processed goods and patented articles had always been considered to be analogous by the Courts, it was but a step to the next decision.

The complete downfall of price maintenance came with the decision in the case of *Bauer vs. O'Donnell* May 1913, 229 U. S. 1. In this decision the Courts held that contracts used to maintain the prices of patented goods were in restraint of trade and void. Hence the simplest and cheapest way for manufacturers to maintain resale prices on their products vanished.

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There remained three chief ways in which manufacturers could attempt to maintain resale prices; by direct agency, by consignment selling and by refusing to sell to dealers who would not adhere to stipulated prices. The direct agency type was used to a small extent, being limited chiefly to commodities requiring considerable investment. There was no question of its legality. Consignment selling was also legal if the arrangement constituted a real consignment. In some instances, however, the Courts held apparent consignments to be merely attempts to circumvent the law. Consignment selling was limited in its use for five other reasons. It required larger capital, it required more detailed accounting and there was the vexatious problem of physical deterioration of the merchandise, as well as shifts in the demand, and changes in price. There remained only the right of refusing to sell for the convenient use of the manufacturer. This right was declared legal in the Supreme Court decision in the case of the Federal Trade Commission *vs.* Beechnut Packing Co., January 1922, 257 U. S. 441, but this decision also took away any effective means the manufacturer had of enforcing that right. The decision prohibited: (1) the use of lists of names of price cutters or of those who had sold to price cutters; (2) the employment of salesmen or agents to report or investigate instances of price cutting; (3) the reporting of the names of price cutters to wholesalers with whom the latter were not to deal; (4) the rewarding of dealers who maintained prices by turning over to them orders for merchandise solicited by the salesmen employed by the Beechnut Co.; (5) the use of serial numbers in tracing the movements of goods.

To all practical purposes this left the manufacturer with only one effective means of maintaining his prices, the buying in of all goods sold at cut prices. This was expensive and cumbersome. It meant watching the sales of every dealer, and when prices were cut it meant hiring people to go into the store as customers and buy the cut-price merchandise until the dealer had no more to sell.

Into this picture we now have the introduction of the Fair Trade Laws, first in California in 1931, and since copied by forty-one other states, making it again possible for the manufacturer to use contracts binding on all dealers in enforcing his prices. These laws have been fortified by a Federal Enabling Act and have been upheld by the Supreme Court in the case of the Old Dearborn Dist. Co. *vs.* Seagrams Distillers Corp. December 7, 1936. This decision makes such contracts binding on all dealers whether or not they are parties to the contract.

*Economics of Price Maintenance.*—Business is a competitive mechanism and is not based on fixed price-levels. Yet the term "price cutting" obviously infers that prices are cut or reduced below certain levels. What constitutes these levels cannot be agreed upon. Therefore, it is extremely difficult to determine just what constitutes cut prices. Nevertheless, it is necessary to consider the meaning of this term as it applies to the problem under the Fair Trade Law. Some commodities, particularly basic commodities, are priced independently of all other commodities. Costs of production are important factors in this type of pricing. Such prices may vary considerably for a variety of reasons. They may change over a period of time, in either seasonal or cyclical movements. They may change due to discrimination, the granting of special concessions, concessions to special customers, quantity discounts, allowances for advertising, trade-in allowances, and for numerous other reasons. Finally, these prices may change on a group basis, as contrasted to discrimination on a personal basis, for such reasons as geographical location, differences in costs of doing business, mistakes or different methods of computing costs of doing business. These changes revolve around a recognized standard price in each industry. The difficulty with approaching the problem from the point of view of standards is that it involves the attempt to

determine what is or should be the standard price. In addition the theory of joint costs of production and overhead or specific costs must be considered, because (1) what may apparently be a cut in price may in reality be a legitimate reduction in price resulting from the introduction of a by-product bearing part of the expenses of production, or because (2) an item which gains popular approval may be reduced in price rather than cut, because it requires less than the average overhead expense to stock and sell it since its rapid turnover is due to its popular appeal.

Some prices which are set are interdependent in nature. A store may handle thousands of items totally unrelated to each other but the prices of which are interdependent. For example, the price of a single item may be reduced even to the point of incurring a loss, in order that a larger amount of other items might be sold on which considerable profit is made. We have here a situation comparatively new in economic theory and practice. It involves a class of transactions without profit. Therefore, the price is not fixed by cost, total cost, joint cost or specific cost. The economics of this type of business consists in reducing prices on standardized well-known articles to attract customers. Its success depends upon increasing the proportion of less well-known high mark-up merchandise sold. The items reduced in price are called "loss leaders."

Loss-leader merchandising involves cumulative price cutting, constantly extending. Item after item is added to the list of loss leaders as competing merchants vie with one another to attract purchasers. The merchandise selected for use as a loss leader possesses certain definite characteristics. It must be standardized, it must be medium priced, it must have a general appeal, and this appeal must be fairly constant. These characteristics are found chiefly among those items patented and sold on a national scale.

Loss-leader merchandising lends itself chiefly to metropolitan areas of transient trade where business is not done on a personal basis. However, due to the cumulative nature of loss-leader merchandising, many neighborhood stores have been compelled to resort to it. When prices are once reduced, it is beyond the power of any individual dealer to restore them. Consequently, the manufacturer's product is cheapened and since it can no longer be sold at a profit the manufacturer loses the valuable coöperation of the dealers. As we have seen above, prior to the Fair Trade Laws, it was also practically impossible for an individual manufacturer to restore the price of his product. This resulted (1) in the loss to the public of dealer coöperation in distributing many valuable products, and (2) the subsequent promotion on the part of dealers of longer profit items which in too many instances were inferior.

*Legal Basis of the Pennsylvania Fair Trade Law.*—Earlier court decisions held that the retailers who had bought merchandise for resale held title to the goods and could sell them at any price they saw fit. The Fair Trade Laws, however, are based on the legal fact that, while the retailer owns the merchandise, the manufacturer owns the trade-mark. By virtue of a trade-mark or patent, a manufacturer is enabled by advertising to build up a following for his merchandise. This represents good-will. Good-will in business constitutes property in a very real sense. For this reason the manufacturer is enabled under the Fair Trade Laws to stipulate the resale prices for his merchandise in order to prevent injury to his good-will. Thus, the property rights of the manufacturer are recognized as well as the property rights of the retailer.

This legal theory has been incorporated into Fair Trade Laws in forty-two states and there are a number of sustaining court decisions. A Federal Enabling Act, without which they were seriously handicapped, has also extended the power of the state laws. This legal basis may be destroyed in two ways: *first*, by counter legislation; and *second*, by adverse court decisions. Legislation repealing the Fair Trade Laws may possibly be introduced into Congress this session but there is lacking any comprehensive program. So far, the courts, classing the problem as indifferent in nature, have been content to leave the responsibility for the Fair Trade Laws on the shoulders of the legislatures and to interpret them as written.

*Economic Significance of the Pennsylvania Fair Trade Law.*—The Fair Trade Laws may very possibly have some far-reaching economic effects. Business in this country has been traditionally one of free competition, with prices free from artificial control and free to reflect the ebb and flow of economic conditions. There has been, however, in the past two decades, or to be more specific since the Supreme Court decision of 1889, an increasingly apparent tendency toward concentration of retail business. The small independent dealer has felt the effects of this tendency in a number of ways. He has been subjected to unprecedented price competition. He has in many instances been driven to cut prices against his will and better judgment by that scourge of

honest retailing, "the loss leader." He has suffered the loss of integrity because his fair prices have been made to look unduly high. In some lines the small retailer has either been driven out of business or has been forced to join voluntary chains in self-protection.

A number of these trends will feel the influence of the Fair Trade Laws. Some manufacturers, having promoted the laws for years, are using contracts. Some manufacturers are frankly opposed to such methods of operation. Other manufacturers don't know what to do. Considerable indecision prevails and the picture is changing rapidly. Some competent observers even feel that the entire Fair Trade movement is on the way out. In all probability, however, the underlying changes and effects of the Fair Trade Laws will not begin to operate until the present chaotic conditions have settled to something more definite.

*Trade Practices after the Pennsylvania Fair Trade Law.*—Immediately after passage of the Fair Trade Act many manufacturers were in a quandary. Some manufacturers welcomed the Fair Trade Acts and immediately made use of Fair Trade contracts. Other manufacturers who had come to depend almost entirely for their volume on large dealers who sold at cut prices were not in position to use Fair Trade contracts. Between these two extremes lay the large number of manufacturers who did not know what to do. However, under the Fair Trade set-up, it will be impossible to straddle the issue. The manufacturer must choose either to operate under Fair Trade contracts or to operate without them.

Under the Fair Trade Laws small manufacturers will probably gain in importance because they will be able to build up a following without fear of their products being cheapened as loss leaders, and their good-will and prestige damaged. They will find themselves on more equal footing with their larger competitors. There will also, in all probability, be a stimulus toward the introduction of new products. With the decrease in the tendency toward centralization there will no doubt be less inducement toward mergers. Many of these and other effects will not become apparent until after the present shifting picture has become more stable.

Under the Fair Trade Laws the wholesalers' position should be greatly enhanced. With the elimination of the loss leader there should be a gradual return toward the traditional method of distribution, manufacturer to wholesaler to retailer. There will also in all probability be less incentive for the wholesalers to promote their own private brands.

The retailers under the Fair Trade Acts should have better and more equal opportunity. At any rate they should have the benefits of a higher integrity or, to put it the other way, with the elimination of the loss leader they will not be placed under the stigma of being inefficient business men or of charging exorbitantly high prices on some goods.

Price cutters will not be eliminated under the Fair Trade Act. They will simply be prevented from using nationally branded merchandise as loss leaders. Most of them will still sell nationally branded goods but at contract prices. The competition will probably be transferred to their own private brand merchandise.

In a sense the Fair Trade battle has really been a fight as to who owns the customer. The national brand manufacturer feels that the customer is his and that the dealer is his agent in supplying the customers' wants. The large dealer feels that the customer is his. In-so-far as his own brands are concerned and the brands of private manufacturers whom he controls, he assumes the responsibility of finding users for the products and accordingly sets his own prices.

The consumer should obtain several benefits from the Fair Trade Laws. First of all the elimination of the tendency toward centralization will assure wide distribution. The elimination of the loss leader will lessen intensive competition in terms of price and permit room for competition in quality and service. The consumer will still be protected as competition will by no means be eliminated. As a matter of fact, competition between brands should be considerably keener. The net result should be to the advantage of the discriminating buyer.

Competition will be keenest in metropolitan areas.

In all probability only the deep cut prices will be raised—those selling below a fair price. The general level of prices should not be affected.

#### CONCLUSION.

The following general conclusions are the result of an attempt to measure the extent of the changes in business practices brought about by the Fair Trade Law, and are based on a survey of sixty retail drug stores in Pittsburgh:

1. That reliable measures of the extent of changes in business practices in the drug field in Pennsylvania as occasioned by the Fair Trade Law are not obtainable at the present time.

2. That for the most part druggists' bookkeeping systems are inadequate for obtaining such measures.

3. That most druggists seem to expect an increase in business rather than an improvement in the character of the business already being done. This may be due to the emphasis on the importance of volume in the minds of business men. Nearly all of the druggists interviewed spoke of increasing their net profit through "increasing their business" but seemed to overlook the fact that the net profit may be increased by doing the same amount of business more efficiently. Increased volume will make up for some inefficiency, but the best combination is to have volume and have that volume handled with efficiency.

4. That there is an intimation that some underlying changes may be slowly developing momentum, such as the predictions that the introduction of new products will increase, that small manufacturers and small retailers will have more equal footing with their large competitors, that business will return to the traditional manufacturer to wholesaler to retailer method of distribution, or that the concentration of retailers into chains will be lessened. These will probably not become demonstrable until the present confused and constantly changing Fair Trade picture becomes more clearly settled.

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#### A CHRONOLOGY OF SOME EVENTS OF PHARMACEUTICAL INTEREST IN ANCIENT CHINA AND JAPAN.\*

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This paper is offered with a view to increasing the interest in things Oriental. Presentations at the meetings of the Historical Section of this ASSOCIATION and other similar bodies usually ignore the possibilities of historio-scientific research in the Orient, especially China and Japan. Many who lack the library facilities or linguistic training necessary to this sort of research nevertheless find the results fascinating reading.

Chinese and Japanese science offer some chronological difficulties, though the former is probably reliable except for the Pre-Hellenic period. The Chinese fondness for literary catalogs and dynastic histories has served to preserve much of the information now available. At the same time, however, it must be stated that much of the ancient literature has never been translated. Most of the translations to date have been made by people not particularly interested in Pharmacy or any other science.

In the material to follow, it should be remembered that the earliest characters are probably legendary. For this reason, the first three dates are only approximations. Other dates about which there seems to be some doubt have been indicated by a "c," or by a parenthetical question mark. It will be noted that there is no

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