TRADING STAMPS, *S & H*, AND THE FTC'S UNFAIRNESS DOCTRINE

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*The Federal Trade Commission's authority to prohibit "unfair methods of competition" was broadly interpreted more than a decade ago by the Supreme Court in *FTC v. Sperry & Hutchinson Co.* That decision allowed the FTC to bar business practices, including restrictions on the distribution of trading stamps, upon a finding that consumers were being injured even though no injury to competition was identified. The FTC since has applied the unfairness doctrine expansively and often without regard to its impact on consumer welfare.*

*Proposing the application of a consumer welfare standard under the Commission's unfairness authority, Dean Gellhorn demonstrates that the FTC and the Supreme Court misunderstood the function of trading stamps and the purpose of the restrictions relied upon by *Sperry & Hutchinson*. As a result, retailers were denied an effective promotional device for seeking consumer patronage, especially in changing markets. With the assistance of economic analysis, Dean Gellhorn then closely examines the FTC's unfairness doctrine, as applied during the past decade in both the decision of cases and the promulgation of rules. Finding the results uniformly unsatisfactory, he concludes that the unfairness doctrine is unnecessary and should be repealed or, at least, should be confined by a more explicit economic rationale.*

In *FTC v. Sperry & Hutchinson Co.*,¹ (*S & H*) the Supreme Court interpreted the Federal Trade Commission's (FTC) authority over un-

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1. 405 U.S. 233 (1972).

fair trade practices² for the first time, ruling that, "like a court of equity," the FTC could consider "public values beyond simply those enshrined in the letter or encompassed in the spirit of the antitrust laws."³ *S & H* was a pivotal, indeed a landmark, decision. In ruling that Congress had given the FTC such wide-ranging powers, the Court upheld the FTC's power to develop its own standard of what constitutes an unfair business practice. Unfortunately, except for noting with apparent approval the three factors relied on by the FTC when it promulgated the 1964 Cigarette Rule,⁴ the Court provided no guidance as to the content of the unfairness standard or how it might be applied to protect consumers. The Court instead said that Congress had lodged primary authority to define unfairness in the FTC, and reviewing courts should not significantly confine that authority. Accordingly, the FTC has constructed its unfairness doctrine on this open-ended foundation. Although both earlier and later cases were critical to the unfairness doctrine's evolution, the FTC could not have brought many of its actions in the 1970's—including requirements for advertising substantiation, orders mandating corrective advertising, and the challenge to advertising on children's television⁵—without the Court's expansive reading of the FTC Act in *S & H*. The case, therefore, must be closely scrutinized to understand the current scope of the Commission's powers under the Act.

The first thesis of this article is that the Court's opinion in *S & H* was based on a misconception of the economic role of trading stamps. Trading stamps are most accurately characterized as a marketing device sold by specialized firms, such as Sperry & Hutchinson Co.

2. See 15 U.S.C. § 45(a)(1) (1982) ("Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are declared unlawful.").

3. *Sperry & Hutchinson Co.*, 405 U.S. at 244.

4. *Id.* at 244 n.5 (whether the practice offends established public policy, violates ethical or moral standards, or causes substantial consumer injury)(quoting Statement of Basis and Purpose of Trade Regulation Rule, Unfair or Deceptive Advertising and Labeling of Cigarettes in Relation to the Health Hazards of Smoking, 29 Fed. Reg. 8324, 8355 (1964) [hereinafter cited as Cigarette Rule] (the requirements of the rule, 16 C.F.R. §§ 408.1-4, were vacated, 30 Fed. Reg. 9484, 9485 (1965), without modifying its underlying findings and conclusions, in light of the Federal Cigarette Labeling and Advertising Act, Pub. L. No. 89-92, 79 Stat. 282 (1965)(codified as amended at 15 U.S.C. §§ 1331-1340 (1982))). It is not clear, however, that the FTC intended these factors to be the legal standard of unfairness. These factors were not relied on either in the Cigarette Rule itself or in any pre-1972 rule or decision. See Craswell, *The Identification of Unfair Acts and Practices by the Federal Trade Commission*, 1981 Wis. L. REV. 107, 113 n.22.

5. For a sampling of FTC actions, see *infra* notes 175-78 and accompanying text.

(S & H), to retailers for use in promoting their stores.⁶ Retailers use trading stamps to offer customers a deferred rebate for their purchases. Such rebates are one of several forms of indirect price competition that retail stores use to stimulate continuity of sales and to build additional clientele. The *S & H* Court, however, seemingly adopted the FTC's assumption that stamps are used by retailers primarily as a substitute for price competition and to coerce and exploit consumers. The implicit rationale of the Court's decision was that S & H's suppression of "trafficking" by trading stamp exchanges and S & H's related full-book requirement not only injured competition among centers redeeming stamps, but also harmed consumers by unfairly denying partial-book savers the value of stamps which they had purchased indirectly from stamp-dealing retailers. In constructing this rationale, neither the FTC nor the Court considered whether these restrictions were designed to contour the promotional service provided by S & H to retailer interests in attracting customers and rewarding repeat patronage. Also, the FTC and the Court failed to examine the economics of trading stamps or consider whether consumer coercion or exploitation is an important element in their success. In short, the expansive holding of *S & H* was based on insufficient economic analysis.

The second, more fundamental, thesis of this article is that the legal theory used in *S & H* to define the unfairness standard is seriously flawed. Congress, in prohibiting unfair trade practices, did not adopt any specific approach to determine what practices are unfair. Instead, it merely identified an area of popular concern and established an administrative agency to seek solutions by rules and adjudications.⁷ Consequently, the Court's reliance on the FTC Act's legislative history to determine what conduct is within the reach of section 5 of the FTC Act is ultimately uninformative.⁸ Whether a practice is unfair is, like the

6. For a discussion of the "ownership" of the stamps themselves, see *infra* text accompanying notes 139-41.

7. Cf. J. FREEDMAN, CRISIS AND LEGITIMACY 100-01 (1978) (FTC's "extraordinarily general charge" is "not one without certain common law connotations").

8. See Craswell, *supra* note 4, at 110 (legislative history of § 5 in developing a definition of unfairness is "virtually useless"). Craswell points out that, although the legislators agreed that "unfair methods of competition" as used in the original Federal Trade Commission Act, Pub. L. No. 63-203, § 5, 38 Stat. 717, 719 (1914) (current version at 15 U.S.C. § 45(a)(1) (1982)), were not limited to practices prohibited at common law, no one could define more precisely just what the Act was meant to prohibit. All the legislators were certain, however, that they could recognize an unfair method of competition when confronted with one. This same conviction persisted when the Wheeler-Lea Act added the prohibition of "unfair or deceptive acts or practices" to the FTC Act in 1938. Pub. L. No. 75-447, § 3, 52 Stat. 111, 111 (1938). As a result, Congress has never promulgated a more precise definition of the phrase.

antitrust policy under the Sherman Act,⁹ primarily a question of public policy. Moreover, the Supreme Court's conclusion in *S & H* that the unfairness doctrine grants the FTC equity-like powers to proscribe injury-causing activity is unsatisfactory. In defining the legal standard so broadly, the Court has in effect given the FTC the power to determine what is unfair without any guidance whatsoever.

In the twelve years since the Court's ruling in *S & H* the FTC has not clarified the meaning of the unfairness standard by carefully documented studies or thoughtful explanations of why particular practices are unfair to consumers. The progeny of *S & H* has been a series of unsound decisions, persistent and unwise use of FTC resources, and imposition of costly and unnecessary requirements on retailers and advertisers. Left without constraint, the FTC has relied on the personal values of its members and on vague notions of consumer injury and public policy in applying its powers.

Economic analysis of *S & H*'s practices suggests that the most appropriate and objective measure for testing FTC intervention under the unfairness doctrine is whether that intervention is likely to improve consumer welfare. The history of section 5's prohibition of "unfair . . . acts or practices"¹⁰ suggests that despite the lack of focus in the legislative debates, Congress was concerned with assuring consumers free and uninhibited opportunities to express their economic preferences. This goal reflects sound economic assumptions, particularly the aim of improving consumer welfare through free and relatively informed consumer decisions. If, as appears to have been the case in *S & H*, the business practice at issue is a more efficient method for promoting retail products, close analysis is likely to reveal that the alleged consumer injury is more imagined than real. In such circumstances, FTC intervention is likely to injure rather than protect consumers. This article, therefore, urges that the unfairness doctrine articulated in *S & H* be redefined in accordance with an efficiency-oriented consumer welfare standard.

I. AN OVERVIEW OF THE TRADING STAMP BUSINESS¹¹

Trading stamps have been a feature of retail store sales promotion in the United States ever since a department store in the Midwest intro-

9. See generally R. BORK, *THE ANTITRUST PARADOX* 3-11 (1978); L. SULLIVAN, *HANDBOOK OF THE LAW OF ANTITRUST* § 2 (1977).

10. 15 U.S.C. § 45(a)(1) (1982).

11. The FTC filed its complaint against *S & H* on November 15, 1965, *Sperry & Hutchinson Co.*, 73 F.T.C. 1099, 1099 (1968); the hearing examiner rendered an initial decision on February 10, 1967, 73 F.T.C. at 1106. This description therefore concentrates on the trading stamp business

duced them in 1891.¹² Then, as now, stores distributed stamps to retail customers in a preset ratio—one stamp per ten cents of the purchase price—under a program where customer-savers could redeem books of stamps for cash or merchandise. Trading stamps proved popular with American consumers, especially after the Second World War, and by 1963 it was estimated that over eighty percent of all consumers saved stamps.¹³ The growth of stamp saving in particular fields has sometimes been spectacular. For example, in the retail grocery business the share of retail sales made by stores issuing trading stamps increased from one percent to forty-seven percent between 1950 and 1962.¹⁴ Like other promotional devices, stamps are “sold” to retailers because of their effectiveness in increasing the sales of stamp-giving retailers. As with other promotions or services, once the technique is copied and competitors also offer stamps, they are also justified as a necessary defensive maneuver to retain customers who might otherwise switch their loyalties.¹⁵

S & H, which entered the trading stamp business in 1896, is the oldest and largest company in the field.¹⁶ For many years it has con-

as it existed in the mid-1960's, and, for the purposes of the *S & H* decisions, uses all dollar figures as of 1972. The trading stamp business as it presently exists is discussed in other sections of this article, and dollar figures are dated where appropriate.

12. FTC STAFF, ECONOMIC REPORT: ON THE STRUCTURE AND COMPETITIVE BEHAVIOR OF FOOD RETAILING 204 (1966) [hereinafter cited as FTC STAFF REPORT], reprinted in part in FTC STAFF, ON THE USE AND ECONOMIC SIGNIFICANCE OF TRADING STAMPS 2 (1966); see also ASSEMBLY INTERIM COMM. ON GOVERNMENTAL EFFICIENCY AND ECONOMY, REPORT ON TRADING STAMPS TO THE CALIFORNIA GEN. ASSEMBLY OF 1959, 8 Assembly Interim Comm. Reports No. 5, at 79, 81 (1959); Note, *Trading Stamps*, 37 N.Y.U. L. REV. 1090, 1090 (1962).

13. FTC STAFF REPORT, *supra* note 12, at 206; see also Note, *supra* note 12, at 1090 n.4.

14. S & H's President, William Penwell, estimated in 1981 that trading stamps are now offered with only 12% to 16% of food store sales. Interview with William Pennwell, President, and Melvyn Shaffir, General Counsel, The Sperry & Hutchinson Company, New York, New York (Nov. 18, 1981) [hereinafter cited as S & H Interview]. Recent market surveys indicate that about 27% of all U.S. families—or 20.5 million households—save trading stamps. Opinion Research Corp., *Consumer Attitudes Toward Trading Stamps: Summary of 21st Nationwide Public Opinion Survey 12-13* (Mar. 5, 1981)(booklet prepared for S & H).

15. A relatively high turnover in retail accounts—S & H, for example, experienced a 10% to 12% annual account turnover even during the 1960's, C. FULOP, *THE ROLE OF TRADING STAMPS IN RETAIL COMPETITION* 29 (2d ed. 1973)—and the substitution of other services for stamps illustrate that trading stamps are only one of the retailer's arsenal of competitive tools used to draw customers. Like price reductions, product advertising, and credit or delivery services, the appeal of trading stamps is not unlimited. Thus, when trading stamps “begin to yield diminishing (or negative) returns, competitive emphasis is likely to shift to other, perhaps new, sales promotion techniques.” *Id.* at 32.

16. Although S & H has long been by far the largest trading stamp company in this country, and although the top two firms have issued approximately half of all stamps, see FTC STAFF REPORT, *supra* note 12, at 207, entry into the trading stamp business is not restricted. The FTC staff estimated in 1966 that there were between 250 and 500 stamp companies operating in the United States. *Id.*

trolled over one-third of the stamp business in the United States.¹⁷ As is typical in the trading stamp business, S & H does not deal directly with book-saving consumers until the stamps are redeemed. Instead, S & H distributes the stamps to consumers through retailer licensees. Large retailers purchase these licenses by paying S & H an agreed percentage of the retailer's gross sales (usually two percent); smaller retailers pay a set amount per stamp-pad.¹⁸ To promote its product, S & H engages in national advertising and generally encourages the widespread adoption of its stamps by a variety of retailers—its “family of merchants”¹⁹—across a spectrum of geographic markets, particularly by retailers selling high volume, low-priced goods. S & H generally avoids licensing merchants who directly compete with each other, because it believes that its protection of each retailer's primary location will give the retailer an edge over non-S & H stamp competitors.²⁰ S & H also maintains redemption stores where savers may redeem stamps for merchandise, as well as a smaller number of mail order centers.

The arithmetic foundation of S & H trading stamps can be easily sketched. The consumer saves the stamps in books which hold 1200 “Green Stamps,” representing \$120 of retail purchases. The retailer will have paid S & H from \$2.40 (for larger volume retailers) to \$2.65 (for smaller stores) for each book of stamps; consumers can exchange a stamp book for merchandise that retails between \$2.86 and \$3.31.²¹ The number of stamps that purchasers finally redeem is uncertain, although S & H has until recent years experienced an annual redemption rate of ninety-five percent.²² Promotional expenditures are justified, of

17. See *Sperry & Hutchinson Co.*, 73 F.T.C. 1099, 1166 (1968) (Commission opinion).

18. S & H Interview, *supra* note 14.

19. See *Sperry & Hutchinson Co.*, 73 F.T.C. at 1155 (appendix to hearing examiner's initial decision):

Where it can, S & H licenses one of each type of merchant in a given shopping area, such as a grocer, a department store, a druggist, a hardware merchant, a laundry, a cleaning and pressing establishment, and several gasoline service stations so as to cover, as nearly as possible, the entire spectrum of merchandise necessary to meet the housewife's ordinary needs The concept is one of a family of merchants

20. See *id.* at 1123 (hearing examiner's initial decision).

21. See *Sperry & Hutchinson Co.*, 405 U.S. at 236.

22. See *Sperry & Hutchinson Co.*, 73 F.T.C. at 1113, 1119-20, 1157-58 (hearing examiner's initial decision); *infra* note 82. In recent years the redemption rate has declined. Beginning in 1979, S & H has prepared its financial statements assuming that 90% of the trading stamps issued by the company after 1978 will ultimately be redeemed. S & H SEC Form 10-K, at 183 (filed April 3, 1981). These figures do not, however, specify the critical time period between issuance and redemption—i.e., the period of the “float.”

Contrary to some charges and, perhaps, one's intuition, S & H's interest in a high rate of consumer redemption does not contradict the arithmetic foundation of trading stamps. Stamps would be even more attractive to retailers and effective as promotional devices if 100% were re-

course, only if they produce additional revenues which exceed the cost of the promotion, and trading stamps are no exception. In order for stamps to justify their cost, it is estimated that the retailer's "sales volume must increase by about twelve percent" over pre-stamp sales.²³

The trading stamp business is profitable for S & H and other stamp companies even though retailers buy the stamps for less than the retail value of the redeemed merchandise and the stamp companies incur incidental expenses beyond the cost of the redeemed merchandise. Several factors contribute to the stamp business's profitability: (1) the stamp company's cost of merchandise is lower than the merchandise's retail value because the company purchases the merchandise as a large wholesaler; (2) the redemption rate need not be much below 100% for the stamp company to have a substantial margin; and (3) the stamp company has the use of the money from the time when the stamps are purchased by the retail merchant until their redemption by customers, which can be a substantial period.²⁴

Stamp companies compete with respect to the comparative cost of their stamps to the retailers, the scope of their promotional activities, the attractiveness of their redemption merchandise, and the ease with which stamp-saving consumers can redeem their stamps. Although stamp companies find it desirable to distribute as many stamps as possible in each market, they also find it desirable to enter into franchise agreements with retailers whereby each store is allocated an exclusive license (for that type of retailer) to distribute that brand of stamp within a specified area. S & H and other stamp companies contend that these self-imposed restrictions provide their retail stores with a distinctive advantage over nearby rivals. The retailers, in turn, promise to promote the particular trading stamps and not to use other companies' stamps. Widespread geographic use of a trading company's stamps, on

deemed—and if redemptions occurred almost immediately—because the redemption rate (and time) reflect the *intensity* of the customer appeal of trading stamps. If consumers redeemed 100% of the stamps the trading stamp companies would undoubtedly reduce the value of the merchandise, lower promotional costs, or rely on the float to maintain a competitive return on investment. Indeed, recent indications of a lowered redemption rate suggest that the consumer appeal of trading stamps has waned as inflation and increasing consumer sophistication have focused attention more directly on price competition.

23. Note, *supra* note 12, at 1093.

24. There is no hard evidence of the duration of this float because stamps are not time-dated. Market forces exist, however, which may operate to restrict the nonredemption period. Retailers are commonly given a period of credit between delivery and payment, and stamps may be issued and redeemed in the meantime. Moreover, the increasing use of the cash option, now mandated of S & H by a consent decree agreement with the FTC, Sperry & Hutchinson Co., 83 F.T.C. 478, 482-83 (1973), has also reduced the duration of nonredemption. The decree has sometimes even required that S & H redeem stamps for cash prior to its receipt of payment for such stamps. S & H Interview, *supra* note 14.

the other hand, makes the stamps more attractive to retailers and consumers as the latter move or travel.

The essence of the stamp company/retail store relationship²⁵ is that the retailer "buys" trading stamps as a promotional device (just as it buys other advertising or contests) to attract and retain customers, not to make a profit on resale of stamps.²⁶ Any effect that trading stamp distribution has on retailer pricing or other policies is only incidental to the primary relationship between the retailer and the stamp company. There has, however, been a constant, if low key, dispute concerning the effect of trading stamps on consumer prices and competition among retailers. A study conducted by the Department of Agriculture in 1958 revealed that consumers who saved and redeemed stamps could actually receive a net benefit of about 1.4% of their food bill.²⁷ Nevertheless, the FTC staff conducted its own study and concluded "that the increased use of trading stamps has increased food store prices by an amount about equal to the cost of stamps."²⁸ Either conclusion seems tenable; the study data and methodologies are not

25. Whether trading stamps issued with purchases of retail goods should be viewed legally as a cash discount from price, a deferred rebate, or a gift, depends on how the relationship between stamp-giving retailers and their customers is defined, as well as how other promotional efforts such as offers of quantity and volume discounts are treated. This issue, however, is irrelevant to a review of the relationship between trading stamp companies and retailers, even though the license agreement may regulate some of the retailers' dealings with their customers.

26. Although trading stamp companies have been required to post a bond to assure redemption, concern that stamp companies will put aside inadequate reserves unless they are properly policed seems misplaced. Stamp company failure or fraud has not proved to be a significant problem in the absence of regulation. Market pressures generally prevent "misappropriation," whether deliberate or accidental, despite the possible temptation for stamp companies to sell stamps to retailers and then disappear with their gains. First, the cost of entry into the trading stamp business is substantial and requires continued operation for the company to earn a return on its investment. S & H Interview, *supra* note 14. Second, the stamp company which makes this initial investment is likely to require outside capital, usually accompanied by investor checks and controls. Third, and even more significant, retailers exercise a measure of oversight over the stamp companies whose stamps they purchase and offer to customers. If the stamp company fails, and consumers cannot redeem their stamps, the retailers who offered these stamps stand to lose both consumer goodwill and their investment in stamp inventory. Thus, retailers have a much larger investment in the continued operation of the trading stamp company than do most individual consumers, who generally redeem no more than a half-dozen books (for approximately \$18 of merchandise) at one time. *Id.*

27. See FTC STAFF REPORT, *supra* note 12, at 230; U.S. DEPARTMENT OF AGRICULTURE, MARKETING RESEARCH REPORT NO. 295, TRADING STAMPS AND THEIR IMPACT ON FOOD PRICES 28 (1958) (value of merchandise received is "about" 2% of purchase price; average purchase price 0.6% greater in stamp-giving stores) [hereinafter cited as DEP'T OF AGRICULTURE REPORT].

28. FTC STAFF REPORT, *supra* note 12, at 231. *Contra* Brown, *Price Movements Following the Discontinuance of Trading Stamps*, 43 J. RETAILING, Fall 1967, at 1, 13-14 ("there is no evidence that prices were affected in the long run for the [studied] area as a whole").

immune from criticism.²⁹ A more sophisticated study noted that "trading stamps can lead to economies of operating costs which may either stimulate lower prices, or make price increases unnecessary."³⁰ A review of available data reveals "little evidence that consumers suffer from the prevalence of trading stamps in higher prices paid for foodstuffs."³¹

II. THE FTC'S CHARGES AND DECISION

Despite the lack of empirical evidence connecting trading stamps with inadequate competition in the grocery retailing industry, critics have blamed stamp plans for a parade of horrors including raising food prices, preying on consumer ignorance or other weaknesses, foreclosing a competitor's entry by tying customers to particular retailers, distracting consumer attention from price competition, and discriminating against small retailers.³² Some members of Congress, especially those

29. The Department of Agriculture's study appears to have focused on retailers who gained substantial sales from stamp promotions. DEP'T OF AGRICULTURE REPORT, *supra* note 27, at 25-27 (10.5% average increase in sales). The FTC's study, on the other hand, seems to have examined markets approaching or beyond the equilibrium point where stamps are less effective in increasing sales. FTC STAFF REPORT, *supra* note 12, at 230. In any case, these reports seem unreliable as demonstrations that trading stamps have any effect on retail prices (either up or down) because geographically unconnected markets were lumped together, and several important variables—such as the level of other promotional expenditures or the introduction of other services—were not held constant or even measured. See FTC STAFF REPORT, *supra* note 12, at 216-17, 229; DEP'T OF AGRICULTURE REPORT, *supra* note 27, at 25-27. Retailers using trading stamps do not operate in static markets, yet these studies made no serious attempt to exclude other factors that may have affected price levels. The FTC staff limited their analyses of the relationship between trading stamps and the intensity of competition among retailers to anecdotal evidence from smaller food retailers who complained that they were disadvantaged by the use of trading stamps. See FTC STAFF REPORT, *supra* note 12, at 226-29. The FTC staff's report nevertheless concluded that stamps "tend to create a 'scale' barrier to entry confronting potential entrants." *Id.* at 244. This conclusion seems insupportable without extensive review of other factors contributing to the supermarket revolution in the grocery retail business.

30. C. FULOP, *supra* note 15, at 23-28 (reviewing five attempts to measure the impact of stamps on prices and finding them "virtually valueless"). For an analysis of the economic operation which provides theoretical support for the textual statement, see *infra* notes 90-114 and accompanying text.

31. C. FULOP, *supra* note 15, at 28 ("In view, therefore, of the inconclusive nature of price surveys it does not seem particularly useful either for retailers to 'prove' from the 'evidence' that trading stamps cause prices to rise, or for trading stamp companies to 'prove' the opposite.").

32. See, e.g., Comment, *The Attack on Trading Stamps—An Expanded Use of Section 5 of the Federal Trade Commission Act*, 57 GEO. L.J. 1082, 1084-85 (1969); see also *Sperry & Hutchinson Co. v. FTC*, 432 F.2d 146, 152 n.3 (5th Cir. 1970) (Wisdom, J., dissenting), *modified*, 405 U.S. 233 (1972).

One of the primary complaints lodged against trading stamps is that they are "forced" on consumers because consumers are denied a choice among taking stamps, receiving a cash discount, or obtaining discounts for merchandise not available in a redemption catalogue. But, all promotions which offer merchandise, credit, gift certificates, credit returns, or other non-cash equivalents without also offering the alternative of a cash rebate, limit consumer choice. If trading

solicitous of smaller retailers that are being forced out by marketing changes, recited these accusations.³³ Not surprisingly, the FTC, pursuing its role as the representative of small business and consumer interests, has listened sympathetically to these complaints. Nevertheless, following an inconclusive investigation in 1957, the FTC decided that trading stamp arrangements did not in themselves constitute unfair trade practices.³⁴ But the agency left the door open for subsequent prosecutions of industry members engaged in specific antitrust or other violations.

Thus it was not a complete surprise when, almost ten years later, the FTC filed a complaint against the industry leader, Sperry & Hutchinson Co., charging it with violations of the FTC Act.³⁵ The complaint stated three grounds: (1) that the company's policy of requiring retailer-licensees to issue one stamp for each ten cents' worth of purchases unlawfully restrained the retailers' freedom of trade; (2) that this one-for-ten policy was illegally enforced by a conspiracy among stamp companies; and (3) that S & H, alone and with retailers and other stamp companies, had unlawfully suppressed trading stamp exchanges and the opportunity freely to redeem trading stamps by requiring that its stamps be redeemed only in full books and only at S & H

stamps do not have a different effect, they should not be treated differently. Retailers are generally allowed to choose which promotion will serve their interests, and consumers are free to decide whether or not to patronize a particular retailer. As long as entry is open and markets are tolerably competitive, the consumer is not at a bargaining disadvantage. Offering trading stamps to attract and hold customers seems no more coercive than a retailer's choice of inventory, pricing policy, location decision, or sales personnel training program. Each affects the consumer, but marketplace pressures constrain each choice. From this perspective, trading stamps add an alternative not otherwise available to consumers. As with any other bundle of services, the option of a cash rebate, whether immediate or delayed, has normally been left to the retailer's discretion in selecting the most attractive consumer package. *See infra* text accompanying notes 116-17.

33. *See* Comment, *supra* note 32, at 1082, 1085; *cf.* Note, *supra* note 12, at 1118-26 (state legislation of trading stamps).

34. FTC Press Release (Oct. 3, 1957)(concluding that the FTC "did not consider trading stamp plans in themselves to be an unfair method of competition"), *quoted in* FTC STAFF REPORT, *supra* note 12, at 242 n.12. The legality of trading stamp practices had been before the FTC at least six times between 1917 and 1954; each time the focus was on particular promotional activities—and each time no charges were filed. *See* DEPT OF AGRICULTURE REPORT, *supra* note 27, at 12.

35. Sperry & Hutchinson Co., 73 F.T.C. 1099, 1099 (1968) (complaint). Contributing to the FTC's change of position were an increasingly expansive view of the FTC's authority to bar "unfair methods of competition," *see* FTC v. Brown Shoe Co., 384 U.S. 316 (1966), the increased concern about the causal relationship between the rise of trading stamps and increasing food prices, *see* FTC STAFF REPORT, *supra* note 12, at 229-31, and general public and congressional concern over food prices, *see* Agency Hearings: *Hearings on Regulatory Agencies Under Jurisdiction of the Committee Before the House Comm. on Interstate and Foreign Commerce*, 90th Cong., 1st Sess. 691 (1967)(testimony of Paul Dixon, Chairman, FTC); *see also* Comment, *supra* note 32, at 1086 n.16.

redemption centers.³⁶ Despite the conclusion the FTC had reached in 1957, it seemed clear that the major thrust of the complaint was against the principal tools relied on by the trading stamp industry to ensure that trading stamp plans were distinctive and attractive to retailers. As S & H conceded in its answer, the entire industry had long used the one-for-ten and anti-trafficking requirements.³⁷

After trial, the hearing examiner was not persuaded that the FTC had proven its charges against the one-for-ten and anti-trafficking policies. Noting that the FTC had taken "pains not to attack the trading stamp business as such,"³⁸ and that S & H had repeatedly obtained state court protection from breaches of S & H's license provision,³⁹ he ruled that the FTC had not shown either practice to be unreasonable. The examiner found that if consumers could trade for competing stamps, the power of S & H's stamps to attract purchasers would be diminished.⁴⁰ Similarly, stamp exchanges that would encourage consumers to trade stamps might also allow retail stores to "free-ride" on the appeal of S & H's service.⁴¹ The hearing examiner concluded that the "limitations on the number of stamps to be issued and the restrictions on their subsequent use are reasonable provisions delimiting the obligations that [an S & H licensee] undertakes by its contracts," and held that section 5 of the FTC Act did not "empower the Commission to exercise its powers solely for [the] convenience of consumers."⁴²

The hearing examiner did, however, sustain the conspiracy charges against S & H's enforcement of its marketing policies. Although these charges were not the focus of the initial complaint—indeed, they appeared to be an afterthought—the FTC counsel's broad antitrust attack on trading stamps found support in the examiner's findings. The examiner found that although S & H had selectively enforced both the one-for-ten and nontransferability license restrictions,⁴³ these restrictions had adversely affected retail price competition and denied consumers the benefit of stamp exchanges.⁴⁴ Thus, although the license policies themselves were reasonable, S & H's method of enforcing these

36. *Sperry & Hutchinson Co.*, 73 F.T.C. at 1099-106 (complaint).

37. *Id.* at 1108 (hearing examiner's initial decision).

38. *Id.* at 1145-46.

39. *Id.* at 1145.

40. *Id.*

41. *Id.* at 1141-43, 1145-46.

42. *Id.* at 1147.

43. *Id.* at 1146 (20% of S & H customers engaged in multiple stamping; larger stores give lower stamp cost, which "tempts" them to issue multiple stamps; S & H did not act against non-commercial exchanges).

44. *Id.* at 1141-43, 1145-47.

policies in combination with others,⁴⁵ and the method of enforcement generally used in the trading stamp industry, violated the antitrust laws.

Both sides appealed to the Commission. Complaint counsel argued that the examiner should have found S & H's policies unlawful; S & H contended that the examiner erred when he did not also uphold S & H's actions, conducted in combination with others, in pursuit of policies that the examiner agreed were legal. The Commission agreed with the complaint counsel's position.⁴⁶ Criticizing the examiner's fragmented consideration of the anticompetitive effects of S & H's acts, the Commission reversed the examiner's holding that the S & H license provisions were lawful.⁴⁷ It concluded that, when considered in their totality, S & H's actions restricted the retailer's ability to compete and eliminated a whole class of small businessmen.⁴⁸ The Commission believed the license restrictions prevented retailers from offering alternative trading stamps or exchanging stamps with their customers, and the anti-trafficking provisions excluded independent trading stamp exchanges from the market. Although the Commission noted that the examiner had found that S & H's restrictions also disadvantaged stamp-collecting consumers, who did not have complete freedom of choice in disposing of stamps, the Commission expressly declined to decide the case "on the narrow and technical basis of a restraint on alienation."⁴⁹

In light of the Supreme Court's subsequent opinion, it is important to note that the Federal Trade Commission decided the case solely on antitrust grounds. As such, the Commission's decision was an important extension of precedent. Previously the FTC had felt obliged to show that the practices challenged under section 5 violated either the language or spirit of other antitrust laws—the Sherman, Clayton or Robinson-Patman Acts.⁵⁰ In *S & H*, the Commission deliberately

45. *Id.* at 1147-48.

46. *Sperry & Hutchinson Co.*, 73 F.T.C. at 1164 (Commission opinion).

47. *Id.* at 1200.

48. *Id.*

49. *Id.* at 1195; see *United States v. Arnold Schwinn & Co.*, 388 U.S. 365, 380 (1967), *overruled on other grounds*, *Continental T. V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 58 (1977).

50. In *FTC v. Brown Shoe Co.*, 384 U.S. 316, 321-22 (1966), the Supreme Court upheld an FTC challenge to a franchise plan where shoe retailers agreed with their supplier not to carry competing shoes, even though the Commission made no findings of probable adverse competitive effects from the arrangements (as would have been required had the action been brought under section 3 of the Clayton Act, ch. 323, § 3, 38 Stat. 730, 731 (1914)(codified as amended at 15 U.S.C. § 14 (1982)), see *L. SULLIVAN*, *supra* note 9, §§ 151-153). See *id.* § 161, at 467-68 (discussing *Brown Shoe*). Reading the FTC Act's prohibition of "unfair methods of competition" broadly, the Court ruled that the Act could be used "to arrest trade restraints in their incipency

chose another path. Although it observed the similarity between the one-for-ten policy and vertical resale price maintenance, the Commission did not determine that stamp plans had a similar effect.⁵¹ Likewise, the FTC refused to pursue the concept of trading stamps as "personal property,"⁵² which would have made the license restraints on stamp resales an unlawful vertical restriction. Instead, the Commission concluded that S & H had violated section 5 because its practices had an adverse effect on competition.⁵³ According to the Commission's analysis, the Act's substantive reach goes beyond what is authorized by the antitrust laws and includes the power to proscribe any activity that adversely affects competition.

III. FROM COMPETITION POLICY TO CONSUMER PROTECTION: THE FIFTH CIRCUIT AND SUPREME COURT OPINIONS

The Federal Trade Commission's reversal of the hearing examiner on the illegality of S & H's practices did not survive review by the United States Court of Appeals for the Fifth Circuit.⁵⁴ A majority of that court held that the FTC Act reaches only violations of either the letter or the spirit of the antitrust laws;⁵⁵ mere injury to a competitor cannot be sufficient because all competition has that effect. In dissent, however, Judge Wisdom argued that S & H's enforcement of its anti-trafficking policies not only violated antitrust standards, but also could

without proof that they amount to an outright violation of Section 3 of the Clayton Act or *any other provisions of the antitrust laws.*" *Brown Shoe Co.*, 384 U.S. at 322 (emphasis added). The italicized language, itself an invitation to a loose reading of the FTC Act, nevertheless seemed to suggest that section 5's antitrust prohibition was limited to acts that could, if effective, be attacked under traditional antitrust laws.

Had the FTC challenged S & H's conduct not as a competition case but as one involving consumer protection—e.g., that the suppression of independent exchanges or the restrictions on trading stamp redemptions were unfair to consumers—the *S & H* Court could have found persuasive authority for the assertion of FTC power to enjoin acts which were inherently unfair. *See, e.g.,* *FTC v. R.F. Keppel & Bros.*, 291 U.S. 304, 309-10 (1934). Even then, however, the Court's prior decisions were distinguishable because they had emphasized the adverse competitive impact of the challenged practices—a requirement seemingly abandoned with the 1938 Wheeler-Lea amendment of the Act, Pub. L. No. 75-447, § 3, 52 Stat. 111, 111 (1938). *See, e.g.,* *Averitt, The Meaning of "Unfair Acts or Practices" in Section 5 of the Federal Trade Commission Act*, 70 GEO. L.J. 225, 228-35 (1981). In any case, the FTC seemed expressly to have avoided this approach. *See supra* text accompanying notes 46-49.

51. *Sperry & Hutchinson Co.*, 73 F.T.C. 1099, 1183-85 (1968).

52. *Id.* at 1194.

53. *Id.* at 1195-200.

54. *Sperry & Hutchinson Co. v. FTC*, 432 F.2d 146, 151 (5th Cir. 1970), *modified*, 405 U.S. 233 (1972). S & H appealed only from the FTC order against the practice of enjoining independent stamp exchanges. It accepted the order stopping the one-for-ten policy which had regulated the maximum number of stamps issued per purchase.

55. *Sperry & Hutchinson Co.*, 432 F.2d at 151.

be reached under the FTC's authority to proscribe "unfair acts or practices"—the consumer protection powers that Congress had confirmed in 1938 in the Wheeler-Lea amendment to section 5.⁵⁶ Under that amendment the agency "may act whenever it uncovers practices which are undesirable or inimical to the public interest," a requirement Judge Wisdom found satisfied by S & H's restrictions on the consumer's right to dispose of stamps freely.⁵⁷

The analyses of the majority and of Judge Wisdom are each subject to criticism. Applying the majority's antitrust perspective, the problem in the Commission opinion was not its legal interpretation of the agency's authority, but rather the paucity of its evidence. Few facts supported either the Commission's determination that retail store competition had been injured, or its implicit finding that the exclusion of trading stamp exchanges injured competition among trading stamp companies. Neither the Commission nor the Fifth Circuit majority reached the basic inconsistency in the FTC's complaint: that the trading stamp business was lawful but that the necessary accompanying restrictions on the exchange of stamps were not. The dissent's more expansive view of the reach of section 5, although finding general support in both the Act's legislative history and the direction, though not the precise holdings, of prior case law, was flawed because it would have sustained the decision on a basis other than that upon which the case had been tried. The prior cases under the "unfair acts or practices" consumer protection segment of section 5 had all involved deception or moral turpitude,⁵⁸ neither of which was alleged in *S & H*. Consequently, the FTC had chosen to treat the case as involving its antitrust powers only. For an appellate court to sustain the Commission on grounds not considered by the agency—that is, because it viewed S & H's practices as causing consumer injury, as Judge Wisdom urged—would have violated long established rules for judicial review of administrative action.⁵⁹

Despite the apparent weakness of its legal position, the FTC felt compelled to appeal from the Fifth Circuit's decision. Left unchallenged, the decision could have been used to justify a narrow reading of the FTC's authority under section 5; indeed, the government argued in

56. Pub. L. No. 75-447, § 3, 52 Stat. 111, 111 (1938)(codified at 15 U.S.C. § 45(a)(1) (1982)).

57. *Sperry & Hutchinson Co.*, 432 F.2d at 153 (Wisdom, J., dissenting).

58. See Comment, *Section 5 of the Federal Trade Commission Act—Unfairness to Consumers*, 1972 WIS. L. REV. 1071, 1078-80.

59. See, e.g., *SEC v. Chenery Corp.*, 318 U.S. 80, 87 (1943)("The grounds upon which an administrative order must be judged are those upon which the record discloses that its action was based.").

its brief that the Supreme Court had "expressly rejected"⁶⁰ this interpretation five years earlier in *FTC v. Brown Shoe Co.*⁶¹ FTC counsel solved the dilemma by switching arguments in the petition to the Supreme Court. Government counsel abandoned the antitrust theory on which S & H had been found guilty, and followed Judge Wisdom's lead by arguing that S & H's practices violated the FTC Act's prohibition of unfair practices that might directly injure consumers.⁶² This consumer protection argument did not depend on any antitrust theory, on any alleged similarities between the prohibited practices and practices proscribed by prior antitrust rulings, or on any claims that the challenged acts had an adverse impact on competition (substantial injury to consumers would be sufficient).

Facing the possibility that the court of appeals's decision would be viewed as a narrowing of the FTC's consumer protection powers, the Supreme Court modified the judgment and ruled that the Federal Trade Commission was empowered to go beyond antitrust policies in enforcing section 5. The Court concluded that the FTC had authority to prohibit as unfair those practices which directly injured consumers regardless of their impact on competition.⁶³ In doing so, the Court relied on the legislative history of the FTC Act and a prior Supreme Court decision.⁶⁴ The Court asserted that the legislative history of the Act made clear Congress's intention that the FTC was to have wide discretion in defining those practices that it found to be unfair.⁶⁵ The legislative debates reveal that Congress repeatedly avoided a more definite or detailed phraseology in section 5 and intended to preserve the FTC's flexibility to respond to abusive practices which might develop in the future.⁶⁶ The Court found support for its generous view of the Commission's powers in its decision in *FTC v. R.F. Keppel & Bros.*⁶⁷ There the Court held that competitive injury, although required in all other section 5 cases, was not a prerequisite for a finding of unfairness where the issue involved consumer protection.⁶⁸ The *S & H* Court held

60. Petition for a Writ of Certiorari at 11, *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233 (1972).

61. 384 U.S. 316 (1966). See generally *supra* note 50 (discussing *Brown Shoe*).

62. Petition for a Writ of Certiorari at 12-13, *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233 (1972).

63. *Sperry & Hutchinson Co.*, 405 U.S. at 239.

64. *Id.* at 240-42.

65. *Id.*

66. *Id.* at 239-40. For an exhaustive examination of the debates, see Averitt, *The Meaning of "Unfair Methods of Competition" in Section 5 of the Federal Trade Commission Act*, 21 B.C.L. REV. 227, 229-38 (1980).

67. 291 U.S. 304 (1934).

68. *Id.* at 309-13.

that Congress removed any doubt that a finding of adverse consumer impact was sufficient to declare a practice unfair when it adopted the Wheeler-Lea amendment four years after *Keppel*. At that time Congress indicated that the FTC's authority no longer depended on a finding that the challenged practice had an adverse competitive impact.⁶⁹ The *S & H* Court concluded:

Thus, legislative and judicial authorities alike convince us that the Federal Trade Commission does not arrogate excessive power to itself if, in measuring a practice against the elusive, but congressionally mandated standard of fairness it, like a court of equity, considers public values beyond simply those enshrined in the letter or encompassed in the spirit of the antitrust laws.⁷⁰

Apart from the Court's mention of *Keppel*,⁷¹ however, nothing in the *S & H* opinion explains how the FTC should apply this legal standard, or even which "public values" supported the application of section 5 to *S & H*'s practices. In a footnote the Court did cite with apparent approval the "factors" the FTC had asserted in its 1964 Cigarette Rule for finding unfairness when the practice "is neither in violation of the antitrust laws nor deceptive."⁷² Yet the Court did not elaborate on the force of this reference and did not attempt to illustrate how the FTC could construct a reasonable or predictable definition of what is "unfair." One reason that the Court spoke in such elliptical generalities and avoided further elaboration is that the Commission's opinion had not shown how *S & H*'s activities were unfair toward consumers. As the Court acknowledged, "the FTC opinion . . . [was] premised on . . . the classic antitrust rationale of restraint of trade and

69. *Sperry & Hutchinson Co.*, 405 U.S. at 244.

70. *Id.* (footnote omitted).

71. In *Keppel*, the respondent candy manufacturer allegedly produced and distributed an assortment of candies inferior in quality to the assortments offered by its competitors at comparable prices. The respondent's practice of including small prizes in some of its packages, however, greatly increased the appeal of its candies among children. For this reason the sales of *Keppel*'s assortments were profitable, and eventually competing candy manufacturers complained to the FTC. See *R.F. Keppel & Bros.*, 291 U.S. at 306-08. The FTC found that the practice violated section 5 of the Act. The court of appeals ruled against the FTC, however, on the theory that *Keppel*'s practice did not involve deception, tend to create a monopoly, or hinder competition—because competing manufacturers were free to include prizes in their assortments. *Id.* at 308.

In reversing the court of appeals, the Supreme Court initially conceded that *Keppel*'s practice involved neither fraud nor deception. *Id.* at 309. But the Court reasoned that Congress did not intend the phrase "unfair methods of competition" to be limited to fixed and unyielding categories, and that under these circumstances the language of section 5 should be interpreted to prohibit the respondent's conduct. *Id.* at 310-12. *Keppel*'s practice was unfair because it unscrupulously encouraged young children to gamble as well as induced them to buy an inferior product. Finally, the Court stated that it would constitute a "gross perversion" of the normal meaning of the word to conclude that *Keppel*'s exploitation of children was not unfair. *Id.* at 313.

72. *Sperry & Hutchinson Co.*, 405 U.S. at 244 n.5. See generally rule cited *supra* note 4.

injury to competition,"⁷³ and thus the Court could not outline a definition of unfairness given the record before it in *S & H*. Indeed, the FTC's failure to link its counsel's conclusion that *S & H* had been unfair to consumers with any findings of consumer injury apart from those rooted in the antitrust laws caused the Court to remand the case for further FTC proceedings.⁷⁴

The anomaly and irony of *S & H* are complete. The Commission reversed the hearing examiner who had absolved *S & H* from any violation stemming from its restrictive stamp trading practices. The Commission relied on the examiner's findings of the nominal effect of these practices on competition to reverse and rule that this injury to competitors and consumers violated section 5. The court of appeals, however, reversed the Commission because its antitrust theory was admittedly unsupported by any finding of injury to competition. Continuing this consistent record of blemishes, the Supreme Court inodified the Fifth Circuit's reversal of the Commission's reversal. In doing so, however, the Court did not provide more than a broad-brush explanation of the statute on which it relied because the Commission's switch in theory between the two courts absolved the Supreme Court from having to show how the business practices violated the Act. Thus, the Supreme Court inerey held that under the evidence it was possible that the FTC could find that such violations had occurred. As if this were not enough, the final result appears to be that the case not only impaired *S & H*'s legitimate business, but also gave the FTC so much discretionary authority that it was almost consumed by its own excesses within a decade.⁷⁵

IV. AN ECONOMIC ANALYSIS

Although the Federal Trade Commission and the Supreme Court purported to focus their opinions on whether the particular restrictive policies adopted by *S & H* violated the FTC Act's prohibition of "unfair" trade practices, the opinions in *S & H* manifest a persistent underlying hostility to trading stamps. The Commission and the courts seem to believe that "the public is being cheated" by the widespread use of stamps, and that trading stamps should be disfavored because they are not "socially desirable."⁷⁶ To these observers, trading stamps are little

73. *Sperry & Hutchinson Co.*, 405 U.S. at 246.

74. *Id.* at 247-48.

75. See, e.g., Gellhorn, *The Wages of Zealotry: The FTC Under Siege*, REGULATION, Jan.-Feb. 1980, at 33.

76. Davis, *The Economics of Trading Stamps*, 32 J. BUS. 141, 141 (1959); see also *Rast v. Van Deman & Lewis Co.*, 240 U.S. 342, 365 (1916)(trading stamps "tempt by a promise of a value

more than a disguised price increase that both injures consumers and contributes to inflation. Moreover, if the "[i]nefficiency of trading stamps . . . as a medium of exchange is beyond doubt,"⁷⁷ their continued use seems explainable only because of consumer deception (through misleading customers into believing that they are getting something for nothing) or consumer coercion (by denying consumers an opportunity to obtain a cash discount alternative). Under either view, the FTC properly condemned trading stamp use in *S & H* as contrary to consumer welfare.

Unfortunately, this sketch of the evils of trading stamps does not accord with reality. First, although such coercion or deception is "rampant" in certain retail businesses, it is absent in others.⁷⁸ Restaurants and fast food stores have generally not offered stamps to their patrons, whereas supermarkets often have offered stamps to their customers. If the same persons generally patronize both these businesses, as seems to be the case, what explains their acceptance of stamps from some businesses and not others? Criticizing stamps as coercive does nothing to explain what makes stamps a favored promotional device in some markets and not in others.

Second, arguments of retailer overreaching do not explain the cyclical nature of the trading stamp business or sudden shifts in their use in particular industries. The use of stamps rose rapidly among grocery stores in the 1950's and declined during the 1970's. Trading stamps almost disappeared from gasoline stations in the middle of the 1970's yet their use quickly grew during this same period at truck stops, private plane bases, car rental firms, and financial institutions.⁷⁹ No consistent structural pattern explains the use of trading stamps.⁸⁰

greater than that article [with which they are distributed] and apparently not represented in its price, and hence it may be thought that thus by an appeal to cupidity lure to improvidence").

77. A. Alchian & B. Klein, *Trading Stamps* 1 (unpublished and undated manuscript provided by Professor Alchian; copy on file with author).

78. Joseph Hall, a former president of the Kroger supermarket food chain, perhaps best captured this contradiction between theory and practice when he said: "Nobody loves stamps except the customers." Bell, *Liberty and Property, and No Stamps*, 40 J. Bus. 194, 194 (1967).

79. *S & H* Interview, *supra* note 14.

80. Recent extensions by trading stamps into promotions of financial institutions and car rentals, *see infra* text accompanying notes 106-14, illustrate the apparent irrelevance of industry structure or the intensity of rivalry on the presence of trading stamps. These industries differ markedly in their structure, with entry rigidly controlled by law in the former, but not controlled at all in the latter. Similarly, price rivalry is strong among car rental firms, but was barred until recently among financial institutions. *See* Depository Institutions Deregulation Act of 1980, Pub. L. No. 96-221, §§ 201-210, 94 Stat. 142, 142-45 (gradual elimination of limits on deposit interest rates over six year period); 12 C.F.R. §§ 1201-1204 (1983)(regulations pertaining to Depository Institutions Deregulation Committee).

To understand the popularity of trading stamps and the fluctuation in consumer favor toward stamps, it is helpful to examine retailing practices where stamps are used and compare these practices with those in industries where stamps are not used or where their use has fallen into disfavor. The economic justification—if any—for S & H's restrictive practices, and the rationales of the Supreme Court and Commission opinions, can be more thoroughly evaluated in light of actual retailer trading stamp practice.

A. *The Trading Stamp Business.*⁸¹

In order for retailers to profit from trading stamps, the revenue increase stamps generate must be greater than their cost. Little is known, however, about how stamp plans achieve increased revenues, why retailers adopt them, or why customers often seek and save stamps.⁸² Several reasons, however, suggest partial answers.

81. Prior economic analyses of trading stamps are of limited value. This article draws from several previous ones but seeks to go beyond their findings. See *supra* notes 12-14, 76-78 (especially Davis, *supra* note 76, and A. Alchian & B. Klein, *supra* note 77); see also L. LYON & H. WHEELER, *THE ECONOMICS OF FREE DEALS* (1933); Beem, *Who Profits From Trading Stamps?*, 35 HARV. BUS. REV., Nov.-Dec. 1957, at 123; Beem & Isaacson, *Schizophrenia in Trading Stamp Analysis*, 41 J. BUS. 340 (1968); Bell, *Reply*, 41 J. BUS. 345 (1968) (reply to Beem & Isaacson); Charvat, *The Economics of Trading Stamps*, 7 J. PUB. L. 450 (1958); Sherman, *Trading Stamps and Consumer Welfare*, 17 J. INDUS. ECON., Nov. 1968, at 29; Strotz, *On Being Fooled by Figures: The Case of Trading Stamps*, 31 J. BUS. 304 (1958). Unfortunately, detailed economic data on stamp markets are not yet available. The paucity of empirical data limits sound policy analyses. Ms. Gale Mostellar, a graduate economics student at the University of Chicago, is preparing a thesis that seeks to explain cycles in the trading stamp business as an implied long term contract between retailers and customers in response to market instability.

82. The only serious published economic analysis of trading stamps is by Otto Davis, a predoctoral candidate, who offered two explanations: first, that stamps are used to increase volume as a price-cutting mechanism or as a device to influence customer store choice; and second, that stamps are used to discriminate in the prices charged retail store customers. Davis, *supra* note 76, at 141, 144.

Although Davis's analysis is instructive, it is often confused, and neither explanation seems fully satisfactory. For example, Davis contends that stamps will not be used by individual retailers to increase volume in a competitive market because price cutting is not feasible in that circumstance (because the retailer will already be pricing at his marginal cost). Thus, when used in competitive markets, "stamps cause a rise in measured prices, although their effect upon the 'true' price level would reflect the stamp discount, and this level would remain unaffected." *Id.* at 150. This conclusion fails to recognize that insofar as stamps increase revenue more than their cost (with overhead fixed in the short and medium run), they allow firms to increase output—and thus could even result in price reductions.

Davis argues, on the other hand, that stamps may be used to provide disguised price cuts where rivalry is clogged by cartels, national price advertising, or resale price maintenance. *Id.* at 142. Aside from questionable assumptions that national price advertising and resale price maintenance necessarily constrain price competition, this distinction between competitive and noncompetitive markets seems forced and contrary to actual practice. Indirect nonprice competition is not limited to less competitive markets; indeed, stamp-giving retailers frequently operate in highly competitive markets such as food retailing.

1. *Promotional appeal: volume increase and repeat business.* Both trading stamp companies and retailers who use stamps contend that the function of trading stamps, as with any promotional device, is to affect customer choice in order to increase the sales volume of stamp-giving stores.⁸³ Every aspect of a store's operation is a potential factor in competing for customers; the successful store manager must select that mix of products, services, and promotions most likely to increase patronage and profits. Compared to other promotional devices, trading stamps are most nearly like retailer-sponsored contests and manufacturer-sponsored ("cents-off") product coupons,⁸⁴ both of which are promoted at supermarkets, often in lieu of stamps. Contests and coupons are attention-seeking devices designed to attract customers to a store or product. Contests appeal to consumer gambling instincts in order to attract repeat business, especially where the contest rules are written to favor

Neither of Davis's volume explanations account for the cyclical nature of trading stamp sales. His price cutting argument does not explain how short-run advantages are likely to accrue or why competing retailers do not immediately neutralize the stamp advantage by offering competitive stamps, games, or similar devices, thus eliminating any gains. Finally, his price discrimination argument fails insofar as it depends on the retailer "giving stamps only to those customers requesting them or by asking each customer whether he saves stamps." *Id.* at 145. In fact, retailers generally do not offer trading stamps in this manner, because the usual license agreement between the larger, volume retailer and the trading stamp company charges the retailer a percentage of his gross sales rather than an amount based on the stamps used. S & H Interview, *supra* note 14.

Alchian and Klein subsequently developed a more refined price discrimination analysis. A. Alchian & B. Klein, *supra* note 77. Although intriguing and often persuasive, its central premise is that stamps are used for price discrimination, that a substantial number of customers given stamps will not redeem them, and that stamps are used to appeal to "elastic demanders" (i.e., poorer consumers less sensitive to time constraints) who would not otherwise patronize the retailer's establishment. *Id.* at 4-7, 18. The difficulty with their price discrimination analysis is that reliance on trading stamps for price discrimination requires market power by retailers and should be reflected in more moderate redemption rates, certainly not more than two-thirds to three-fourths of issued stamps. Yet, the redemption rate among large stamp companies is actually much higher. S & H, the industry leader, has until recent times had a redemption rate of 95%. See Sperry & Hutchinson Co., 73 F.T.C. 1099, 1166-67 (1968) (Commission opinion) (figure supplied by S & H and its tax returns filed with the IRS); see also *supra* note 22 and accompanying text. But see Brief for the Federal Trade Commission at 6, *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233 (1972) (14% of S & H stamps issued between 1914 and 1964 not redeemed as of 1964); but cf. 73 F.T.C. at 1167 (Commission finding that redemption rate cannot be determined with certainty, but probably somewhere between 86% and 95%). Classic price discrimination also requires that the discriminating seller exercise substantial market power, and available evidence suggests that stamp-dealing retailers do not have such power.

83. See generally H. VREDENBURG, *TRADING STAMPS* 62 (1956) ("The desire to increase sales volume is nearly always a dominant reason for installing a stamp plan."). It is possible, of course, that consumers generally view stamps as substantially enhancing the value of the goods they receive, because, for example, they believe that the present value of the deferred merchandise rebate from stamps exceeds the price increase stamps cause. In this case, sales would not necessarily decrease. Such a refund determination by the consumer, however, seems implausible.

84. See, e.g., Haugh, *Are Grocery Promos Loved or Hated?*, 40 *ADVERTISING AGE*, Aug. 7, 1978, at 47.

returning customers. Product coupons appeal to consumer price consciousness and are most frequently used to introduce new products. Trading stamps, like contests, encourage customers to return to the stamp-giving store because consumers must save stamps in order to redeem them for merchandise of value. Stamps rely, however, on a specified merchandise rebate instead of an uncertain lottery prize and are calibrated to the volume of a customer's purchases. Stamps also, like coupons, appeal to price conscious consumers, with the price discount deferred and usually available only in merchandise. Studies in consumer motivation also suggest that stamps focus consumer attention on stamp-giving stores by creating an interest in the stamp itself, and in particular in the automatic savings they generate for merchandise available on redemption.⁸⁵

Critics often question why retailers offer stamps when consumers are likely to prefer an immediate cash rebate. This criticism ignores the "appeal" of trading stamps as a promotional device. By limiting redemption of stamps to substantial numbers of stamps in full books rather than giving consumers an immediate cash discount for individual stamps, retailers reinforce repeat patronage. Similarly, a requirement that stamps be redeemed only for merchandise maximizes the available value of trading stamps for repeat customers who save stamps.⁸⁶

Two arguments might be made to challenge the conclusion that retailers use stamps to achieve an across-the-board volume increase in retail sales, but each of these arguments is flawed. First, the volume increase theory does not explain why stamps are used selectively by retailers. Why, for example, are stamps generally not available from

85. See SUPER MARKET INSTITUTE, A REPORT: SMI MID-YEAR MEETING 10-13 (O. Glissendorf ed. 1956)(panel discussion of research by Bertrand Klass)(available in Cornell Graduate School of Management Library); Davis, *supra* note 76, at 143 n.3 (citing work of Mr. Klass); see also FTC STAFF REPORT, *supra* note 12, at 231-34. The trading stamp industry also sometimes claims that customers select stores that give stamps because of their favorable quality and service image. Although possibly true for individual stores, no evidence suggests that this perceived difference either is true generally or substantially affects consumer choice. More significant, it seems, is the signal retailers send through trading stamps to consumers—namely, that they are offering a price rebate by deferred merchandise redemptions. See *infra* text accompanying note 117.

86. The consumer motivation studies noted earlier, see *supra* note 85, suggest that part of the appeal of trading stamps is their merchandise savings feature, a point reinforced by stamp company investment in widespread distribution of their merchandise catalogues and further illustrated by moves to upgrade and diversify the available merchandise. A deferred cash rebate—even if limited, for example, to the redemption of five full books or more—would undercut this appeal for repeat patronage based on the identified merchandise savings. Cash, in contrast to merchandise, also has the disadvantage to the stamp company of not being available in wholesale lots, and thus not only denies the stamp company any retail markup, but, more importantly, also reduces the apparent value of stamps to savers.

discount stores, restaurants and fast food stores, and barber and beauty shops? For that matter, what explains why supermarkets and some drug stores often rely on stamps, or why stamps once were popular at service stations? The same customers generally patronize all these types of establishments; they cannot be differentiated by customer income, education, sex, race, or any other obvious criterion. Thus, if trading stamps in fact have a widespread appeal, it would seem that all retailers would offer them, or at least that their use would not be segregated in certain types of retail businesses.

There are, however, explanations that suggest why some but not all retailers offer trading stamps for promotional purposes. Stamp companies do not design trading stamps for, nor offer them to, every type of retail business. Stamps are primarily attractive to businesses with high volume, relatively low-priced standardized goods. Immediate price discounts, informational advertising, and service are more effective competitive tools for high-priced and specialized goods for which customers frequently shop around, such as refrigerators, television sets, and ranges. In other words, stamps are likely to be effective only where individual items involve small amounts—as in supermarkets but not appliance stores—and where the price is uniform and patronage is not widely affected by service or taste—thus excluding personal service outlets such as restaurants, fast food outlets, or barber shops.

The second argument against the volume increase theory is that trading stamps are most useful for retailers who adopt it first, with any advantage being lost⁸⁷ once competitors offer stamps and saturate the market. In economic terms, according to this argument, the primary impact of stamps is on individual store demand, particularly in the short run. Therefore, only the initial focus of trading stamp plans is on a volume increase for individual stores. Why do retailers adopt stamp programs and fail to recognize the futility of introducing stamps when in the long run they will not redistribute market shares but will only drive up costs and prices, and thereby reduce overall sales?

This second argument is flawed because it rests on a static and seemingly unrealistic view of competition. Stamps are but one of many promotional packages that retailers use to satisfy widely varying consumer preferences which are constantly in flux and respond to market instability. As a result, retailers change their mix of promotional tactics continually by including (or excluding) stamp offerings in their promotions as they seek to adjust to the demands of the competitive market. It is therefore not surprising that even in periods of peak popularity,

87. See Note, *supra* note 12, at 1093-94.

stamps have not saturated any industry or market.⁸⁸ Indeed, abrupt changes in the use of stamps are not uncommon. Such changes were illustrated most dramatically with the almost overnight disappearance of stamps from service stations during the oil embargo of 1973,⁸⁹ when price controls assured consumer demand and retailers were able to abandon all promotional efforts. Correlatively, trading stamps are used to change buying patterns, as when they were used to induce customers to transfer their allegiance to supermarkets in the 1950's and 1960's.

2. *Product design.* As these last comments suggest, it is too simple and overbroad to say that retailers use stamps solely to increase sales volume. At its extreme this approach assumes that stamps have universal appeal for consumers; yet it is clear that not all consumers are attracted by trading stamps.⁹⁰ The fact that some consumers are attracted to stamps while others are repelled or indifferent may provide a more complete basis for understanding the focus of the volume increase rationale.

The theory suggested here is akin to price discrimination, which is well established and not particularly complex.⁹¹ More specifically, if a seller can differentiate his product from others through trading stamps, in accordance with the different desires of his customers, he can gain a competitive advantage. Trading stamps offer all customers a deferred rebate, but they do so at a "price" to the consumer—namely, a consumer must be willing to collect, save, and redeem the stamps to receive the rebate. For those customers who purchase the retailer's product or service but are not willing to save and redeem stamps for merchandise, the stamps are no inducement and may indeed have negative impact. For those customers who are relatively price-sensitive (and time-insensitive), however, the stamp service represents a deferred rebate. In other words, successful product design through trading stamps has the double advantage for retailers of generating both additional volume

88. See C. FULOP, *supra* note 15, at 28-32; see also H. VREDENBURG, *supra* note 83, at 112.

89. S & H Interview, *supra* note 14.

90. Stamps are not universally attractive to consumers in part because of the time and effort that goes into collecting them. Collecting stamps requires an extra transaction at the time of purchase, care in handling to prevent loss, saving, licking and pasting stamps in stamp books, and redemption at the stamp company's merchandise store or mail order center. Each step requires time—particularly the book-filling and redemption of stamps—and the merchandise offered is limited, although far less so than in earlier years. Moreover, the merchandise rebate is unavailable until the required number of books have been saved, and this also takes time. Although stamp companies have ameliorated some of these drawbacks—for example, by making redemption centers more attractive and by increasing merchandise inventories—stamp plans necessarily entail many limitations and clearly are not desired by all consumers.

91. See R. POSNER, *ANTITRUST LAW: AN ECONOMIC PERSPECTIVE* 62-65, 171-84 (1976).

and increased profits.⁹² In order to be successful, this scheme must both detect the different demands of customer groupings and be able to prevent arbitrage. If the retailer fails to prevent arbitrage, those customers being "charged" less may resell the retailer's product sans stamp to those not attracted by stamps, at a price lower than the retailer's.⁹³ The arbitraging customer will profit from the resale as long as the value of the stamps received exceeds the sum of the price differential and any transaction and search costs incurred.

Retail merchants that use trading stamps in order to promote products benefit consumers by allowing them to save search costs and purchase time. Although many (perhaps most) consumers are probably indifferent to trading stamps, some consumers will be more stamp-sensitive and less time-sensitive, and will thus be attracted to stores with trading stamps. For example, those who are unemployed, elderly, or poor are likely to find stamps a critical factor, on the one hand, and their time less highly valued, on the other. These customers may be willing to expend the extra time that trading stamps require in order to obtain deferred merchandise rebates—which are, to them, a delayed price reduction. These customers, not otherwise drawn to a store, may shift their patronage to stamp-giving stores.

This scenario shows how merchants can use trading stamps to redesign retail products and why shifts in trading stamp use are likely to accompany market changes. Counting the value of the deferred rebate in the purchase price (discounted for the stamp saving period), retail goods accompanied by stamps are in effect offered to the stamp saver at a lower price than they are to the non-saver.⁹⁴ The trading stamp thus is an effective device for retailers to segregate customers according to differences in their willingness to pay a higher price rather than expend the time to save and redeem stamps. This form of price discrimination has the advantage of allowing each customer to select the price category in which he fits, and of allowing consumers to switch categories as their demand elasticities change. The use of trading stamps is likely to have the greatest appeal when market changes occur and established trading patterns are under pressure.

92. This assumes, of course, that if only one product configuration is available, some sales will be lost to the retailer and his overall profits would be reduced.

93. See A. ALCHIAN & W. ALLEN, *UNIVERSITY ECONOMICS* 126-27 (3d ed. 1972)(requisites of price discrimination).

94. Whether the price is viewed as being lower to the stamp saver or higher to the customer who does not save stamps is, of course, irrelevant because what matters is that there is a relative price difference.

An examination of the available evidence, however, does not fully support this product design hypothesis. For most retail stores, the unemployed, elderly, and poor are unlikely major targets for increased sales—unless stamp-saving housewives are also classified in this group—and constitute limited markets. Likewise, if retailers use trading stamps to differentiate among customers, one would expect to find either that a substantial number of stamps were not being redeemed by consumers or that retailers were issuing stamps selectively, seeking to limit them to customers who were not time-sensitive. Neither situation appears to be the case. Trading stamp companies report an extraordinarily high redemption rate—somewhere between ninety and ninety-five percent of all stamps issued are redeemed⁹⁵—and this certainly dilutes the strength of a product design theory.⁹⁶

Moreover, stamp companies exert considerable pressure on retailers to encourage consumers to redeem stamps⁹⁷ because stamp companies use redemption rates for competitive purposes to show the degree to which consumers are attracted by stamps. Although a high redemption rate might be explained if trading stamps are disproportionately available to consumers who are “time-insensitive,”⁹⁸ the available evidence again does not bear this out. Stores using trading stamps in no way limit the availability of stamps nor do they distinguish these customer groupings in any manner. Indeed, retailers have generally instructed sales personnel to give stamps to customers even if the customer initially declines them; some have even gone so far as to provide opportunities for rejected stamps to be taken by subsequent customers.⁹⁹

Other aspects of the trading stamp business similarly indicate that the product design theory is somewhat tenuous. If product design were a principal object of trading stamp promotions, one would expect most stamp programs to be controlled by retailers rather than run by independent companies because retailers would immediately capture the

95. See *supra* notes 22, 82 and accompanying text.

96. Because some stamps are inevitably lost, a differential of at most 10% hardly justifies such a costly scheme; the returns to the retailer would be simply too small.

97. See, e.g., Sperry & Hutchinson Co., License Agreement Form 22M, ¶ 2(c) (Jan. 1974) (licensee agrees to offer stamps “unconditionally to all customers making cash purchases”) (copy on file with author).

98. This could be accomplished through several methods. For example, retailers could control stamp distribution by making stamps available only on request, by denying them to express line customers, or by limiting them to cash customers (assuming credit is a proxy for time insensitivity).

99. S & H's standard license agreement is illustrative. It requires licensees to abjure any limitation on the availability of stamps to all customers. Sperry & Hutchinson Co., License Agreement Form 22M, *supra* note 97, ¶ 2(c).

benefits of differential redemption rates.¹⁰⁰ Again the facts are to the contrary. Retailer owned stamp plans have at times been successful, particularly those operated by large food chains, but only in the short run.¹⁰¹ The stamp plans that have survived and sometimes prospered are operated by independent companies such as S & H. Moreover, the majority of stamps are distributed through retailers who are charged on a percentage of gross sales,¹⁰² and this further discourages retailers from promoting redemption differentials. This payment system is deliberately designed so that individual retailers will promote a high redemption rate because the redemption rate reflects a high degree of customer acceptance of the retailer's stamp plan,¹⁰³ although it is only the overall redemption rate that determines the cost to the retailer.¹⁰⁴

On the other hand, these limitations do not necessarily demonstrate that retailers never use trading stamps for product design. Retailers often face mixed consumer classes that include (but are not limited to) the unemployed, the elderly, and the poor—or other groups who are not time-sensitive. In this circumstance, stamp plans that would increase sales by attracting stamp-sensitive consumers without an across-the-board price cut are highly desirable. In addition, market factors such as retail innovations may make trading stamps more appealing for a period of time. The limitations of the design theory reflect the fact that trading stamps serve many related purposes and that product design does not always predominate, that perfect product configuration is not possible, and that the degree of product discrimination afforded by stamp plans varies greatly. Nonetheless, even this scenario of limited product configuration cannot be fully substantiated. The evidence of a differential redemption rate is simply inconclusive.¹⁰⁵ Con-

100. See C. FULOP, *supra* note 15, at 11, 51-52.

101. See FTC STAFF REPORT, *supra* note 12, at 214.

102. S & H Interview, *supra* note 14.

103. See *supra* note 22.

104. See FTC STAFF REPORT, *supra* note 12, at 204.

105. The unreliability of the redemption data is one factor; another is its sole focus on ultimate redemption rather than the time between issuance and redemption. The high redemption rate noted earlier, see *supra* note 22 and accompanying text, is misleading as long as the duration between issuance and redemption is not similarly tracked. Stamps are, like money, an item of recognized value. One would not expect large quantities to be lost over time. Thus, the figure of importance may be the time between issuance and redemption rather than the ultimate redemption rate. In other words, the near-term redemption rate may be a more accurate reflection of the rate of consumer savings, and it seems probable that it would reflect a much lower redemption differential.

Stamps are, however, neither time-dated nor otherwise marked. Figures on the "duration period" of trading stamps are not available and there are no published studies of analogous situations, such as the redemption rates in areas of stamp expansion. As a result, it is unclear whether

sequently, the product design theory of trading stamp use is, in the absence of a fuller demonstration, plausible but not proven.

3. "*Chiseling*." A persuasive but more limited theory explaining retailer reliance on trading stamps in some markets is their use by selected groups of customers either to avoid price controls, or otherwise to shift income between a purchaser and his employer or the Internal Revenue Service. Labeled as "cheating" in other contexts,¹⁰⁶ the stamp premium is used in this circumstance to evade legal requirements or established norms. Despite its sometimes questionable purpose, this theory probably explains much of the stamp industry's recent growth in four markets: financial institutions, truck stops, private plane refueling, and car rentals.¹⁰⁷ It may also explain the early popularity of stamps among retailers hampered by resale price maintenance encouraged under fair trade laws.¹⁰⁸ Trading stamps provide an opportunity for chiseling because stamp redemption does not directly contravene rules against cash payments, yet it operates like a deferred cash discount, leaving few traces, and is difficult to police.

The use of stamps to promote savings accounts is, however, one partial exception to the generally low visibility of chiseling. Financial institutions are heavily regulated.¹⁰⁹ These institutions are required to keep extensive records and are subject to detailed rules governing the interest rates they can offer customers. On the other hand, close price regulation has not eliminated all rivalry among savings institutions. One manifestation of this competition has been the offer of "gifts" such as toasters, clocks, or pots and pans to new customers. Such merchandise offerings, however, are necessarily limited and unlikely to have broad customer appeal. Thus, in recent years savings institutions have sometimes offered trading stamps as an alternative because stamps offer both a wider range of merchandise as well as an opportunity for the customer to combine these stamps with those saved from other sources.

retailers commonly use trading stamps to divide customers into separate classes and redesign the product according to their desires.

This argument is easily overstated, however. Retail stores, particularly in the grocery business, operate in highly competitive markets with relatively small margins. Even slight shifts of trade can make a substantial difference in profitability. As a consequence, the nonredemption rate plus the duration which consumers hold stamps prior to redemption may, when cumulated, provide solid evidence of product configuration.

106. See, e.g., R. POSNER, *supra* note 91, at 53 ("cheating" by members of a price-fixing cartel).

107. S & H Interview, *supra* note 14.

108. See Davis, *supra* note 76, at 142.

109. See, e.g., T. MORGAN, CASES AND MATERIALS ON ECONOMIC REGULATION OF BUSINESS 170-89 (1976).

The irony of these stamp offerings is that although initiated as an effort to evade the restraints of price controls imposed by bank regulators, these premiums are themselves now regulated.¹¹⁰ So regulated, the use of stamps constitutes "lawful chiseling."

A more substantial illustration of the use of trading stamps to chisel is found in their use in recent years at stations for the retail refueling of private planes and at truck stop service centers,¹¹¹ although in both instances the legality or at least propriety of this use of stamps by the purchasers may be doubtful. Where the gas or oil purchaser is the employee of a third party, the stamps are apparently used by retailers as the equivalent of a side payment to the employee, and are obviously designed to attract his patronage by offering the stamps as an unaccounted-for discount. That is, the employee-pilot or driver pays for the fuel by credit card or cash and uses the receipt to obtain subsequent reimbursement from the employer; in either event, the transaction does not record the value of the trading stamps that the employee receives from the retailer for diverting the sale to the stamp-issuing retailer. If this side payment were made in cash rather than trading stamps, there would be no question that such payments were illegal commercial bribery.¹¹² On the other hand, noncash payments have long been used in trade to assure business, and where their value is insubstantial few questions are raised either by employers or tax collectors. As the value of the noncash payment increases, however, certainty fades, and at some point it is clear that large noncash payments become indistinguishable from cash.

The problem is well illustrated by truck stop orders. When fuel prices were low, a two or three percent discount would not amount to much when compared to the inconvenience of obtaining the discount by a deferred merchandise rebate through saving trading stamps. Today, by contrast, a trucker will receive a book of trading stamps for each refill of the truck's tanks, and the average trucker is likely to acquire a dozen books—each worth about three dollars in merchandise—on a single long distance haul. Thus, it is not surprising that stamps are now an attractive lure. Indeed, some truck stops have gone so far as to steal stamps in order to make them available to their patrons.¹¹³

110. See 12 C.F.R. §§ 217.147, 1204.109-.111 (1983)(regulation of premiums and prepayment of interest). As interest rates are deregulated, *see supra* note 80, the advantages of trading stamps for financial institutions for chiseling will decline.

111. S & H Interview, *supra* note 14.

112. See MODEL PENAL CODE § 224.8 (Proposed Official Draft 1962).

113. S & H Interview, *supra* note 14. This may also explain the introduction of trading stamps in the car rental market in recent years and by airlines since deregulation. See, e.g., Wall St. J., Jan. 5, 1982, at 29, col. 4 (Air Florida adoption of S & H Green Stamps).

The "efficiency" of trading stamps as a medium for such payments is likewise easy to see: stamps are better than cash because they do not clearly fall within most company reporting requirements and the IRS does not identify them as wages. Like cash they are hard to trace and difficult to monitor because the employer (or IRS) must rely on the employee to report the stamp transaction. Recent efforts of trading stamp companies to upgrade their merchandise catalogues to include top-of-the-line appliances, quality furnishings, and tasteful clothing have enhanced the desirability of stamps as a noncash medium. These "advantages" are not restricted to trucking company or other employees; owner-operators can also use such "off-the-book" transactions to reduce stated revenues and thus lower reported taxable income.

Whatever the particular basis by which customers use trading stamps to chisel, the economic justification for retailers seems clear. Retailers use stamps to shift patronage; and, because fixed costs will not change markedly in the short run, this volume increase both reduces unit costs and thus increases profits.¹¹⁴

4. *Coercion, deception, and exploitation.* Critics frequently assert that despite widespread adoption of trading stamp plans by retailers, consumers generally dislike trading stamps.¹¹⁵ According to this theory, if consumers were given a "free" choice they would reject stamps and prefer a cash discount. The proponents of this view buttress their argument by showing that stamp companies generally disallow cash options. Thus the "attraction" of trading stamps for consumers must, it is assumed, rely on some unfair advantage held by stamp companies or retailers over consumers, be it coercion, deception, or exploitation.

The coercion argument is easiest to state. Stamps are, after all, "forced" on consumers; consumers pay for them whether or not they want the stamps. Nonsaving customers accordingly are required to subsidize the retail purchases of others. Nor does the coercion stop here. It also extends to those who save and redeem stamps, because trading stamp companies deny consumers a choice by limiting the

114. The above-listed major justifications for retailer reliance on trading stamps do not exhaust all possibilities. Offers of bonus stamps for purchases made during particular days, for example, are obvious attempts to transfer store traffic to off-peak periods. At one time, retailers introduced stamps as a premium for cash rather than credit purchases; however, the continued use of stamps as a reward for cash payments seems unpersuasive as long as a cash discount is available and at less cost to the retailer. The difficulty with these or similar analyses is that they explain, at most, particular events and not a widespread, sustained use of stamps.

115. This, at least, was the view of many law faculty as revealed to me in several law and economics workshops where an intense, visceral antagonism to trading stamps was only slowly muted by focusing attention on the analysis and argument presented here. *But see* FTC STAFF REPORT, *supra* note 12, at 231-34.

products they can purchase with their stamp books. The deception and exploitation arguments assume that consumers willingly save stamps only because they incorrectly believe stamps are more valuable than they actually are. In this scenario consumers are misled by trading stamp companies and their witting agents through retail promotions that exploit consumer weaknesses to make them believe that stamps provide something for nothing (or at least are worth more than they cost the consumer). The claim, in other words, is that stamps rely for their success on a failure in the information market. If consumers only knew that trading stamp plans rely in part on nonredemptions, on the wholesale/retail differential, and on the use of the "float" for their profitability, they would not be attracted to trading stamps and stamps would disappear as promotional attractions.

Although these contentions cannot be definitively rebutted in every particular, they are on the whole neither theoretically sound nor empirically supportable. There is another more plausible theory, also consistent with the economics of retailing, that explains why consumers are attracted to trading stamps. For a promotional technique to be effective, it is necessary only that the aggregate net return from each additional unit of cost be positive—not that the marginal return from every particular customer be positive. Trading stamps, like all other promotions, must be examined in context. They are designed to appeal to limited segments of the buying audience who cannot be attracted by the retailer in a more effective or less costly way. Consumers save stamps because they consider them valuable. Retailers use stamps because they are an efficient technique to increase volume, lower unit cost, and attract repeat customers in highly competitive markets. Indeed, trading stamps are used most frequently where retail innovations or other changes have made markets unstable and customers more willing to shift their patronage.

It also seems a distortion of reality to talk of consumer coercion as long as customers have a choice of retail stores not offering trading stamps. In any case, however, just as it is not coercive for all supermarkets to offer services never used by some shoppers (express lines, carryout helpers, free parking, etc.), so it is irrelevant that competing retailers may in some situations all adopt trading stamps. Similarly, the conjecture that trading stamps rely on consumer deception or exploitation is highly speculative and has not been documented despite repeated investigations.¹¹⁶ Certainly, consumers are not deceived into believing that stamp savers will be able to redeem books of stamps for

116. See *supra* notes 32-42 and accompanying text.

merchandise not listed in redemption catalogues. It is more likely that consumers understand that trading stamps are a signal that price discounts by deferred merchandise rebates are available through repeat shopping at stamp-giving stores.¹¹⁷ There is simply no evidence to suggest that consumers are less knowledgeable about the economics of trading stamps than they are about the economics of other promotional devices.¹¹⁸ In short, trading stamps are no more or less coercive, deceptive, or exploitative than any other promotional device.

5. *Summary.* Each of the above explanations is essentially a variation of a single theme: retailers use trading stamps to attract customers not otherwise attracted to their stores because trading stamps are the most efficient method available. In other words, none of these explanations of the economic function of trading stamps is exclusive, yet each helps explain why stamps are often a popular and effective promotion technique, particularly in response to periods of market instability. Promotional devices do not have to be universally applauded to be economically effective for both consumers and retailers. Trading stamps are similar to product coupons, contests, or even price advertising, in that even though each does not appeal equally to every retail customer, their effect is to increase the aggregate economic efficiency of retail store operations.

B. *S & H's Restrictive Practices.*

Two of the three charges brought by the FTC against S & H involved restrictive practices greatly relied upon by the trading stamp business.¹¹⁹ One practice, S & H's one-for-ten policy, prevented retailers from offering bonus stamps or otherwise distributing stamps in multiples of the normal distribution. The other practice, S & H's limitation on the transferability of trading stamps by consumers, restricted consumers to only full book redemption, and only at S & H merchandise centers. Prior to the FTC's prosecution of S & H, alternatives such as cash options, exchanges of Green Stamps for non-S & H stamps or

117. See *supra* note 85.

118. In any event, there are at worst a number of explanations for the existence of trading stamps. Even if none is without its puzzles and difficulties, it is hardly appropriate to place the burden on trading stamp companies to explain the success of their product. If the disinclination to provide a (deferred) cash redemption option is a thorn in the side of the "efficiency-based" explanation of trading stamp use, then so too is the emergence of hundreds of stamp companies—intensely competitive on all grounds except the cash redemption variable. This fact poses an evidentiary obstacle to the adoption of a collusion-deception view.

119. See *supra* note 35-36 and accompanying text. The conspiracy charge, that S & H in agreement with other stamp companies agreed to fix the number of stamps per purchase, followed traditional cartel theory and is unrelated to this analysis.

merchandise, or partial book redemptions were unavailable and often were enjoined by court order. The initial FTC order banned both restraints,¹²⁰ and they remain barred a decade after the Supreme Court's decision.¹²¹ An economic analysis of these restrictions, however, indicates that not only did they pose little or no threat to consumer well-being, but that their ban may have decreased the welfare of consumers.

1. *The one-for-ten policy.* The FTC staff charged that S & H's rule controlling the rate at which retailers could issue stamps was an illegal restraint because it injured retailers and dampened competition.¹²² In accordance with the mandatory one-for-ten ratio, retailers could not independently exercise their judgment as to what rate was most advantageous for them, including any use of multiple stamping. Because the latter was said to be a cause of intensified price competition, the FTC's position was that cutting off bonus promotions—an admitted effect of the restriction—limited competition and injured consumer welfare. In light of the Supreme Court's analysis in 1977 in *Continental T. V., Inc. v. GTE Sylvania Inc.*,¹²³ however, these arguments have a quaint ring. In *Sylvania* the Supreme Court ruled that manufacturer-imposed nonprice vertical restrictions are not subject to a per se rule of antitrust prohibition, but should be scrutinized under the Rule of Reason.¹²⁴ Applied to S & H, the lawfulness of any nonprice restrictions would depend on their impact on competition under a standard of reasonableness, and in particular, on whether they would "promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products."¹²⁵ Thus, restrictions on distribution such as the one-for-ten rule would survive antitrust scrutiny today as long as S & H faced promotional service competition and the restraints were in fact designed to increase the appeal of S & H's stamp plan.

Both tests are readily met in this instance. First, as to interbrand competition, S & H's stamp plan competed not only with other stamp companies, but also with numerous other promotional devices that re-

120. *Sperry & Hutchinson Co.*, 73 F.T.C. 1099, 1226-27 (1968).

121. *Sperry & Hutchinson Co.*, 83 F.T.C. 478, 482-84 (1973)(consent decree); cf. *Sperry & Hutchinson Co.*, 82 F.T.C. 388, 389-90 (1973)(final order on counts I & II prohibiting S & H from controlling distribution ratios).

122. Complaint Counsel's Brief in Support of Appeal from Initial Decision at 41-46, *Sperry & Hutchinson Co.*, 73 F.T.C. 1099 (1968).

123. 433 U.S. 36 (1977); see Baker, *Interconnected Problems of Doctrine and Economics in the Section One Labyrinth: Is Sylvania A Way Out?*, 67 VA. L. REV. 1457, 1460-63 (1981).

124. *GTE Sylvania Inc.*, 433 U.S. at 57-59.

125. *Id.* at 54.

tailers used to attract customers.¹²⁶ Next, as to the purpose of the restrictions in promoting the appeal of S & H's stamp plan, it is clear that the restrictions were designed specifically to make S & H's plan more desirable. This is demonstrated by the number of advantages that the ratio restriction had for stamp promotions. For instance, the one-for-ten policy provided a standard by which consumers could both identify the product and rely on the amount to be distributed, and both are necessary to establish brand identity. More importantly, it provided a measure to limit the number of stamps issued by larger stores which pay for stamps as a percentage of gross revenues. Otherwise, these stores could impose additional costs on S & H by distributing more stamps than the one-for-ten ratio permitted.¹²⁷ For smaller stores, which purchase the stamps on a per stamp-pad basis, an established issuance rate simplifies the preparation of promotional budgets and avoids problems caused by the ease with which small stores can alter their books.¹²⁸ The restriction was also central to a critical feature of trading stamp promotions: stamps appeal to consumers of high volume, low value goods. By setting the stamp value at a small amount, an appreciable number of stamps were issued with each purchase. S & H thereby assured that customers were constantly reminded of the stamp premium. Constant distribution also created customer loyalty and encouraged further stamp saving. The restriction was, in other words, an integral part of the S & H promotional system for attracting and retaining customer patronage.¹²⁹

126. It may be objected that stamps and other promotional devices may not occupy the same product market. Indeed, in the mid-1960's, when some 250 to 500 stamp companies were in operation, trading stamps plausibly could have been defined as a single product market. See *supra* note 14 and accompanying text. Given the decline in the use of stamps and the stamp business in the past decade, however, it does not appear that stamps are as highly valued as they once were. Retailers now perceive stamps as only one out of many ways to promote their stores. Consequently, stamps and other promotional devices—coupons, contests, etc.—should be seen as occupying the same product market. See Landes & Posner, *Market Power in Antitrust Cases*, 94 HARV. L. REV. 937, 961-63 (1981).

127. By using both a one-for-ten policy and pricing stamps based on a percentage of gross sales, S & H can prevent large retailers from increasing their sales through the discriminate use of S & H stamps without paying S & H for these benefits. Large retailers might otherwise lure new customers with bonus stamps and then discourage customers from claiming their stamps. Apart from allowing S & H to gauge the value of the stamps' service, the one-for-ten and percentage of gross sales policies thus discourage a practice which is inimical to consumer choice and welfare, and which would tarnish the good will of S & H.

128. Although large stores are offered a volume discount on stamps by being guaranteed that stamp costs will not exceed 2% of gross sales, smaller stores pay for them on a per stamp-pad basis. S & H Interview, *supra* note 14. Thus, the number of stamps issued determines the costs incurred by smaller stamp-giving stores.

129. This rationale for the one-for-ten rule can, however, be overstated. Multiple stamping is also used by retailers offering stamps to attract patronage and adjust store traffic. C. FULOP, *supra*

2. *Limits on transferability.* By the time the *S & H* case reached the Supreme Court, the only conduct at issue was the limitation *S & H* had imposed on the transferability of trading stamps by retail licensees and their customers.¹³⁰ These restrictions took a variety of forms, but the most important restriction limited customer redemption of stamps to merchandise available at *S & H* centers in exchange for at least one full book of stamps. In particular, *S & H* did not honor requests for cash in lieu of merchandise—except in the twenty states which required a cash redemption option as a matter of law¹³¹—and savers of partial books could not redeem their collected stamps in any circumstance. Indeed, most merchandise at *S & H* redemption centers cost at least two books of 1200 stamps apiece, and the average number of books per redemption exceeded this figure.¹³² *S & H* enforced these restrictions not only at its redemption centers but also by active prosecution of independent trading stamp exchanges which offered for a fee to redeem or exchange partial or full books for cash, merchandise, or other trading stamps.¹³³

The FTC staff supported its complaint against *S & H* with two arguments attacking the transferability restraints. First, the staff contended the restrictions unduly insulated *S & H* from competition by eliminating an entire segment of the industry from the market, namely, the independent stamp exchanges.¹³⁴ Second, it claimed that the restraints unfairly narrowed consumers' right to free alienability of their property because the restrictions limited consumer opportunities to redeem trading stamps.¹³⁵ The FTC staff argued that both effects were contrary to consumer welfare: competition was lessened because in-

note 15, at 23, 34; *see also* *Sperry & Hutchinson Co.*, 73 F.T.C. 1099, 1123, 1146 (1968)(hearing examiner's initial decision). Moreover, *S & H* has not always enforced the restriction, especially when its licensees have faced bonus stamp competition. *See id.*; *Sperry & Hutchinson Co.*, 73 F.T.C. at 1169-70 (Commission opinion)(20% of *S & H* licensees offer multiple stamps to combat stamp competition). Thus, it is not surprising that *S & H* did not appeal the FTC order excising the one-for-ten provision from its licenses. This suggests merely that trading stamps can be marketed in more than one way, not that issuance restrictions adversely affected retail competition or consumer welfare.

130. Brief for Petitioner at 3, *Sperry & Hutchinson Co. v. FTC*, 432 F.2d 146 (5th Cir. 1970), *modified*, 405 U.S. 233 (1972).

131. *See Sperry & Hutchinson Co.*, 83 F.T.C. 478, 479 (1973)(Comm'r Jones, dissenting). Of course, consumers could also redeem the stamps for merchandise.

132. *See C. FULOP, supra* note 15, at 48 n.1 (average redemption in U.S. is 2½ books); *Sperry & Hutchinson Co.*, 73 F.T.C. at 1119 (hearing examiner's initial decision).

133. *See Sperry & Hutchinson Co.*, 73 F.T.C. at 1133-35 (hearing examiner's initial decision), 1192 (Commission opinion); Note, *supra* note 12, at 1103-09.

134. Complaint Counsel's Brief in Support of Appeal from Initial Decision at 25-36, 62-77, *Sperry & Hutchinson Co.*, 73 F.T.C. 1099 (1968).

135. *Id.* at 59-76.

dependent exchanges were excluded from the redemption market, and consumer sovereignty was impaired because customers could redeem only full books, and then only for S & H merchandise. Thus, the FTC staff sought an order requiring free transferability (including an end to actions seeking to suppress exchanges), a full opportunity for cash options, and a recognition of partial book redemptions to aid the competitive process and benefit consumers.¹³⁶ Such an order would also be consistent with consumer desires as reflected by the patronage of independent exchanges.

Both of these arguments are flawed, and reflect a basic misunderstanding of the operation of retail markets. Considering first the competitive impact of S & H's efforts to suppress independent exchanges, the FTC staff's market analysis was little more than a self-fulfilling prophecy. The analysis assumed that there is a separate market in trading stamp redemptions and that S & H's actions were designed solely to protect its market position among redemption centers. Yet stamps are not a separate retail product sold for resale at a profit. They are, instead, one of several promotional schemes competing with each other for retailer approval.¹³⁷ Moreover, it is incorrect to suggest that the redemption process can be examined in isolation from its role in trading stamp retail promotion; it is only one aspect of stamp promotions.

To understand S & H's high-pressure response to independent exchanges, it must be recalled that the main focus of trading stamp promotions is to shift consumer shopping habits to stamp-giving stores as part of an effort to develop repeat patronage. To this end, independent trading stamp exchanges threatened S & H, not for any rivalry they might offer in merchandise competition (which comes in fact from competing stamp plans), but because they undermine the "pull" of the S & H brand. The availability of independent exchanges diminishes consumer incentives to save Green Stamps. Instead of needing to collect several books of S & H stamps in order to redeem them for desired merchandise, the stamp-saving customer is free to collect any stamps. With alternative redemption arrangements, the stamp saver may at anytime "redeem" any mix of stamps for cash, merchandise, or other stamps.¹³⁸ In that circumstance, the stamp saver would no longer be

136. *Id.* at 77-79.

137. See *supra* text accompanying notes 84-85; see also *supra* note 126 and accompanying text.

138. Independent exchanges charge for this service—from 25 to 50 cents per book in 1970—and their profits derive solely from this arbitrage. See *Sperry & Hutchinson Co. v. FTC*, 432 F.2d 146, 149 (5th Cir. 1970), *modified*, 405 U.S. 233 (1972); *Sperry & Hutchinson Co.*, 73 F.T.C. at 1191 (Commission opinion); see also Note, *supra* note 12, at 1105-06.

obliged to amass several books of stamps because even partial books would be accepted. In fact, if exchanges became commonplace there would be little reason for customers to save stamps or for retailers to offer them, because all incentives for accumulation would be removed and stamps would become nothing more than a functional cash discount. In this case, of course, the free-riding independent exchanges would put themselves as well as the stamp companies out of business.

The FTC's second argument, that limits on the alienability of trading stamps improperly restricted consumer sovereignty, was similarly misplaced. The staff sought to determine the legality of S & H's redemption restrictions based upon whether or not S & H's retention of title to the stamps in its license agreements was valid.¹³⁹ If the retention was invalid, the FTC staff argued that the restriction was an impermissible invasion of consumer sovereignty, and consumer welfare was impaired.¹⁴⁰ This reasoning turns on a mere formalism—the vesting of title—to determine the law, and then infers detrimental economic effects from the legal conclusion. The sterility of this analysis is apparent; indeed, it has long been recognized that legal consequences should be derived from economic realities, and not the other way around.¹⁴¹

Viewed from the perspective of the stamp program in its entirety, S & H's limits on redemption were designed to shift consumer patronage by creating consumer loyalty to stamp-issuing retail stores. The effectiveness of any stamp plan depends upon its ability to encourage consumers to save stamps from a particular firm over time. This means that the consumer must be discouraged from switching either stamps or stores over this period. Protection from competing stores is furthered by exclusive territories and the "family of merchants" concept.¹⁴² Inducements for consumers to choose stamp-giving stores include offers of attractive merchandise, reminders of stamp availability, and most importantly, requirements that encourage long-term saving. The full book minimum serves this last function in particular by requiring that the customer makes at least \$120 worth of purchases in order to obtain the deferred rebate.¹⁴³ Allowing cash options or partial book redemptions also reduces pressure to save stamps;

139. Complaint Counsel's Brief in Support of Appeal from Initial Decision at 59-61, Sperry & Hutchinson Co., 73 F.T.C. 1099 (1968).

140. *Id.*

141. See generally Kitch, *The Intellectual Foundations of "Law and Economics"*, 33 J. LEGAL EDUC. 184 (1983).

142. See *supra* notes 19-21 and accompanying text.

143. In 1981, between three to five books (or \$360 to \$600 of purchases) were needed to obtain the most frequently desired merchandise. S & H Interview, *supra* note 14.

the merchandise-only requirement and the multiple-book command operate to induce continued patronage of stamp-giving stores.

So understood, it seems clear that S & H's restrictions on transferability served two purposes quite different from those that the FTC staff identified. The suppression of independent exchanges was necessary to prevent free-riders—here, competing retailers not offering stamps or other independent exchanges—from capturing the advantages created by trading stamps.¹⁴⁴ If the stamp companies had permitted independent exchanges to operate without hindrance, competing retailers could attract the S & H stamp-saving customer by buying or exchanging these customers' stamps without having themselves to invest in the stamp program.¹⁴⁵ The redemption restrictions, on the other hand, were an inherent component of the savings feature in trading stamp plans. Without the full-book and merchandise-only requirements, S & H promotions would be deprived of the primary tools needed to induce stamp saving and thus to assure repeat patronage.

C. *The Supreme Court's Opinion.*

Whether the Supreme Court similarly misunderstood the economic functions of trading stamps and the various restrictions developed by S & H is unclear from Justice White's opinion. In upholding the FTC's authority, however, the Court went beyond the legislative history of the statute and assumed that consumer welfare could be adversely affected by these practices regardless of their economic functions.¹⁴⁶ Indeed, the Supreme Court remanded the case to the FTC because the commissioners had not fully "address[ed] themselves to noncompetitive and consumer injury."¹⁴⁷ Had the FTC done so and listed its findings with a conclusion that the restrictions were unfair in a

144. See generally *GTE Sylvania Inc.*, 433 U.S. at 55 (discussion of free-riders).

145. See Answering Brief of Respondent to Appeal of Complaint Counsel at 24, *Sperry & Hutchinson Co.*, 73 F.T.C. 1099 (1968):

The good will and value of the system which respondent has created have engendered various attempts by persons outside the system to use respondent's stamps and system for their own profit without paying for them. Some retailers have sought to take advantage of the promotional value of respondent's system by acquiring respondent's stamps in order to issue them to their own customers. . . . Others have tried to profit from the popularity of S&H stamps by offering to exchange them for the stamps they were issuing or to accept them in partial payment for their own goods and services. . . . Still others have established trading stamp exchanges in order to profit directly from the value of the stamps themselves by charging fees for the purchase, sale and exchange of stamps.

146. *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233, 239 (1972)(FTC has power to proscribe practices under section 5 "regardless of their nature or quality as competitive practices or their effect on competition").

147. *Id.* at 248 ("The [FTC's] opinion is barren of any attempt to rest the order on its . . . considerations of consumer interests independent of possible or actual effects on competition.").

way that "referred to or developed" the manner in which these restrictions violated public values,¹⁴⁸ the Court would not have disturbed the order.

The difficulty with the Court's analysis lies in its willingness to consider the "unfairness" of S & H's practices without regard to their economic function. This failure, in turn, misled the Court into ruling that the FTC had nearly unconfined authority under the unfairness mandate, limited only by the "public values" of public policy, immoral conduct, and substantial consumer injury.¹⁴⁹ A brief review of these criteria and their application to S & H's practices reveals their severe limitations. The first, public policy, is an amorphous, unconfined concept that allows the FTC to roam freely in search of business practices that are inconsistent with the personal and social values of individual commissioners.¹⁵⁰ The FTC's effort to develop standards of morality and ethics provided no certain guidelines and was abandoned in 1980.¹⁵¹ Nor does the requirement of substantial consumer injury provide a firm policy base, for almost any business practice that benefits some consumers is likely to "injure" others when viewed in isolation. For example, trading stamps, when used to respond to market instability and to increase volume, "injure" not only the stamp-giving store's competitors but also those consumers still purchasing goods at a non-stamp store who now may find the stamp-giving store less convenient or desirable; and price breaks for non-time-sensitive consumers "injure" those consumers whose time is more valuable (and thus injure those with greater wealth or others with greater time commitments).

In *S & H* the Court never explicitly considered the effect on consumer welfare of the challenged restraints or the proposed remedy. The Court should have examined whether the restraints increase or lower retail distribution costs, and how prohibition of the restraints would affect retail competition and various groups of consumers. Instead of determining the answers to these queries, the *S & H* Court (and subsequently, the FTC¹⁵²) focused on allocating rights and redistributing

148. *Id.*

149. *See id.* at 244 n.5 (quoting Cigarette Rule, *supra* note 4, at 8355).

150. *See* Averitt, *supra* note 50, at 275-78; Gellhorn, *supra* note 75, at 40; *see also* Gellhorn, *Regulatory Reform and the Federal Trade Commission's Antitrust Jurisdiction*, 49 TENN. L. REV. 471, 477-96 (1982) (review of FTC antitrust record focused on all cases completed in fiscal 1979 and major actions during 1975-80); Gellhorn, *The New Gibberish at the FTC*, REGULATION, May-June 1978, at 37, 42 (questioning proposed applications of section 5 by then FTC Chairman Michael Pertschuk).

151. *See infra* note 161 and accompanying text.

152. *See* Sperry & Hutchinson Co., 83 F.T.C. 478, 482-84 (1973) (mandating redemption option and prohibiting restraints on stamp exchanges).

wealth between stamp-saving and stamp-disregarding consumers, and on protecting nonstamp retailers from stamp competition. The argument before the Court examined the effect of S & H's practices on consumers as well as the limits of FTC authority,¹⁵³ and thus emphasized the supposed coercion of consumers to save full books and to receive merchandise instead of cash on redemption.

Even if the Commission and the Court had carefully reviewed the economic functions of trading stamps and the justification for the restraints on redemption and transferability, they might not automatically have found them lawful. Where stamps are used to respond to market changes by increasing volume or designing a product, the stamps seemingly serve valid purposes and are not unfair. But, when stamps are offered solely to promote chiseling on employers or the Internal Revenue Service—as seems increasingly to be the case—the validity of the practice seems questionable. Without an economic focus, however, the Court tended to ask the wrong questions and, not surprisingly, to accept the wrong answers. In any case, the supposed consumer injury which the Supreme Court implicitly recognized¹⁵⁴ and which the FTC relied upon to prohibit restraints on trading stamp redemption and alienability¹⁵⁵ is unsubstantiated.

V. A DOCTRINAL ANALYSIS

The FTC's unfairness doctrine has not suffered from lack of attention in recent years. Critics have charged that, as formulated by the FTC, the unfairness doctrine is so broad as to be unpredictable,¹⁵⁶ is largely unsupported by either theory or systematic rationale,¹⁵⁷ and does not adequately focus on when a consumer injury warrants FTC intervention.¹⁵⁸ Other critics have gone even further to suggest that the

153. See Brief for the Federal Trade Commission at 27-29, *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233 (1972).

154. See *Sperry & Hutchinson Co.*, 405 U.S. at 247 n.6, 248.

155. See *Sperry & Hutchinson Co.*, 83 F.T.C. 478, 482-84 (1973)(consent decree).

156. See Erxleben, *The FTC's Kaleidoscopic Unfairness Statute: Section 5*, 10 GONZ. L. REV. 333, 342 (1975).

157. See Boyer, *Defining Unfairness Under Section 5 of the Federal Trade Commission Act*, in STAFF OF SENATE COMM. ON COMMERCE, SCIENCE, AND TRANSPORTATION, 96TH CONG., 2D SESS., UNFAIRNESS: VIEWS ON UNFAIR ACTS AND PRACTICE IN VIOLATION OF THE FEDERAL TRADE COMMISSION ACT 121, 122 (Comm. Print 1980) [hereinafter cited as UNFAIRNESS HEARINGS] ("various definitions . . . lack coherence and conceptual precision"); Rice & Keller, *Market Place Unfairness: An Objective Basis for Restricting Commercial Speech to Children Within the Bounds of the First Amendment*, in UNFAIRNESS HEARINGS, *supra* at 97; Schwartz, *Regulating Unfair Practices Under the FTC Act: The Need for a Legal Standard of Unfairness*, 11 AKRON L. REV. 1 *passim* (1977).

158. See Hobbs, *Unfairness at the FTC—The Legacy of S & H*, 47 ANTITRUST L.J. 1023, 1029-32 (1978).

FTC's application of the doctrine not only exceeds its legal mandate but also constitutes an unconstitutional infringement of commercial speech and an abuse of authority.¹⁵⁹

In 1980, Congress responded to these and numerous other criticisms by adopting detailed amendments to the FTC Act which prohibited application of the unfairness doctrine in several specified proceedings and curtailed its use in rulemaking for at least three years while Congress engaged in oversight hearings.¹⁶⁰ Later that year, the FTC reacted by issuing a policy statement that outlined a "consumer choice" rationale for the unfairness doctrine and also spelled out in more precise terms the proper scope of its unfairness jurisdiction.¹⁶¹ In a unanimous statement by all five commissioners, the FTC abandoned the second of the *S & H*-approved unfairness criteria—whether the challenged conduct was immoral or unethical—and pledged to proceed only if either the unjustified consumer injury test or the violation of public policy test was satisfied.¹⁶² Finally, FTC staff members have attempted further clarification through major articles. For example, Craswell has usefully identified common commercial practices which have already been determined to be unfair in past decisions;¹⁶³ Averitt has sought to integrate the FTC's 1980 policy statement and existing case law into a systematic statement of the current law of consumer unfairness by focusing on consumer sovereignty—"that is, the free exercise of individual purchase decisions"—and by arguing that the FTC Act is invoked "most often to ensure that retail markets function fairly."¹⁶⁴

159. See UNFAIRNESS HEARINGS, *supra* note 157, at 17, 20 (statement of Robert H. Bork); *id.* at 3, 12 (statement of American Advertising Federation).

160. Federal Trade Commission Improvements Act of 1980, Pub. L. No. 96-252, §§ 7, 8, 11, 21, 22, 94 Stat. 374, 376, 376, 378, 393, 396 (amending 15 U.S.C. §§ 57a, 57a-1 and mandating oversight hearings). The provisions of section 11(b), which prohibited the expenditure of funds to initiate any new rulemaking proceeding to regulate commercial advertising under the unfairness doctrine, and section 21, which provided for congressional review of final FTC rules, were extended to Sept. 30, 1983 by the Further Continuing Appropriations Act, 1983, Pub. L. No. 97-377, 96 Stat. 1830, 1870, 1909 (1982); section 11(b) was extended further by the Continuing Appropriations Act, 1984, Pub. L. No. 98-107, 97 Stat. 733, 737 (1983). The congressional oversight provision of section 21, which included a "two house" congressional veto, was omitted due to constitutional infirmities. See *Consumers Union of U.S., Inc. v. FTC*, 691 F.2d 575, 577-78 (D.C. Cir. 1982) (per curiam) (section 21(a) held unconstitutional), *aff'd mem. sub nom. United States Senate v. FTC*, 103 S. Ct. 3556, 3557 (1983). See generally *Immigration & Naturalization Serv. v. Chadha*, 103 S. Ct. 2764, 2787-88 (1983).

161. Letter from Federal Trade Commission to Senators Ford and Danforth (Dec. 17, 1980), reprinted in Averitt, *supra* note 50, at 288-96.

162. *Id.* at 12, reprinted in Averitt, *supra* note 50, at 295.

163. Craswell, *supra* note 4, at 116-51.

164. Averitt, *supra* note 50, at 227-28; see also Beales, Craswell, & Salop, *The Efficient Regulation of Consumer Information*, 24 J.L. & ECON. 491, 513-14, 537-39 (1981); Gage, *The Discriminat-*

Useful as this gloss may be, it remains just that, for the FTC's authority has been neither substantially narrowed nor made more predictable. All that has changed since 1972 is that the FTC has formally discarded the unused morality criterion for finding unfairness, and Congress has temporarily suspended any use of the doctrine in rulemaking—although the FTC continues to retain its much broader authority to prohibit deceptive practices.¹⁶⁵ The FTC's effort in the 1980 policy statement to rationalize the unfairness doctrine case law under a consumer choice label seems more a reformulation in form than in substance. The FTC can still use the unfairness doctrine to reach any sales practice called coercive, or any failure to disclose information deemed material to some consumers.¹⁶⁶ Perhaps this is as it should be. But the labels of consumer choice or sovereignty tell us little about when FTC intervention is justified. Neither label explains why consumer choice and sovereignty are so important, or what values, if any, the label protects. It is this gap in the underlying theoretical justification that the following analysis seeks to fill.

The thesis offered here for a redefinition of the scope of the FTC's unfairness doctrine is simple and straightforward: the unfairness doctrine should be explicitly recast, preferably by Congress, under a consumer welfare standard. The FTC should condemn as unfair business practices which are not deceptive, yet cause consumers injury, only if the prohibition of such practices is likely to improve efficiency and thus advance consumer welfare. Under this standard, the FTC and reviewing courts would be required to examine the economic foundation and impact of the challenged conduct before applying the proscription of section 5.

A. *The Application of Section 5 to S & H.*

Two questions about the application of the unfairness doctrine in *S & H* arise once the economic basis of trading stamps and *S & H*'s practices is understood. The first is whether, even if stamp promotions

ing *Use of Information Disclosure Rules by the Federal Trade Commission*, 26 U.C.L.A. L. REV. 1037 *passim* (1979); Pitofsky, *Beyond Nader: Consumer Protection and the Regulation of Advertising*, 90 HARV. L. REV. 661, 663-71, 680, 686-87 (1977); Pridgen & Preston, *Enhancing the Flow of Information in the Marketplace: From Caveat Emptor to Virginia Pharmacy and Beyond at the Federal Trade Commission*, 14 GA. L. REV. 635, 653, 665-70 (1980); Reich, *Toward a New Consumer Protection*, 128 U. PA. L. REV. 1, 19-31 (1979).

165. See Boyer, *supra* note 157, at 122 ("the underlying assumption is that the prevention of deceptive practices is the core of the Commission's consumer protection mission").

166. See Averitt, *supra* note 50, at 252-65; Craswell, *supra* note 4, at 116-23, 143-46. The 1980 Policy Statement might be read more narrowly. For example, Averitt asserts that the area of mandatory information disclosure is restricted to basic facts about product price and product identity necessary to the exercise of a purchase decision. Averitt, *supra* note 50, at 258, 260-64.

are permissible competitive devices, S & H's restrictions on its stamps' issuance, redemption, and transferability were consistent with consumer welfare. The second is whether stamp plans are legitimate promotional devices to shift consumer patronage, or whether section 5 should be used to bar them either in whole or in part.

Addressing the first question, which was mentioned in the economic analysis above, it is important to note that each of S & H's restrictions had a legitimate business purpose. Because these restrictions were primarily designed to restrain free-riding by nonstamp retailers or parasite exchanges, they fall within the Supreme Court's economic analysis of vertical nonprice restrictions in *Sylvania*.¹⁶⁷ In short, the restrictions were contoured to fit the needs of the stamp business; without these restrictions stamps would be less attractive to retailers because they would be less effective in attracting new customers. If these business restrictions were denied to S & H and not to other stamp companies, S & H would be placed at a competitive disadvantage because only S & H would be subject to free-riders. If the restrictions were denied to all trading stamp companies, then S & H would be placed at a similar disadvantage with respect to other firms offering promotional devices such as coupons, contests, and advertising. In each of these cases such disparate treatment would be unsupportable if the challenged restrictions were otherwise legitimate.

Characterizing S & H's license restrictions as legitimate business practices, however, answers only half of the question; the other half is whether consumers who are denied opportunities to receive bonus stamps, redeem partial books, or choose cash redemptions have suffered a cognizable injury that overrides the interests of S & H and other stamp companies. Before answering this question it must be remembered that stamp promotions do not operate in isolation; not only do retailers use other promotions to compete with stamps, but also other stamp plans exist and other promotion schemes would be available if consumers desired them. Thus, as long as market opportunities for alternative promotion schemes are available and the restrictions are dictated by market realities, limiting the use of stamp restrictions is unlikely to improve consumer welfare. Indeed, in this instance such limits might force retailers to rely on more costly devices, such as extensive advertising, which would raise unit costs and thus increase prices.

167. *Continental T. V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977); see *supra* notes 144-45 and accompanying text.

The next question, more difficult and more general than the first, is whether the stamp plans should be permitted as a promotional method at all. To the extent retailers use trading stamps to shift patronage and increase volume, stamps serve to increase consumer welfare, as do point-of-sale programs, advertising, or similar promotions. That is, stamps provide opportunities for retailers to reach new scale economies and compete more effectively against each other to attract new business.¹⁶⁸ It likewise seems difficult to question retailer use of trading stamps to affect the design of products or services to attract less time-sensitive patronage.¹⁶⁹ Their connection to new and innovative retail methods seems unassailable. In this respect, trading stamps are not unique. Numerous opportunities exist throughout the economy for special appeals to time-sensitive consumers—from fast food restaurants to prepackaged products, electric rather than manual typewriters, and so forth—and it is well recognized that these appeals serve consumer welfare.¹⁷⁰

A different result, however, may be justified where retailers use trading stamps to aid consumers chiseling on their employers and the tax collector. Here it is difficult to point to any legitimate justification for trading stamps. An increase in a particular retailer's sales at the expense of the customer's employer or the IRS seems indefensible. Protection of the employer and the IRS would seem to weigh heavily on the public balance sheet.¹⁷¹

In any case, however, there are several difficulties with applying the unfairness doctrine to limit the distribution of trading stamps. First, the practice does not in and of itself seem unfair to consumers. It is clear from their purchase patterns that consumers strongly favor stamps. Second, there are other more direct methods for controlling undesirable uses of stamps. Employers can protect their interests, for

168. See *supra* notes 122-29 and accompanying text.

169. See *supra* notes 91-105 and accompanying text.

170. The fact that tapping consumer time sensitivity has an effect similar to discriminatory prices charged by a monopolistic seller should not condemn the practice. Unlike classical price discrimination, the stamp-giving retailer does not have monopoly power in the market place, or at least it is not a necessary condition for retailer use of trading stamps, and thus stamps do not meet the usual conditions in which price discrimination may reduce consumer welfare. See R. POSNER, *supra* note 91, at 62-65. Retailers often use trading stamps when they face particularly intensive competitive pressures and therefore seek to rely on stamps for a unique competitive edge. Moreover, if stamps are viewed as tools for price discrimination, that effect occurs only because the customer chooses not to redeem stamps. The terms by which the retailer offers his products are identical for all and thus do not constitute illegal price discrimination. See *FTC v. Anheuser-Busch, Inc.*, 363 U.S. 536, 549-50 (1960).

171. See also *FTC v. Winsted Hosiery Co.*, 258 U.S. 483, 494 (1922) (order designed to protect honest retailer against manufacturer's provision of unlawful instrument to other retailers).

example by including stamp receipts in an employee's wages or requiring employee accounting for all stamps received. The same is true, of course, for the IRS, which has not sought under analogous circumstances to bar all tips given by patrons, even though they too are not fully reported on all tax returns.¹⁷² The third and most important point is that less desirable uses of stamps are not easily separated from other legitimate uses. It is likely that many customers of financial institutions, rental car companies, or truck stops patronize stamp-giving institutions when on personal business. Indeed, where nontrivial amounts are involved, some customers may turn stamps over to their employers or include them on their tax returns. Moreover, the Federal Reserve Board's regulation of stamps issued by financial institutions adds at least one implied official endorsement and makes FTC prohibition incongruous.¹⁷³ It is also questionable whether the FTC and its unfairness doctrine are the appropriate vehicles for controlling chiseling, an issue more related to efficient law enforcement and normative policy than to the economics of the marketplace.

For these reasons, the FTC's initial decision not to attack the trading stamp business itself when it issued the initial *S & H* complaint seems sound. The same reasons, however, should have led the Commission to then dismiss the complaint.

B. *Section 5 after S & H.*¹⁷⁴

As noted earlier, the Supreme Court's affirmation of broad FTC authority to fashion an unfairness doctrine under section 5 has led to serious problems of standards, or more accurately a lack of standards, in FTC cases. Notions of public policy, of morality and ethics, and of substantial consumer injury do little to limit the FTC's discretion, and they add no logic to the pattern of cases that has come before the Commission. Instead, that pattern indicates the lack of direction in these "limits" on the FTC. Although any summary of FTC unfairness rulings is unlikely to be accurate or comprehensive given the idiosyncratic nature of most of the adjudications and many of the rules that have emanated from the unfairness doctrine, the FTC has most frequently applied the doctrine in four situations: (1) where the seller has relied

172. *But cf.* I.R.C. § 3401 (1983); 26 C.F.R. § 31.3402(k)-1 (1983)(providing special withholding procedures for tips).

173. *See supra* note 110.

174. This analysis draws heavily from the excellent studies by Averitt and Craswell, *see* Averitt, *supra* note 50; Craswell, *supra* note 4; however, I draw different conclusions about the utility and rationale of the unfairness doctrine as applied by the FTC, *see supra* notes 166-67 and accompanying text.

on coercive or otherwise undue methods of persuasion;¹⁷⁵ (2) where the seller has not disclosed material information;¹⁷⁶ (3) where the seller has made unsubstantiated claims;¹⁷⁷ or (4) where the seller's remedies after sale are in some manner improper.¹⁷⁸ Unfortunately, there is little consistency in these rules and decisions other than certain factual similarities—at least when examined through the lens of price theory.

1. *Undue methods of persuasion.* Although originally focused on games of chance and lottery-type sales promotions,¹⁷⁹ recent decisions and rules applying the unfairness doctrine in situations of undue methods of persuasion have often emphasized the seller's reliance on coercion through high-powered pressure tactics,¹⁸⁰ or overreaching by sophisticated sellers preying on the vulnerabilities of particular classes of consumers.¹⁸¹ Other than a terse finding of substantial consumer injury, the FTC seldom offers any express economic or other rationale to justify these rulings;¹⁸² yet one feels hard-pressed to argue that consumer welfare would have been measurably improved by contrary re-

175. See, e.g., *FTC v. R.F. Keppel & Bros.*, 291 U.S. 304, 313 (1934)(candy lottery used to exercise undue influence over children); *Arthur Murray Studio, Inc. v. FTC*, 458 F.2d 622, 625 (5th Cir. 1972)(high pressure sales tactics on elderly female customers); *Holland Furnace Co. v. FTC*, 295 F.2d 302, 305 (7th Cir. 1961)(refusal to reassemble home furnace until customer ordered added parts and service); *Gellman v. FTC*, 290 F.2d 666, 667 (8th Cir. 1961)(lottery paraphernalia); *Cooling Off Period For Door-to-Door Sales*, 16 C.F.R. § 429.1 (1983); *Proprietary Vocational and Home Study Schools*, 16 C.F.R. §§ 438.1-.10 (1983), *set aside and remanded*, *Katherine Gibbs Schools (Inc.) v. FTC*, 612 F.2d 658, 662 (2d Cir. 1979), *effective date stayed indefinitely*, 45 Fed. Reg. 1011 (1980); *Children's Advertising*, 43 Fed. Reg. 17,967 (1978)(notice of proposed rulemaking by FTC), *rulemaking terminated*, 46 Fed. Reg. 48,710, 48,713 (1981).

176. See, e.g., *Labeling and Advertising of Home Insulation*, 16 C.F.R. §§ 460.1-.24 (1983), *Advertising of Ophthalmic Goods and Services*, 16 C.F.R. §§ 456.1-.9 (1983), *rule suspended in part and remanded*, *American Optometric Ass'n v. FTC*, 626 F.2d 896, 917 (D.C. Cir. 1980); *Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures*, 16 C.F.R. §§ 436.1-.3 (1983); *Care Labeling of Textile Wearing Apparel*, 16 C.F.R. §§ 423.1-.2 (1983); *Funeral Industry Practices*, 16 C.F.R. §§ 453.1-.10 (1983), *effective date deferred in part*, 48 Fed. Reg. 45,537, 45,538 (1983).

177. See *Porter & Dietsch, Inc. v. FTC*, 605 F.2d 294, 303 (7th Cir. 1979), *cert. denied*, 445 U.S. 950 (1980); *National Comm'n on Egg Nutrition v. FTC*, 570 F.2d 157, 161 (7th Cir. 1977), *cert. denied*, 439 U.S. 821 (1978); *Firestone Tire & Rubber Co. v. FTC*, 481 F.2d 246, 249 (6th Cir.), *cert. denied*, 414 U.S. 1112 (1973); *Pfizer, Inc.*, 81 F.T.C. 23, 54 (1972).

178. See *Beneficial Corp. v. FTC*, 542 F.2d 613, 618 (3d Cir. 1976), *cert. denied*, 430 U.S. 983 (1977); *Spiegel, Inc. v. FTC*, 540 F.2d 287, 294 (7th Cir. 1976); see also *Preservation of Consumers' Claims and Defenses*, 16 C.F.R. §§ 433.1-.3 (1983); *Use of Negative Option Plans by Seller in Commerce*, 16 C.F.R. § 425.1 (1983).

179. See, e.g., *FTC v. R.F. Keppel & Bros.*, 291 U.S. 304, 313 (1934); *Gellman v. FTC*, 290 F.2d 666, 667 (8th Cir. 1961).

180. See, e.g., *Arthur Murray Studio, Inc. v. FTC*, 458 F.2d 622, 625 (5th Cir. 1972).

181. See, e.g., *Travel King, Inc.*, 86 F.T.C. 715, 772 (1975); *Funeral Industry Practices*, 16 C.F.R. §§ 453.1-.10 (1983), *effective date deferred in part*, 48 Fed. Reg. 45,537, 45,538 (1983).

182. See *Craswell*, *supra* note 4, at 139-51.

sults. To be sure, an argument could be made that allowing "scare" tactics in furnace repairs or dance lessons increases output, but that rationale is an awkward basis for criticizing FTC intervention in these cases. Nor is it persuasive to argue that market forces will correct such excesses in the long run, on the one hand, or that the unfairness doctrine can effectively police all sales tactics that go beyond the pale of legitimate salesmanship, on the other. The first argument often is contradicted by the facts, and the second returns to a non-standard that allows the FTC to intervene almost at will.

What seems striking about these decisions, however, is the "grossness" of the violations¹⁸³ and the inadequacy of the FTC remedy. Most of these factual situations fit within ordinary notions of fraud condemned by other statutes and deserve more punishment than the FTC may give. Although the offenders could be attacked under section 5's false advertising ban when criminal prosecution is not feasible, that remedy requires a showing of deception.¹⁸⁴ By shifting to the unfairness ground, however, the FTC avoids having to show either a promise or consumer misunderstanding¹⁸⁵—although, admittedly, neither requirement is much of a burden under FTC false advertising law.¹⁸⁶

As with other categories of unfairness doctrine applications, a major objection to its use against undue methods of persuasion is its unconstrained nature. Defining the proper level of "morality" in the marketplace is hardly a judgment that the FTC has shown, or is likely to show, to be peculiarly within its competence. Just as the Pertschuk-led Commission of the 1970's pursued "children's advertising" on television under this standard,¹⁸⁷ a future FTC might be free to attack sexually explicit promotions, "excessively" low prices, inadequate or excessive product differentiations, inconvenient shelf display arrangements—or almost anything else that displeases three commissioners.

183. This is not so with the gambling-type cases, but these reflect the mores of a different era.

184. See 15 U.S.C. § 45(a)(1) (1982) ("deceptive acts or practices in or affecting commerce, are declared unlawful"); cf. Gellhorn, *Proof of Consumer Deception Before the Federal Trade Commission*, 17 U. KAN. L. REV. 559 *passim* (1969) (reviewing FTC proof of deception and suggesting expanded use of scientific surveys). But cf. Memorandum from Timothy Muris, Director of Consumer Protection Bureau, to FTC Chairman James Miller 2 (Mar. 25, 1982), reprinted in 42 ANTI-TRUST & TRADE REG. REP. (BNA) No. 1058, at 699, 699 (Apr. 1, 1982) (advocating "new" standard of deception: "if it would mislead consumers, acting reasonably in the circumstances, to their detriment").

185. See G. ROBINSON, E. GELLHORN, & H. BRUFF, *THE ADMINISTRATIVE PROCESS* 470-71 (2d ed. 1980).

186. See, e.g., *Charles of the Ritz Distribs. Corp. v. FTC*, 143 F.2d 676, 680 (2d Cir. 1944) (claims of restorative qualities of facial cream violated "capacity to deceive" standard).

187. *Children's Advertising*, 43 Fed. Reg. 17,967 (1978) (notice of proposed rulemaking by FTC), *rulemaking terminated*, 46 Fed. Reg. 48,710, 48,713 (1981).

Perhaps political pressure, reviewing courts, or common sense will prevent such misadventures; but recent history does not justify much confidence on this score.

2. *Nondisclosure of material information.* Clearly the most frequent and often most controversial use of the unfairness doctrine involves the nondisclosure of material information by sellers. On this point the FTC has ruled that

sellers are acting unfairly if they do not disclose the efficiency rating ("R-Value") of home insulation or the octane level of gasoline, the recommended method of caring for clothing and textiles, the dropout and placement rates of vocational schools, the terms and obligations of franchise agreements and "negative option" buying plans, and the fact that cigarette smoking can be hazardous to health.¹⁸⁸

These decisions have concentrated on the benefits consumers receive from this additional information. The decisions seek to increase the amount of information available to consumers in the market, often relying on the fact that consumers are in an unequal position vis-a-vis sellers of goods and services. In these decisions the FTC tacitly assumes that consumers are uninformed about what information to seek, unaware of the dangers they face, or unable to evaluate the information sellers otherwise make available. Although these rules and orders are often stated in antitrust terms of seeking to assure the proper functioning of a competitive market, they do not address any market clogs inhibiting such information. Instead, they focus on mandating that information be generated and supplied. The FTC has yet to indicate the quantum of information that must be disclosed in order to satisfy the unfairness theory. The Commission's rulings have, however, implicitly recognized the existence of limits—namely, that information is not costless and that sellers are not required to disclose all that they know about a product.¹⁸⁹

Again, the initial reaction is that these results seem just and fair. The perfectly rational consumer undoubtedly should know the R-value of the home insulation he purchases or the octane level of the gasoline he buys. Arguments for ignorance have a hollow ring.¹⁹⁰ But to state the issue in this fashion is to misunderstand the FTC's use of the unfairness doctrine in this circumstance. None of these cases involve

188. Craswell, *supra* note 4, at 116 (footnotes omitted).

189. See rules cited *supra* note 176; see also Muris, *supra* note 184, at 10, reprinted in 42 ANTI-TRUST & TRADE REG. REP. (BNA) No. 1058, at 699, 702 (Apr. 1, 1982).

190. See *Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council, Inc.*, 425 U.S. 748, 765-70 (1976) (state law prohibiting price advertising of prescription drugs violates first amendment; rationale relies on information necessary for market operation).

either affirmative misrepresentation about the products or a material difference between the product and the consumers' reasonable expectations—both of which are already covered by the case law against deception.¹⁹¹ Nor do these cases generally involve markets where only one firm has cornered the market or where other forces prohibit the distribution of product information.¹⁹² Instead, the FTC's nondisclosure rulings under the unfairness doctrine involve an assessment that, if given additional information, consumers would make a different purchase choice (this is the market "failure") and that the benefits in seller performance and consumer satisfaction derived from this different choice outweigh the information production costs. And, it is said, disclosure maintains consumer sovereignty because it permits rational comparisons by consumers making their buying decisions.¹⁹³

Missing from this analysis, however, is any consideration of the possibility that the information was not supplied because consumers did not want or need the information, or could not make effective use of it. These decisions do not analyze why the market did not supply the information in the first instance.¹⁹⁴ For example, when it first approved the octane rating rule,¹⁹⁵ the Commission made no effort to assess either consumer understanding of motor octane ratings or research octane ratings or how gas purchasers might use disclosure of the average of the two.¹⁹⁶ In fact, the rule is probably counterproductive: it is not costless and many consumers who pay attention to octane ratings

191. See G. ROBINSON, E. GELLHORN, & H. BRUFF, *supra* note 185, at 469-72; *Developments in the Law—Deceptive Advertising*, 80 HARV. L. REV. 1005, 1063-97 (1967).

192. See, e.g., *Labeling and Advertising of Home Insulation*, 16 C.F.R. §§ 460.1-.24 (1983). *But cf.* *Advertising of Ophthalmic Goods and Services*, 16 C.F.R. §§ 456.1-.9 (1983) (holding invalid state and professional restrictions on advertising of prescription eyewear or eye examinations), *rule suspended in part and remanded*, *American Optometric Ass'n v. FTC*, 626 F.2d 896, 917 (D.C. Cir. 1980); *Retail Prices for Prescription Drugs*, 43 Fed. Reg. 54,951 (1978) (withdrawal by FTC of proposed trade regulation rules).

193. See *Posting of Minimum Octane Numbers on Gasoline Dispensing Pumps*, 36 Fed. Reg. 23,871, 23,876 (1971) (current rule codified at 16 C.F.R. §§ 306.0-.11 (1983)).

194. See Craswell, *supra* note 4, at 119-20.

195. See rule cited *supra* note 193.

196. See *Petroleum Marketing Practices Act: Hearing on S.19, S.743, H.R. 130 Before the Subcomm. on Energy Conservation and Regulation of the Senate Comm. on Energy and Natural Resources*, 95th Cong., 1st Sess. 239-70 (1977) (statement of Mr. Owen Johnson, Director, Bureau of Competition, FTC; testimony of Mr. Christian White, Assistant to the Chairman, FTC); *Petroleum Marketing Practices: Hearings on H.R. 13000, H.R. 612, H.R. 5663, H.R. 10070, H.R. 12712, and S. 323 (and all identical bills) Before the Subcomm. on Energy and Power of the House Comm. on Interstate and Foreign Commerce*, 94th Cong., 2d Sess. 387-404 (1976) (statement of Mr. Owen Johnson, Director, Bureau of Competition, FTC); *Consumer Fuel Disclosure Act of 1975: Hearing on S.1508 Before the Subcomm. for Consumers of the Senate Comm. on Commerce*, 94th Cong., 1st Sess. 26-34 (1976) (statement of Ms. Joan Bernstein, Acting Director, Bureau of Consumer Protection, FTC).

and purchase higher rated gasoline may obtain only insignificant benefits.¹⁹⁷

A similar problem, which often explains in part the "failure" of the market to supply the information, is that it cannot be readily or cheaply supplied in useful form. When energy prices rise and inflation squeezes consumer resources, information about the R-values of home insulation or the energy consumption of appliances is undoubtedly increasingly important to consumers. Some producers will inevitably seek to capitalize on this interest, and the FTC has sought to police sales programs that mislead consumers.¹⁹⁸ Problems of standardization also are likely to arise, and antitrust oversight of private efforts to develop consensus standards may be necessary to protect against collusion or to protect competition from boycotts or cartels.¹⁹⁹ But FTC intervention by prescriptive rule is likely to force consumers to pay for information that most consumers are unlikely to use or at least would not choose to use if the costs of providing the information were borne directly.²⁰⁰ Indeed, it is ironic that mandated information provided at the command of the FTC often serves highly educated upper income consumers least needing the FTC's special protection.²⁰¹

On the other hand, there are situations in which the unfairness doctrine's application to expand the supply of material information satisfies a consumer welfare standard. First, where the doctrine is used only proscriptively—for example, to remove restraints on the flow of information as was the case with the eyeglass or prescription drug rules²⁰²—the amount of information actually supplied will be determined by marketplace competition. The only question with such proscriptive applications is whether the FTC's action is based on its unfair practices powers, or is instead grounded on the antitrust authority provided by section 5's prohibition of "unfair methods of competition."

197. See, e.g., *Consumer Fuel Disclosure Act of 1975*, *supra* note 196, at 51-62 (statement and testimony of Mr. John Tessieri, Vice President, Texaco, Inc.).

198. See, e.g., *Labeling and Advertising of Home Insulation*, 16 C.F.R. §§ 460.1-.24 (1983).

199. See L. SULLIVAN, *supra* note 9, at 275-92.

200. These costs, however, may be minor in some instances because much information need only be collected once, and added printing costs may be minimal. Moreover, a rule requiring all market participants to provide information overcomes free-rider objections.

201. For example, the home insulation rule, *see* rule cited *supra* note 176, is designed to protect homeowners who in fact compare insulation ratings. Lower income consumers are less likely to be homeowners, sophisticated label readers, or comparison shoppers.

202. *Advertising of Ophthalmic Goods and Services*, 16 C.F.R. §§ 456.1-.9 (1983) (holding invalid state and professional restrictions on advertising of prescription eyewear or eye examinations), *rule suspended in part and remanded*, *American Optometric Ass'n v. FTC*, 626 F.2d 896, 917 (D.C. Cir. 1980).

The Cigarette Rule illustrates a second application of the unfairness doctrine to mandate information disclosure that satisfies a consumer welfare standard.²⁰³ The rule forced disclosure of the dangers of cigarettes, a fact that the cigarette companies previously chose not to reveal. The requirements included the disclosure of information that was relatively costless to supply—a warning label on all cigarette advertising and packages²⁰⁴—and that was not likely to be supplied in a competitive market because it was against the self-interest of any company to provide the warning as long as all cigarettes were unsafe.²⁰⁵ Nonetheless, the primary assumption underlying such FTC action is that consumers would otherwise presume that the product was safe in normal use—in which case, of course, the rule could be issued under the FTC's power to prohibit deceptive and misleading practices.²⁰⁶ The advantage of the false advertising approach is that in theory it anchors the FTC's action in consumer beliefs and thus limits allowable rulings to situations where the understood promise is real rather than imagined. In short, in both situations in which use of the unfairness doctrine to mandate information disclosure meets a consumer welfare test, the doctrine is superfluous because well accepted, and more controllable, doctrines are otherwise available.

3. *Unsubstantiated advertising claims.* Closely related to mandated disclosure is the use of the unfairness doctrine to proscribe advertising claims lacking adequate substantiation, even though the claim is not proven false or is subsequently demonstrated to be true. The FTC has held it unfair for sellers to make any claim about their product or service if they do not have a "reasonable basis" for believing that the claim is true.²⁰⁷ The FTC believes that without this requirement consumers would be forced to bear the risk that the claim was false.²⁰⁸ Thus, consumers would have to verify the claim in advance or buy the product without knowing whether or not the claim was reliable—neither of which is acceptable under the advertising substantiation rulings. The FTC believes this requirement is justified because the producer is better able to bear the costs of providing this information, and

203. See Cigarette Rule, *supra* note 4.

204. See *id.* at 8325.

205. See, e.g., R. POSNER, THE REGULATION OF ADVERTISING 7 (1973); Gellhorn, *Braking the Cigarette Habit*, 3 J. CONSUMER AFF. 145, 148 (1969).

206. See 15 U.S.C. § 45(a)(1) (1982) ("[D]eceptive acts or practices in or affecting commerce, are declared unlawful").

207. Pfizer, Inc., 81 F.T.C. 23, 62 (1972); see also *Heinz v. Kirchner*, 63 F.T.C. 1282 (1963).

208. See Pfizer, Inc., 81 F.T.C. 23, 61-62 (1972).

because it is inefficient to impose these costs on consumers.²⁰⁹

It is unclear whether consumer welfare is improved by this requirement to a greater extent than would be the case if the FTC pursued only false claims under the prohibition on deception. The FTC has made no effort to determine whether the pretesting burden imposed by the unfairness approach on all sellers (assuming perfect FTC enforcement) is worth the benefit of eliminating false claims that would otherwise go undetected. Nor is it clear why, absent deception, it will be unsatisfactory for the market to determine the level of risk that consumers will bear with unsubstantiated claims, or, more importantly, why the FTC can determine this level better than the unregulated market. The FTC has sought to resolve the latter question implicitly by leaving uncertain the standard it will apply to determine whether the claim is one of fact (requiring verification),²¹⁰ and whether the testing adequately substantiates the claim.²¹¹ On the other hand, the very uncertainty of the legal standard, along with the undetermined nature of the impact of the requirement on consumer welfare, undercuts the application of the unfairness doctrine. Application of the consumer welfare standard would thus shift the focus to these unanswered yet critical assumptions.

4. *Improper post-sale remedies.* A final class of cases involves the FTC's application of the unfairness doctrine to protect consumers against overreaching by sellers after the sale has been completed and the parties are disputing the delivery of the goods or the payment of the price. Some of these decisions involve FTC suits on behalf of consumers where the allegation is that the seller has breached the contract by nondelivery, delivery of inferior products, refusal to refund the price, or some other means;²¹² others go beyond the parties' contract and challenge whether the seller may rely on legal rights such as long-arm jurisdiction statutes or holder-in-due-course doctrines, in response to

209. See Pitofsky, *supra* note 164, at 663-67.

210. Pfizer, Inc., 81 F.T.C. 23, 64-65 (1972).

211. *Id.* at 67. Compare Firestone Tire & Rubber Co., 81 F.T.C. 398, 444-49 (1972) (testing found to be inadequate), *aff'd*, 481 F.2d 246 (6th Cir.), *cert. denied*, 414 U.S. 1112 (1973) with National Dynamics Corp., 82 F.T.C. 488, 559-60 (1973) (complaint counsel tested substantiation by wrong standard), *remanded on other grounds*, 492 F.2d 1333 (2d Cir.), *cert. denied*, 419 U.S. 993 (1974).

212. See, e.g., National Trade Publications Serv., Inc. v. FTC, 300 F.2d 790, 791 (8th Cir. 1962); E.T. Moye, 50 F.T.C. 926, 929 (1954); Interstate Home Equip. Co., 40 F.T.C. 260, 263 (1945).

the consumer's complaint.²¹³ Close analysis of these cases reveals that their underlying rationale is grounded in the FTC's view of desirable public policy.²¹⁴ To be sure, the Commission often asserts a cost-benefit principle, but that determination depends invariably "on subjective valuations which may vary from person to person, as well as across sociological or income groups."²¹⁵ Thus, here more than elsewhere, the FTC has used its equity-like powers to intervene in the market and to adjust post-sale rights among the parties.

Apart from economic analysis, there is no way to determine whether the FTC's intervention in these cases helps or harms consumers. For example, the FTC's attempts to limit the holder-in-due-course doctrine may have increased the cost of installment credit to lower income consumers—and, again, may have protected only upper income groups who could otherwise protect themselves.²¹⁶ Application of the doctrine to overrule state law in this circumstance seems questionable;²¹⁷ because most of these cases involve at least an implicit overruling of state legislative action, they directly raise the question whether an appointed federal administrative body should be allowed wide discretion to make normative policy judgments that conflict with the express wishes of elected state legislatures.²¹⁸ The issue becomes particularly troublesome when one recalls the FTC's unfocused and practically unlimited power based on supposed rules of public policy.²¹⁹

C. *The Unfairness Rule Under a Consumer Welfare Standard.*

It is simple to spell out the proper standard for the FTC's unfairness doctrine suggested under a consumer welfare standard; finding

213. See *Spiegel, Inc. v. FTC*, 540 F.2d 287, 292-93 (7th Cir. 1976); *All-State Indus. Inc.*, 75 F.T.C. 465, 491-94 (1969), *aff'd*, 423 F.2d 423 (4th Cir.), *cert. denied*, 400 U.S. 828 (1970); *Preservation of Consumers' Claims and Defenses*, 16 C.F.R. §§ 433.1-.3 (1983).

214. See *Craswell*, *supra* note 4, at 138.

215. *Id.* at 134.

216. Note, *Let the Holder Beware! A Problematic Analysis of the FTC Holder in Due Course Rule*, 27 CASE W. RES. L. REV. 977, 1005-07 (1977).

217. This does not suggest, however, that the FTC's use of the unfairness doctrine to implement state law, *see, e.g.*, *FTC v. R.F. Keppel & Bros.*, 291 U.S. 304, 313-14 (1934) (state gambling statutes), is desirable—although such actions are likely to be less objectionable.

218. See, *e.g.*, Verkuil, *Preemption of State Law by the Federal Trade Commission*, 1976 DUKE L.J. 225, 226; Note, *The State Action Exemption and Antitrust Enforcement Under the Federal Trade Commission Act*, 89 HARV. L. REV. 715, 744-51 (1976). *But cf.* Levmore, *Interstate Exploitation and Judicial Intervention*, 69 VA. L. REV. 563, 569-70 (1983) ("one might view the federal judiciary then as a surrogate or agency of Congress instructed to protect the national interest by overturning those state actions which an attentive Congress would disapprove") (footnote omitted).

219. See *supra* notes 144-49 and accompanying text.

cases where it should be applied is more difficult. This raises the question whether the result is likely to be worth the effort,²²⁰ and invites consideration of whether Congress should repeal the "unfair . . . acts or practices" portion of section 5.²²¹ Recognizing that the existence of unconfined authority generally leads to its use,²²² Congress should at the least rewrite section 5 to limit the unfairness doctrine by the consumer welfare standard developed here.

A business practice which is not deceptive but causes a substantial class of consumers significant injury should be condemned as unfair only if its prohibition will improve consumer welfare.²²³ In making this determination, the FTC and the courts should examine whether any market failure justifying government intervention actually exists; what economic justifications, if any, support the practice; what costs would result from FTC intervention; and finally, whether the remedy is likely to be cost effective or efficient. Unless these or similar tests are satisfied, FTC intervention in the marketplace is likely to be counter-productive and should not be upheld.

Although the concept of market failure is not without ambiguity,²²⁴ the FTC should be skeptical of assertions of market failure where buyers face competing alternatives and the forces of supply and demand are operating. Insofar as market failure means deviation from theoretically perfect markets, market "failures" are common. FTC intervention may be warranted only with respect to those departures from market norms that can be corrected on a cost-effective basis.

Even where there are special circumstances indicating market failure, as in the example of cigarette safety where there was no incentive to discover and distribute information because all the products sold were dangerously unsafe, skepticism may still be warranted. The marketplace is most effective in locating the degree of information desired

220. See Easterbrook, *Breaking Up is Hard to Do*, REGULATION, Nov.-Dec. 1981, at 25, 26 (discussing "the nirvana fallacy, the belief that if a cost or a flaw in existing affairs can be identified, it must follow that some other state of affairs (the 'remedy') is better").

221. 15 U.S.C. § 45(a)(1) (1982).

222. See, e.g., *United States v. Southwestern Cable Co.*, 392 U.S. 157, 167-68 (1968); *National Petroleum Refiners Ass'n v. FTC*, 482 F.2d 672, 674-78 (D.C. Cir.), cert. denied, 415 U.S. 951 (1973); see also Aranson, Gellhorn, & Robinson, *A Theory of Legislative Delegation*, 68 CORNELL L. REV. 1, 35 (1983); cf. W. NISKANEN, BUREAUCRACY AND REPRESENTATIVE GOVERNMENT 36-42 (1971) (motivation of bureaucrats related to maximization of bureau's budget).

223. Note that if the practice is deceptive, it is already prohibited by the FTC Act and there is no need to stretch the meaning of section 5. The advantage to the FTC of proceeding under the unfairness doctrine, of course, is that it need not prove the mismatch between the seller's promise and the buyer's understanding. See, e.g., Gellhorn, *supra* note 184, at 562.

224. See Averitt, *supra* note 50, at 249 n.155. In addition, it is easy to supplement litigation strategy with expert testimony on both sides of this issue. See *id.*

by consumers, as measured by the costs consumers are willing to bear; government agencies generally are not well suited to this role. Nonetheless, the FTC will focus its attention on the most efficient remedy available and whether it is likely to improve consumer welfare if Congress requires this market failure analysis.

Once the market failure hurdle is passed, the FTC's attention should concentrate on an economic analysis of the specific business practices. Why were they adopted? Why are consumers responding to them? Which classes of consumers are benefited by them and which are not? Why is it that the "disadvantaged" consumers have no alternative to the practice? What separates the consumers benefiting from the practice from those who are disadvantaged? Answering these questions would lead immediately to the remaining inquiries: namely, if the government were to intervene and prohibit the practice or prescribe another practice, what are the costs and benefits—to the business, to competition, and to consumers—from such intervention? These inquiries must not be limited simply to what would happen when the challenged practice is ended, but also must include an estimate of the effect of the relief ordered on consumers, market competition, and the affected businesses.

Without experience, of course, it is difficult to be confident of any prediction regarding the effects of such a test. It does seem clear, however, that the test would stop most, if not all, of the unwarranted applications of the unfairness doctrine.²²⁵ It also seems likely that many of the remaining cases would be more appropriately addressed as cases of simple fraud deserving criminal prosecution or as matters of deception or antitrust violations already reached by section 5 or the antitrust laws.

VI. CONCLUSION

The analytical failure of the FTC and the Supreme Court in *S & H*—in their economic analysis of trading stamp programs as well as in their legal analysis of section 5—continues to be reflected in recent attempts to restate the unfairness doctrine. These recent efforts have sharpened the focus on consumer injury and have drawn more explicitly and carefully a proper balance of the interests at stake. In particular, the FTC's December 1980 letter, which responded to recent criticisms by narrowing the unfairness doctrine, dropped the morality criterion and emphasized a "substantial consumer injury" standard.²²⁶

225. See *supra* notes 175-219 and accompanying text.

226. See *supra* note 161 and accompanying text. But see *Horizon Corp.*, 97 F.T.C. 464, 849 (1981)(FTC only "focuses primarily" on the two criteria of the 1980 letter).

Thus, the Commission now agrees that it must first establish that consumers have suffered a substantial injury from the challenged act or practice before it applies the unfairness doctrine.²²⁷ This injury must, furthermore, not be outweighed by offsetting benefits to consumers or competitors and it must not be one that consumers could reasonably avoid.²²⁸

Without a more explicit economic focus, however, this modification still allows the FTC and the courts to roam freely in applying the unfairness doctrine. Consumer injury is not self-defining and, indeed, imposes no serious limitation on the FTC's powers. For example, any business practice can be said to cause substantial consumer injury on some commissioner's normative balance wheel. Thus, unless the terms "consumer injury" or "substantial consumer injury" are further defined and restricted, the test is a meaningless measure; it would not in any significant sense restrict the FTC's application of the unfairness doctrine. Nor does the interest balancing also required by the FTC's December 1980 letter supply much restraint.²²⁹

Admittedly, application of the consumer welfare standard suggested here is not without difficulty and would not assure future satisfactory application of the unfairness doctrine by the FTC. At best, cost-benefit calculations are crude guesses, whether made by the FTC staff and commissioners or by reviewing courts. Fact determinations, allocations of the burden of proof, standards for judicial review of administrative determinations, etc., are still likely to be influential and probably dispositive. This is not, however, a persuasive argument against considering the consumer welfare standard. If both the FTC and reviewing courts are forced to make these calculations they will be pressed to improve their decisions and to avoid the policy errors reflected in *S & H*. If the consumer's maximum welfare is the objective, it is indisputable that governmental regulation of marketplace practices must apply economic analysis.

227. See *Reauthorization of the Federal Trade Commission: Hearings Before the Senate Comm. on Commerce, Science, and Transportation*, 97th Cong., 2nd Sess. 7 (1982) (opening statement of James C. Miller III, Chairman, FTC) (supporting legislation for limiting the unfairness doctrine to the substantial consumer injury and interest balancing tests) (Commissioner Michael Pertschuk dissented from this proposal, *id.* at 223-25); see also *supra* notes 61, 150-51 and accompanying text.

228. See *Reauthorization of the Federal Trade Commission*, *supra* note 227, at 11 (opening statement of James C. Miller III).

229. Moreover, left without a firm anchor of what constitutes consumer injury, the interest balancing refinement only gives a false sense that the doctrine has been properly confined. As long as the consumer injury criterion can be measured so liberally, it is likely that either the FTC or the courts can readily find that the injury from the challenged practice outweighs countervailing concerns and could not reasonably be avoided.

One of the puzzles not answered by this article is why the FTC and the courts have persisted in interpreting section 5 of the FTC Act so broadly, thereby granting almost untrammelled authority to the FTC under the unfairness doctrine. This is particularly questionable once close analysis reveals the unsatisfactory results of such authority. One answer, of course, is the populist strain that has long governed, or at least influenced, FTC commissioners and staff. Another is that the administrative law doctrines that limit judicial review to minimal scrutiny free the FTC of effective outside check. This, however, runs counter to the notion that the common law and administrative review are subject to pressures from efficiency concerns, and assumes that regulations are immune from business criticism.

There is nothing new or particularly startling about the economic analysis offered here. The surprise is that it has not been applied to the *S & H* case or the unfairness doctrine before.²³⁰ Past criticisms of the FTC's unfairness doctrine have not considered an explicit economic model, even though the Commission itself has increasingly sought to justify its applications with economic argument.²³¹ The answer, if there is one, lies in the failure until recent years to understand the implications of microeconomic analysis for legal questions. Recent years have seen an outpouring of scholarship in law and economics. For some this is disturbing.²³² As North and Miller observe, however, "[e]conomists cannot tell people what they ought to do. They can only expose the costs and the benefits of various alternatives so that citizens in a democratic society can make better choices."²³³ It is that thesis which underlies this analysis and leads to the conclusion that the unfairness doctrine should either be repealed or narrowly confined by a rigorous application of a consumer welfare standard.

230. For an earlier survey of FTC actions applying economic analysis, see Posner, *The Federal Trade Commission*, 37 U. CHI. L. REV. 47 (1969).

231. See *supra* notes 161, 189, 192, 207, 226 and accompanying text.

232. See, e.g., Kennedy, *Cost-Benefit Analysis of Entitlement Problems: A Critique*, 33 STAN. L. REV. 387 (1981).

233. D. NORTH & R. MILLER, *THE ECONOMICS OF PUBLIC ISSUES* vii (6th ed. 1983); see also Gellhorn & Robinson, *The Role of Economic Analysis in Legal Education*, 33 J. LEGAL EDUC. 247 (1983).