

UNCERTAINTY IN U.S. PRICE-GOUGING LAW COMPLIANCE AND DEFENSE



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I. INTRODUCTION

On July 14, 2020, Colorado became the latest state to enact legislation explicitly prohibiting price gouging following emergencies. Currently, 40 U.S. states and the federal government have in place prohibitions against price gouging triggered by the COVID-19 pandemic. While initial widespread shortages of common household goods such as hand soap and toilet paper have subsided, the COVID-19 pandemic continues to cause demand spikes and supply shortages of essential products such as sanitizing products, face masks, and gloves which are used to prevent the spread of the virus. Supply shortages and food prices also remain a concern in the U.S. Amid surging demand and dwindling supply, prices for many of these essential products have jumped.

In response, price-gouging laws and enforcement efforts in the U.S. have expanded in number, scope, and duration. Unlike prior periods of enforcement after more regionalized natural disasters, such as hurricanes, the COVID-19 pandemic is having a major impact on supply chains around the world and is likely to continue doing so for months or even years to come.

The proliferation of price-gouging laws and increased enforcement in the U.S., combined with the nationwide and sustained nature of the COVID-19 crisis, have highlighted some of the difficulties of complying with and enforcing price-gouging laws. There is concern over the potential adverse effects such laws can have on both the supply and demand of products that price-gouging laws are meant to address. Many economists and policy analysts have warned that price-gouging laws in effect set a price ceiling for the goods most needed in the wake of a disaster, and price ceilings have a predictable effect of limiting normal supply responses and exacerbating shortages.²

Despite these concerns, state price-gouging laws have accumulated on the books over the past 40 years, typically popping up in the wake of a natural disaster that causes a supply shock. New York was the first state to enact a price-gouging law, in 1979, after heating oil prices spiked during the winter of 1978-1979. By 1990, only three more states – Hawaii, Connecticut, and Mississippi – had added price-gouging laws. Price-gouging laws picked up steam between 1990 and 2010, with 27 states passing them, and another nine states have passed them in the past decade, bringing the total to 40. The penalties for violating these laws can be steep, with civil penalties ranging from \$1,000 to \$10,000 per violation, and many carry possible jail time. Not only are there state laws, but President Trump also signed an executive order in March triggering the Defense Production Act (DPA), temporarily making price gouging and hoarding of crucial medical supplies a federal crime.³

² See, e.g. W. David Montgomery, Robert A. Baron, Mary K. Weisskopf, "Potential Effects of Proposed Price Gouging Legislation on the Cost and Severity of Gasoline Supply Interruptions," *Journal of Competition Law & Economics*, Volume 3, Issue 3 (2007).

³ The White House, *Executive Order on Preventing Hoarding of Health and Medical Resources to Respond to the Spread of COVID-19* (March 23, 2020), <https://www.whitehouse.gov/presidential-actions/executive-order-preventing-hoarding-health-medical-resources-respond-spread-covid-19/>; 50 U.S.C. §§ 4501-4568.

II. FIGURING OUT THE PROHIBITED GOUGE PRICE IS NOT EASY

Price-gouging laws present significant challenges for producers looking to supply and retailers trying to stock and sell essential and high-demand goods in the wake of a disaster without running afoul of the price-gouging laws. The first obstacle that a supplier, particularly one selling nationwide, faces is complying simultaneously with the patchwork of state laws and the DPA executive order, as there is significant variation among the 40 different state price-gouging laws. Nearly all the price-gouging laws consist of some sort of price ceiling, but the level of the price ceiling varies. Some states prohibit prices 10 percent higher than pre-emergency price levels, while others prohibit prices 15 or 25 percent higher. Other states vaguely prohibit “unreasonable” or “excessive” prices. And the time period for which the baseline price is determined also varies from state to state, ranging from the price immediately before the emergency to the average price during the month or months preceding the emergency. Determining the relevant baseline comparison prices can also be very difficult – it is sometimes the seller’s price and other times the general market price.

This variation across states presents a legal minefield for nationwide sellers, including most online retailers, to navigate during a nationwide emergency. Determining compliance with a price-gouging law can be a difficult task even under the simplest scenario. Take, for example, an existing seller (as opposed to a new entrant) seeking to sell goods in only one or two states where the price ceiling is based on a specific percentage increase. That seller must determine which current prices to compare (e.g. advertised or sales), then which baseline pre-emergency prices to compare and, finally, what is an acceptable price increase. Determining the acceptable prices is only half of the story, as sellers often face increased costs during times of emergency and therefore need to determine how much of those increased costs can be recovered while not running afoul of the applicable price-gouging laws. Compliance is even more difficult for a prospective new entrant looking to supply a good that is in high demand for the first time. Such a prospective new entrant would not have ready access to historical price data with which it could calculate some baseline, nor would it have cost data to support a cost increase defense. Many state price-gouging statutes refer to prior pricing, and it is unclear what the comparison price is for new sellers.

Sellers of essential and high-demand goods during the pandemic are looking for a safe-harbor price at which to sell, where they can be sure they will not run afoul of price-gouging laws, but there is no such price given the discretionary nature and variables involved in the web of state and federal price-gouging prohibitions currently in place. Even an army of lawyers and economists could not ensure nationwide compliance with absolute certainty under these vague and varying standards. And businesses are having to make these decisions in real time, as many companies are struggling to stay in business or struggling to supply high-demand products to customers in need of those products and offering to pay higher prices for them.

Unfortunately, as a result of this enormous uncertainty surrounding compliance and the high costs of non-compliance, many sellers simply choose not to supply goods under emergency circumstances at all. This further exacerbates supply effects even beyond what would be expected from an explicit price ceiling. And consumers are left without even the choice to pay higher prices for high-demand products.

III. EXCEPTIONS FOR INCREASED COSTS PLACE ADDITIONAL BURDEN ON SELLERS

Nearly all laws allow some sort of exception with respect to cost increases, recognizing that supply costs often significantly increase during emergencies. But again, the details with respect to these exceptions or defenses vary. Some make price increases that were a result of cost increases a complete defense, while others allow for a cost increase plus some specified margin. These statutes do not delineate what increased costs can be included in cost-exempted increases – for instance, the increased cost of personal protective equipment, cleaning and sanitizing, or other health and safety measures frequently incurred during the current pandemic. Unfortunately, most statutes place this burden on the seller to prove increased costs, even though those increased costs are ubiquitous during the current pandemic and can be very difficult to quantify and demonstrate.

IV. RISK OF PROSECUTION OR LITIGATION

Individuals and companies that do find themselves the target of a price-gouging investigation or lawsuit face a daunting challenge. In addition to the ambiguities in price-gouging laws, the difficulty of establishing a defense, and fines and potential jail time, there is little case law out there that defines the boundaries of these laws and their defenses because price-gouging laws go into effect only during times of emergency.

Perhaps unsurprisingly, the vast majority of defendants end up settling price-gouging charges rather than litigating them. For example, in 2008, the Tennessee attorney general opened investigations into the prices charged by 17 gas retailers after Hurricanes Gustav and Ike destroyed oil production in the Gulf of Mexico. All 17 of the retailers denied wrongdoing but agreed to pay penalties and refund money to customers. One of the retailers released a statement indicating that the company sold gas below its actual cost 50 percent of the time during the three-day period in question. The CEO of another of the retailers said that it was cheaper for his company to agree to the settlement than to fight charges of which it is not guilty. The last retailer to settle, Weigel Stores, did so more than a year after the investigation. On the day it settled, its owner issued a statement explaining the difficult situation it faced: “We continue to maintain that we operated our business appropriately in the difficult circumstances and market disruptions caused by Hurricane Ike. On some days, the company was paying more to buy gas than it was selling it for at the pumps . . . the terms of the settlement proposed to us last year implied that Weigel’s admitted to violating the law. The settlement reached now does not carry that implication, and is on such terms, economic and otherwise, that from a business standpoint it is in the best interests of the Company and our customers that we put the matter behind us.”⁴

There are relatively few litigated price-gouging cases in the U.S. In *White v. R.M. Packer Co. Inc.*, the First Circuit Court of Appeals upheld a district court’s grant of summary judgement in favor of defendant gas stations related to a price-gouging claim.⁵ Plaintiffs brought claims under Massachusetts’ price-gouging law over the defendants’ prices following Hurricanes Katrina and Rita in 2005. The Massachusetts law was typical of many price-gouging laws, prohibiting prices that represented “a gross disparity between the price of the petroleum product and the price at which the same product was sold or offered for sale by the petroleum-related business in the usual course of business immediately prior to the onset of the market emergency . . . the disparity is not substantially attributable to increased prices charged by the petroleum-related business suppliers or increased costs due to an abnormal market disruption.”

The court noted the vagueness of the standard, commenting, “The regulation defines neither ‘gross disparity’ nor ‘immediately prior.’ Significantly, there have been no Massachusetts state court decisions interpreting the rule.” Recognizing that the laws are “not regulations meant to give the government control over the setting of petroleum product prices” but rather are “designed to protect consumers from acute and unconscionable increases in the prices they must pay for basic consumer goods during times of market emergency,” the court found that margins, not prices, need to be considered. The court wrote, “The language of the price-gouging regulation does not reach gross disparities in price alone. The regulation is concerned with increases in both price and cost, the two factors that determine gross margin . . .” The court stated, “Dramatic changes in gross margin might illustrate that a price increase is a ‘gross disparity’ in price because it reflects price increases unexplained by cost increases.” In applying these principles to the facts, the court found that while the defendants’ prices were increasing, “their gross margins were generally rising only very moderately, since their costs were climbing as well,” and held that there was no showing of a gross disparity in price.

In a more recent ongoing litigation, defendants have had early success in their constitutional challenge of state price-gouging laws on the basis of the dormant commerce clause doctrine, and the court recognized some of challenges faced by online sellers trying to comply with the patchwork of state price-gouging laws. A federal court in Kentucky granted a trade group representing Amazon sellers’ preliminary injunction request to stop price-gouging investigations by the Kentucky Attorney General. It held that the trade group proved a likelihood of success on the merits.⁶ The court explained that the dormant commerce clause doctrine prohibits a state law if the “practical effect of the regulation is to control conduct beyond the boundaries of the state, regardless of whether such an effect was intended by the legislature.” The Kentucky price-gouging laws had such an effect because there was no way for the sellers to set state-specific prices, and the Kentucky law therefore “effectively dictate[d] the price of items for sale on Amazon nationwide.” Additionally, the practical effect of the law must be evaluated “what effect would arise if not one, but many or every, State adopted similar legislation.” On this point, the court found that “restrictions imposed by other states would have the potential to subject merchants, as Amazon suppliers, to conflicting state requirements.”

⁴ Knoxville News Sentinel, “*Weigel’s settles price-gouging case*” (April 29, 2010), available at <https://archive.knoxnews.com/business/weigels-settles-price-gouging-case-ep-408565374-358765961.html/>.

⁵ 635 F.3d 571 (2011).

⁶ *Online Merchants Guild v. Cameron*, Civil No. 3:20-cv-00029-GFVT (E.D. Ky. June 23, 2020).

The court's reasoning in the Kentucky case borrows heavily from a 2018 Fourth Circuit Court of Appeals opinion that similarly overturned that a Maryland law prohibiting an "unconscionable increase" in the wholesale price of a prescription drug because it violated the dormant commerce clause doctrine.⁷ In that case, the court reasoned that "[b]ecause the Act targets wholesale rather than retail pricing, an analogous restriction imposed by a state other than Maryland has the potential to subject prescription drug manufacturers to conflicting state requirements." The court explained, "If Maryland compels manufacturers to sell prescription drugs in the initial transaction at a particular price but another state imposes a different price, then manufacturers could not comply with both laws in a single transaction. The manufacturers' compliance would require more than modification of their distribution systems; it would force them to enter into a separate transaction for each state in order to tailor their conduct so as not to violate any state's price restrictions."

While it is too soon to think that these cases signal the end of state price-gouging laws as we know them, they do show that there are potentially fruitful bases for constitutional challenges of such laws based in the very real practical difficulty presented by over 40 different – and sometimes conflicting – state price-gouging laws.

V. POSSIBLE REFORMS

In order to address some of the burdensome practical and legal challenges that the current formulations of price-gouging laws present suppliers, some areas for possible rethinking include:

- Consider revising price-gouging laws to focus on prohibiting exorbitant profit margin increases rather than pre- and post-crisis price increases. Such an approach would focus on preventing crisis profiteering and build in an appreciation that costs often increase due to market forces during states of emergency. This approach would also do away with the difficult task of figuring out which pre- and post-crisis prices to compare.
- If the current increased price focus is maintained, price-gouging statutes could build increased costs into the elements of offense rather than having them as "exceptions," with the burden falling on sellers. For instance, price-gouging statutes could be revised to prohibit increased prices "above actual costs" during an emergency period.
- Price-gouging statutes could be revised to address the comparison point new sellers should use. This would encourage new entrants to provide essential products during an emergency and provide the clarity they need when setting first-time prices during a state of emergency.
- Price-gouging statutes could specifically address resellers and distributors; current statutes focus on pre- and post-emergency prices but do not specifically address how those prohibitions play out for brokers and intermediaries who connect sellers with buyers in need of high-demand products.

The current COVID-19 pandemic is affecting lives around the globe in ways never before experienced in our lifetimes. People will be processing lessons learned and vulnerabilities exposed for decades. Perhaps this crisis will provide a reflection point on existing price-gouging laws.

⁷ *Association for Accessible Medicines v. Frosh*, 887 F.3d 664 (4th Cir. 2018).

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