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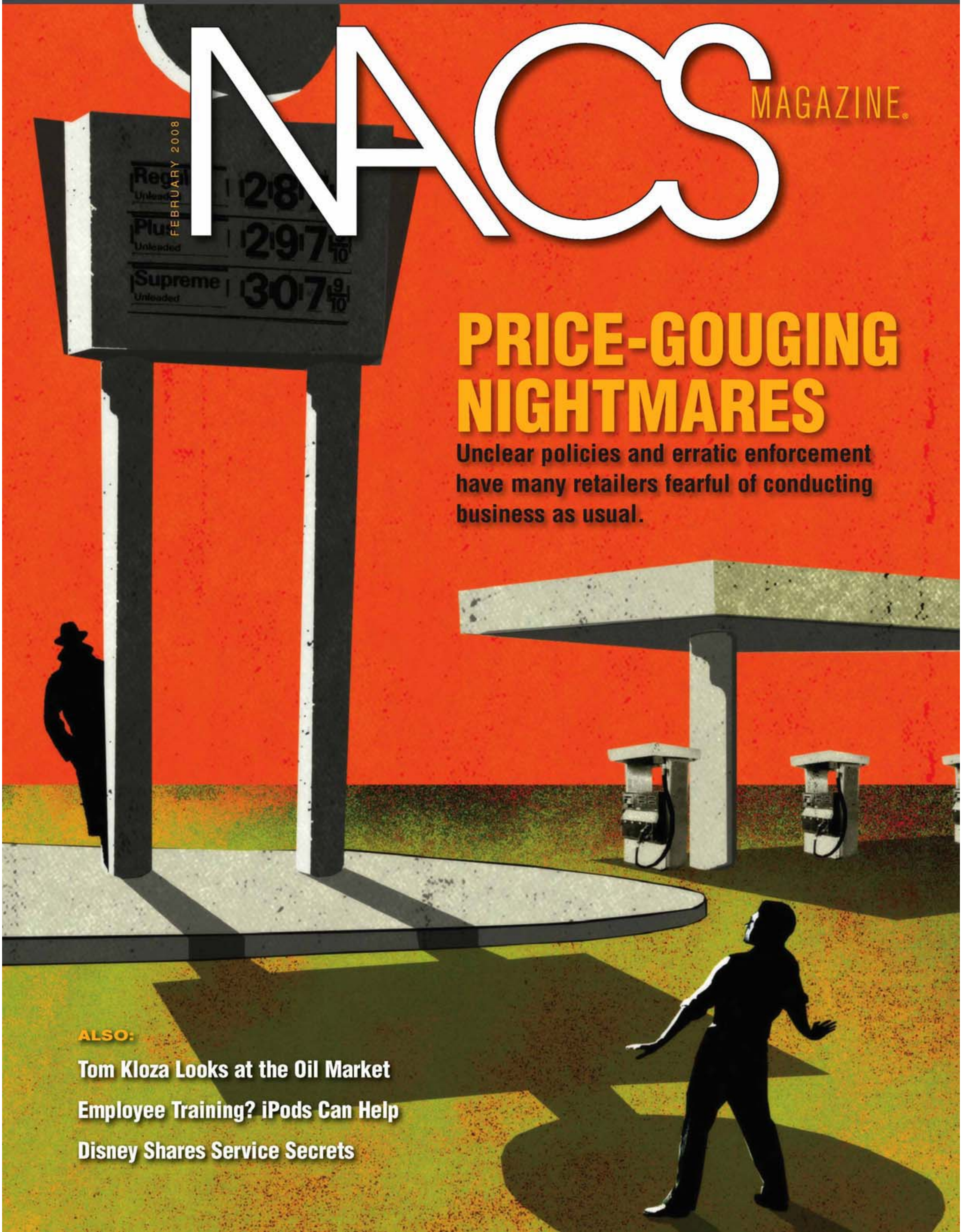

PRICE-GOUGING NIGHTMARES

Unclear policies and erratic enforcement have many retailers fearful of conducting business as usual.

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PRICE-GOUGING NIGHTMARES

Unclear policy and erratic enforcement have made many well-intentioned retailers fearful of tremendous financial and legal penalties. Will the recent political landscape change all that?

By Jerry Soverinsky

A FEW DAYS AFTER HURRICANE KATRINA REACHED U.S. shores, Eric*, a Midwest gasoline retailer and owner of several dozen outlets, received a letter from his state's attorney general.

"The letter mentioned price gouging," he said, the frustration evident in his voice more than two years later. "Someone in the community had reported one of my stores; we got a letter requesting information. [The Attorney General] gave us 48 hours to give them all of our information — gallons sold, gallons delivered, and times of price changes." After submitting the requested information, it wasn't long before Eric received a follow-up.

**Unless otherwise noted, the names of oil retailers have been changed to protect their privacy.*

"We got a phone call, they determined that we had price gouged. They faxed over a document, it was 3:15 on Friday afternoon, they said I had until 5:00 pm to sign the [admission of guilt letter], there would be a fine of a thousand dollars…and if I didn't sign the letter, I would be taken to court…It was strong arm treatment."

"I called to ask what **price gouging was.** They said it's **like pornography,** they **know it when they see it."**

— ERIC*

The speed at which the review was processed was puzzling to him, and the conclusion even more so. He couldn't understand how his actions could have been construed as price gouging. Eric felt he had "done everything in good faith" and that he had nothing to hide.

"…[Our] suppliers were saying they didn't know what the price was going to be…All the news was telling people to fill up, there was going to be a shortage, they brought about a panic in the marketplace…and if I'm sitting here and I'm [selling gasoline for] $2.99 and the station across the street is $3.19, I'm getting flooded, I'm out of fuel, and my commercial business depends on me for fuel. We have a responsibility every day to get fuel to taxicabs, mothers, and truckers. If it's higher priced tomorrow, people will be mad, but not as mad as when we're out of product."

As a result, Eric said he raised his prices to stay competitive with the store directly across the street, ensuring he would maintain his supply. He felt confident that he had broken no laws and therefore refused to sign the attorney general's letter, instead turning the matter over to his attorney. At that point, the case against him quickly unraveled.

"My attorney contacted them and requested all of their information; he asked them to show him on what basis I had price gouged. And just like that, they dropped the case. No other follow-ups. That was it."

While Eric's ordeal was quickly resolved at modest expense (total attorney fees were less than $1,000 and the entire matter was kept private), the experience was unsettling. He said his state's price-gouging laws are fraught with ambiguity, an oversight that produces anxiety in any retailer who finds himself the target of an investigation. "We have no guidance on what to do. The AG won't tell us, they just say, 'Don't take advantage of the public.' I called to ask what price gouging was. They said it's like pornography, they know it when they see it."

The landscape is likely to change soon. Price-gouging legislation is on a path for resolution, and it will profoundly affect how gasoline retailers conduct business. For many owners and operators, the guidelines will be a welcome relief from the uncertainty that permeates the current retail setting. For others, though, it revisits an emotionally charged subject, one that carries painful memories of public relations disasters and customer backlash. And one that they prefer would just go away.

WHAT IS GOUGING?

The fundamental obstacle in dealing with price-gouging allegations is identifying precisely what action constitutes the violation. And the uncertainty doesn't rest with just retailers and suppliers. Those in charge of setting policy and enforcement are equally unclear.

"One of the problems with price gouging is that there are a lot of different definitions of what price gouging is," notes Jeffrey Schmidt, director of the Federal Trade Commission's (FTC) Bureau of Competition, whose office was called upon by Congress in 2006 to both define the practice as well as pursue violators.

The task will not be easy, concedes Representative Joe Barton (R-TX), former chairman of the House Energy and Commerce Committee (in charge of developing the House of Representative's price-gouging legislation). "It's true that we all think we know price gouging when we see it, but that's not the sort of definition that a prosecutor can take to a judge or jury." (Incidentally, this quote has been reprinted out of context in several news reports, modified to imply that Barton — and by association law enforcement officials — sets his own subjective definition. "We know price gouging when we see it.")

ANDREW'S STORY

Southeast retailer Andrew*, owner of "15 to 25" stores, understands firsthand the dangers that vague price-gouging statutes pose to retailers. He was caught by surprise when he received a subpoena from his state's attorney general office less than two weeks after Hurricane Katrina, alleging that one of his company's stores had engaged in price gouging. But unlike Eric's private inquiry, Andrew's investigation coincided with a well-covered press conference.

"There was a lot of media coverage, print and electronic," Andrew said. "And there was a lot of [local consumer] conversation about it."

Twenty thousand dollars later in attorney fees and "dozens of hours" assembling sales reports, the attorney general settled with Andrew; he agreed to make a charitable contribution without any finding of guilt. (His attorney

PRO

Price Gouging — On Target

Matt Rothschild charges that any talk of anti-price gouging ignores reality. "Driving a car, for many of us, is a necessity," he writes in a 2006 editorial in *The Progressive*.

"…[H]ow free is the independent trucker, or the taxicab driver…? How free is the service worker who can't afford to live in the expensive city where she is employed, so she has to live thirty miles away, where there is no public transportation? Oil companies know that they have a lock on a crucial product. They're charging accordingly…Fantasies of a free market die-hard…[W]e need to get over the illusion of the self-regulating marketplace and the sovereign consumer…"

CON

Price Gouging — Economically Incorrect

While price gouging receives increased scrutiny by legislators, the concept has economists uneasy. "Many economists cringe when they hear politicians talk about price gouging," said Harvard University economics professor N. Gregory Mankiw. "To economists, the price system is central to how market economies allocate resources. Sometimes prices need to rise to balance supply and demand, even if that outcome is politically unpopular."

Retailer Andrew agrees. "We were below every other marketer in town," he said. "My fear was that if we stayed 20 to 26 cents a gallon cheaper, we would have run out of product. And we had no way of resupplying."

The Ayn Rand Institute's Alex Epstein poses the issue as one of choice. "Gas station owners cannot force us to buy gasoline," he wrote in "The Myth of 'Price Gouging'." "They can only offer us a trade, which we are free to accept or reject."

Economists also warn that price-gouging legislation is tantamount to price control, which can lead to supply-demand imbalances and ultimately fuel outages. "In the 1970s, when price controls were in effect," noted the President's Council of Economic Advisers in its 2007 white paper "The Economic Consequences of Gasoline 'Price Gouging' Legislation," "oil price increases were accompanied by long lines at the pump and economic recession."

Politically Charged?

With gasoline prices exceeding $3 per gallon, price-gouging detractors say the legislative momentum is not difficult to understand.

"Politicians…have their eyes on fleeting opportunities to make political hay," writes columnist Thomas Sowell in *Capitalism Magazine*. "The high price of gasoline is the opportunity du jour. Nothing is easier than to blame high prices on whoever charges those high prices, regardless of what the underlying cause is."

said he would have won if he went to court, but he didn't want to chance it; he would have owed another $50,000 in legal fees.) Two years later, Andrew is still shaking his head, unclear as to why he was targeted.

"I was actually the last retailer in my area to increase prices, I was 26 cents [per gallon] cheaper than some of the others [retailers]," he said. "I went up for two days only — 20 cents — then came down again. But I went up only to meet competition and because my supplier was out at the terminal. He had no way of resupplying my store."

"My store did a small business. Maybe 15,000 gallons a month…When the AG did the math, the number of gallons he determined we sold during the two days in question at the pricing difference was $120…It cost me more than $20,000 to defend myself from the state's claim that I gouged customers a total of $120."

CODIFYING PRICE GOUGING

In the past few years and commensurate with rising gasoline prices, the federal government has focused its attention on price gouging. While NACS opposes anti–price-gouging legislation as an unnecessary government intervention in the free market, it recognizes that the movement toward resolution is progressing. To be clear, NACS maintains that its price-gouging involvement in no way seeks to protect, exculpate or excuse unethical retailers. Rather, it is focused on ensuring that honest retailers are not penalized for reacting to legitimate market conditions.

Recent legislation in the House demonstrates how NACS' involvement produced modifications advantageous to retailers. On May 23, 2007, the House of Representatives passed H.R. 1252, the Federal Price Gouging Prevention Act, which makes price gouging a federal crime.

As originally introduced, the bill prohibited retailers from selling gasoline at prices that are unconscionable *or* from taking unfair advantage of market conditions. Additionally, it provided that in order to assess a violation, prior pricing (charged during the preceding 30 days) or the price of competitors' product must be considered. In a statement NACS attempted to submit into the congressional record during a hearing on gasoline prices, the association criticized the vagueness of these provisions, warning that if passed, they would "endanger the livelihoods of gasoline retailers across the country."

Final language in the bill, subsequent to NACS efforts, prohibits retailers from selling gasoline at prices that are unconscionable *and* that take unfair advantage of market conditions. Additionally, it mandates that in order to assess a violation, prior pricing *and* the price of competitors' product *and* whether price increases reflect additionally incurred costs *and* whether the price increase was attributed to geographic market conditions *and* how quantity of product sold during the period in question changed, must be considered.

The bill also requires the president to "issue an emergency proclamation for any area within the jurisdiction of the United States during which the [price gouging] would apply." The bill's amended language is significant; it provides conditions that enforcement officials must prove before assessing guilt.

NACS is pleased with the changes; it wrote a letter to House members after the amended language was included (a day before final passage) emphasizing that "the legislation now clearly addresses unscrupulous market activity during a period within which consumers may be susceptible to actual price gouging" while also "provid[ing] much needed clarity for retailers."

The House language includes harsh penalties for price gougers: fines equaling three times the price-gouging profits, up to $150 million criminal fines for corporations, and $2 million fines and/or 10 years imprisonment for individuals.

For both Eric and Andrew, accepting the facts they presented, it seems unlikely that an attorney general following H.R. 1252's criteria would be able to arrive at a finding of guilt. In both cases, their price changes represented their attempts to stay competitive with other documented price increases in their area and an anticipation of increased supply costs. The criteria should especially help other retailers who find themselves in an arm-twisting situation such as the one Eric reported. While he held his ground, others might have agreed to quick settlements in an effort to avoid litigation that involved an uncertain outcome. With greater clarity of retailers' rights, many retailers might feel more confident standing up to the pressure.

Legislation in the Senate also underwent significant change. As originally introduced in May 2007 as S.1263, the Petroleum Consumer Price Gouging Protection Act, the bill defined a violation as "the charging of an unconscionably excessive price by a supplier in an affected area." Similar to the House bill, the Senate version went on to define "unconscionably excessive" as needing to pass several tests.

Among the criteria: pricing that represents a gross disparity between the original price and the price charged after the emergency declaration, pricing that grossly exceeds competitors', pricing that "represents an exercise of unfair leverage" during the emergency, and pricing that is not reflected in increased wholesale costs. However, this version failed to consider anticipated replacement costs or to combine the various criteria as ultimately included in the House bill.

NACS worked with the sponsor of the legislation to explain the retail market fundamentals and the need to provide honest retailers with sufficient legal clarity to continue operations during periods of uncertain supply. The legislation that was finally passed by the Senate as part of its comprehensive energy bill ensured that retailers could factor

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— ANDREW*

replacement costs into their pricing decisions and could not be found guilty of price gouging if they were competitive within their market. In addition, the other provisions adopted by the House were included in the Senate bill.

In contrast to the House version, the Senate bill prescribes less dramatic fines for violators: up to $500,000 for small marketers and up to $5 million for other suppliers. Criminal penalties are also available: up to $5 million and/or up to five years imprisonment.

SIGNING OFF

When finalizing its energy policy legislation in December 2007, the House and Senate attempted to resolve the remaining differences between their legislation. Faced with limited available time for negotiation and a renewed threat from the White House to veto the legislation if price-gouging provisions were

Price Gouging and **Collusion**

In a 2007 white paper, the President's Council of Economic Advisers argues against price-gouging legislation, citing marketplace competition and antitrust laws as providing adequate consumer protections. "Existing antitrust law based on economic principles already ensures healthy competition by protecting against anticompetitive business practices…[it] prohibits sellers from explicitly colluding to impose higher prices. Retailers and refiners are prohibited from taking exclusionary actions that would create monopoly power."

Federal Trade Commission Chair Deborah Platt Majoras presented a similar view in 2005 before a Senate committee studying the issue. "[T]he commission remains persuaded that federal price gouging legislation would unnecessarily hurt consumers. Enforcement of the antitrust laws is the better way to protect consumers."

NACS cannot guarantee protection for retailers without legislative change at the state level.

included in the energy package, the issue was put on the shelves.

But there should be no illusions that price gouging will be forgotten. Congressional staffers have assured NACS that the bill will be renewed sometime during 2008.

FEDERAL VS. STATE INFLUENCE

Even assuming White House endorsement, a federal price-gouging law will not provide the desired protection for all retailers. For while a federal price-gouging law would apply in states that lack their own provisions, in those states with existing legislation (assuming that it doesn't conflict with federal law), the government can pursue retailers on the basis of either state or federal law. As such, while NACS is doing its part in advocating for precision in the federal price-gouging legislation, it won't guarantee protection for retailers like Eric and Andrew, absent legislative change on the state level.

At least 23 states have enacted price-gouging laws, and most resemble those that affected Eric and Andrew. While they address profiteering scenarios, most ignore supply and demand implications. Kansas, for instance, defines price gouging as raising prices more than 25 percent pursuant to a disaster — without reference to wholesale costs. Florida makes no attempt to quantify price gouging, defining the practice as any post-state of emergency price increase that "grossly exceed[s] the average price of the commodity the thirty days before the declaration." Indiana's law is similar to Florida's, except that the 30-day comparison period is reduced to seven.

Other states, recognizing the issue's ramifications, are treading carefully. While Illinois lacks formal guidance, proposed legislation is proceeding slowly. And the state concedes on its official Web site that final resolution won't be easy. "[I]t must lay out a means of differentiating between market factors affecting price and blatant opportunism or profiteering. Given the complexity of factors affecting the price of oil and gasoline this is not a straightforward task."

The task is definitely not straightforward. But with gasoline prices showing little signs of retreat and the November elections fast approaching, the issue will undoubtedly continue to move forward, with tremendous financial and legal implications for retailers. And without clarification and precision in final legislation, both on the state and federal levels, ethical, well-intentioned retailers will continue to be vulnerable to subjective determinations that threaten their corporate survival.

Stay tuned.

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To review the most recent price gouging legislative efforts, visit

- www.govtrack.us/congress/billtext.xpd?bill=h110-1252 (House; H.R. 1252: Federal Price Gouging Prevention Act)
- thomas.loc.gov/cgi-bin/query/z?c110:S.1263: (Senate; S. 1263; Petroleum Consumer Price Gouging Protection Act)
- www.govtrack.us/congress/bill.xpd?bill=s110-1419: (Senate; S. 1419: Renewable Fuels, Consumer Protection, and Energy Efficiency Act of 2007)