UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Bureau of Competition
Bureau of Economics
Office of Policy Planning

March 12, 2004

The Honorable Les Donovan
Assistant Majority Leader, Kansas Senate
Kansas State Capitol,
Room Number: 120-S
300 SW 10th St.
Topeka, KS 66612

Re: Comment on Kansas House Bill No. 2330

Dear Senator Donovan:

The staffs of the Federal Trade Commission's Bureau of Competition, Bureau of Economics, and Office of Policy Planning are pleased to respond to your request for comments on Kansas House of Representatives Bill No. 2330 (the "Bill"), which concerns the sale of motor fuel. The bill would prohibit a "marketer" or "retailer" from selling motor fuel below cost, without any showing that the below-cost sale harmed competition. The Bill would allow the state to seek injunctive and monetary relief, and would allow aggrieved private parties to seek injunctive relief and legal fees.

In your letter of February12, 2004, you asked us to comment on the proposed Bill, and especially on its "impact on the consumers of Kansas and on fair competition within the state's borders." A summary of our comments appears below:

- Low prices benefit consumers. Consumers are harmed only if below-cost prices allow a dominant competitor to raise prices later to supracompetitive levels.

- Economic studies, legal studies, and court decisions indicate that below-cost pricing that leads to monopoly occurs infrequently. Below-cost sales of motor fuel that lead to monopoly are especially unlikely.

- The federal antitrust laws deal with below-cost pricing that has a "dangerous probability" or a "reasonable prospect" of leading to monopoly. The FTC, the Department of Justice's Antitrust Division, state attorneys general, and private parties can bring suit under the federal antitrust laws against anticompetitive below-cost pricing. The Bill, however, not only duplicates these protections, it exceeds them in ways that are likely to harm consumers. Federal law prohibits pricing that could harm competition and consumers, not just competitors, whereas the Bill would prohibit below-cost pricing regardless of its effect on competition.

- The Bill likely would discourage fuel retailers and marketers from engaging in price competition. The Bill would subject vendors to the potential of a $10,000 fine per violation for cutting prices even if there is no likelihood of harm to market-wide competition. Further, a price-cutting vendor found in violation of the proposed Bill may be forced to pay for investigatory fees for actions brought by the state, and to pay for a private plaintiff's court costs and legal fees. The Bill also defines "costs" in a way that does not reflect the true marginal cost of the motor fuel in a vendor's inventory, thus potentially subjecting some above-cost prices to condemnation. As a result, the Bill likely would lead many vendors to avoid procompetitive price-cutting for fear of liability.

For these reasons, we believe that the Bill likely would harm consumers and restrict competition. Moreover, the Bill is unnecessary because the federal antitrust laws already protect against anticompetitive predatory pricing.

Interest and Experience of the Federal Trade Commission

The FTC is charged by statute with preventing unfair methods of competition and unfair or deceptive acts or practices in or affecting commerce.[1] Under this statutory mandate, the Commission seeks to identify business practices that impede competition or increase costs without offering countervailing benefits to consumers. In particular, the Commission staff has often assessed the competitive impact of regulations and business practices in the petroleum industry. In recent years, the Commission has investigated, among others, the mergers of several diversified energy companies: Chevron and Texaco; Exxon and Mobil; BP and Amoco; petroleum refiners Valero Energy and Ultramar Diamond Shamrock; and the combination of the refining and marketing businesses of Shell, Texaco, and Star Enterprises.[2]

The Commission and its staff have also investigated, conducted workshops, and commented on proposed regulations regarding motor fuel pricing. In 2001, the Commission completed investigations of spikes in reformulated gasoline prices in several Midwestern states,[3]

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[1] Federal Trade Commission Act, 15 U.S.C. § 45.

[2] *See* Valero Energy Corp., Docket C-4031 (Feb. 19, 2002); Chevron Corp., Docket C-4023 (Jan. 4, 2002); Exxon Corp., Docket C-3907 (Jan. 26, 2001); British Petroleum Co. p.l.c., 127 F.T.C. 515 (1999); Shell Oil Co., 125 F.T.C. 769 (1998). All of these orders are available at the FTC's website.

[3] FTC, Final Report, Midwest Gasoline Price Investigation (Mar. 29, 2001), at http://www.ftc.gov/os/2001/03/mwgasrpt.htm.

and of gasoline price increases in West Coast markets.[4] In the last two years, the Commission held two public conferences to examine factors that affect prices of refined petroleum products in the United States.[5] Commission staff also filed public comments with the Environmental Protection Agency concerning "boutique fuel" regulations.[6] On many occasions, the Commission staff has offered comments on proposed state laws covering various aspects of gasoline sales, including laws that would ban sales of motor fuel below cost.[7]

Analysis of Proposed Bill No. 2330

The Bill would make it illegal to sell motor fuel at prices below cost. Specifically, the Bill provides that "no marketer or retailer of motor fuel shall sell or offer for sale, by posted price or indicating meter, motor fuel at a price below cost."[8] The Bill defines "cost" in the following manner:

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[4] *FTC Closes Western States Gasoline Investigation,* FTC Press Release (May 7, 2001), at http://www.ftc.gov/opa/2001/05/westerngas.htm.

[5] *FTC to Hold Public Conference/Opportunity for Comment on U.S. Gasoline Industry,* FTC Press Release (July 12, 2001), at http://www.ftc.gov/opa/2001/07/gasconf.htm; *FTC to Hold Second Public Conference on the U.S. Oil and Gasoline Industry in May 2002*, FTC Press Release (Dec. 21, 2001), at http://www.ftc.gov/opa/2001/12/gasconf.htm.

[6] FTC Staff comments, *Study of Unique Gasoline Fuel Blends, Effects on Fuel Supply and Distribution and Potential Improvements,* EPA 420-P-01-004, Public Docket No. A-2001-20 (Jan. 30, 2002), at http://www.ftc.gov/be/v020004.pdf.

[7] *See* Letter from Susan Creighton, Director, FTC Bureau of Competition, et al., to Demetrius Newton, Speaker Pro Tempore of the Alabama House of Representatives (Jan. 29, 2004), at http://www.ftc.gov/be/v040005.htm; Letter from Susan Creighton, Director, FTC Bureau of Competition, et al., to Wisconsin State Rep. Shirley Krug (Oct. 15, 2003), at http://www.ftc.gov/be/v030015.htm; Letter from Joseph J. Simons, Director, FTC Bureau of Competition, et al., to Eliot Spitzer, Attorney General of New York (July 24, 2003), at http://www.ftc.gov/be/nymfmpa.pdf; Letter from Joseph J. Simons, Director, FTC Bureau of Competition, et al., to Roy Cooper, Attorney General of North Carolina (May 19, 2003), at http://www.ftc.gov/os/2003/05/ncclattorneygeneralcooper.pdf; *Competition and the Effects of Price Controls in Hawaii's Gasoline Market: Before the State of Hawaii, J. Hearing House Comm. On Energy and Environmental Protection et al.* (Jan. 28, 2003) (testimony of Jerry Ellig, Deputy Director, FTC Office of Policy Planning), at http://www.ftc.gov/be/v030005.htm; Letter from Joseph J. Simons, Director, FTC Bureau of Competition, et al., to Gov. George E. Pataki of New York (Aug. 8, 2002), at http://www.ftc.gov/be/v020019.pdf; Letter from Joseph J. Simons, Director, FTC Bureau of Competition, and R. Ted Cruz to Hon. Robert F. McDonnell, Commonwealth of Virginia House of Delegates (Feb. 15, 2002), at http://www.ftc.gov/be/V020011.htm. *See also* Letter from Ronald B. Rowe, Director for Litigation, FTC Bureau of Competition, to Hon. David Knowles, California State Assembly (May 5, 1992); Prepared Statement of Claude C. Wild III, Director, FTC Denver Regional Office, before the State, Veterans, and Military Affairs Committee of the Colorado State Senate (Apr. 22, 1992); Letter from Claude C. Wild III, Director, FTC Denver Regional Office, to Hon. Bill Morris, Kansas State Senate (Feb. 26, 1992); Letter from Claude C. Wild III, Director, FTC Denver Regional Office, to David Buhler, Executive Director, Utah Department of Commerce (Jan. 29, 1992); Letter from Thomas B. Carter, Director, FTC Dallas Regional Office, to Hon. W.D. Moore, Jr., Arkansas State Senate (Mar. 22, 1991); Letter from Jeffrey I. Zuckerman, Director, FTC Bureau of Competition, to Hon. Jennings G. McAbee, Chairman, Other Taxes and Revenues Subcomm., Ways and Means Comm., South Carolina House of Representatives (May 12, 1989). All of these letters are on file at the FTC.

[8] House Bill No. 2330 § 1(a). The Bill contains two limited exceptions where below-cost sales are allowed: (1) for promotional sales associated with "a grand opening," to introduce a "new or remodeled business," or "during special promotions, not to exceed three days per calendar quarter;" and (2) sales "made in good faith to meet an equally low retail price, net of any discounts received at the time of sale." *Id*. at § 1(b)(1)-(2).

> "[C]ost" means product cost and actual freight or transportation costs plus applicable taxes and fees pursuant to federal, state and local law or if such costs are unavailable then "cost" means the average of the three lowest terminal prices posted by a supplier on the day at the terminal from which the most recent supply of motor fuel delivered to the retail location was acquired as published by a nationally recognized petroleum price reporting service and actual freight offered from a common carrier for hire designated for the terminal from which the most recent supply of motor fuel delivered to the retail location, plus applicable taxes and fees pursuant to federal, state and local law.[9]

If the Division of Weights and Measures of the Department of Agriculture "receives a complaint and has reason to believe that a marketer or retailer has violated the provisions of this act," the Bill would have the Division demand that the offending marketer or retailer "raise [its] price . . . to comply with the provisions of this act."[10] Within 10 business days following this demand, the Division "shall investigate and determine whether the allegations contained in the complaint are still true."[11] If the allegations are "still true," the marketer or retailer "shall provide the [D]ivision with all records and documentation requested in order . . . to determine if a violation of the act has occurred."[12] If the Division determines that a violation has occurred, it will provide the Attorney General "with all records, documentation and findings of the [D]ivision related to such violation."[13]

In turn, the Attorney General may seek a declaratory judgment, injunctive relief, monetary penalties, and "reasonable expenses and investigation fees" incurred by both the Division and the Attorney General.[14] On the first violation, "the [A]ttorney [G]eneral shall send to the violator by certified mail, return receipt requested, an order that the violator cease and desist from the violation within 24 hours of receipt of such order."[15] A second violation "shall render the violator liable for the payment of a civil penalty in a sum of $1,000 for each day the violation occurs."[16] A "third or subsequent" violation "shall render the violator liable for the payment of a civil penalty in a sum of $10,000 for each day such violation occurs."[17]

The Bill also would allow a retailer or marketer "aggrieved by a violation of the provisions of this act" to seek a declaratory judgment that a violation has occurred, and

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[9] *Id.* at § 1(c).

[10] *Id.* at § 1(d).

[11] *Id.*

[12] *Id.* If a retailer or marketer fails to comply with the request for documents, the Division "shall take [its pumps] out of service." *Id.*

[13] *Id.*

[14] *Id.* at § 1(e)(1)-(4).

[15] *Id.* at § 1(f). It appears that a violation is defined either with respect to a specific transaction with a specific customer or, if a specific transaction cannot be identified, with respect to each day. *Id.*

[16] *Id.*

[17] *Id.*

injunctive relief to prevent current and future violations, and to "recover court costs and reasonable attorney fees."[18]

We believe that, if followed by retailers and marketers, the Bill likely would restrict competition and may lead to higher prices for consumers. Unlike federal antitrust law, the Bill would have the effect of protecting individual retailers and marketers of motor fuel from lower-priced competitors. In doing so, the Bill likely would harm consumers by discouraging procompetitive price-cutting. We also believe that the Bill is unnecessary, both because scholarly studies and court decisions indicate that anticompetitive below-cost pricing happens infrequently, and because the federal antitrust laws already prohibit anticompetitive below-cost pricing.

I. Legal and scholarly analysis of predatory pricing

A. Federal antitrust law condemns below-cost pricing that harms competition

i. Antitrust law protects consumers, not competitors

The federal antitrust laws are fundamental to national economic policy and our free market system. The antitrust laws ensure that markets remain competitive, efficient, and dynamic. Under these laws, both the FTC and the Department of Justice's Antitrust Division may bring enforcement actions against anticompetitive below-cost pricing.[19] The federal government has launched several predatory pricing investigations and predatory unilateral conduct cases during the past several years.[20] In addition, private plaintiffs and state attorneys general have the right to bring predatory pricing cases. Under Section 4 of the Clayton Act, any person who has been injured in his business or property as a result of conduct forbidden by the antitrust laws can seek treble damages for that injury.[21] State attorneys general, acting as *parens patriae*, also may bring such actions.

Although below-cost pricing that harms competition is illegal, the United States Supreme Court has cautioned that antitrust law should not prevent procompetitive price-cutting. Congress designed the antitrust laws for "the protection of competition, not competitors," and vigorous competition allows consumers to reap the benefits of lower prices, greater variety, and higher quality goods and services.[22] In several important antitrust decisions, the Court has been absolutely clear that consumer welfare is the linchpin of the antitrust laws, and that as a general

[18] *Id.* at § 1(g)(1)-(3).

[19] Predatory pricing claims generally are brought either as violations of Sherman Act § 2 (15 U.S.C. § 2) or as "primary-line" violations of the Robinson-Patman Act (15 U.S.C. § 13(a)).

[20] One notable example is *United States v. Microsoft*, 253 F.3d 34 (D.C. Cir.), *cert. denied*, 534 U.S. 952 (2001).

[21] 15 U.S.C. § 15.

[22] Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477, 488 (1977) (quoting Brown Shoe Co. v. United States, 370 U.S. 294, 320 (1962)).

matter, low prices are "a boon to consumers."[23] As the Supreme Court observed in *Spectrum Sports, Inc. v. McQuillan*:

> The purpose of the [Sherman] Act is not to protect businesses from the working of the market; it is to protect the public from the failure of the market. The law directs itself not against conduct which is competitive, even severely so, but against conduct which unfairly tends to destroy competition itself.[24]

Thus, unless conduct threatens to lead to lower output, higher prices, lower quality, or less variety, it is of no concern to the antitrust laws.[25]

ii. Only below-cost prices can be predatory

The Supreme Court has directly addressed low-pricing strategies. In *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, the leading case in this area, the Court expressly held that a defendant does not violate the federal antitrust laws by cutting prices merely because the low prices decrease a competitor's profits. "Low prices benefit consumers regardless of how those prices are set. . . . To hold that the antitrust laws protect competitors from the loss of profits due to such price competition would, in effect, render illegal any decision by a firm to cut prices in order to increase market share."[26] To be unlawful, the low prices must, at a minimum, be predatory. "[S]o long as they are above predatory levels, [low prices] do not threaten competition . . . . We have adhered to this principle regardless of the type of antitrust claim involved."[27]

The Court has defined predatory pricing, in turn, as "pricing below an appropriate measure of [the defendant's] cost for the purpose of eliminating competitors in the short run and reducing competition in the long run."[28] Although the Court has not stated what the appropriate measure of cost should be, prominent antitrust scholars and several federal circuit courts have concluded that the price-cutter's marginal costs, or a close proxy such as average variable costs, should be the yardstick.[29]

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[23] Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 224 (1993). *See also* Atlantic Richfield Co. v. USA Petroleum Co., 495 U.S. 328 (1990); Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574 (1986). After *Brooke Group*, it is clear that a plaintiff must show injury to competition in a primary-line case under the Robinson-Patman Act. *See Brooke Group*, 509 U.S. at 222-23.

[24] 506 U.S. 447, 458 (1993).

[25] *Cf. Brooke Group*, 509 U.S. at 224 ("That below-cost pricing may impose painful losses on its target is of no moment to the antitrust laws if competition is not injured: It is axiomatic that the antitrust laws were passed for the protection of *competition*, not *competitors.*") (internal quotations and citations omitted) (emphasis in original).

[26] *Id.* at 223 (internal quotations and citations omitted).

[27] *Id.* (quoting *Atlantic Richfield*, 495 U.S. at 340).

[28] Cargill, Inc. v. Monfort of Colorado, Inc., 479 U.S. 104, 117 (1986).

[29] Marginal costs are those costs associated with producing an additional unit of output. *See* United States v. AMR Corp., 335 F.3d 1109, 1116 (10th Cir. 2003) (marginal cost and average variable cost are relevant in determining whether prices are predatory); Kelco Disposal, Inc. v. Browning-Ferris Indus., 845 F.2d 404, 407 (2d Cir. 1988), *aff'd on other grounds,* 492 U.S. 257 (1989) (finding that "[p]rices that are below reasonably anticipated marginal cost, and its surrogate, reasonably anticipated average variable cost . . . are presumed predatory"); MCI

iii. Below-cost pricing can harm consumers only in limited circumstances

Below-cost pricing has the potential to injure consumers *only* if it allows a firm subsequently to engage in sustained supracompetitive pricing. As the Supreme Court has noted in regard to predatory pricing:

> [T]he short-run loss is definite, but the long-run gain depends on successfully neutralizing the competition. Moreover, it is not enough simply to achieve monopoly power, as monopoly pricing may breed quick entry by new competitors eager to share in the excess profits. The success of any predatory scheme depends on *maintaining* monopoly power for long enough both to recoup the predator's losses and to harvest some additional gain.[30]

Thus, even if a below-cost pricing strategy succeeds in temporarily reducing the number of competitors, the price-cutter must keep competitors from returning after it tries to raise prices again: "The second prerequisite to holding a competitor liable under the [federal] antitrust laws for charging low prices is a demonstration that the competitor had a reasonable prospect, or, under § 2 of the Sherman Act, a dangerous probability, of recouping its investment in below-cost prices."[31] Otherwise, the below-cost pricing strategy, which requires that the firm incur losses on every sale, will not succeed. As a practical matter, the recoupment test can be satisfied only when the price-cutter enjoys substantial market power so that it can affect prices through a contraction in its output, and when there are significant barriers to entry and reentry so that the price-cutter's supracompetitive prices will not be undercut by new entrants.[32]

When a firm is unable to recoup its short-run losses later through supracompetitive pricing, consumers enjoy a windfall. And without harm to consumers, an antitrust violation does not occur. "[U]nsuccessful predation is in general a boon to consumers . . . . That below-cost pricing may impose painful losses on its target is of no moment to the antitrust laws if competition is not injured."[33]

Communications Corp. v. AT&T, 708 F.2d 1081, 1122-23 (7th Cir. 1983) (holding that no predatory intent can be presumed from prices at or above long-run incremental cost); Int'l Air Indus. v. American Excelsior Co., 517 F.2d 714, 724 (5th Cir. 1975) (holding that plaintiff must show that "either (1) a competitor is charging a price below his average variable cost . . . or (2) the competitor is charging a price below its short-run, profit-maximizing price and barriers to entry are great enough to enable the discriminator to reap the benefits of predation before new entry is possible"); P. AREEDA & H. HOVENKAMP, ANTITRUST LAW ¶ 724; P. Areeda & D. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697 (1975). In *Brooke Group*, the parties both agreed that average variable cost should be the appropriate measure.

[30] *Matsushita Elec.*, 475 U.S. at 589 (emphasis in original).

[31] *Brooke Group*, 509 U.S. at 224.

[32] *See id.* at 226 (citing entry barriers, market concentration, and capacity constraints as factors to guide the recoupment inquiry).

[33] *Id.* at 224.

B. Scholarly studies and court decisions suggest that predatory below-cost pricing happens infrequently

In recent years, many scholars have studied anticompetitive below-cost pricing. In an exhaustive discussion, Frank Easterbrook, now sitting on the U.S. Court of Appeals for the Seventh Circuit, noted that "[s]tudies of many industries find little evidence of profitable predatory practices in the United States or abroad. These studies are consistent with the result of litigation; courts routinely find that there has been no predation."[34]

Other analyses largely confirm Easterbrook's conclusion. A leading textbook on industrial organization economics notes that "[g]iven all the problems in identifying predatory pricing, it is not surprising that economists and lawyers have found few instances of successful price predation in which rivals are driven out of business and prices then rise. Although predation is frequently alleged in lawsuits, careful examination of these cases indicates that predation in the sense of pricing below cost usually did not occur."[35] Predation sometimes occurs,[36] but not nearly as frequently as claimed.[37]

The Supreme Court has endorsed this scholarship. Because it is difficult to profit from anticompetitive below-cost pricing, the Supreme Court has observed that "there is a consensus among commentators that predatory pricing schemes are rarely tried, and even more rarely successful."[38] Therefore, the Court has emphasized the need to take great care to distinguish between procompetitive price cutting and anticompetitive predation because "cutting prices in order to increase business often is the very essence of competition . . . ."[39]

Indeed, the Supreme Court has made it clear that when it comes to unilateral activity, antitrust law should be extremely hesitant to condemn conduct that is consistent with competition. In *Spectrum Sports*, for example, the Supreme Court noted how difficult it is to "distinguish robust competition from conduct with long-term anticompetitive effects," and observed that "this Court and other courts have been careful to avoid constructions of § 2 [of the Sherman Act] which might chill competition, rather than foster it."[40] And this year, in *Verizon Comm. Inc. v. Law Offices of Curtis V. Trinko*, the Court once again cautioned against legal rules that too easily condemn activities associated with competition, observing that "[m]istaken

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[34] F. Easterbrook, *Predatory Strategies and Counterstrategies*, 48 U. CHI. L. REV. 263, 313-14 (1981) (citations omitted).

[35] DENNIS W. CARLTON & JEFFREY M. PERLOFF, MODERN INDUSTRIAL ORGANIZATION 342 (3d ed. 2000).

[36] *See* J. CHURCH & R. WARE, INDUSTRIAL ORGANIZATION: A STRATEGIC APPROACH 659 (2000).

[37] P. AREEDA & H. HOVENKAMP, ANTITRUST LAW at ¶ 723a ("as the Supreme Court has observed, although competitors allege predation frequently, it is probably quite uncommon").

[38] *Matsushita Elec.*, 475 U.S. at 589.

[39] *Id.* at 594.

[40] *Spectrum Sports*, 506 U.S. at 458-59.

inferences and the resulting false condemnations 'are especially costly, because they chill the very conduct the antitrust laws are designed to protect.'"[41]

C. Past studies show that anticompetitive below-cost sales of motor fuel are especially unlikely

Several studies suggest that anticompetitive below-cost pricing is especially unlikely in gasoline retailing. During the past two decades, many government agencies have investigated laws to prevent anticompetitive below-cost pricing of motor fuel. The issue originally arose in the 1980s, when various parties expressed concern that major oil companies were selling gasoline below cost to drive independent stations out of business. Numerous states considered enacting legislation to ban below-cost pricing of motor fuel. The U.S. Department of Energy (USDOE) comprehensively investigated these allegations.

In 1984, USDOE released a final report to Congress examining whether vertically integrated refiners were "subsidizing" their retail gasoline operations in a way that was predatory or anticompetitive. The study relied on extensive pricing data and internal oil company documents. USDOE found no evidence of predation or anticompetitive subsidization. Instead, the agency concluded that the decline in the overall number of retail outlets and intensified competition among gasoline marketers resulted from decreased consumer demand for gasoline in some areas and a continuing trend toward the use of more efficient, higher-volume retail outlets.[42]

Several states have conducted their own studies. In 1987, Arizona's Joint Legislative Study Committee recommended no new legislation to restrict the pricing of motor fuel in Arizona. "The marketplace for petroleum products is very competitive in Arizona," the Committee concluded.[43] Similarly, in 1986, the Washington State Attorney General studied whether refiners were subsidizing company-owned service stations in an anticompetitive manner. Washington gathered information on the practices of all eight of the major companies in the state for a three-year sample period. The Washington study found that lessee-dealers paid essentially the same prices as company-owned stations more than 99% of the time.[44]

In 2000, the Commonwealth of Pennsylvania studied a variety of proposals for bills affecting retail gasoline sales in the state. The report extensively analyzed "sales below cost" laws and declined to recommend that Pennsylvania enact one. In fact, the Pennsylvania study raised significant doubts about the theory that gasoline retailers were engaging in

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[41] 124 S. Ct. 872, 882 (2004) (quoting *Matsushita*, 475 U.S. at 594).

[42] USDOE, DEREGULATED GASOLINE MARKETING: CONSEQUENCES FOR COMPETITION, COMPETITORS, AND CONSUMERS (Mar. 1984); DR. JAMES B. DELANEY & DR. ROBERT N. FENILI, U.S. DEP'T OF ENERGY, FINAL REPORT: THE STATE OF COMPETITION IN GASOLINE MARKETING (Jan. 1981).

[43] STAFF OF ARIZ. JOINT LEGISLATIVE STUDY COMMITTEE, FINAL REPORT ON PETROLEUM PRICING AND MARKETING PRACTICES AND PRODUCER RETAIL DIVORCEMENT, at 35 (Dec. 1988)

[44] WASH. ATTORNEY GENERAL, FINAL REPORT TO THE WASHINGTON STATE LEGISLATURE ON THE INVESTIGATION OF RETAIL GASOLINE MARKETING, at 14 (Aug. 12, 1987).

anticompetitive below-cost pricing, and it warned that a "sales below cost" law could harm consumers:

> Unfortunately, such laws may serve to deter, rather than enhance, competition. The reason for such deterrence is that it may open up firms who engage in low, but non-predatory, pricing to litigation. Seeing the threat of litigation, such firms may change strategy and charge consumers higher prices.[45]

Of course, competitors often will complain that the competition charges prices that are "too low." Competitors have an incentive to do so if they believe such complaints will lead to legislation that will allow them to charge higher prices. To date, however, no systematic study has produced evidence that predatory pricing is a significant problem in retail gasoline markets.

II. The Bill likely would restrict competition and harm consumers

To the extent that motor fuel sellers would adjust their behavior to comply with the proposed Bill, it would most likely have a detrimental effect on competition and consumer welfare. By allowing liability to be predicated on a single act of below-cost pricing, regardless of any effect on competition, the Bill would shield vendors of motor fuel from competition by deterring competitive price-cutting. This result would harm consumers. Additionally, the Bill's definition of "cost" does not reflect the true marginal cost of motor fuel in a vendor's inventory. Finally, we believe that the Bill is unnecessary, both because scholarly studies and court decisions indicate that anticompetitive below-cost pricing happens infrequently, and because the federal antitrust laws already prohibit anticompetitive instances of below-cost pricing.

A. The Bill likely would deter price-cutting and thus harm competition

A marketer or retailer found to have violated the Bill would face penalties that include a fine of up to $10,000 per violation, as well as private litigation that could result in injunctive relief and legal fees. Given the possibility of mistakenly being found liable and facing these substantial penalties, the Bill likely would deter vendors from cutting prices. Indeed, the Supreme Court has cautioned that because of the risk of false condemnation, rules that too easily condemn behavior consistent with competition (*e.g.*, price-cutting), will have the effect of deterring firms from competing.[46] Thus, unlike federal antitrust law, which protects competition, the Bill likely would lead marketers and retailers to compete less vigorously, thus having the effect of protecting marketers and retailers of motor fuel *from* competition.

The Bill, moreover, would condemn below-cost sales, even if those sales result in lower prices for consumers, and even where there is no danger that the price-cutter subsequently will

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[45] STAFF OF BUDGET AND FINANCE COMM., COMMONWEALTH OF PA. LEGISLATURE , FACTORS AFFECTING MOTOR FUEL PRICES AND THE COMPETITIVENESS OF PA.'S MOTOR FUELS MARKET, A REPORT IN RESPONSE TO H.R. 451, at 35 (Oct. 2000).

[46] *See* notes 40 & 41, *supra*, and accompanying text.

recoup its losses by charging higher prices.[47] In this manner, the Bill would deprive consumers of lower motor fuel prices without providing any countervailing benefits in terms of protection from subsequent anticompetitive prices.

The Bill also would allow the Division of Weights and Measures, on the basis of a single complaint and without first conducting an investigation, to "demand that such marketer or retailer raise [its] price."[48] Consequently, it is possible that even if a marketer or retailer were not in violation of the Bill, the state could nonetheless compel the vendor to raise its prices, to the detriment of consumers.

In all of these ways, the Bill likely would cause consumers to pay more for gasoline than they would have had the Bill never taken effect. Indeed, a growing body of empirical economic research from the past two decades generally finds that state "sales below cost" laws on retail gasoline prices raise those prices or leave them unchanged.[49]

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[47]As the staff of the FTC has noted in prior comments concerning below-cost sales laws, provisions that allow a violation to be premised on harm to a single competitor (as opposed to harm to competition as a whole) are likely to have adverse effects on competition and consumer welfare. *See* Letter to Demetrius Newton, *supra* note 7.

[48]House Bill No. 2330 § 1(d).

[49] *See*, *e.g.*, R. Anderson & R. Johnson, *Antitrust and Sales-Below-Cost Laws: The Case of Retail Gasoline*, 14 REV. IND. ORG. 189, 203 (1999); R. Fenili & W. Lane, *Thou Shalt Not Cut Prices! Sales-Below-Cost Laws for Gas Stations*, 9 REGULATION 31, 32 (Sept./Oct. 1985). One study, currently in draft form, finds that these laws increase gasoline prices initially and lower them (relative to pre-enactment levels) in subsequent years. The authors, however, do not fully report the statistical significance of the price changes in subsequent years. *See* M. Skidmore, J. Peltier, and J. Alm, "Do Motor Fuel Sales-Below-Cost Laws Lower Prices?" (unpublished manuscript, University of Wisconsin-Whitewater). Many of the studies suffer from methodological problems that make it unclear whether they are measuring the impact of sales below cost laws or something else. The most carefully controlled study, conducted by a senior economist in the FTC's Bureau of Economics, found that the laws had no effect on retail prices. M. Vita, *Regulatory Restrictions on Vertical Integration and Control: The Competitive Impact of Gasoline Divorcement Policies*, 18 J. REG. ECON. 217 (2000). One possible explanation for these varied findings is that the studies do not account for the vigor of enforcement (by state governments or by competitor lawsuits), but focus on the mere existence of a relevant law. These laws are often difficult to enforce or are enforced unevenly. Therefore, the mere existence of such a law may have only a limited effect on retail gasoline prices. Vigorous and sustained enforcement, however, could significantly chill competition and increase retail gasoline prices.

B. The Bill's definition of "cost" does not reflect the true marginal cost of motor fuel in a vendor's inventory

By focusing on historic cost rather than replacement cost, the Bill ignores a vendor's opportunity cost, and thus does not accurately reflect the true marginal cost of motor fuel in inventory.[50] For instance, a marketer or retailer that lowers its prices in response to a decline in wholesale motor fuel prices would be subject to liability if its new lower prices were below its actual acquisition cost or "the average of the three lowest terminal prices posted by a supplier" on the day the vendor purchased its most recent supply of motor fuel.[51] Further, the use of an average of posted prices (when a vendor's actual costs of acquisition are unavailable) would not reflect discounts received by the vendor, thus overstating a vendor's actual marginal cost. Because the Bill's definition of "cost" does not comport with the true marginal cost of the motor fuel in a vendor's inventory, it is likely to subject some above-cost prices to condemnation, further acting to deter price-cutting.

C. The Bill is unnecessary

Aside from its effect of protecting motor fuel retailers and marketers from competition, the Bill simply is unnecessary. Anticompetitive below-cost pricing is unlikely to occur, and already is covered by the federal antitrust laws in any event. Given the strong stance of the Supreme Court in favor of low prices and the care the Court has devoted to explaining what types of price-cutting are illegal under the antitrust laws, the Bill is not necessary to protect consumers. Its passage likely would serve only to protect motor fuel marketers and retailers in Kansas from competition, which would harm consumers.

Conclusion

For these reasons, the staffs of the FTC's Bureau of Competition, Bureau of Economics, and Office of Policy Planning believe that, if enacted, House Bill No. 2330 likely would harm competition. We believe that the Bill would deter procompetitive price-cutting and cause some vendors to raise their prices, to the detriment of Kansas' consumers. Moreover, the Bill addresses a problem that is unlikely to occur. Finally, to the limited extent that anticompetitive below-cost pricing poses any threat to the motor fuel market, federal antitrust laws are sufficient to address the problem.

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[50]Opportunity cost is "the value of the best forgone use of the resources employed in that action." CARLTON & PERLOFF, *supra* note 35, at 33.

[51]*See* House Bill No. 2330 at § 1(c).

Respectfully submitted,

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