

CGB Report

Special Interest

- *Disruption in the refining, supply and distribution system of motor fuels often results in price spikes, shortages*
- *By gouging, the consumers and the news media often mean pricing which is unfair, immoral, unconscionable, opportunistic, or just a plain rip-off.*
- *For a discussion of "Price Fixing" see Lawletter No. 191*
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"PRICE GOUGING"

What is it and when is it illegal?

California
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Disruption in the refining, supply and distribution system of motor fuels often results in price spikes, shortages and even government allocation. The news media, consumers and government officials are quick to claim "price-gouging" but what is it, and is it different from "price fixing?"

By "price-gouging" consumers and the news media often mean pricing which is unfair, immoral, unconscionable, opportunistic, or just a plain rip-off. This article will discuss when retailer pricing decisions may be illegal, resulting in civil or criminal action against the retailer, damages, disgorgement of excessive profits and even fines or jail.

"Price fixing vs. price-gouging"

Price fixing involves at least two persons or companies or the dominance of a market by one monopoly player. Price gouging can be the retailing pricing decision of one retailer, even if the one retailer does not dominate the market.

The basic federal law prohibiting "price fixing" is the Sherman Antitrust Act. The basic California antitrust law is the Cartwright Act. Price fixing is generally defined as any combination, contract, agreement or arrangement, express or implied, the purpose and effect of which is the fixing, raising, depressing, pegging, or stabilizing the price of a product or service. It does not matter whether the parties involved are producers, wholesalers or retailers.

Dealers must be extremely careful about discussing price with each other. You have a right to discuss problems

and legal issues. *But any kind of agreement among competitors to set, peg or fix prices or margins is a criminal offense.* Prosecutors are always very interested in filing such cases due to their political appeal. (E.g., see *Lawletter No. 191*).

Refiners sometimes refuse to discuss company station pricing or price breaks given to other dealers. Often marketing personnel claim that any such discussion would be illegal price fixing. But you have a right to discuss with your supplier whether the price that *you* are being charged is "commercially reasonable." Furthermore, the wholesale and retail prices of your competitors, including stations operated by your supplier, are a lawful, legitimate and relevant factor in such discussions.

Illegal "price-gouging," on the other hand, is limited to violation of "declaration of emergency" laws, government allocation or other legally enacted price controls.

Either subject must be approached with an abundance of caution, particularly in industries in which price is often a highly charged political issue--such as motor fuel.

The dealer's right to set his or her own price

You have a legal right to set your own prices, free of interference or coercion by your supplier or anyone else. Oil companies formally recognize this fact. For example, for many years ARCO has distributed a pamphlet to its dealers titled "A Statement to Our Dealers and

Franchisees on Resale Prices." This pamphlet states in part as follows:

"Prices charged by each ARCO dealer/franchisee are entirely and exclusively a matter to be determined by him or her, subject to applicable laws and governmental regulations. Each ARCO dealer/franchisee is free to resell his or her products at any price he or she considers appropriate."

Pricing regulations

In normal times there is no "price-gouging" law in California. California law recognizes that "the pricing of consumer goods and services is generally best left to the marketplace under ordinary conditions." The consumer's remedy to unfair pricing is not to patronize that establishment, and to take their business elsewhere.

Legal prohibitions against "price-gouging" can come into effect when conditions are not ordinary, because of emergencies and major disasters, including, earthquakes, fires, floods, war or civil disturbances.

Both the state and federal governments have the constitutional authority to impose price controls on motor fuel. The last time that motor fuel price controls were imposed was during the 1979 crisis.

A discussion of the *merits* of price controls is beyond the scope of this report. But you will want to be prepared if such controls are imposed again.

The "crises" of 1973 and 1979 were caused by *shortage*, the result of which the retailer could virtually sell every gallon he could get his hands on for practically any price. Normal laws of supply and demand no longer functioned to restrain prices: the consumer could not take his or her business elsewhere. Therefore the government stepped in to control pricing and the allocation of product by the refiner.

During the 1973 crisis the President, through the Department of Energy and pursuant to the Emergency Petroleum Allocation of

Act of 1973, imposed both price controls *and* allocation *regulations*. The federal or state government could move to freeze or control prices again as a result of foreign or domestic disruption of the fuel supply, refining or distribution system. It is also possible that if the Congress or the California legislature voted to reduce or repeal fuel or sales taxes, they might also consider requiring refiners and retailers to pass along the savings directly to the consumer.

It would probably be meaningless for any such federal legislation to simply state that the reduction must be passed on to the consumer. It would have to include a price-control scheme.

The federal government has been reluctant to resurrect the DOE pricing regulations since 1979. Those pricing regulations generated heated controversy, and were subject to a barrage of legal challenges. Dealer discontent over enforcement of regulations governing retail margins nearly led to a nationwide station shutdown in May of 1979.

The basic federal price control law said that marketers at all levels were not supposed to make any more profit per barrel or gallon than they had in May of 1973. DOE translated this fiat into a maze of bewildering regulations governing prices that refiners, jobbers and dealers could charge.

Initially, the DOE calculated the maximum allowable ceiling price by using Lundberg Survey data to determine May 1973 margins. Department auditors then added the retailer's current buying price to that figure, and cited dealers who priced any higher.

As a result, legally allowable margins varied radically from

station to station. Although the regulations in theory entitled the retailer to recover increased nonproduct costs (such as rent), DOE enforcement officials usually ignored this factor. In order to assert any right to relief, the dealer would have had to file a prohibitively expensive federal court suit against the government.

In August 1979, the Department simplified the regulations by declaring that the dealer was entitled to recover a flat 15.4 cent per gallon margin. This was later adjusted for inflation to 16.1 cents.

It is difficult to predict what margins the government might permit the next time around. Practically any form of price control is bound to work some substantial injustices.

Under certain circumstances "price-gouging" automatically can become illegal.

California criminal laws include a "standby" prohibition against "price-gouging" but only in case of "emergency" or "disaster."

California Penal Code Section 396 (footnote 1) makes price gouging illegal during emergencies and major disasters. Emergencies and disasters are limited to the proclamation of a state of emergency resulting from an earthquake, flood, fire, riot, storm, or natural or manmade disaster declared by the President of the United States or the Governor, or upon the declaration of a local emergency resulting from an earthquake, flood, fire, riot, storm, or natural or manmade disaster by the executive officer of any county, city, or city and county, and for a period of 30 days following that declaration.

During or shortly after a

declared state of emergency, price-gouging is defined as excessive and unjustified increases in the prices charged goods and services that are vital and necessary for the health, safety, and welfare of consumers. The law generally makes it unlawful for any person, contractor, business, or other entity to sell or offer to sell any consumer food items or goods, including gasoline or other motor fuels for a price of more than 10 percent above the price charged by that person for those goods or services immediately prior to the proclamation of emergency. Allowance is made for the retailer to pass through increased costs, but the burden would be on the retailer to prove the reasonableness of those price increases.

Violation of this law can be severely punished. A violation of section 396 is a misdemeanor punishable by imprisonment in a county jail for a period not exceeding one year, or by a fine of not more than ten thousand dollars (\$10,000), or by both that fine and imprisonment. Violation can also result in a civil law suit against the dealer as an "unlawful business practice" and an act of unfair competition within the meaning of Section 17200 of the Business and Professions Code. The remedies and penalties provided by this section are cumulative to each other.

Retaliation by the Oil Company

There is however, one more caution for branded gasoline franchisees to consider, that is the possibility of retaliation by the oil company supplier, for real abuses by the dealer, or as a deflection of public criticism. The dealer who reacts to real or threatened supply disruptions by raising prices may take the heat for the oil company from consumers and government officials anxious to blame someone; anyone.

Oil Express recently reported that Conoco threatened to

immediately debrand jobbers and dealers who posted "unconscionable" prices after the September 11, 2001 attack on the World Trade Center Towers and Pentagon (OE 9/22/01). Conoco claimed that its brand name was "tarnished" by dealers and jobbers who "chose to raise prices to unconscionable levels," bringing their trademark into "disrepute" by media reports of price gouging.

The franchise agreements of some major brand oil companies contain prohibitions against which would damage the brand name. For example, ExxonMobil's lessee dealer franchise agreement provides that, "Franchise Dealer shall not engage...in any conduct that: (i) reflects unfavorably on the reputation of Franchise Dealer, Mobil or the System; (ii) impairs the goodwill associated with the Proprietary Marks including conduct which jeopardizes Franchise Dealer's good relations with ... (iii) constitutes a deceptive or unfair trade practice under applicable law.

There is no case law, and it is far from certain that an oil company could terminate the franchise of a dealer whom it accuses of "price-gouging" under this type of contract provision, however the federal Petroleum Marketing Practices Act (PMPA) 15 USC 2801 et seq., does permit termination or nonrenewal for "1. Failure to comply with any provision of the franchise...that is reasonable and of material significance. 2. Failure to exert good faith efforts to carry out provisions of franchise, with prior written notice, and 3. any "Event" relevant to franchise relationship making termination/nonrenewal reasonable.

Recommended procedures:

The following suggestions are designed to help you spot possible problems in case of product shortages and price spikes. Keep in mind that these recommendations cannot predict all possible events, conditions and occurrences that can result in shortages or price instability and cannot address the provisions of your individual agreement with your supplier:

Anytime it appears that a shortage or price spike may be in the offing, the issue of pricing and allocation (a form of rationing) will arise as well. In such a case, we will report on how such regulations could affect you.

1. Pricing: If a state of emergency has been declared in your city, for California or nationally, freeze your prices at least until you are sure you are legally permitted to pass cost increases along to customers. Don't panic. If you panic and raise your prices to ridiculous levels to prevent a run on your station, you are sure to end up on the evening news!

2. Closure: Closing your station or gas islands may violate your lease or supply contract with your supplier. You may restrict sales to a maximum number of gallons per purchase, but resist closing islands or your station unless authorized to do so in writing by our refiner or ordered to do so by the government.

3. Documentation: Dealing with any pricing regulation will most likely depend heavily on the documentation you can assemble. What follows below will give you a general idea of what kinds of information you may need.

4. Submit exception and related requests early: Any regulatory program will almost certainly involve a procedure for requesting special relief from the

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Department of Energy. Such applications should be submitted at the earliest possible date. The DOE will start with no backlog at all. But it will quickly be deluged with demands for special treatment by many of the more than 100,000 refiners, jobbers and dealers who would be affected by any regulations.

Therefore, it is important that you determine how any applicable pricing regulations might affect you at the earliest possible time. In the last shortage, too many dealers failed to anticipate the effect of the regulations on their businesses and to apply for relief in advance.

Your application should be as complete as possible. Otherwise, you run the risk of having the Department put it at the bottom of the pile while it waits for the additional information or documentation it wants.

In the meantime, you may be put out of business. In the last shortage, those who acted quickly were often able to avoid losses. This is one reason why we are trying to provide you with some advance warning.

5. Make sure you have a record of purchases and sales: It may be particularly important to have good records of the amount of product purchased from any source, particularly during the 12-month period immediately predating the effective date of any price control laws or regulations. If you have only purchased motor fuel from one major refiner at the location involved, this may not be a major issue.

It may be that you will have a need to document your retail margins. We suggest that if you aren't able to document your cost of goods sold, operating expense and daily street prices for all grades, you start assembling this information right now.

6. New or rebuilt outlets: Retailers who have opened or reopened new or rebuilt outlets within the past year may need to make a special application for relief from any pricing regulations.

Any such application should be supported with extensive documentation of the investment

involved, e.g., construction expenditure, loan payments, etc. Furthermore, the application should provide the best possible basis for DOE to grant the relief requested. For example, you may have submitted volume and profit projections to a lender in order to obtain construction funds. The Department will probably want profit and loss statements as well.

7. Buying a business: If you buy a business during any period of uncertain supply or price spike, it might be helpful to obtain copies of the station's sales and purchases for the last year or two. In the last shortage, DOE based its pricing regulations in part on what prices the business had been charging during the "base period," regardless of who operated the station.

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- Bureau of Auto Repair Problems
- Department of Weights & Measures
- California Air Quality Management Districts
- Environmental Regulation and Litigation
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California Penal Code Section 396

California Penal Code Section 396

(a) The Legislature hereby finds that during emergencies and major disasters, including, but not limited to, earthquakes, fires, floods, or civil disturbances, some merchants have taken unfair advantage of consumers by greatly increasing prices for essential consumer goods and services. While the pricing of consumer goods and services is generally best left to the marketplace under ordinary conditions, when a declared state of emergency results in abnormal disruptions of the market, the public interest requires that excessive and unjustified increases in the prices of essential consumer goods and services be prohibited. It is the intent of the Legislature in enacting this act to protect citizens from excessive and unjustified increases in the prices charged during or shortly after a declared state of emergency for goods and services that are vital and necessary for the health, safety, and welfare of consumers.

Further it is the intent of the Legislature that this section be liberally construed so that its beneficial purposes may be served.

(b) Upon the proclamation of a state of emergency resulting from an earthquake, flood, fire, riot, storm, or natural or manmade disaster declared by the President of the United States or the Governor, or upon the declaration of a local emergency resulting from an earthquake, flood, fire, riot, storm, or natural or manmade disaster by the executive officer of any county, city, or city and county, and for a period of 30 days following that declaration, it is unlawful for any person, contractor, business, or other entity to sell or offer to sell any consumer food items or goods, goods or services used for emergency cleanup, emergency supplies, medical supplies, home heating oil, building materials, housing, transportation, freight, and storage services, or gasoline or other motor fuels for a price of more than 10 percent above the price charged by that person for those goods or services immediately prior to the proclamation of emergency. However, a greater price increase shall not be unlawful if that person can prove that the increase in price was directly attributable to additional costs imposed on it by the supplier of the goods, or directly attributable to additional costs for labor or materials used to provide the services, provided that in those situations where the increase in price is attributable to additional costs imposed by the seller's supplier or additional costs of providing the good or service during the state of emergency, the price represents no more than 10 percent above the total of the cost to the seller plus the markup customarily applied by the seller for that good or service in the usual course of business immediately prior to the onset of the state of emergency...

(d) The provisions of this section may be extended for additional 30-day periods by a local legislative body or the California Legislature if deemed necessary to protect the lives, property, or welfare of the citizens.

(e) A violation of this section is a misdemeanor punishable by imprisonment in a county jail for a period not exceeding one year, or by a fine of not more than ten thousand dollars (\$10,000), or by both that fine and imprisonment.

(f) A violation of this section shall constitute an unlawful business practice and an act of unfair competition within the meaning of Section 17200 of the Business and Professions Code. The remedies and penalties provided by this section are cumulative to each other, the remedies under Section 17200 of the Business and Professions Code, and the remedies or penalties available under all other laws of this state.

(g) For the purposes of this section:

(1) "State of emergency" means a natural or manmade disaster or emergency resulting from an earthquake, flood, fire, riot, or storm for which a state of emergency has been declared by the President of the United States or the Governor of California.

(2) "Local emergency" means a natural or manmade disaster or emergency resulting from an earthquake, flood, fire, riot, or storm for which a local emergency has been declared by the executive officer or governing body of any city or county in California...

(8) "Gasoline" means any fuel used to power any motor vehicle or power tool.

(h) Nothing in this section shall preempt any local ordinance prohibiting the same or similar conduct or imposing a more severe penalty for the same conduct prohibited by this section.

(i) Any business offering an item for sale at a reduced price immediately prior to the proclamation of the emergency may use the price at which they usually sell the item to calculate the price pursuant to subdivision (b) or (c).