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

Bureau of Competition
Bureau of Economics
Office of Policy Planning

January 29, 2004

The Honorable Demetrius C. Newton
Speaker Pro Tempore
Alabama State House of Representatives
Alabama State House
Montgomery, AL 36130

Re: The Alabama Motor Fuels Marketing Act

Dear Speaker Newton:

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 Alabama's Motor Fuels Marketing Act.(1)

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 and price discrimination. The Act, however, does more than duplicate these protections; it exceeds them in ways that do not benefit consumers. Federal law prohibits pricing that could harm competition and consumers, not just competitors, whereas the Act prohibits pricing that could harm competitors even if there is no harm to consumers.

- Current Alabama law discourages competitive pricing. The Act subjects vendors to civil liability - including treble damages and a $10,000 fine per violation - for cutting prices even if there is no likelihood of harm to market-wide competition. Further, by focusing on total unit costs rather than marginal costs, the Act subjects a greater range of prices to liability in comparison to federal antitrust law. As a result, many vendors likely avoid procompetitive price-cutting.

For these reasons, we believe that the Act likely harms consumers and restricts competition. Moreover, the Act is unnecessary because the federal antitrust laws already protect against anticompetitive predatory pricing and price discrimination.

The Act includes certain limited exceptions, including ones for clearance sales and meeting the competition.(17) Further, the Act allows differential pricing based on cost differentials.(18)

We believe that, if followed by retailers, the Act is likely to restrict competition and may lead to higher prices for consumers. Unlike federal antitrust law, the Act aims to protect individual competitors, not competition, thereby discouraging procompetitive price-cutting. Moreover, the Act defines "cost" in a way that lacks a firm economic foundation. Again, this definition likely deters firms from cutting prices by subjecting a range of prices that are consistent with vigorous competition to liability under the Act. Finally, we believe that the Act 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 and price discrimination

A. Federal antitrust law condemns below-cost pricing and price discrimination that harm competition

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)

iii. Below-cost pricing and price discrimination 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,

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 atoryc ul04 Tw 12.893 0 Td [(()4(29))]TJ /7ng

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."(40) 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 . . . ."(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)

More recently, 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 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)

Competitors will, of course, often 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 AMFMA likely restricts competition and harms consumers

To the extent that motor fuel sellers adjust their behavior to comply with the Act, the AMFMA likely restricts competition and leads to higher prices for consumers. First, the Act protects competitors, not competition. Second, the Act defines "cost" in a way that lacks a firm economic foundation and likely discourages procompetitive price-cutting. Finally, we believe that the Act 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 and price discrimination.

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.

9. Ala. Code § 8-22-6 (emphasis added). Similarly, § 8-22-7 makes it a violation of the Act for a person to "sell or transfer motor fuel to itself or an affiliate for resale at another marketing level of distribution at a transfer price that is below cost or lower than the price it charges a person who purchases for resale on the same day and at the same distribution level, within the same market area, where the effect is to injure competition." The Act defines "person" as "[a]ny person, firm, association, organization, partnership, business trust, joint stock company, company, corporation, or legal entity." § 8-22-4(1). Further, it appears that the Act is directed at sales made by refiners, wholesalers, and retailers. *See* §§ 8-22-2(2), 8-22-3. To make out a *prima facie* case, the Act does not require a plaintiff to show the defendant acted with intent. However, a defendant can raise lack of intent as an affirmative defense. Lack of intent can be shown by satisfying one of the enumerated exceptions in §§ 8-22-12, 8-22-13, or "generally . . . if the facts do

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Petroleum, Inc., 519 So. 2d 1275, 1286-87 (Ala. 1987). *See also* McGuire O13((12)-e 0 7.467 04 not)2(r(f)2(i)1y)11()4(o.)2(2d 12)p1

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 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.

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

32. *See Brooke Group*, 509 U.S. at 226 (citing entry barriers, market concentration, and capacity constraints as factors to guide the recoupment inquiry).

33. *Id*. at 224.

34. See D. Carlton & J. Perloff, Modern Industrial Organization 289-90 (3d ed. 2000). See also Luke Froeb, Price Discrimination and Competition: Implications for Antitrust, Speech Before the American Bar Association's Fall Forum, National Press Club, Washington, DC (Nov. 19, 2003), at <http://www.ftc.gov/speeches/other/031118froeb.pdf>; B. Klein & J. Wiley, *Competitive Price Discrimination as an Antitrust Justification for Intellectual Property Refusals to Deal*, 70 Antitrust L.J. 599, 613 n.29 (2003) (observed price discrimination by a firm does not indicate a unilateral ability to affect the market price; rather, price discrimination is common in competitive differentiated product markets).

35. As the leading antitrust treatise observes with regard to price discrimination:

[T]he manufacturer is best off when its distribution system as a whole distributep:/ate Tj ET EMCe ya1(z)1 off cosm11(c)s to

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