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

October 15, 2003

Shirley Krug
State Representative
12th Assembly District
Post Office Box 8952
Madison, WI 53708

Re: Wisconsin's Unfair Sales Act

Dear Representative Krug:

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 Wisconsin's Unfair Sales Act.(1) The Act prohibits the retail sale of motor fuel below a statutory definition of "cost," where "cost" includes a minimum markup "to cover a proportionate amount of the cost of doing business." The Act provides for fines and private actions against violators.

In your letter of May 14, 2003, you asked us four questions about the Act. Your questions, and a summary of our answers, appear below:

- **Does the law harm consumers by significantly raising prices to consumers?**

  Most likely yes. Minimum markup laws likely deter pro-competitive price cutting and can ultimately lead to higher prices for consumers. They can prevent efficient vendors from passing on savings to consumers, and they can discourage entry from new competitors that may be more efficient. Moreover, when compared to other states with similar laws, the Act exacerbates these problems by employing one of the steepest minimum markups on retail fuel sales in the country.

- **Does the current Wisconsin law duplicate existing protections against "predatory pricing" found in the federal antitrust law?**

  The federal antitrust laws deal specifically with below-cost pricing that has a reasonable prospect or dangerous probability of leading to monopoly. The FTC, the Department of Justice's Antitrust Division, state attorneys general, and private parties can sue under these laws in response to anticompetitive below-cost pricing. 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.

- **Does the current Wisconsin law discourage or encourage competitive pricing?**

  Current Wisconsin law discourages competitive pricing. The Act forbids below-statutory cost price cutting that has the intent or effect of diverting trade from a competitor. Thus, unlike federal antitrust law, the Act focuses on harm to competitors rather than harm to competition. In fact, the Act subjects vendors to civil liability - including treble damages

United States.[6] Commission staff also filed public comments with the Environmental Protection Agency concerning "boutique fuel" regulations.[7]

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.(10) State attorneys general, acting as parens patriae, also may bring such actions.

Although anticompetitive below-cost pricing is illegal, the United States Supreme Court has cautioned that antitrust law should not prevent pro-competitive price-cutting. Congress designed the antitrust laws for "the protection of competition, not competitors."(11) In other words, the federal antitrust laws promote and maintain legitimate, vigorous price competition, irrespective of how individual competitors may fare. Vigorous price competition allows consumers to reap the benefits of lower prices, greater variety, and higher quality goods and services. 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 matter, low prices are "a boon to consumers."(12)

[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.(19)

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."Ia13(l)s 3o-1( )]TJ T*tsve9ces.o holo-1( )]s EMC /e, Foit 0 Et1( )]TJ T*tbr(i)ook,nno(i) s EMC

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

breaks from federal antitrust law and prohibits conduct that benefits consumers. In particular, the Act protects competitors, not competition, and the Act defines "cost" in a way that lacks a firm economic foundation and discourages pro-competitive price-cutting. Moreover, 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. The Act protects competitors, not competition

Unlike federal antitrust law, the Act protects competitors, not competition. The Act states that "any sale" below-statutory cost with the intent or effect of "unfairly diverting trade from a competitor" impairs and prevents "fair competition." Accordingly, the Act bans all below-statutory cost sales that take business from a single competitor, even if those sales result in lower prices for consumers.(32)

For these reasons, the Act likely discourages pro-competitive price-cutting. The Act subjects a vendor to liability for pricing below the statutory definition of cost on a single occasion if a single competitor is hurt, even if there is no danger that the vendor would be able to recoup its lost profits, and even if there are dozens of other competitors in the relevant market. Moreover, because the Act imposes liability if there is an intent or effect to divert business from a competitor, a vendor could be held liable for pricing below statutory cost inadvertently, even on a single occasion. Similarly, the Act prohibits pro-competitive below-cost pricing, such as special promotions or below-cost pricing that may accompany the launch of a new retail outlet. The penalties include a fine of up to $5,000 and private litigation that could result in treble damages or a $2,000 penalty *per violation*, whichever is greater.

In all these situations, there is no risk to consumers of monopolization or any other anticompetitive effects, because there is no risk that the vendor could later recoup its losses. The risk of damages and a substantial civil penalty, however, likely deter vendors from cutting prices. Likewise, the mere threat of litigation may deter vendors from selling gasoline at prices that are legal and above cost, but low enough to prompt complaints from competitors.

ii. The Act defines "cost" to include a minimum markup

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the minimum markup simply protects the profit margins of vendors, efficient and inefficient alike. One study found that, when penalties for violating the Act were increased in 1998, the average markup of retail gasoline increased by two to three cents per gallon.(33) This study is consistent with a growing body of empirical economic research from the past two decades that has assessed the impact of state "sales below cost" laws on retail gasoline prices. Most studies find these laws raise gasoline prices or leave them unchanged.(34)

Moreover, the Act discourages entry by new participants that may be more efficient. Some potential entrants, including those with alternative station formats, may have lower average fixed costs per gallon than older stations, and these competitors could pass on their lower costs to consumers. The Act discourages such potential competitors from ever competing in the marketplace.

The Act exacerbates these problems by employing one of the steepest minimum markups on retail fuel sales in the country. A few other states have minimum markup provisions specifically targeting motor fuel retail sales, but the highest outside Wisconsin is typically 6%.(35) Wisconsin's minimum markup of 9.18% exceeds that rate by more than 50%. Furthermore, the Act's use of the 9.18% measure - as well as the 3% and 6% measures - appears completely arbitrary. FTC staff could locate no support for these measures from any authority on competition policy, including Supreme Court precedent, federal antitrust law, basic economic theory, or empirical studies. In fact, the minimum markup percentages do not, as the Act suggests they should, accurately reflect a "proportionate part of the cost of doing business." Because the Act ties operating costs to the wholesale price, the dollar value of the minimum markup rises if wholesale prices rise. Operating costs, however, generally do not increase with increases in the wholesale price. For example, rent is an operating cost that does not vary with the wholesale price. Nevertheless, when wholesale prices rise, the Act increases the amount of money consumers have to pay for a "proportionate part of the cost of doing business," even if those costs remain unchanged. This link likely leads to even higher retail prices, with no attendant benefits for consumers or competition.

iii. The Act defines "cost" by reference to other competitors' costs

The Act defines "cost" in another way that discourages pro-competitive price-cutting. Although the Act's definition of "cost" varies with the location and identity of the vendor, the Act typically defines "cost" to include the greater of (1) the vendor's invoice or replacement cost (adjusted for

Furthermore, the "average posted terminal price" may not accurately reflect the prices available to vendors. For example, the average posted terminal price does not reflect discounts that jobbers and retailers may receive. A jobber or retailer who negotiates a lower price cannot legally pass on that price to consumers. Vendors sometimes negotiate volume-based discounts, but under the law's definition of cost, such vendors may be unable to put gasoline on sale at the end of the month to achieve volume-based savings. Consumers most likely pay higher prices as a result.

Timing presents another problem. A vendor may decide, for procompetitive reasons, to charge a lower price based on the cost of gasoline when purchased, rather than the current average posted terminal price. As a result, if the average posted terminal price subsequently increases, a vendor could violate the law by selling gasoline above its own costs, but below subsequent prices. There is no consumer benefit to punishing vendors in this situation.

Inversions present yet another problem. Jobbers and retailers usually pay a higher price for branded than for unbranded gasoline; inversions occur when the unbranded price for gasoline exceeds the branded price. When gasoline supplies are tight, the unbranded price rises and can surpass average branded prices (and implicit branded wholesale prices paid by lessee-dealers and company operated outlets). In this situation, branded stations could violate the proposed law during a price inversion, even if the vendors charged prices that exceeded their actual costs.

Finally, the terminal at which a retailer's marginal cost of a gallon of gasoline is lowest may not be "the terminal closest to the retail station." For example, if a retailer has lower laid-in costs from a different, more distant terminal, it will be more profitable for him to buy gas at that terminal.

iv. The Act is unnecessary

Aside from the problems with the Act's definitions and focus, the Act is simply unnecessary. The Act addresses a problem, anticompetitive below-cost pricing, that is already covered by the federal antitrust laws, and that is unlikely to occur 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 the types of price cutting that are illegal under the antitrust laws, Wisconsin's Act is not necessary to protect consumers.

Conclusion

For these reasons, the FTC's Office of Policy Planning, Bureau of Competition, and Bureau of Economics believe that Wisconsin's Unfair Sales Act harms competition. The Act addresses a problem that is unlikely to occur. To the extent that anticompetitive below-cost pricing is a danger in the retail gasoline market, federal antitrust laws are sufficient to address the problem. Moreover, we believe that the Act most likely deters pro-competitive price-cutting and causes some vendors to raise their prices, to the detriment of Wisconsin's consumers.

Respectfully submitted,

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Endnotes:

1. Wis. Stat. Ann. § 100.30 (West 2003). This letter expresses the views of the FTC's Bureau of Competition, Bureau of Economics, and Office of Policy Planning. The letter does not necessarily represent the views of the Commission or of any individual Commissioner. The Commission has, however, voted to authorize us to submit these comments.

2. Federal Trade Commission Act, 15 U.S.C. § 45.

3. *See Chevron Corp*., Docket C-4023 (decision and order 2002); *Exxon Corp*., Docket C-3907 (decision and consent order 2001); *British Petroleum Co. p.l.c.*, Docket C-3868 (decision and order 1999); *Valero Energy Corp*., Docket C-4031 (decision and order 2002); *Shell Oil Co.*, Docket C-3803 (decision and order 1998). All of these orders are available at the FTC's website.

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

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

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

Law ¶ 724; Phillip Areeda and Donald 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.

18. *Brooke Group*, 509 U.S. at 223 (quoting *Cargill*, 479 U.S. at 116).

19. *Matsushita Elec.*, 475 U.S. at 589.

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

21. *Id*. at 224, 226.

22. Frank H. Easterbrook, *Predatory Strategies and Counterstrategies*, 48 U. Chi. L. Rev. 263, 313-14 (1981) (citations omitted).

23. Dennis W. Carlton and Jeffrey M. Perloff, Modern Industrial Organization 342 (3d ed. 2000).

24. See Jeffrey Church and Roger Ware, Industrial Organization: A Strategic Approach 659 (2000).

25. P. Areeda and H. Hovenkamp, Antitrust Law ¶ 723a (2d ed. 2002) ("as the Supreme Court has observed, although competitors allege predation frequently, it is probably quite uncommon").

26. *Matsushita Elec*., 475 U.S. at 589.

27. *Id*. at 594.

28. USDOE, *Deregulated Gasoline Marketing: Consequences for Competition, Competitors, and Consumers* (Mar. 1984); Dr. James B. Delaney and Dr. Robert N. Fenili, U.S. Dep't of Energy, *Final Report: The State of Competition in Gasoline Marketing* (Jan. 1981).

29. Final Report to the Arizona Joint Legislative Study Committee on Petroleum Pricing and Marketing Practices and Producer Retail Divorcement 35 (Dec. 1988).

30. Final Report to the Washington State Legislature on the Attorney General's Investigation of Retail Gasoline Marketing 14 (Aug. 12, 1987).

31. Commonwealth of PA. Legislative Budget and Finance Comm., *Factors Affecting Motor Fuel Prices and the Competitiveness of PA's Motor Fuels Market, A Report in Response to H.R. 451*, 35 (Oct. 2000).

32. *Gross v. Woodman's Food Mkt., Inc.*, 655 N.W.2d 718, 737 (Wis. Ct. App. 2002) (holding that the Act "prohibits a sale at less than statutory cost if there is either the intent or effect of injuring a competitor").