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TO: TEMPORARY CO-CHAIRPERSONS SENATORS JERRY BEHN AND JACK KIBBIE AND REPRESENTATIVE JACK DRAKE AND MEMBERS OF THE MOTOR VEHICLE FUEL INTERIM STUDY COMMITTEE

FROM: SUSAN CROWLEY, SR. LEGAL COUNSEL
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RE: BACKGROUND INFORMATION

I. INTRODUCTION.

The charge of the Motor Vehicle Fuel Interim Study Committee is to "investigate issues related to the sale of motor vehicle fuel, including minimum markup, selling below cost, and limiting quantities of gasoline." This background information memorandum gives an overview of federal and Iowa laws regarding restraint of trade. It also discusses the elements of state unfair competition laws. Finally, it summarizes recently introduced legislation regarding unfair competition in motor vehicle fuel sales in Iowa.

II. FEDERAL LAW.

The Sherman Antitrust Act (15 U.S.C. ch. 1) prohibits anticompetitive restraints of trade through horizontal and vertical price fixing, boycotts, exclusive dealing agreements, and similar practices. The Act also prohibits monopolies and attempts to monopolize any part of trade or commerce whether through conspiracy or individual action. Violations require either proof of conspiracy or proof of a dangerous probability of actual monopolization.

The Clayton Act, as amended by the Robinson-Patman Act (15 U.S.C. ch. 1, § 12 et seq.), prohibits price discrimination where the effect of the discrimination may substantially lessen competition or create a monopoly. The Act applies to discrimination in actual sales and not intracompany transfers, leases, or consignments. Violations require proof of a reasonable probability of substantial injury to competition through market power. The Act also prohibits the sale of goods at unreasonably low prices for the purpose of destroying competition or eliminating a competitor, but this provision does not provide for private remedies available to other violations of the Act.

III. IOWA LAW.

Iowa Code chapter 553, the "Iowa Competition Law," generally prohibits a contract or conspiracy between two or more persons to restrain or monopolize trade or commerce. The chapter also prohibits the establishment or the attempt to establish a monopoly by a person for the purpose of excluding competition or controlling or fixing prices.

Iowa Code section 551.1 prohibits price discrimination in sales. Similar to the federal Clayton Act, the section prohibits the sale of commodities at a lower price in one "section, locality, community, or city" than in another for the purpose of destroying the business of a competitor or creating a monopoly unless the sale is made to meet competition in such area. This discrimination is without regard to whether the lowered prices are below, at, or above the cost of the goods and requires proof of intent to injure competition.

Under current Iowa law, there is not a specific provision prohibiting the sale of goods below cost except with regard to the sale of cigarettes under Iowa Code chapter 421B, the "Iowa Unfair Cigarette Sales Act." See Iowa Code section 421B.3.

IV. OTHER STATES AND IOWA — PRACTICES NOT COVERED BY FEDERAL LAW.

While many states have statutes essentially mirroring the federal prohibitions, the strict requirements of federal law to find a violation have led states to modify their general antitrust statutes and adopt laws with more specific application or to protect specific markets. Many such states have adopted unfair competition laws governing all sales, including the sale of motor fuel. At least 17 states have enacted fair competition statutes specific to the sale of motor fuel. These include Alabama, Arkansas, Colorado, Florida, Georgia, Massachusetts, Minnesota, Missouri, Montana, New Jersey, North Carolina, South Carolina, South Dakota, Tennessee, Utah, Wisconsin, and Wyoming. The intent of these statutes is to provide more protection to local markets from the effects of unfair competition than has been provided by federal law. These state statutes differ in many respects from federal law, including elements of proof, application, and enforcement.

Proof of Predatory Intent

Federal antitrust law has been interpreted by the courts to require proof of predatory intent to injure competition for a plaintiff to prevail. [Brooke Group Ltd. v. Brown and Williamson Tobacco Corp., 509 U.S. 209 (1993).] Moreover, federal law requires plaintiffs to demonstrate that the alleged violator has a "reasonable possibility" or "dangerous probability" of recouping its losses incurred by the below-cost pricing scheme. This means that the plaintiff must show that there is a likelihood that the alleged violator will eventually raise its prices above market level, effectively hurting consumers, as it is the threat of inflated prices that the federal antitrust laws were adopted to protect against.

Several states have found this "predatory intent" burden too difficult to sufficiently protect competition in local markets and have enacted fair competition legislation that requires less direct evidence of intent or no intent. Some of these statutes have survived constitutional due process scrutiny while others have been held unconstitutional. For example, Alabama's Motor Fuel Marketing Act (Ala. Code 8-22-1 et seq.) was upheld even though the Act did not require proof of intent to injure competition. The Alabama statute prohibited below-cost sales "where the effect is to injure competition." The Alabama Supreme Court found that it was sufficient that the defendant may raise a lack of intent to injure competition as an affirmative defense even though the defense was not expressly stated in statute but was enacted in the findings provisions. [State ex rel. Galanos v. Mapco Petroleum Inc., 519 So. 2d 1275 (Ala. 1987).] However, the Supreme Court of Arkansas considered the distinction between predatory practices and competitive pricing and held the Arkansas Petroleum Trade Practices Act (Act 380 of 1983) unconstitutional because the Act failed to require intent to injure competition for a violation. [Ports Petroleum Co., Inc. of Ohio v. Tucker, 916 S.W.2d 749 (Ark. 1996).] The Arkansas Act required only proof that below-cost sale practices injured competition. Other states require a plaintiff to only show that a sale occurred at or below cost and then the burden of proof shifts to the defendant to show that either the sale was not below cost or that there was not an intent to injure competition. Some state laws provide that proof of injury to a single competitor, rather than injury to competition to the surrounding market as a whole, is sufficient to show injury to competition.

Iowa Code chapter 421B, which prohibits the sale of cigarettes below cost, does not specify whether an intent to injure competition or effect of injuring competition is required. This below-cost sale prohibition was found to be constitutional by the Iowa Supreme Court even though the statute did not include an element in the offense specifying that below-cost pricing was made with an intent to injure a competitor. [May's Drug Stores, Inc. v. State Tax Commission, 45 N.W.2d 245 (Iowa 1950)(rehearing denied 1951).] However, under Iowa's general price discrimination statute in Iowa Code section 551.1, the Iowa Supreme Court has found that because the expressly stated purpose of the statute is to prohibit anticompetitive effects, a plaintiff must provide evidence of predatory intent in actions alleging violations. [Des Moines Area Dairy Queen Store Operators and Owners, Inc. v. Wapello Dairies, Inc., 226 N.W.2d 9 (Iowa 1975).]

Use of Loss Leaders

Without a requirement for predatory or other intent to injure competition, state fair competition laws or petroleum marketing laws could prohibit the use of "loss leaders," a practice used by many large retailers who sell motor fuel as a relatively small part of their total goods sold. These retailers have made it a practice to sell motor fuel below cost as a means of attracting buyers to their place of business where the buyer will then purchase, at the same time the motor fuel is purchased, other goods sold by the retailer.

This has been used as more of a marketing tool rather than a plan with the specific intent to injure or eliminate the competition among retail fuel sellers. This practice of using "loss leaders" is also termed "contemporaneous recoupment" because the retailer experiences a loss on the sale of motor fuel but, at the same time, recoups the loss through the sale of its other products. The product that is sold below cost is termed the "loss leader." The Arkansas court in Tucker stated that the use of loss leaders was not enough to infer an intent to destroy competition.

Defining Cost

Because federal law does not specifically prohibit below-cost sales, but rather the more general restraint of trade, it does not define "cost." A definition of "cost" is not uniform among those states who have adopted their own statute but, typically, it is defined in statute as either the total cost of doing business or the direct cost of retail motor fuel sales. Both definitions include the actual cost of the product and freight or transportation charges. A "direct cost" definition may include those costs necessary for operation of the retail outlet where the fuel is sold, including labor costs of those who work at the retail outlet, real and personal property taxes, insurance, and utilities. A "total cost of doing business" definition generally includes those items comprising a "direct cost" definition and, in addition, such things as salaries of executives and officers, interest on borrowed capital, depreciation, maintenance of equipment, credit card fees, credit losses, all types of licenses, and advertising.

Some statutes define "cost" as the actual cost of the product and freight or transportation charges (basic cost) plus a minimum markup of a percentage of the basic cost to allow for unspecified costs of doing business. The following states have adopted general fair competition laws that include a minimum markup ranging from 4 percent to 9 percent: Hawaii, Louisiana, Maine, Maryland, Oklahoma, Pennsylvania, Rhode Island, West Virginia, and Wisconsin. Some states define "cost" differently for wholesalers as opposed to retailers. Iowa Code section 421B.2, regarding cigarette sales, defines "cost" to include a "presumed" cost of doing business of 6 percent for retailers and 3 percent for wholesalers.

Wholesalers vs. Retailers

Federal law does not differentiate between the antitrust activities of wholesalers versus retailers. Several states have chosen to do so, including Alabama, Georgia, Missouri, Montana, Utah, and Wisconsin. Arkansas and Florida prohibit discriminatory allocations of fuel to resellers, also referred to as limiting quantities of fuel. This practice may occur when a refiner limits the availability of motor fuel to jobbers and dealers while supplying its own outlets without limit to the detriment of jobbers and independent dealers who may only have a single source of supply. In Iowa, the practice of limiting quantities of gasoline has also occurred at the retail level. Discriminatory pricing occurs when refiners favor their own dealers through the use of rebates or other concessions. The practice of refiners offering volume or rent rebates to their dealers allows the dealers to sell at lower prices than independent dealers not offered the rebates. Similarly, intracompany transfers from refiner to dealer may not be considered a "sale" unless specifically defined as such, and may not be subject to federal or state antitrust regulations or state fair competition laws unless it is included in the definition of "sale."

Enforcement and Remedies

Enforcement of state fair competition laws and motor fuel marketing laws may be provided through private lawsuits, by state government agencies, or both. State enforcement typically includes injunctive relief and the assessment of civil penalties, with penalties ranging from $500 to $10,000 per day or per violation per day. Other civil remedies include assessment of actual damages incurred, treble or liquidated damages, and attorney fees. Another approach is to suspend or revoke required state licenses or to lock out motor fuel pumps to prevent the sale of fuel for specified periods of time. A few states, such as Colorado and Wyoming, have chosen to criminalize violations as misdemeanors.

V. IOWA LEGISLATION INTRODUCED.

House Study Bill 282 by Committee on Ways and Means was introduced during the 2005 Session of the General Assembly. The bill prohibits the sale of gasoline below cost by a refiner, wholesaler, or retailer without requiring proof of intent to injure competition. The bill defines "cost" to include the basic cost of the gasoline plus applicable taxes, fees, freight, and a minimum markup of 8 percent of the basic cost for retailers and a minimum markup of 3 percent for wholesalers. The bill includes several exceptions to the prohibition, including meeting competition, clearance or liquidation sales, and short-term sales. Enforcement of violations and assessment of fines is assigned to the Department of Agriculture and Land Stewardship with assistance from the Attorney General. The bill does not allow for a private right of action so that injured competitors must file a complaint with the department for enforcement. Civil penalties include monetary penalties for the first three violations and tagging and rendering inoperable the gasoline pumps at the site of the violation for up to 90 days. The bill also provides that four or more violations shall be evidence of a monopoly subject to the penalties of Iowa Code chapter 553, which does provide for a private right of action against violators.

A similar bill, SF 2218, was introduced in 2004. Senate File 2218 includes a statement of legislative findings and intent of prohibiting sales that create monopolies or unfair methods of competition in the sale of motor fuel. The bill defines "cost" the same for wholesalers and retailers to include actual invoice or replacement cost, plus taxes and fees, but before cash discounts. The bill's definition of "cost" does not provide for a minimum markup. Senate File 2218 prohibits a refiner, wholesaler, or retailer from offering to sell motor fuel at a price that is below cost. The bill offers slightly different exceptions to the prohibition from HSB 282, including isolated transactions and the fuel sold is imperfect or damaged and advertised as such. Senate File 2218 adds a prohibition against a producer or refiner operating a retail motor fuel outlet by an agent, employee, subsidiary company, or by contract unless it was operated as such prior to the effective date of the enacted bill. The sole enforcement provision of SF 2218 allows the Department of Agriculture and Land Stewardship to tag and render inoperable the motor fuel pumps at the site of the violation with the periods of inoperability ranging from 24 hours to 30 days.

Senate File 496 passed out of Committee on Commerce in 2001. The bill creates new Code chapter 473B. The chapter includes a statement of legislative intent of protecting the public interest against monopolies or unfair methods of competition in sales of motor fuel, as well as preventing injury to competition from the sale of motor fuel below cost. The bill prohibits certain below-cost sales of motor fuel. The bill also prohibits certain below-cost transfers of motor fuel where the effect is to injure competition. The bill applies to the sale of fuel at wholesale and retail. The bill sets out circumstances that show a prima facie violation of the statute and then shifts the burden to the defendant. The bill makes exceptions from violation of the prohibited below-cost sales and below-cost transfer provisions for certain price differentials and for certain types of sales. The bill provides for injunctive and other relief and recovery of attorney fees in a civil action brought by the Attorney General or a county attorney. The bill also provides for a private cause of action by a competitor injured or threatened by injury by a violation of Code chapter 473B. The competitor may sue for injunctive relief, declaratory judgment, and for actual damages that are trebled.

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