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

Bureau of Competition
Bureau of Economics
Office of Policy Planning

May 19, 2003

Senator Daniel G. Clodfelter
Chairman, Judiciary I Committee
300 N. Salisbury Street
408 Legislative Office Building
Raleigh, NC 27601

Re: House Bill 1203 / Senate Bill 787 (proposed amendments to North Carolina's Motor Fuel Marketing Act)

Dear Chairman Clodfelter:

The staffs of the Federal Trade Commission's Bureau of Competition, Bureau of Economics, and Office of Policy Planning welcome the opportunity to submit this letter in response to your request for comments on North Carolina House Bill 1203/Senate Bill 787 ("the bill").[1] We have received a similar request from Attorney General Roy Cooper and are responding to his request with a letter identical to this one.

The bill would amend North Carolina's Motor Fuel Marketing Act ("the Act"), which declares that it shall be unlawful "where the intent is to injure competition" to sell motor fuel below cost "with such frequency as to indicate a general business practice of selling [below-cost]." The bill would eliminate the intent and business practice requirements, so that vendors could be liable for inadvertently pricing motor fuel below cost, even on a single occasion. The bill also would redefine "cost." For most vendors, the Act currently defines "cost" as the vendor's own invoice or replacement cost, plus taxes and freight expenses. The bill would redefine "cost" as the average or low Oil Price Information Service ("OPIS") rack price, plus taxes and freight expenses. In addition, the bill would prevent vendors from limiting the quantity of motor fuel sold or offered for sale to any customer.

---

[1] This letter expresses the views of the Bureau of Competition, Bureau of Economics, and Office of Policy Planning of the Federal Trade Commission. 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.

We believe that there is a significant risk that the bill could harm consumers. Gasoline is a significant consumer expenditure; assuming no change in demand, even a 1 cent increase in the retail price of gasoline would cost North Carolina consumers approximately $42.5 million annually.[2]

Our views are summarized below:

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

- Scholarly studies indicate that below-cost pricing that leads to monopoly rarely occurs. The Supreme Court has found such studies to be credible.

- Past studies suggest that below-cost sales of motor fuels that lead to monopoly are especially unlikely.

- The federal antitrust laws deal with below-cost pricing that has a dangerous probability 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.

- If the proposed legislation leads to higher prices in circumstances in which there is no danger of the lower prices leading to monopoly, then consumers will be harmed.

- The bill likely would deter procompetitive pricing. By eliminating the Act's intent and business practice requirements, the bill could subject vendors to civil liability – including treble damages and a $10,000 fine per violation – for cutting prices, even if the vendors have no intent to engage in anticompetitive conduct, and even if the vendor prices below cost on a single occasion. As a result, many vendors likely would avoid procompetitive price-cutting.

- There is a substantial risk that the bill will cause some vendors to raise their prices. In redefining cost as the average or low reseller rack cost rather than the vendor's own cost, the bill could force vendors to sell motor fuel based on their competitors' costs rather than their own costs. This requirement likely would cause some vendors to raise their prices.

---

[2] *See* U.S. Energy Information Administration data available at http://www.eia.doe.gov/emeu/states/oilsales_trans/oilsales_trans_nc.html (showing North Carolina average daily gasoline sales of 11.65 million gallons between March 2002 and February 2003).

I. Interest and Experience of the Federal Trade Commission

The Federal Trade Commission is charged by statute with preventing unfair methods of competition and unfair or deceptive acts or practices in or affecting commerce.[3] 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, Commission staff have 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 Chevron and Texaco, Exxon and Mobil, and BP and Amoco; the proposed merger of petroleum refiners Valero Energy and Ultramar Diamond Shamrock; and the combination of the refining and marketing businesses of Shell, Texaco, and Star Enterprises.[4]

The Commission and its staff have also investigated, conducted workshops, and commented on proposed regulations regarding motor fuel pricing. In 2001, the Commission, using the competition analysis principles in the Merger Guidelines, completed investigations of spikes in reformulated gasoline prices in several Midwest states in the spring and summer of 2000,[5] and of gasoline price increases in West Coast markets.[6] In the last two years, the Commission has held two public conferences to examine factors that affect prices of refined petroleum products in the United States.[7] Commission staff also has filed public comments with the Environmental Protection Agency concerning "boutique fuel" regulations.[8] On numerous occasions, Commission staff has offered comments on proposed state laws covering various aspects of gasoline sales, including laws that would ban sales of motor fuels below

---

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

[4] *See Valero Energy Corp.*, Docket C-4031 (2001) (consent order), *Chevron Corp.*, Docket C-4023 (2001) (consent order); *Exxon Corp.*, Docket C-3907 (2001) (consent order); *British Petroleum Company p.l.c.*, 127 F.T.C. 515 (1999) (consent order); *Shell Oil Co.*, 125 F.T.C. 769 (1998) (consent order).

[5] Midwest Gasoline Price Investigation, Final Report of the Federal Trade Commission (Mar. 29, 2001).

[6] *FTC Closes Western States Gasoline Investigation*, FTC Press Release (May 7, 2001).

[7] *FTC to Hold Public Conference/Opportunity for Comment on U.S. Gasoline Industry*, FTC Press Release (July 12, 2001); *FTC to Hold Second Public Conference on the U.S. Oil and Gasoline Industry in May 2002*, FTC Press Release (Dec. 21, 2001).

[8] Comments of the Staff of the General Counsel, Bureaus of Competition and Economics, and the Midwest Region of the Federal Trade Commission, *Study of Unique Gasoline Fuel Blends ("Boutique Fuels"), Effects on Fuel Supply and Distribution and Potential Improvements*, EPA 420-P-01-004, Public Docket No. A-2001-20 (Jan. 30, 2002).

cost.[9]

II. Analysis of House Bill 1203 / Senate Bill 787

Currently, North Carolina's Motor Fuel Marketing Act prohibits vendors from selling motor fuel below cost.[10] The Act declares that it shall be unlawful "where the intent is to injure competition" to sell motor fuel below cost "with such frequency as to indicate a general business practice of selling at . . . less than the cost of the [fuel]." The Act defines "cost" for refiners or terminal suppliers as "the refiner's or terminal supplier's prevailing price ... or the lowest prevailing price within 10 days prior to a sale alleged to be in violation of [North Carolina law]," plus freight expenses and taxes. For all other vendors, the Act defines cost as "the invoice or replacement cost, whichever is less . . . of motor fuel within 10 days prior to the date of sale," plus freight expenses and taxes.

If signed into law, the bill would amend the Act in several ways. Most important, the bill would redefine "cost" for all vendors as freight charges, taxes, and the lesser of (1) the "most recently published average reseller rack cost of motor fuel by grade and quality, as calculated by the Oil Price Information Service" or (2) the "low OPIS Rack Price as reported by OPIS," in either case for the particular terminal from which the motor fuel was delivered. As a practical matter, the "low OPIS Rack Price" will be lower than the "average reseller rack cost."

---

[9] *See, e.g.*, Testimony of Jerry Ellig, Deputy Director, Office of Policy Planning, Before the State of Hawaii Joint Legislative Hearing (Jan. 28, 2003) available at http://www.ftc.gov/be/V030005.htm; Letter from Joseph J. Simons, Director, FTC Bureau of Competition, and R. Ted Cruz, Director, FTC Office of Policy Planning, to Gov. George E. Pataki of New York (Aug. 8, 2002) available at http://www.ftc.gov/be/V020019.pdf; Letter from Joseph J. Simons, Director, FTC Bureau of Competition, and R. Ted Cruz, Director, FTC Office of Policy Planning to Hon. Robert F. McDonnell, Commonwealth of Virginia House of Delegates (Feb. 15, 2002) at http://www.ftc.gov/be/V020011.htm; 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, Ways and Means Committee, Other Taxes and Revenues Subcommittee, South Carolina House of Representatives (May 12, 1989).

[10] *See* N.C. GEN. STAT. § 75-80 *et seq.*

The bill has several other notable provisions. Under the Act, below-cost pricing is unlawful only where "the intent is to injure competition" and where the below-cost sales occur "with such frequency as to indicate a general business practice of selling [below-cost]." The bill would eliminate both requirements. In addition, the bill would raise the maximum civil penalty for each offense from $1,000 to $10,000, and would allow private entities to recover treble damages and attorneys' fees for offenses (rather than actual and exemplary damages, and costs). The bill would retain the Act's exception for meeting competition. Finally, the bill would prevent vendors from limiting the quantity of motor fuel sold or offered for sale to any customer.

We believe that the bill is unnecessary to protect North Carolina's consumers. Anticompetitive below-cost pricing is already illegal under federal antitrust laws.[11] Moreover, by eliminating the Act's intent and business practice requirements, and by redefining costs to the average or low reseller rack cost, the bill likely would deter procompetitive price-cutting and cause some vendors to raise their prices.

A. Anticompetitive below-cost pricing is already illegal under federal antitrust law and North Carolina law

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 Federal Trade Commission and the Antitrust Division of the United States Department of Justice may bring enforcement actions against anticompetitive below-cost pricing. The federal government has launched several predatory pricing investigations and predatory unilateral conduct cases during the past several years.[12] 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.[13] State attorneys general, acting as *parens patriae,* also may bring such actions.

---

[11] Predatory pricing claims are brought under Section 2 of the Sherman Act, 15 U.S.C. § 2. Plaintiffs can also claim anticompetitive predation under the Robinson-Patman Act, 15 U.S.C. § 13(a) (as amended).

[12] Notable examples include *American Airlines* and *Microsoft*. *See,* e.g., *United States v. AMR Corp.*, 2001-1 Trade Cas. (CCH) ¶ 73,251 (D. Kan. 2001); *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir.), *cert. denied*, 534 U.S. 952 (2001).

[13] 15 U.S.C. § 15.

Although anticompetitive below-cost pricing 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."[14] 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 low prices, as a general matter, are "a boon to consumers."[15]

ii. Only prices below the price cutter's costs can be predatory

The Supreme Court has directly addressed low pricing strategies. In *Brooke Group*, the seminal case in this area, the Court expressly held that a defendant does not violate the antitrust laws by cutting prices merely because the low prices decrease a plaintiff's profits. "Low prices benefit consumers regardless of how those prices are set."[16] Rather, to be unlawful, the low prices, at a minimum, must 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."[17] "[W]e have rejected elsewhere the notion that above-cost prices that are below general market levels or the costs of a firm's competitors inflict injury to competition cognizable under the antitrust laws."[18]

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."[19] 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-

---

[14] *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)).

[15] *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 224 (1993); *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).

[16] *Brooke Group*, 509 U.S. at 223 (quoting *Atlantic Richfield Co.* 495 U.S. at 340).

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

[18] *Id.* (citing *Atlantic Richfield Co.,* 495 U.S. at 340).

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

cutter's marginal costs, or a close proxy such as average variable costs, should be the yardstick.[20]

It is critical to note that, whatever cost measure is chosen, the pertinent comparison is to the *price-cutter's* costs, not the costs of its rivals. If the price-cutter has lower costs, and thus is more efficient, than its rivals, no predatory pricing occurs when it prices above its own costs, irrespective of whether those prices are below its rivals' costs. "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."[21]

iii. Not all below-cost pricing harms consumers

Below-cost pricing by itself, however, is insufficient under the antitrust laws to constitute a violation. Under federal law, consumers must also be injured, and consumers are not harmed by below-cost pricing *unless* sustained above-cost prices occur later on:

> [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.[22]

Thus, even if a below-cost pricing strategy succeeds in temporarily reducing the number of competitors, the price-cutter must find a way to keep competitors from returning after it tries to raise prices again. Otherwise, the below-cost pricing strategy, which requires that the firm incur losses on every sale, will not succeed. When a firm fails to recoup short-run losses (from sales at below-cost

---

[20] *See 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 Communications Corp. v. AT&T*, 708 F.2d 1081, 1122-23 (7th Cir.), *cert. denied*, 464 U.S. 891 (1983) (holding that no predatory intent can be presumed from prices at or above long run incremental cost); *International Air Indus. v. American Excelsior Co.*, 517 F.2d 714, 724 (5th Cir. 1975), *cert. denied*, 424 U.S. 943 (1976) (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 and H. Hovenkamp, *Antitrust Law*, ¶ 724; P. Areeda and 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.

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

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

prices) in the long run, consumers enjoy a windfall. And without harm to consumers, an antitrust violation does not occur. "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. ... Evidence of below-cost pricing is not alone sufficient to permit an inference of probable recoupment and injury to competition. ... Although unsuccessful predatory pricing may encourage some inefficient substitution toward the product being sold at less than its cost, unsuccessful 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. ..."[23]

Given the strong stance of the Supreme Court in favor of the benefits of low prices and the care it has devoted to explaining what types of price cutting are illegal under the antitrust laws, the North Carolina bill is not necessary to protect consumers from anticompetitive below-cost pricing.[24]

B. Scholarly studies and court decisions suggest that anticompetitive below-cost pricing rarely happens

To assess further whether this legislation is necessary, it may be helpful to consider the extensive scholarship on anticompetitive below-cost pricing. In an exhaustive discussion of the topic, 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."[25]

More recent 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

---

[23] *Brooke Group*, 509 U.S. at 224, 226.

[24] Under federal law, competition is not considered harmed unless consumers are harmed. Mere injury to competitors is insufficient. *See, e.g., Rebel Oil Co., Inc. v. Atlantic Richfield Co.*, 51 F.3d 1421, 1433 (9th Cir.), *cert. denied*, 516 U.S. 987 (1995) ("Of course, conduct that eliminates rivals reduces competition. But reduction of competition does not invoke the Sherman Act until it harms consumer welfare."). Whether or not North Carolina's state courts would interpret injury to competition similarly is not clear. Courts construing below-cost pricing statutes in other states have not always done so. *See, e.g., Home Oil Co. v. Sam's East, Inc.*, 2002 WL 857391 (M.D. Ala. Apr. 26, 2002).

[25] Frank H. Easterbrook, "Predatory Strategies and Counterstrategies," 48 *U. Chi. L. Rev.* 263, 313-14 (1981).

lawsuits, careful examination of these cases indicates that predation in the sense of pricing below cost usually did not occur."[26] Predation sometimes occurs,[27] but not nearly as frequently as claimed.

Because it is difficult to profit from anticompetitive below-cost pricing, the Supreme Court, in keeping with scholarship on this point, has found that "there is a consensus among commentators that predatory pricing schemes are rarely tried, and even more rarely successful."[28] 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. . . ."[29]

In short, the bill appears to address a problem that not only is already covered under federal antitrust law, but also is unlikely to occur in any event.

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

A series of studies suggests that anticompetitive below-cost pricing is especially unlikely in gasoline retailing. Laws to prevent anticompetitive below-cost pricing of motor fuels have been investigated extensively during the past two decades. The issue originally arose in the 1980s, when various parties expressed concern that major oil companies were selling gasoline below cost in order 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) conducted a comprehensive investigation of predatory pricing allegations in gasoline markets.

In 1984, USDOE released a final report to Congress examining whether vertically integrated refiners were "subsidizing" their retail gasoline operations in a way that might be predatory or anticompetitive. The study was based on extensive pricing data and internal oil company documents subpoenaed by the USDOE. USDOE found that there was no evidence of predation or anticompetitive subsidization. The agency concluded that increased pressures on gasoline retailers were not caused by anticompetitive behavior on the part of the major oil companies. Rather, the decline in the overall number of retail outlets and the intensification of competition among gasoline marketers were attributable to decreased consumer demand for gasoline in some areas and a continuing trend toward

---

[26] Dennis W. Carlton and Jeffrey M. Perloff, *Modern Industrial Organization* 342 (Addison-Wesley, 2000).

[27] *See* Jeffrey Church and Roger Ware, *Industrial Organization: A Strategic Approach* 659 (Irwin McGraw-Hill, 2000).

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

[29] *Id.* at 594.

the use of more efficient, higher-volume retail outlets.[30]

Since 1996, the Commission has investigated the pricing practices of virtually every major oil company, and Commission staff have found no convincing evidence of predatory pricing in the retail gasoline market. In several recent investigations, the FTC has expressed concern about unduly high concentration levels in certain gasoline markets. In these cases, however, the Commission was concerned that concentration, among other things, could lead to *higher,* not predatory (lower), gasoline prices.

Several states have also conducted their own studies. In 1987, a Joint Legislative Study Committee created by the Arizona legislature recommended that no new legislation be enacted to restrict the pricing of motor fuels in Arizona. "The marketplace for petroleum products is very competitive in Arizona," the committee concluded.[31]

In 1986, the Washington State Attorney General initiated a study of motor fuel pricing to determine whether refiners were engaged in anticompetitive subsidization of company-owned service stations. Information was gathered on the practices of all eight of the major companies in Washington 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 percent of the time.[32]

More recently, the Commonwealth of Pennsylvania conducted a study examining a variety of proposals for legislation 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 might harm consumers more than it would help them:

> 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

---

[30] USDOE, *Deregulated Gasoline Marketing: Consequences for Competition, Competitors, and Consumers* (Mar. 1984); USDOE, *Final Report: The State of Competition in Gasoline Marketing* (1981).

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

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

higher prices.[33]

Competitors will, of course, sometimes 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. Thus far, no systematic study has produced evidence that predatory pricing is likely to be a significant problem in retail gasoline markets.

D. The bill likely would deter procompetitive price-cutting and cause some vendors to raise their prices

By eliminating the Act's intent and business practice requirements, and by redefining costs to the average reseller rack cost, the bill likely would deter procompetitive price-cutting and force some vendors to raise their prices. The provision prohibiting quantity limits also likely would deter procompetitive price-cutting.

i. The intent and business practice requirements

The Act's intent and business practice requirements preclude vendors from being held liable for isolated or unintended instances of below-cost pricing. By eliminating these requirements, the bill likely would deter procompetitive price-cutting. Under the bill, vendors could be liable for treble damages, attorneys' fees, and a civil penalty of up to $10,000 for inadvertently pricing motor fuel below cost, even on a single occasion. Similarly, the bill would prohibit procompetitive below-cost pricing, such as special promotions or below-cost pricing that may accompany the launch of a new retail outlet. For such short-term price cuts, there is no risk to consumers of monopolization or any other anticompetitive effects. The risk of damages and a substantial civil penalty, however, likely would deter vendors from cutting prices. Moreover, the mere threat of litigation may deter vendors from selling motor fuel at prices that are legal and above cost, but low enough to prompt complaints from competitors.

In short, by eliminating these requirements, the bill likely would deter vendors from offering consumers low prices, without providing consumers with any corresponding benefit.

ii. The redefinition of cost

Similarly, by redefining "cost" to the average or low reseller rack cost, the bill likely would deter procompetitive price-cutting and could even cause some vendors to raise their prices. In the first place, the bill calculates cost based not on a vendor's own costs, but on costs to other competitors. Unless the vendor happens to purchase its gasoline at a price greater than or equal to the bill's definition of cost, the definition will not correspond to the vendor's actual cost. The federal courts, basic

---

[33] Commonwealth of Pennsylvania, Legislative Budget and Finance Committee, *Factors Affecting Motor Fuel Prices and the Competitiveness of PA's Motor Fuels Market* 35 (Oct. 2000).

economic principles, and virtually all prominent antitrust scholars agree that the relevant measure of cost should be that of the vendor, not its competitors.[34] If the vendor has lower costs than its competitors and prices equal to or above those costs, consumers will benefit from the vendor's greater efficiency. Predatory or anticompetitive pricing can never occur when a vendor prices at or above its own costs, even if those prices are below its rivals' costs.

There are additional problems with the bill's definition of cost. In particular, data from OPIS may not accurately reflect the prices available to vendors. OPIS data is simply a rack posting and does not reflect discounts that may be available to jobbers and retailers. A jobber or retailer who negotiates a price better than those reported by OPIS would not be able to pass that price reduction on to consumers. Vendors sometimes negotiate volume-based discounts, but under the bill'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 would pay higher prices as a result.

The timing of the OPIS prices 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 rack price. As a result, if the price at the rack subsequently increases, a vendor could violate the bill by selling gasoline above its own costs, but below subsequent rack 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 branded rack 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.

iii. The quantity limit provision

Finally, by preventing vendors from limiting the quantity of motor fuel sold or offered for sale to any customer, the proposed law would further discourage procompetitive price-cutting. This provision would prevent a vendor from offering its customers a special price for a limited quantity. For many products, such as groceries and fast food products, vendors offer consumers a low price and limit the quantity of the product that consumers can buy. Vendors find it necessary to limit quantity, because it is possible that competing vendors could buy the entire inventory and deprive consumers of the benefit of the low price. These types of offers are procompetitive because they offer consumers low prices. This provision preventing vendors from limiting quantities effectively would allow competitors to buy a rival's entire inventory, thereby making it more difficult for the rival to sell motor fuel to consumers at low prices. It is not clear if competitors would do so; FTC staff could not find any empirical data on this point, perhaps because of the rarity of such a provision for motor fuel. By preventing vendors from

---

[34] *See* notes 19 and 20, *supra*, and accompanying text.

limiting the quantity of motor fuel offered for sale, the provision could deter price-cutting while offering no benefits to consumers.[35]

[35] Federal antitrust law generally permits unilateral refusals to deal. *See United States v. Colgate & Co.*, 250 U.S. 300 (1919).

III. Conclusion

For these reasons, the FTC's Bureau of Competition, Bureau of Economics, and Office of Policy Planning believe that House Bill 1203 / Senate Bill 787 would more likely harm than promote competition. The bill 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, the bill likely would deter procompetitive price-cutting and cause some vendors to raise their prices, to the detriment of North Carolina's consumers.

Respectfully submitted,

Joseph J. Simons, Director
Bureau of Competition

David T. Scheffman, Director
Bureau of Economics

Todd Zywicki, Director
Office of Policy Planning