edgeworth | economics

April 2020

Are Pandemic Sellers Actually Violating Price-Gouging Laws?

John H. Johnson, PhD
CEO | Washington, DC
jjohnson@edgewortheconomics.com
+1 202 559 4388

George Korenko, PhD
Partner | Washington, DC
gkorenko@edgewortheconomics.com
+1 202 559 4408

Matthew Milner
Partner | Washington, DC
mmilner@edgewortheconomics.com
+1 202 559 4387

As COVID-19 spreads throughout the country, it is especially important unscrupulous sellers do not take advantage of Americans by selling products at unconscionable prices.[1]

Introduction

Anecdotal examples abound of purported price gouging during the Coronavirus crisis, such as two bottles of Purell hand sanitizer selling for $149[2] and a roll of toilet paper costing $10 at a local store.[3] Recently, a group of 33 Attorney Generals sent letters to major online retailers including Amazon and eBay asking for assistance to stop price gouging online.[4] When a governor or mayor declares a state of emergency in an area, local "price gouging" statutes go into effect in their area. Price gouging occurs when a supplier of a product or service charges "excessive" prices—taking advantage of an emergency situation—to acquire "unconscionable" profits.[5] Economic analysis provides a framework to empirically test whether prices being charged by sellers for goods or services rise to the level that constitute price gouging as defined by state law. The key question in conducting an economic analysis hinges on how to rigorously define "excessive" prices and distinguish between "reasonable" and "unconscionable" profits.[6] Not surprisingly, the breadth and variety of state and local laws create a wide range of "definitions" of what behavior constitutes price gouging. In this paper, we describe various concepts used when identifying appropriate benchmarks and comparators in an assessment of price gouging. Throughout, we highlight examples of how key differences in state and local statutes would affect the relevant economic analysis.

Economic Framework to Apply Price Gouging Statutes

While the state and local price gouging statutes vary, they typically provide important guidance for addressing the relevant economic questions of how to distinguish price gouging from what are considered normal pricing practices. The general framework is to compare the actual prices charged during a state of emergency to an allowed benchmark price that is considered normal or reasonable. This benchmark price is, under most statutes, based on the experiences in the relevant industry during a period immediately before the emergency declaration. To determine this benchmark price, several questions are relevant:

- What is the precise time window before the declaration of the emergency over which benchmark prices represent acceptable "normal" market pricing?
- What are the relevant geographic areas over which benchmark prices can be observed?
- What constitutes a comparable product or service for the purposes of benchmarking?
- What are relevant costs that can be considered and what constitutes a "reasonable" margin if allowed?

Time Periods

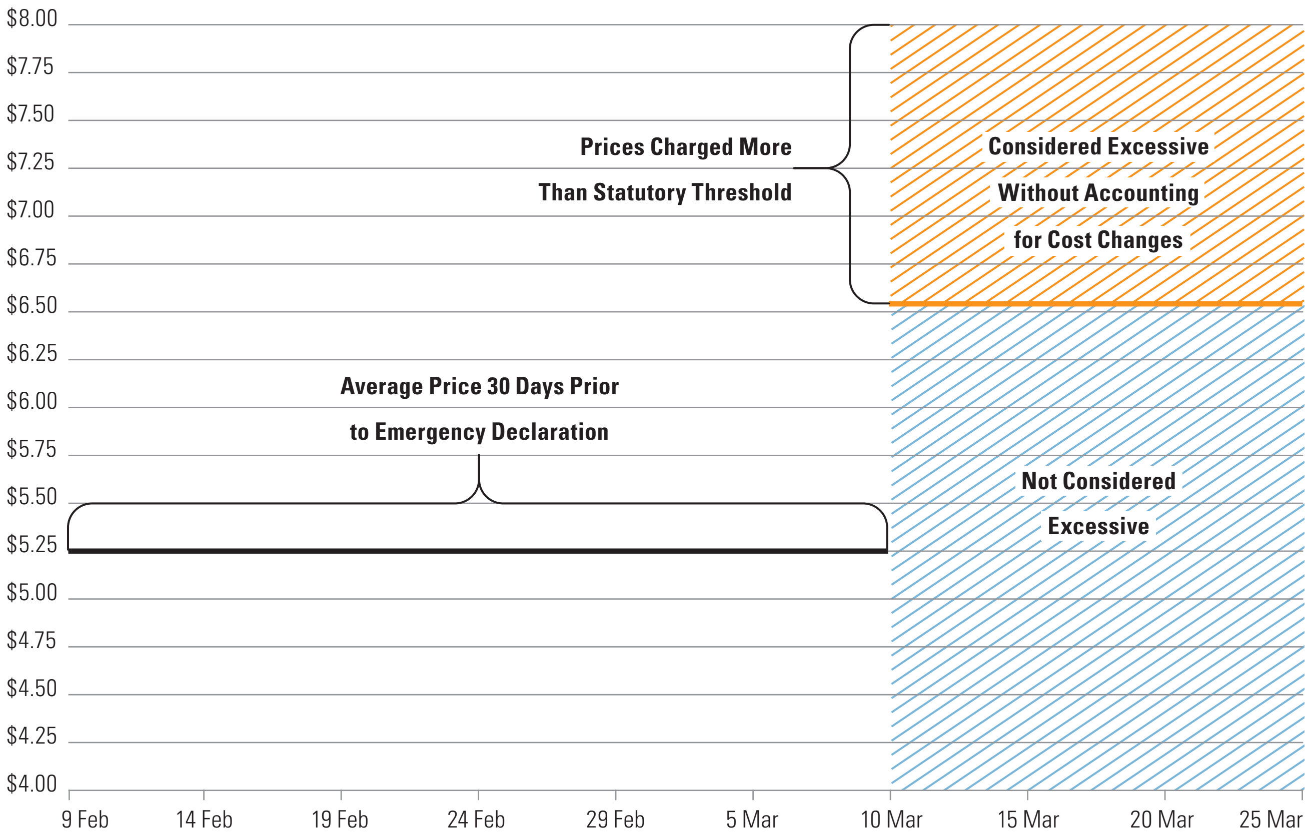
To assess whether price gouging has occurred, the starting point is determining what time period will constitute the measurement of "normal" pre-emergency economic conditions. This approach is akin to a before and during methodology frequently used in the calculation of antitrust damages. The "during" period is straightforward; the potential "price-gouging" period begins the day that a state of emergency is declared and the "during" period begins when a potential price gouging event occurs. Most statutes also specify the length of the look-back period to be used to determine the benchmark price, but there is wide variation in the precise time periods prescribed by law. For example:

- California's statute simply describes the relevant time period as "immediately prior to the proclamation or declaration."[7]
- Alabama's Unconscionable Pricing Act prescribes looking at "30 days immediately prior to the declared state of emergency."[8]
- North Carolina's statute prescribes a "60 day" window prior to the emergency.[9]

The definition of the appropriate window with which to observe "normal" economic pricing will be critical to the ultimate conclusions. Exhibit 1 is a hypothetical example that compares prices before and after an emergency declaration. Here, the average price of the product was $5.25 prior to the announcement on March 10th. In the red area of Exhibit 1, prices would appear to be artificially elevated above the statutory threshold established by a state. Price changes below the threshold would not be flagged for potential price gouging.[10] Note, however, that from an economic perspective, observing a price in the red area alone may not be sufficient to demonstrate that prices were artificially elevated. As state statutes recognize, even if a price is above a pre-determined level relative to a benchmark, there is often a rebuttable presumption if the price changes can be accounted for by changes in costs and potentially other economic factors.[11]

Exhibit 1

Illustrative Example of Price Comparison Before and After An Emergency Declaration



Geographic Region

Another important factor in establishing the benchmark price is the relevant geographic area. Many statutes anticipate that comparator prices must be selected from within a certain geographic area, and statutes vary widely as to what these areas might be. For example, the benchmark price may differ in a particular city (*e.g.*, Washington, DC) compared to the Washington, DC metropolitan area, which also includes parts of Virginia, Maryland, and West Virginia. State and local statutes generally define one or more relevant geographic areas for defining benchmark prices:

- For example, Hawaii's statutes limit the price-gouging assessment to the areas within which the state of emergency has been issued, either the entire state or specific cities.[12]
- Similarly, Mississippi defines an "emergency impact area" over which the assessment occurs.[13]
- New York allows for benchmarking not just within the emergency area but within "any area outside the geographic scope of the declaration of the state of emergency or an adjoining state."[14]

Why is geography so important? Consider, for example, the U.S. Bureau of Economic Analysis' comparison of prices across states, which shows that in 2017 prices in New York were 116 percent higher than the national average while prices in the adjacent state of Pennsylvania were 98 percent of the national average.[15] Variation of supply and demand conditions in locales combined with the geographic specifications in certain statutes can be critical in the assessment of prices before and after an emergency declaration.

Product at Issue

Many statutes allow for not just products, but also services to be the focus of a price-gouging complaint. However, there is variation across states as to which products are subject to price gouging enforcement. For example:

- California's statute pertains to "goods or services used for emergency cleanup, emergency supplies, medical supplies, home heating oil, building materials, housing, transportation, freight, and storage services."[16]
- Georgia provides protection for "any goods or services identified by the Governor in the declaration of the state of emergency necessary to preserve, protect, or sustain the life, health, or safety of persons or their property."[17]
- In contrast, Idaho's statute applies only to "fuel or food, pharmaceuticals, or water for human consumption."[18]

Even though the product at issue may be readily identified, an important issue for the purposes of the benchmarking exercise is to determine what product features are essential for identifying a comparator? Clearly, it is important for the comparator product to be similar to the product at issue, but it may not be possible to obtain price information for the *exact same* product. It will be important to weigh the availability of pricing and other data against the precision of the comparable product features. For example, it may be relevant to consider how factors such as brand, grade, and package size may affect pricing when selecting an appropriate benchmark. For services, similar issues arise, such as whether the service must be provided by the same vendor to provide benchmark prices.

Measurement of "Excessive" Prices

The statutes for each locality have their own definition of what constitutes an "excessive" price. Each of these measures of excessive prices compares the actual price to a benchmark price and determines if it exceeds the threshold established as "excessive." However, there is substantial variation between states and localities in the threshold that is applied:

- California and Oklahoma consider price changes greater than 10 percent to be "excessive."[19]
- Oregon considers a price change of greater than 15 percent to be "unconscionably excessive."[20]
- Alabama looks for a price change "equal or in excess of 25 percent."[21]

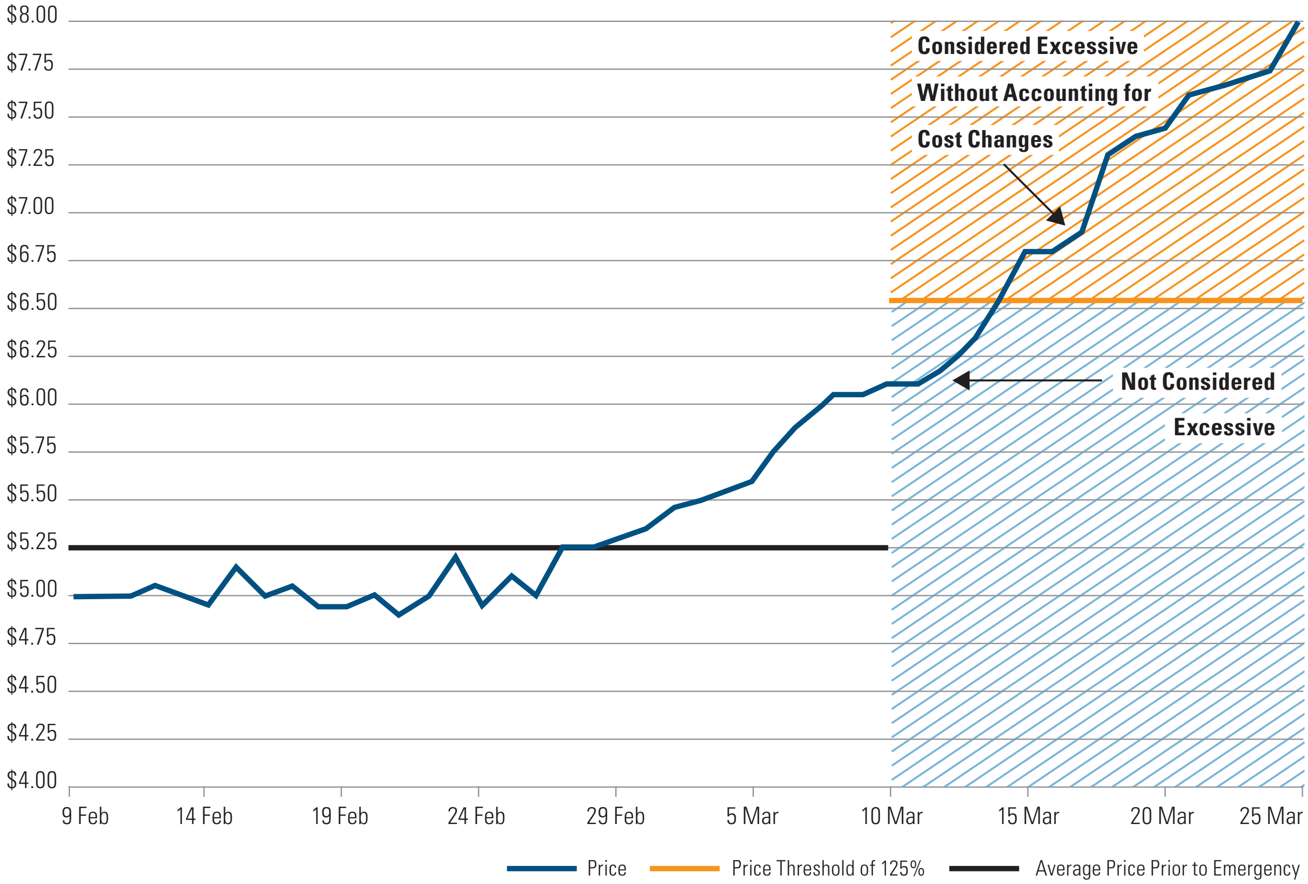
In Exhibit 2, we compare hypothetical product prices before and after the emergency declaration. The average price prior to the crisis was $5.25. In this example the statutory threshold is a 25 percent increase (or 125 percent of the average price 30-days beforehand, which is $6.56 as denoted by the red line). When prices exceed this threshold after the government decree on March 10th, the prices are initially flagged as unacceptable by the statute. Some statutes are very specific with respect to how the benchmark prices are to be calculated; for example, the Alabama Unconscionable Pricing Act explains:

> *To avoid violation, figure the price charged for each of the previous 30 days. Add the 30 daily prices, divide by 30, and multiply the price by .25, or 25 percent, to determine the maximum price increase allowed for any one day.*[22]

Again, the observation that a price is flagged as potential price gouging is often followed by an assessment of the circumstances surrounding the price increase.

Exhibit 2

Comparison of Prices Before and After An Emergency Declaration



Prices, Costs, and Margins

Whether a given statute expressly describes a "rebuttable presumption" or exception based on additional circumstances, as a practical matter, most states are not simply trying to limit prices in and of themselves, but rather seek to limit increases in prices that are not explainable by increased costs. For example:

- Pennsylvania allows for a price increase if that "increase in price is due to a disparity that is substantially attributable to additional costs that arose within the chain of distribution."[23]
- Oregon allows price increases during a state of emergency if they are "[a] ttributable to additional costs imposed by the merchant's or wholesaler's suppliers" or the "result of increased internal costs or expenses" related to the emergency declaration.[24]

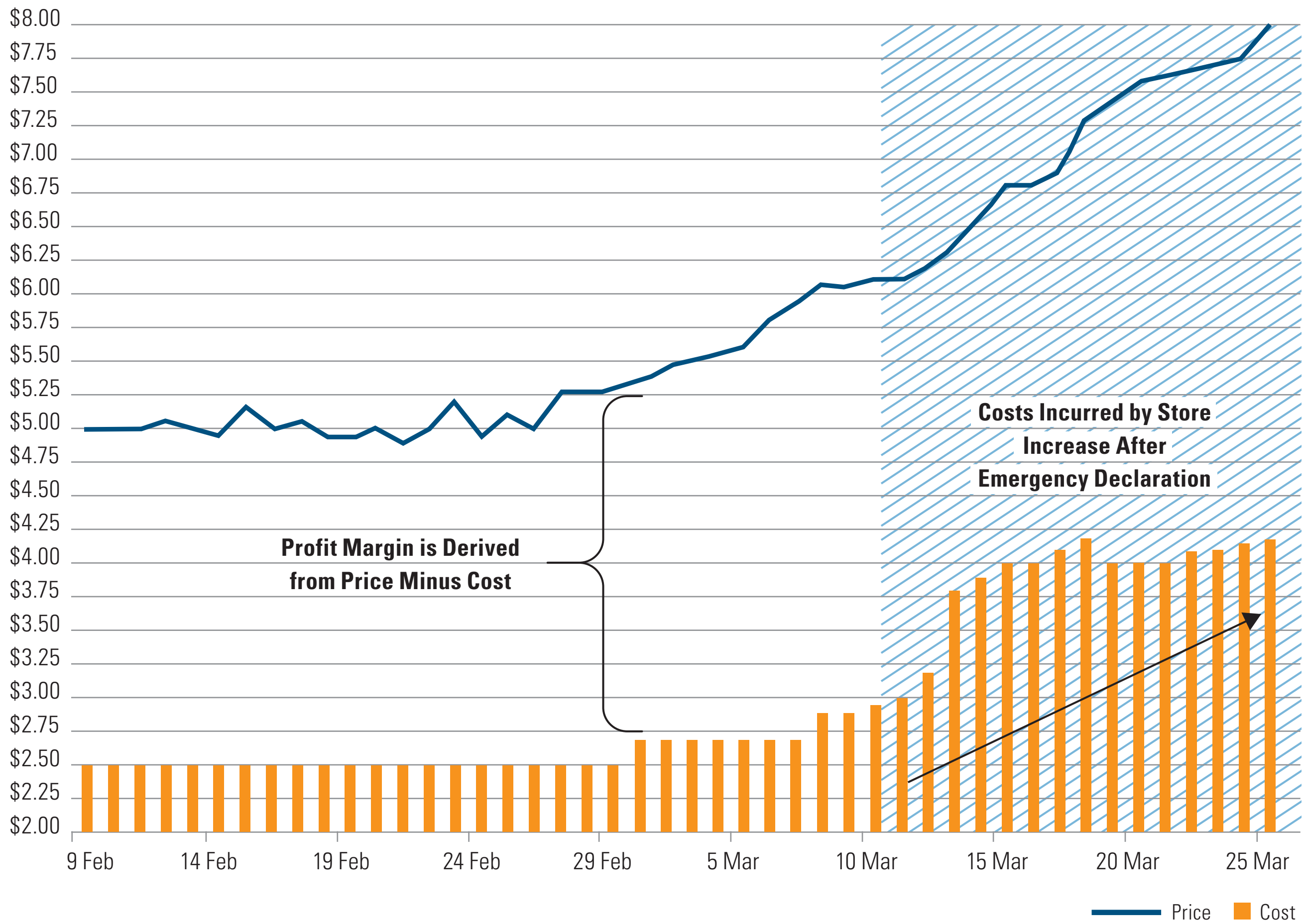
Other states seek to limit margins, i.e. the percentage difference between the price paid (cost to the business) and the price charged (revenue to the business) for a product or service. For example, the percent difference between a wholesale price and a retail price is typically a "retail markup," which is a margin charged by the retailer to cover its costs and potentially earn a profit. Statutes that reference margins include:

- The District of Columbia measures a "normal average retail price" for merchandise as "the price equal to the wholesale cost plus a retail mark-up that is the same percentage over wholesale cost as the retail mark-up for similar merchandise…"[25]
- Iowa's statute provides for a presumption of an excessive price if there was a "substantial increase in the price" relative to the period immediately prior to the state of emergency or "from a substantial increase in the markup from cost if wholesale prices or costs have increased."[26]

Both of these approaches account for costs when assessing whether a price increase is "excessive." Exhibit 3 is an illustration of how, for a given product, unit prices and costs can change before and after an emergency declaration. For example, Oregon's statute recognizes that the price increase may be due to an increase in costs from a supplier or from increased internal costs.[27] If both prices and costs increase after the emergency declaration, it is possible that margins stay flat or even decrease during the same time period.[28]

Exhibit 3

Daily Prices Charged to Customers and Costs Incurred by the Seller Before and After the Emergency Declaration



Key Takeaways

The economic analysis of pricing subsequent to a declaration of emergency is a fact-specific inquiry that varies by state, locale, and business. The analytical framework for the analysis is guided by statutory requirements to determine if price gouging has occurred—the relevant products, benchmark period, contemporaneous factors, and comparable prices are idiosyncratic to state and local laws. Economists need to account for these factors on a state-by-state basis in formulating a data driven analysis that is rigorous and informs whether pricing behavior is consistent with price gouging or can be explained by other contemporaneous factors.

Notes

1 See Letter from State Attorney Generals to Jeff Bezos, Founder/CEO of Amazon, dated March 25, 2020. https://www.attorneygeneral.gov/wp-content/uploads/2020/03/03_25_2020_Multistate-letter.pdf

2 https://www.usatoday.com/story/money/2020/03/03/coronavirus-hand-sanitizer-face-masks-price-gouging-amazon-walmart-ebay/4933920002/

3 https://www.chicagotribune.com/coronavirus/ct-chicago-price-gouging-coronavirus-20200324-lqbu2nr7rrgtbcnnx6erg3vbry-story.html. See also: https://41nbc.com/2020/03/19/virus-outbreak-profiteering/

4 https://www.npr.org/sections/coronavirus-live-updates/2020/03/25/821513190/stop-price-gouging-33-attorneys-general-tell-amazon-walmart-others. Amazon reports suspending over 3,900 third party vendors from its platform in the last few weeks for suspicious pricing activity, see https://blog.aboutamazon.com/company-news/price-gouging-has-no-place-in-our-stores

5 State statutes vary widely in the language they use to describe price gouging, including "excessive prices" (Iowa Code section 714.16(2)"a."), "profiteer from disaster" (Kansas Chapter 50. Unfair Trade and Consumer Protection §,106 50-6,106) and "unconscionable" (Florida Title XXXIII, Chapter 501.160:). For a useful summary of state price gouging statutes, see the FMI (Food Industry Association): https://www.fmi.org/docs/default-source/gr-state/price-gouging-state-law-chart.pdf?sfvrsn=9058b75c_2

6 Some economists argue "price-gouging" is nothing more than the efficient functioning of a market driven by supply and demand. Although this debate is beyond the scope of this paper, price gouging policy is driven in part on fairness and ethical considerations, and from a greater social welfare standard to prevent these practices from creating winners and losers unfairly, including hurting populations that would be most vulnerable and most in need in a time of crisis. See, for example, https://online.hbs.edu/blog/post/supply-and-demand-or-price-gouging-an-ongoing-debate

7 California Penal Code Section 396. See http://leginfo.legislature.ca.gov/faces/codes_displaySection.xhtml?sectionNum=396&lawCode=PEN

8 Alabama Unconscionable Pricing Act. See https://law.justia.com/codes/alabama/2006/4653/8-31-4.html

9 North Carolina General Statutes Chapter 75. Monopolies, Trusts and Consumer Protection §75-38. See https://www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_75/GS_75-38.html

10 As we discuss below, the threshold level varies state by state.

11 See, for example, Maine Title 10: Commerce and Trade, Part 3: Regulation Of Trade, Chapter 201: Monopolies and Profiteering for a discussion of the rebuttable presumption.

12 Hawaii, §127A-30. See https://www.capitol.hawaii.gov/hrscurrent/Vol03_Ch0121-0200D/HRS0127A/HRS_0127A-0030.htm

13 Mississippi, § 75-24-25. See https://casetext.com/statute/mississippi-code-1972/title-75-regulation-of-trade-commerce-and-investments/chapter-24-regulation-of-business-for-consumer-protection/general-provisions/section-75-24-25-restriction-on-prices-charged-for-goods-during-state-of-emergency-definitions-penalties

14 New York Consolidated Laws, General Business, Article 26 §395-R. See New York Assembly Bill 237 and New York Senate Bill 803.

15 https://www.bea.gov/news/2019/real-personal-income-states-and-metropolitan-areas-2017

16 California Penal Code, Section 396.

17 Georgia Fair Business Practices Act §10-1-393.4.

18 Idaho Consumer Protection Act §48-603.

19 California Penal Code, Section 396; Oklahoma Office of Attorney General, "Disaster Scam Prevention."

20 Oregon Revised Statutes, §401.965.

21 Alabama Unconscionable Pricing Act.

22 Ibid.

23 Pennsylvania Price Gouging Act.

24 Oregon Revised Statutes, §401.965.

25 District of Columbia Code, § 28-4101.

26 Iowa Administrative Code, §61—31.1(714) Excessive prices.

27 Oregon Revised Statutes, §401.965.

28 Note that the customer and the seller can be situated at any point in the supply chain—e.g., manufacturer to distributor, distributor to retailer, retailer to consumer—and it will be important that the comparator prices or margins occur at the same level of the supply chain as the product at issue.

edgeworth | economics

About Edgeworth

Edgeworth Economics is an economic and quantitative consulting firm that provides economic analysis and expert testimony for clients facing complex litigation, regulatory, and other challenges involving antitrust, class certification, intellectual property, and labor and employment. Edgeworth's expert economists, statisticians, data analysts, and other professionals assist clients with innovative solutions rooted in the rigorous application of economic principles and hard data. Organizations including leading law firms, Fortune 500 companies, and government agencies rely on Edgeworth Economics to help them navigate through their most critical legal disputes and other challenges.

www.edgewortheconomics.com