Professional Perspective

Defense Against Price Gouging Allegations Amid Falling Prices

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Bloomberg Law

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"News Alert: Unscrupulous profiteers take advantage of the Covid-19 pandemic by selling surgical masks and sanitizer for astronomical prices." Headlines like this epitomize the spirit of state price gouging laws that take effect during emergencies, when sellers elevate the prices of products that consumers desperately want, but are unable to purchase because the emergency has caused demand to far outstrip supply. But can a price gouging allegation be based on falling prices?

The answer is, apparently, yes. On Nov. 12, 2020, District of Columbia Attorney General Karl Racine sued dozens of D.C. gas stations for price gouging, "despite lower gasoline prices during the pandemic," and we have heard rumblings of similar allegations elsewhere. Racine's suit is unlikely to be the last of its kind, and these novel enforcement actions could leave a lasting impact on price gouging cases for years to come. This article provides an overview of price gouging statutes in the U.S. and examines the potential defenses available to companies facing unprecedented enforcement theories.

Emergency Price Gouging Statutes

State emergency price gouging statutes are laws designed to prevent sellers from increasing the price of a service or good during an emergency, such as the ongoing Covid-19 pandemic, or other disasters, such as a hurricane or ice storm. These laws are aimed at protecting consumers from a sudden supply disruption or demand spike triggered by the emergency.

The specific language of the statutes varies by state, but they are generally triggered by increases in price above a certain threshold or price increases that are deemed unreasonable. In some instances, the statutes also provide that increased prices due to escalating input costs are not a basis for price gouging. For instance, the District of Columbia prohibits the sale of services for more than 10% over the price of similar products and services sold during the 90-day period preceding the emergency. D.C. Code § 28-4101(2).

By contrast, the emergency price gouging statute in Massachusetts prohibits the sale of petroleum products for an "unconscionably high price," unless "the disparity is not substantially attributable to increased prices charged by … business suppliers or increased costs due to an abnormal market disruption." 940 Mass. Code Regs. 3.18(1), (2).

Where a violation is shown, emergency price gouging statutes can impose significant civil, injunctive, or even criminal penalties. For example, while the Alabama price gouging statute authorizes a $1,000 civil penalty per incident, (Ala. Code § 8-31-5.), price gouging in California is punishable by up to one year in jail, a $10,000 fine, civil penalties up to $2,500 per violation, and injunctive relief and restitution. Cal. Penal Code § 396(h), (i). Oklahoma goes further still, with up to $10,000 per claim, and a misdemeanor or felony charge punishable by up to 10 years in prison. Okla. Stat. tit. 15, § 761.1.

Defense Strategies

While the penalties for a violation can be severe, defendants, with the assistance of experienced counsel, have a variety of factual and legal defenses at their disposal.

Defenses Based on the Statute

Setting aside factual arguments based on the specific economic conditions of the defendant's conduct, a defendant's first line of defense is that the relevant price gouging statute does not apply to their conduct. These arguments are likely be have significant appeal where a price gouging enforcement action is based on falling prices.

Inapplicability to Price Reductions

Price gouging statutes apply most intuitively when prices rise during an emergency. Depending on the specific statute at issue, defendants may be able to rely on multiple statutory hooks to argue that the price gouging provisions cannot apply when prices fall.

This argument is most straightforward when the statute explicitly refers to an increase in prices. For example, California law prohibits the sale of certain items and services "for a price of more than 10 percent greater than the price charged by that person for those goods or services immediately prior to a date set in the proclamation or declaration of emergency." Cal. Penal Code § 396(b).

Other states, such as Texas, more generally prohibit sales of certain goods "at an exorbitant or excessive price." Tex. Bus. & Comm. Code Ann. 17.46(b)(27). In these states, a defendant might argue that these terms refer to exceedances of normal levels, and, therefore, the statute only applies where the price has gone up relative to its previous position. Any state statute that makes reference to price levels before the emergency also provides a hook for a company to argue that the law cannot apply where prices have fallen.

These arguments should be supported by any available legislative history that makes clear the statute was enacted in response to emergencies like hurricanes, floods, and terrorist attacks that cause a spike in prices. This legislative history should support the common understanding of price gouging, which is the "unlawful or unfair raising of prices." Black's Law Dictionary (11th ed. 2019).

The Nexus Requirement

Some state price gouging laws include a nexus requirement, meaning that the state must show a connection between the emergency and the purportedly excessive prices charged. Such a nexus requirement provides another avenue for a defendant to attack an enforcement action based on falling prices.

For example, Idaho's price gouging statute prohibits a company from "[t]aking advantage of a disaster or emergency declared by the governor" by selling certain products at excessive prices. Idaho Code § 48-603(19). In a state with a similar nexus requirement, a defendant may argue that the statute does not apply to certain commodities, such as fuel, which have seen falling prices during the Covid-19 pandemic.

Unlike a flood or hurricane, which creates an opportunity for sellers to take advantage of increased demand and decreased supply for fuel, the Covid-19 emergency has not created unusual demand for fuel. Because there is no connection or nexus between the emergency and fuel prices that a seller could take advantage of, the statute simply does not apply.

Knowledge or Intent Requirements

Many state price gouging statutes include a knowledge or intent requirement, and, in some statutory schemes, an increased penalty might apply to willful or repetitive violations of the statute. Generally speaking, these knowledge or intent provisions require the seller to knowingly or intentionally commit the act prohibited by the statute.

While state enforcement agencies are likely to consider the act of setting prices to be a decision made with knowledge and intent, the unusual posture of a price gouging enforcement action in the context of falling prices provides an opening for a defendant to argue that their conduct does not meet the knowledge or intent requirement.

At a minimum, a defendant should explore the specific language of the relevant price gouging statute's knowledge requirement to determine whether a viable defense exists that the conduct alleged was appropriate—based on the common sense understanding that price gouging applies to increases in prices and the paucity of price gouging enforcement related to falling prices—and therefore the defendant could not have acted with the requisite knowledge or intent.

Other Legal Defenses

In addition to these statute-specific defenses, defendants also have a variety of other potential legal defenses.

Due Process

The due process clause of the Fifth and Fourteenth Amendments prohibits the deprivation of "life, liberty, or property, without the due process of law." U.S. Const., amends. V, XIV § 1. A "fundamental principle" of due process "is that laws which regulate persons or entities must give fair notice of conduct that is forbidden or required. *F.C.C. v. Fox Television Stations, Inc.*, 567 U.S. 239, 253 (2012).In other words, the law must be sufficiently clear to apprise the defendant of what conduct is proscribed, and provide sufficient guidelines to law enforcement about when to allege a violation. See, e.g., *United States v. Harris*, 705 F.3d 929, 932 (9th Cir. 2013).

Due process defenses can take two forms: "facial" challenges, and "as applied" challenges. In a facial challenge, defendants argue that the law violates due process on its face, regardless of the facts of the defendant's specific case. By contrast, in an as applied challenge, defendants argue that the law violates due process as applied to the facts of the defendant's case.

In addition to a facial challenge to the state-specific price gouging law under which an allegation has been made, defendants whose product prices decreased during the relevant period likely have significant as applied defenses. Specifically, regardless of whether the relevant state price gouging statute identifies a specific, impermissible price increase, like the District of Columbia, or simply prohibits "excessive" or "unconscionable" prices, like Massachusetts, such statutory provisions arguably do not provide defendants with the "fair notice" that the constitution and due process requires that price gouging laws could be applied to falling prices.

While few cases have addressed state price gouging statutes, to our knowledge all known challenges have involved price increases during the relevant emergency, and the only known case to address the possibility of price gouging applying to price decreases soundly rejected the proposition. In that Massachusetts case, the court concluded, "[N]othing in the regulation suggests that increases in gross margin alone, in the absence of any price increase and simultaneous with *declining* retail prices, can support a price-gouging claim." *White v. R.M. Packer Co.*, 635 F.3d 571, 588 (1st Cir. 2011).

The court further acknowledged that this fundamental limitation extended well beyond the specific Massachusetts statute at issue, and rather applied to price gouging nationwide, stating, "While there is no specific history available as to the Massachusetts price-gouging rule, such rules are generally designed to protect consumers from acute and unconscionable increases in the prices they must pay for basic consumer goods during times of market emergency, not to mandate that retailers *decrease* their prices as quickly as their costs decline after the most acute crisis in supply of the good has passed."

Read together, these cases suggest that price gouging statutes do not provide defendants with the requisite fair notice that such statutes could be applied to falling prices during the relevant period, and thus provide an additional line of defense.

Quasi-Estoppel

Quasi-estoppel is an equitable doctrine that bars a party from asserting a right that is inconsistent with a position it previously held if the change in position would disadvantage another party. With variations across states, quasi-estoppel applies where it would be unconscionable to allow the offending party to maintain an inconsistent position from one it previously benefited from or acquiesced in.

Defendants should review materials prepared by the state regarding its price gouging laws and enforcement. Relevant documents may include regulatory guidance for businesses, investigatory reports, alerts for consumers, or testimony by state enforcement officers. These materials are likely to set forth the common sense and widely held understanding that price gouging statutes apply only when prices go up. If a defendant can point to the state taking that position, the defendant may be able to make a persuasive equitable argument that it would be unfair or unconscionable for the state to change its public position to the detriment of businesses operating in good faith.

Ripeness

Ripeness refers to whether it is an appropriate time for a court to adjudicate the alleged claim. Under Article III of the constitution, federal courts can only decide actual cases and controversies. Cases brought too early, such as by a plaintiff that has not yet suffered injury, may not yet be "ripe" because there is not yet a case or controversy for the courts to adjudicate.

Many state price gouging statutes include provisions requiring the court to consider whether changes in price were reasonable based on changes in input costs during the emergency, or through comparisons with average prices before, during, or after the emergency. In addition, statutes without express conditions that require the collection of adjacent or average pricing data may implicitly require that data as part of an analysis of whether prices or profits were excessive or unreasonable.

Price gouging allegations leveled during an extended emergency, such as the ongoing Covid-19 pandemic, will not always have this data, either because collection of the data remains ongoing, or is impossible to determine at the time the allegation is brought. For instance, the Idaho price gouging statute expressly requires a comparison between prices before and after the emergency period, thus rendering collection of the requisite data potentially impossible prior to the conclusion of the emergency. ID ST § 48-603(19).

Likewise, analyses of product markup or margin requires data on input costs that may not yet exist. To support a potential ripeness challenge, defendants should carefully examine the types of data the relevant price gouging statute requires, and assess whether any data is incomplete. Such informational holes are ripe for ripeness challenges.

The Dormant Commerce Clause

Finally, depending on the specific state statute and the conduct at issue, a defendant should consider whether an enforcement action violates the principles of the Dormant Commerce Clause. The clause gives Congress the power to regulate interstate commerce, and courts have also interpreted that federal power to imply a correlated restraint on state authority.

Courts have identified different categories of state regulation that violate the Dormant Commence Clause. First, a state law that facially discriminates against interstate commerce is invalid and can survive only if the discrimination is justified by a valid state interest other than protectionism. See *Wyoming v. Oklahoma*, 502 U.S. 437, 454–55 (1992). Second, a statute is also invalid if it has the practical effect of "extraterritorial" control of commerce occurring entirely outside the boundaries of the state. See *Healy v. The Beer Inst.*, 491 U.S. 324, 336 (1989).

Third, even if the statute does not discriminate against interstate commerce, it may be struck down under a balancing test if it imposes a burden on interstate commerce incommensurate with the local benefits it provides. See *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970).

The Fourth Circuit's decision in *Association for Accessible Medicines v. Frosh* provides useful guidance. 887 F.3d 664 (4th Cir. 2018). The Maryland statute at issue prohibited price gouging in the sale of certain drugs regardless of any state of emergency, and the state argued that the law applied to wholesale transactions outside of Maryland's borders as long as the drug was eventually sold to Maryland consumers.

A pharmaceutical group challenged the law, arguing that no drug wholesalers were based in Maryland and therefore the majority of transactions between drug makers and wholesale distributors took place outside of the state. The Fourth Circuit agreed and held that the statute violated the Dormant Commerce Clause because it "is not triggered by any conduct that takes place within Maryland," "controls the prices of transactions that occur outside the state," and "would impose a significant burden on interstate commerce involving prescription drugs" if enacted by other states.

Defendants in any price gouging action, particularly where prices have actually declined, should carefully examine the role of interstate commerce in their market to determine if enforcement violates the principles of the Dormant Commerce Clause.

Conclusion

As the Covid-19 pandemic continues, companies will face an ongoing risk of criminal prosecution or civil enforcement based on allegations of price gouging, including in instances where prices have in fact fallen during the relevant period. When these allegations arrive, a vigorous defense by counsel experienced in price gouging investigations is essential to mitigate potential civil or criminal exposure.