"STATE SALES BELOW COST LAWS: EVERYTHING YOU WANTED TO KNOW ABOUT NAVIGATING A WORLD WITHOUT *BROOKE GROUP*"

(Summary of Teleseminar Sponsored by the BTCR Committee)

by David Brenneman

On January 28, 2010, the American Bar Association Section of Antitrust Law Business Torts & Civil RICO Committee & the Pricing Conduct Committee presented State Sales Below Cost Laws: Everything You Wanted to Know About Navigating a World Without Brooke Group. The presentation was led by panelists Harvey Saferstein of Mintz, Levin, Cohn, Ferris, Glovsky & Popeo, P.C., Los Angeles, CA and James Donahue, Office of the Pennsylvania Attorney General, NAAG Multistate Antitrust Task Force, Morristown, New Jersey and moderated by Amanda Reeves, Attorney Advisor to Commissioner J. Thomas Rosch, FTC. The panelists discussed state sales "below-cost" laws which prohibit companies from selling goods at below cost.

I. History and Purpose of Sales Below Cost Statutes

Many states enacted sales below cost statutes in the late 1930's for the purpose of eliminating cut throat competition, and in particular, loss leader pricing. Loss leader pricing refers to the practice of selling one product below cost to attract customers into a store where customers would then purchase other products at above cost. Many state legislatures considered such practices deceptive and believed that those practices would mislead customers into erroneously believing that a store discounts all of its products.

Accordingly, states passed laws which explicitly prohibited the practice of selling below cost. However, soon thereafter state courts struck down some of these statutes for being vague and in violation of state constitutions and the 14th Amendment, and found that they unreasonably interfered with persons business and did not actually protect competition. For example, in 1940 the Supreme Court of Pennsylvania struck down Pennsylvania's Fair Sales Act, which prohibited any sale made below cost, just three years after the Act's passage. *Commonwealth v. Zasloff*, 338 Pa. 457 (Pa. 1940). The court found that "[p]rice cutting in itself is not an evil; on the contrary, the more intense the competition the greater the likely advantage to the purchasing public." *Id.* at 462.

Currently, about half of all states have state cost cutting laws that prohibit selling products below cost. According to the panelists, state attorney generals usually only investigate and seek action against companies that sell below cost *and* whose actions are anticompetitive.

II. Problems with State Sales Below Cost Laws

Although the laws of the 50 states vary widely, the panel discussed representative issues that typically come up in conjunction with state sales below cost laws.

A. Fixed Minimum Markups

Because cost can be difficult to determine, statutes often have certain mark up thresholds (e.g., a 6% mark up); if a company makes a sale below that mark up, the company is presumed to sell below cost. The panelists noted that many of these "mark up" thresholds, which were drafted decades ago, are now outdated; e.g., where retailers may have had to mark up prices by 10% to stay above cost fifty years ago, today those same retailers may need to markup a product by only 5%. Many criticize these thresholds for penalizing companies that incorporate modern innovation or distribution channels allowing them to sell goods cheaply.

Further, some courts have repealed such statutes altogether. Most recently, Wisconsin's "Minimum Markup Law" was found unconstitutional by the U.S. District Court for the Eastern District of Wisconsin, which prohibited the sale of gasoline under a 9.18% mark up. *Flying J., Inc. v. Van Hollen*, 597 F.Supp.2d 848 (E.D. Wis. 2009).

B. Bundling

As the panelists discussed, another difficulty in calculating cost occurs when a company bundles products, offers cus-

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tomer-loyalty rewards, or gives out free samples. For instance, in *Parrish Oil Co. v. Dillon Companies*, 523 F.3d 1244 (10th Cir. 2008), a grocery store started a loyalty rewards program whereby the store offered a discount on gasoline for customers who purchased $50 or more on groceries. In the aggregate, the store made a profit on such transactions, although it was unclear whether it sold gasoline at a loss. Initially, the jury awarded the rival gas-station plaintiffs $200,000. The Tenth Circuit reversed, and held that when "sales of more than one item are bundled, whether in a single transaction or in the form of coupons or other concessions, compliance with the statute is determined by comparing the selling price to the cost of all items." *Id.* at 1249. The court noted that this type of bundling relationship is analogous to offering a free milk shake with the purchase of a hamburger and french fries: as long as the transaction in its entirety is above cost, it would not violate the Colorado statute. *Id.*

III. California Unfair Practices Act: An Illustration of How State Sales Below Cost Laws Function

To provide an illustration of the types of issues that one might encounters with state sales below laws, Panelist Harvey Saferstein discussed the California Unfair Practices Act ("UPA") in some detail. That statute states: "It is unlawful for any person engaged in business within this State to sell or use any article or product as a 'loss leader.'" CAL BCP CODE §17044. A "loss leader" is defined as "any article or product sold at less than cost: (a) Where the purpose is to induce, promote or encourage the purchase of other merchandise; or (b) Where the effect is a tendency or capacity to mislead or deceive purchasers or prospective purchasers; or (c) Where the effect is to divert trade from or otherwise injure competitors." §17030.

The California Supreme Court has required the plaintiff to prove the defendant acted with the purpose of harming competition. *Cel-Tech Commc's v. Los Angeles Cellular Tel. Co.*, 973 P.2d 527 (Cal. 1999). The panelists noted that proving "purpose" can be challenging for plaintiffs, likely must rely on defendants' emails and/or depositions to acquire evidence of purpose. Despite this barrier, successful suits are occasionally filed and can impose substantial penalties. As proof that the below cost provisions of the California Unfair Practices Act are not a dead letter, Mr. Saferstein called attention to in *Bay Guardian Co. Inc. v. New Times Media LLC et. al.*, CA No. CGC-04-435584 (Cal Super. Ct., San Francisco). In the *Bay Guardian* litigation, a small local newspaper successfully sued the San Francisco Weekly for pricing their ads below cost in an attempt to drive out competition. A jury rewarded Bay Guardian with a $16 million verdict.

IV. Interaction with Federal Law

The panel concluded by briefly discussing issues involving the interplay between state sales below cost laws and federal law. As a matter of federal law, sales below cost are governed by the *Brooke Group* decision, where the Supreme Court held that a plaintiff must prove (i) goods were sold below cost and (ii) a reasonable probability of recovering cost. *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993). Courts have found that state sales below cost laws are not preempted by federal law.

The panel also discussed how state below cost laws interacts with the Supreme Court's holding in *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007). Because it can be difficult for plaintiffs to determine what the defendant's cost is, it is extremely difficult for plaintiffs to sue under a state below-cost statute in a federal court. Accordingly, plaintiffs that file below-cost claims attached to other federal claims must have some real knowledge of how the defendant prices its products.