General Counsel Corner

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Two Out of Three Ain't Bad

Two federal appeals courts and one state supreme court recently released opinions regarding state predatory pricing statutes. The score was competing dealers 2, below-cost seller 1. Two out of three ain't bad, unless you're from Missouri.

Probably most significant is the 2-to-1 decision against Sam's Club in *Star Fuel Marts, LLC v. Sam's East, Inc.*, which was released by the Circuit Court for the Tenth Circuit in March 2004.

A competing dealer complained that three Oklahoma City Sam's Clubs had persistently sold gasoline to club members as a loss leader. The federal district court agreed and entered a preliminary injunction prohibiting the practice pending a full trial on the merits. Sam's Club appealed the ruling.

Affirming, the federal appeals court rejected a string of arguments raised by Sam's Club, including its attempt to exempt itself from the Oklahoma Unfair Sales Act by reason of its status as a "private" club, and its protestation that its pricing policies had neither substantially lessened competition nor tended to deceive purchasers or prospective purchasers.

Perhaps the most significant aspect of the majority's opinion is its criticism of the dissent.

The dissenting judge attempted to superimpose on the Oklahoma statute a requirement that the complaining dealer show an actual injury to competition throughout the marketplace.

A similar requirement has rendered federal antitrust law virtually valueless to dealers complaining about predatory pricing because they must satisfy the Herculean tasks of defining relevant geographic and product markets, showing a measurable effect on competition in those markets and demonstrating that any short-term drop in prices will ultimately lead to the imposition of high, monopolistic prices. In sum, good luck.

Finding that the Oklahoma legislature had not intended to freight the Oklahoma statute with the same requirement that has so limited enforcement of federal antitrust law, the majority stressed that the statute "was enacted to ensure the viability of individual small merchants who cannot afford to sell below cost."

Rejecting the minority's approach, the court continued:

> Imposing a requirement that a plaintiff establish that a below-cost seller will actually be able to recoup its loss by exercising its monopoly power and

> charging higher than competitive prices for a sustained period … would defeat the purposes of the [Oklahoma statute]. Small competitors are not required to go out of business (with their market share going to the below-cost seller) before the [statute] can be enforced.

The second federal opinion -- another win for a competing dealer -- is *R.L. Jordan Oil Co. v. Boardman Petroleum, Inc.*, which was decided by the Fourth Circuit Court of Appeals.

Before the appeals court was the district court's decision striking down the below-cost sales provision of South Carolina's Unfair Trade Practices Act as being violative of the due process guarantee contained within the South Carolina Constitution.

South Carolina's law is typical of many such statutes. It provides:

> Except as otherwise permitted to meet competition …, it is declared an unfair trade practice and unlawful for any person who is in the retail business of selling motor fuel to sell motor fuel of like grade and quality at retail at a price which is below the cost of acquiring the product plus taxes and transportation where the intent or effect is to destroy or substantially lessen competition or to injure a competitor.

In ruling against the price cutter's competitor, the trial court had determined, somewhat contradictorily, that (1) the competing dealer had failed to make out a case under the statute because it had not demonstrated a market-wide adverse effect on competition, and (2) the statute was unconstitutional because violation could be found based only on injury to a single competitor, without showing a market-wide adverse effect on competition.

Ruling unanimously, the appeals court reversed on both issues. First, it held that the district court's attempt to impose a requirement that the complaining dealer demonstrate a market-wide anticompetitive effect "was an error under the plain language of the statute."

The South Carolina statute, the appeals court emphasized, expressly prohibited below-cost pricing the intent or effect of which was merely "to injure a competitor." The lower court had erred by imposing a broader standard.

Next, the appeals court addressed the trial court's finding that the statute violated the South Carolina Constitution.

Rejecting that conclusion, the appeals court emphasized that the statute could be upheld as a measure to promote legitimate state interests, other than prohibiting predatory pricing aimed at injuring competition, such as "the prevention of 'loss leader' selling or the promotion of stability in the market for gasoline prices."

The appeals court also concluded that, even if the only justification for the statute could be the prevention of predatory pricing, the legislature could reasonably have chosen "to accept the plaintiff's own injury as a proxy for such anticompetitive effect" throughout the market.

In sum, the statute was held to be constitutional because it bore a reasonable relationship to a legitimate government interest.

On the other side of the ledger is the March 2004 4-to-3 opinion of the Supreme Court of Missouri in *State v. QuikTrip Corp.*, which interpreted the predatory pricing provision contained within that state's Motor Fuel Marketing Act.

The state attorney general had sued QuikTrip for repeatedly selling petroleum products below cost. Under the state act, such below-cost selling was illegal if its "intent or affect" was "to injure competition" or "to induce the purchase of other merchandise, to unfairly divert trade from a competitor, or otherwise injure a competitor."

The majority held this meant that the law would only be violated when a competitor "is in effect forced to operate its over-all business at a loss." The mere loss of business through unfair competition, the majority said, would not suffice.

A strong dissent faulted the majority's opinion as a judicial rewriting of the statute. The dissent criticized the majority's interpretation as --

> based not on the plain meaning of the word "injure" but the majority's own policy determination that if "injuring" were broadly interpreted, the statute could "greatly diminish or eliminate the competition in the sale of motor fuel and, thus, create a state-enforced cartel of motor fuel sellers." If we are to consider policy, however, the real policy behind the act … is to prevent predatory pricing, which otherwise would drive competitors from the market and allow the formation of monopolies, which results in higher prices in the long run. Conversely, the majority policy analysis would encourage price wars among competitors, which only result in lower prices in the short run.

Unlike the two federal court opinions, the narrow majority opinion in *QuikTrip* either refused to see or didn't want to see that imposing an overly stringent standard frustrates a core purpose of below-cost selling statutes, which is eliminating predatory pricing in its incipiency, *before* competing businesses are decimated.

Fortunately, the majority opinion in *QuikTrip* itself represents a distinctly minority position, as is shown by the opinions in *State Fuel Marts* and *R.L. Jordan*.

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