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Price-Gouging Or Normal Market Functioning Amid COVID-19?

By **Mary Beth Savio and Timothy Snail** (April 20, 2020, 6:31 PM EDT)


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The progression of COVID-19 into a global pandemic and measures taken to flatten the curve have resulted in severe economic disruptions.

Demand has skyrocketed for personal protective equipment (e.g., masks and gloves), hand sanitizer, certain health care products (e.g., respirators and test supplies), and essentials for day-to-day living (e.g., toilet paper and cleaning supplies).

Demand has further increased due to hoarding of some of these products. At the same time, illness-winnowed workforces and measures to prevent the spread of COVID-19 have slowed or halted many manufacturing, sales and distribution activities, creating a patchwork of global supply chains that limits the availability of many products.

While it is not surprising that prices rise for products whose demand outstrips supply, COVID-19 has been accompanied by government investigations and litigation alleging manipulation of prices referred to as price-gouging. What do economics, prior litigation and agency guidance tell us about the kinds of issues these price-gouging cases will need to consider?

Price-Gouging Investigations and Litigation Involving COVID-19

In the span of eight weeks, numerous price-gouging complaints and investigations have been filed.[1] For example, Florida's attorney general has issued subpoenas to 43 third-party sellers in the state that have been accused of price-gouging of essential goods on Amazon.com during the coronavirus pandemic.[2]

Missouri's attorney general has also issued subpoenas to third-party sellers on Amazon.com suspected of price-gouging, seeking sales history and pricing of face masks, respirator masks and hand sanitizer.[3]

The Texas Attorney General's Office filed a lawsuit against an auction business for offering for sale face masks, hand sanitizer and cleaning supplies at exorbitant or excessive prices after the state declared a disaster, in violation of the Texas Deceptive Trade Practices Act.[4] Amazon.com Inc., Wal-Mart Stores Inc., eBay Inc. and Etsy Inc. are among the online marketplaces that are making efforts to identify suppliers who may have engaged in price-gouging or making unverified claims during the COVID-19 pandemic.[5]

While there is no federal law against price-gouging, in most states price-gouging is a violation of unfair or deceptive trade practices law.[6] Many of these laws allow private actions on behalf of consumers (e.g., class actions), and some states have prohibited price-gouging through executive orders.[7] Most of these state laws provide for civil penalties as enforced by the state attorney general, some allow for restitution or injunctions, and some also enforce criminal penalties for price-gouging violations.

State price-gouging laws apply during emergencies (e.g., natural disasters and declared states of emergency). However, these laws have widely differing definitions of price-gouging along several dimensions: the pre-emergency comparison period (e.g., 30 days, 60 days, or immediately prior to the emergency), applicable types of products (e.g., gasoline, food, medicine, all retail products), comparison products (e.g., the same or similar products), the trade area (e.g., areas in which the state of emergency is declared, cities, the entire state and areas including adjoining states), and the magnitude of a price change that is considered to be excessive.

Many of the laws focus on prices during the emergency that are at least a specified percentage greater than preemergency prices (e.g., 10% or 25%),[8] while others apply to unconscionable price increases.[9] Some laws make allowances for price increases if the party is passing along increased costs.[10]

Economics of Elevated Pricing During Emergencies

To the extent that price-gouging laws consider the source of price increases, the issues at play are particularly amenable to economic analysis. What can economics tell us about the genesis and impact of price spikes?

In emergency situations, surges in demand and reductions in supply are common. In these situations, prices play an important role. Higher prices identify the areas of greatest need and help ensure that scarce resources go to consumers who value them the most. Higher prices also attract entrants who provide new sources of supply and create an incentive for individuals and companies to keep an inventory of critical products in anticipation of an emergency, both of which can mitigate the magnitude of price spikes.

It has often been observed that price restrictions have the opposite effect: under laws that limit companies' ability to increase price, pinpointing the areas of greatest need can be difficult, goods are sold to consumers on a first-come, first-served basis (often requiring time spent in a queue), potential entrants have less incentive to ship in supplies from unaffected regions or shift productive resources to the goods in highest demand, and consumers and companies have less incentive to maintain an emergency stockpile.

Economists have often made these points by way of highlighting the implicit trade-off that is made when states impose price restrictions during times of emergency.[11]

One area of intersection between price-gouging laws and economic analysis is the recognition by some state laws that price increases in times of emergency can be driven by increases in cost. Thus, it is essential to understand the economic factors that cause costs — and thus prices — to rise. Such factors may include:

Supply Chain Interruptions

Natural disasters and other emergencies can knock out key resources and reduce the pool of available labor, causing the cost of production to spike even at typical levels of demand. For example, Hurricanes Katrina and Rita resulted in the loss of refinery capacity and disruptions of major pipelines, which contributed to a nationwide spike in gasoline prices in 2005.[12]

Similarly, FedEx Corp.'s form 8-K filed on April 3 describes disruption to manufacturing operations and global supply chains caused by the COVID-19 pandemic and notes that reductions in the number of passenger flights — the lower decks of which are often used to transport cargo — have reduced available airfreight capacity.[13]

At maritime ports, the COVID-19 pandemic has caused supply chain disruptions that reduce the movement of goods. Cargo is accumulating as some retailers and manufacturers cannot pick it up because of full warehouses or closures; this limits ports' abilities to handle additional incoming cargo. Some ports have stayed open with reduced workforces, limitations which exacerbate the cargo congestion.[14]

Increased Search Costs

When conventional supply chains are disrupted or there are shortages during emergencies, companies may incur additional costs in efforts to arrange new supply channels. These new supply arrangements may also involve new pricing terms — for example, spot-market pricing instead of prior-contract pricing.[15] Prior contracts' terms for prices and quantities of goods might be deemed inapplicable in the event that a supplier invokes a force majeure clause or otherwise is able to pass additional costs up the supply chain.[16]

Arranging new supply channels and negotiating prices will likely involve additional costs. For example, during the COVID-19 pandemic, companies, cities, states and the federal government have been bidding against each other to secure limited supplies of personal protective equipment and respirators;[17] unsuccessful bidders incur additional costs to repeat the search process.

Capacity Constraints Due to a Surge in Demand

A state of emergency can cause a surge in demand for certain goods, such as the recent runs on consumer items including cleaning supplies, hand sanitizer, face masks and toilet paper. Anticipatory buying — such as hoarding — can further increase demand for products.

The surges in demand can also occur for specific types of retailers; for example, shelter-in-place measures have led to increased patronage of online retailers that offer home delivery. A sudden shift in demand toward particular goods or merchants can strain the existing capacity of a retailer or their suppliers, causing them to incur additional costs in order to meet the surge in demand.

For example, Amazon recently announced an increase in overtime pay for warehouse workers from 1.5 times to 2 times normal wages, and an increase in wages for hourly associates from $15 to $17 per hour, due to an increase in online orders during the COVID-19 pandemic.[18] Some grocery stores have reduced hours of operation, increased stocking activities and taken additional measures to prevent the spread of COVID-19 — such as increased sanitization efforts, regulating the flow of customers into stores, and implementing new rules and signage — which may result in increased costs.

Elevated Costs Incurred by New Suppliers

Demand and supply shocks can attract entry by companies offering a new source of supply. Examples of such entry range from individuals who truck in everyday necessities in the wake of a hurricane, to established companies that shift their productive capacity away from their current offerings to new, urgently needed products. New entrants may incur higher costs than an established company, due to a learning curve, a lack of volume discounts from suppliers and other factors.[19]

It is important to note that in times of emergency, some companies in an industry might pass elevated costs on to their customers in the form of higher prices, while other companies in the industry might not. A difference in pricing across companies in an industry is not dispositive evidence of a lack of cost increases. Companies in the latter case may choose to absorb cost increases as an investment in their long-term relationship with their customers.

As one example, in the wake of Hurricanes Andrew and Katrina, The Home Depot Inc. froze prices on building supplies like roof tiles, lumber and plywood despite increases in wholesale costs, choosing to sell items at a loss as a gesture of goodwill.[20] Companies that choose to absorb supplier cost increases may ration their offerings to mitigate their profit loss.[21]

Lessons From Prior Investigations and Litigation Involving Price-Gouging During Emergencies

It is still too soon to know how COVID-19-related price-gouging investigations and litigation will unfold, but we can gain insights from economic analyses in prior matters involving price-gouging during emergencies. One of the most-studied emergencies that also involved severe economic disruptions akin to those arising during the COVID-19 pandemic was a pair of natural disasters: Hurricane Katrina and Hurricane Rita. How did authorities try to understand price changes amid widespread reports of price-gouging?

In 2005, Hurricanes Katrina and Rita hit major portions of the Gulf Coast region. In their aftermath, the price of gasoline spiked in particular regions and at some individual gasoline stations, leading to allegations of price-gouging. Congress directed the Federal Trade Commission to investigate whether these developments resulted from market manipulation or price-gouging practices in the sale of gasoline[22] under Section 632 of the FTC's appropriations legislation for fiscal year 2006.[23]

The FTC determined that Hurricanes Katrina and Rita substantially reduced crude oil production and refining capacity, and the post-hurricane price increases were commensurate with what would be predicted by standard supply and demand models for a perfectly competitive market. In its analysis of potential gasoline price-gouging under Section 632, the FTC examined price, cost and profit margin data for large sellers of petroleum products (refiners and wholesalers) and for retailers that were targets of state price-gouging enforcement actions after Katrina.

The FTC found among other things that price-gouging by individual retailers occurred only to a limited extent; in all but one case, local or regional market trends explained the price increases. The FTC found that individual retailers maintained the highest prices for very short periods and that some retailers explained that they were responding to station-level supply shortages and to imprecise and changing perceptions of market conditions.[24]

Among the lawsuits filed in the wake of Hurricanes Katrina and Rita was one in U.S. District Court for the District of Massachusetts alleging price-gouging by four gasoline stations on the island of Martha's Vineyard. The Massachusetts regulatory law prohibited selling gasoline at unconscionably high prices during market emergencies.[25] The district court ruled for the gas stations on summary judgment, after which the decision was appealed to the U.S. Court of Appeals for the First Circuit.[26]

The First Circuit determined that while the defendants' average weekly prices were increasing during the relevant time period, their gross margins were generally rising only very moderately since their costs were also increasing. The stations' margins were volatile because different stations increased prices and experienced higher wholesale costs at different times.

The court found that there was no gross disparity in either the price increases or gross margin increases. The defendants' margins peaked after their retail prices began to decline. The court ruled that unless the resulting prices are unconscionably high, the price-gouging rule does not prohibit retailers from raising their prices in reasonable anticipation of future increases in costs, and that "nothing 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."[27]

The First Circuit ruled that the high pump prices at the Martha's Vineyard gas stations arose from permissible conscious parallel pricing rather than illegal price-fixing or price-gouging.[28]

Does Price-Gouging Intersect With Antitrust?

On March 17, members of Congress sent a letter to the chairman of the Federal Trade Commission, urging the commission to protect consumers from price-gouging during the COVID-19 pandemic.[29] On March 24, the U.S. Department of Justice Antitrust Division and the Federal Trade Commission issued a joint statement regarding competitor collaborations during the COVID-19 pandemic,[30] activities that might otherwise raise antitrust issues.

This might lead one to wonder whether there is a relationship between price-gouging and anti-competitive conduct. There are some key differences. One is the types of situations in which they arise. In antitrust, a defendant is typically alleged to have taken action to restrict marketplace supply, through unilateral exclusionary actions, collusion with rivals or an anti-competitive merger. An increase in price results from the intentional behavior of the defendant(s) to undermine the competitive process.

In contrast, price-gouging claims often allege that a disaster caused a shortfall in supply and/or a surge in demand to which the defendant(s) then responded. In other words, a price-gouging claim is often brought in a situation where the defendant(s) have not caused the change in economic incentives; instead, they are responding to a change in incentives created by an exogenous factor like a hurricane or an epidemic. Another key difference is that, under federal antitrust law a company is generally free to set prices as it sees fit as long as it does so independently of its rivals;[31] this may not be the case under price-gouging laws.

Nonetheless, economic tools used to study antitrust issues may shed light on whether elevated pricing during emergencies constitutes price-gouging activity. For example, a commonly-used method of assessing price-fixing claims is to compare the price increase at issue to two different benchmarks. First, the company's price during the period of collusion is compared to its price before the alleged collusion occurred. Second, the increase in the company's price during the period of alleged collusion is compared to a comparable company's change in price (if any) during that period.[32]

This so-called difference-in-differences approach exploits both cross-sectional and time-series variation in the data as a source of econometric identification. Further, the difference-in-differences approach has the advantage of controlling not only for observable variables included in the regression, but also for unobservable changes to the extent that they impact both the affected and control groups in the same manner.[33] A similar method of analysis could also be used to analyze claims of price-gouging, particularly in states that use prior or peer prices as a comparative benchmark.

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[1] The COVID-19 pandemic has already given rise to numerous types of class action litigation, including suits alleging price gouging, false advertising, deceptive business practices, foreclosures and bankruptcies, adverse employer actions, securities fraud, failure to refund booking or service fees, and other claims. See https://www.lexology.com/library/detail.aspx?g=fcd73b00-1259-41b5-ae7c-c3c01053ab29.

[2] https://www.law360.com/articles/1256694/fla-ag-targets-43-vendors-for-amazon-price-gouging-claims.

[3] https://ago.mo.gov/home/news/2020/03/30/ag-schmitt-issues-civil-investigative-demands-to-eight-third-party-amazon-sellers.

[4] State of Texas v. Auctions Unlimited LLC, in the District Court of Harris County, Plaintiff's Original Petition and Application for Temporary and Permanent Injunctions, March 26, 2020.

[5] Annie Palmer, "Amazon, Walmart and others battle price gouging on coronavirus-related products," CNBC, March 3, 2020, https://www.cnbc.com/2020/03/03/amazon-walmart-e-retailers-battle-price-gouging-on-coronavirus-products.html. See also Josh Rivera, "Amazon removes more than 3,900 seller accounts from US store due to 'coronavirus-based price gouging," USA Today, March 23, 2019, https://www.usatoday.com/story/money/2020/03/23/coronavirus-amazon-price-gouging-removed-accounts/2904729001/.

[6] Heather Morton, "Price Gouging State Statutes," National Conference of State Legislatures, March 30, 2020, https://www.ncsl.org/research/financial-services-and-commerce/price-gouging-state-statutes.aspx. On March 23, 2020, the President signed an executive order giving the Health and Human Services Secretary the authority to designate certain materials as critical; those found to be hoarding or price gouging such materials could face criminal action.
See https://thehill.com/homenews/administration/489125-trump-signs-executive-order-to-prevent-price-gouging-of-medical.

[7] Levine, Jan P., et al., "Rarely Invoked Price-Gouging Statutes Are Now Front and Center Due to COVID-19," Pepper Hamilton Client Alert, April 3,

2020, https://www.pepperlaw.com/publications/rarely-invoked-price-gouging-statutes-are-now-front-and-center-due-to-covid-19-2020-04-03/.

[8] Ibid. See also https://www.law360.com/articles/1076395/cloudy-with-a-chance-of-price-gouging; https://www.law360.com/articles/1252142?scroll=1&related=1.

[9] Anthony Argiropoulos and Sheila A. Woolson, "Coronavirus Emergency Declarations Trigger Anti-Pricing Gouging Laws," National Law Review, March 13, 2020, https://www.natlawreview.com/article/coronavirus-emergency-declarations-trigger-anti-pricing-gouging-laws.

[10] Ibid; Anthony Argiropoulos & Sheila A. Woolson, "Anti-Price Gouging Laws Triggered by Coronavirus Emergency Declarations," March 13, 2020, https://www.healthlawadvisor.com/2020/03/13/anti-price-gouging-laws-triggered-by-coronavirus-emergency-declarations/.

[11] See for example "FTC Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases," presented by Deborah Platt Majoras, Chairman, Before the Committee of Commerce, Science and Transportation, U.S. Senate, May 23, 2006; "Planning Disaster: Price Gouging Statues and the Shortages They Create," Brooklyn Law Review, Vol. 73, Issue 3, 2007; Steven Suranovic, "Surge Pricing and Price Gouging: Public Misunderstanding as a Market Imperfection," Institute for International Economic Policy Working Paper Series, Elliot School of International Affairs, The George Washington University.

[12] "FTC Issues New Report on Gasoline Prices and the Petroleum Industry," Federal Trade Commission, September 1, 2011, https://www.ftc.gov/news-events/press-releases/2011/09/ftc-issues-new-report-gasoline-prices-and-petroleum-industry.

[13] FedEx Corporation, Form 8-K, April 3, 2020, p. 1.

[14] Philip Teoh, "The Impact of the Covid-19 Pandemic on Shipping," The Maritime Executive, April 7, 2020, https://www.maritime-executive.com/editorials/the-impact-of-the-covid-19-pandemic-on-shipping.

[15] Lydia DePillis and Lisa Song, "In Desperation, New York State Pays Up to 15 Times the Normal Prices for Medical Equipment," ProPublica, April 2, 2002.

[16] Kirsty Adams, "Supply chain crisis management during Covid 19," SHD Logistics, March 18, 2020, https://www.shdlogistics.com/people/supply-chain-crisis-management-during-covid-19.

[17] Action News, "Action News Investigation: PPE procurement is ongoing struggle amid COVID-19 outbreak," https://www.msn.com/en-us/news/us/action-news-investigation-ppe-procurement-is-ongoing-struggle-amid-covid-19-outbreak/ar-BB125ZqJ.

[18] Justine Coleman, "Amazon Doubling Overtime Pay for Warehouse Workers," The Hill, March 22, 2020.

[19] For example, one company that tried to retool its factory to make face masks initially produced 10,000 masks per day, after which it ramped up to 200,000 masks per day. Companies that have shifted their productive resources to manufacture face masks have also found that they would need to acquire

costly equipment that uses materials in short supply globally; see Emily Feng and Amy Cheng, "COVID-19 Has Caused A Shortage Of Face Masks. But They're Surprisingly Hard To Make," NPR, March 16, 2020, https://www.npr.org/sections/goatsandsoda/2020/03/16/814929294/covid-19-has-caused-a-shortage-of-face-masks-but-theyre-surprisingly-hard-to-mak.

[20] Patricia Sellers and Andrew Erdman, "Companies That Serve You Best," Fortune, May 31, 1993; Justin Gillis and Michael Barbaro, "Retail Sales Skyrocket as Storm Survivors Rebuild," Sentinel Source, September 10, 2005; Gabriel Sandoval, "NYC Store Owners Say Suppliers Fuel Disinfectant Price Gouging," March 18, 2020, The City, https://thecity.nyc/2020/03/nyc-suppliers-price-gouging-on-coronavirus-cleaners.html.

[21] Alberto Cavallo, Eduardo Cavallo, and Robert Rigobon, "Prices and Supply Disruptions During Natural Disasters," NBER Working Paper 19474, http://www.nber.org/papers/w19474.

[22] https://www.law360.com/articles/33937/demand-not-gouging-caused-gas-price-hike-ftc; https://www.law360.com/articles/33937/attachments/0 ("FTC Report").

[23] Science, State, Justice, Commerce, and Related Agencies Appropriations Act, 2006, Pub. L. No. 109-108 ' 632, 119 Stat. 2290 (2005) ("Section 632"). In Section 632, Congress directed the FTC to treat as evidence of price gouging any finding that "the average price of gasoline available for sale to the public in September, 2005, or thereafter…exceeded the average price of such gasoline in that area for the month of August, 2005, unless the Commission finds substantial evidence that the increase is substantially attributable to additional costs in connection with the production, transportation, delivery, and sale of gasoline in that area or to national or international market trends." Accordingly, the FTC analyzed whether specific post-Katrina price increases were attributable either to increased costs or to national or international trends. See https://www.law360.com/articles/33937/attachments/0. See also "FTC Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases," presented by Deborah Platt Majoras, Chairman, Before the Committee of Commerce, Science and Transportation, U.S. Senate, May 23, 2006.

[24] FTC, Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases, Spring 2006. See also https://www.law360.com/articles/6663/ftc-report-no-evidence-of-gas-price-gouging; "FTC Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases," presented by Deborah Platt Majoras, Chairman, Before the Committee of Commerce, Science and Transportation, U.S. Senate, May 23, 2006.

[25] Mass. Gen. Laws Ch. 93A § (2)(a), (c); 940 Mass. Code Regs. 3.18. The rule defines a price as "unconscionably" high if it represents a "gross disparity" between the price of the same petroleum product "immediately prior" to the market emergency, or the price at which the same or similar petroleum product is readily obtainable by other buyers in the trade area, and the disparity is not substantially attributable to increased prices charged by the petroleum-related business suppliers or increased costs due to an abnormal market disruption.

[26] William White et al. v. R.M. Packer Co. Inc., case number 10-1130, in the U.S. Court of Appeals for the First Circuit, Decision on Appeal from the U.S. District Court for the District of Massachusetts, February 18, 2011.

[27] https://www.law360.com/articles/227183/attachments/0.

[28] https://www.law360.com/articles/227183/.

[29] Letter to the Honorable Joseph J. Simmons, Chairman, Federal Trade Commission, from Jerrod Nadler, Chairman, Committee on the Judiciary, House of Representatives, et al., March 17, 2020, https://energycommerce.house.gov/sites/democrats.energycommerce.house.gov/files/documents/FTC.2020.3.17.%20Joint%20Letter%20re%20Price-Gouging.CPC__0.pdf.

[30] Department of Justice and Federal Trade Commission, Joint Antitrust Statement Regarding COVID-19, March 2020, https://www.ftc.gov/system/files/documents/public_statements/1569593/statement_on_coronavirus_ftc-doj-3-24-20.pdf.

[31] "The US DOJ and FTC Issue a Joint Statement to Outline That They Are Monitoring Markets Behaviour During the Global Health and Economic Crisis Caused by the COVID-10 Outbreak," Concurrences, March 24, 2020, https://www.concurrences.com/en/bulletin/news-issues/preview/the-us-doj-and-ftc-issue-a-joint-statement-to-outline-that-they-are-monitoring.

[32] See Timothy S. Snail, "Estimating Damages in Collusion Cases," in Antitrust Economics for Lawyers, LexisNexis, 2019 ed.

[33] This approach assumes that the control group (another market, time period, or combination of both) is, except for the collusion, similar to the affected market/period. In particular, the control group should be comparable in terms of competitive structure, cost and demand characteristics to the collusive market/period — the outcome should reflect the outcome in the collusive market/period in the counterfactual scenario. Departures from comparability of these two groups could be a focus of critical examination of the expert's damages methodology.