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State Sales-Below-Cost Laws:
A Legal-Economic Analysis of Effectiveness

by
Thomas W. Paterson and Willard F. Mueller

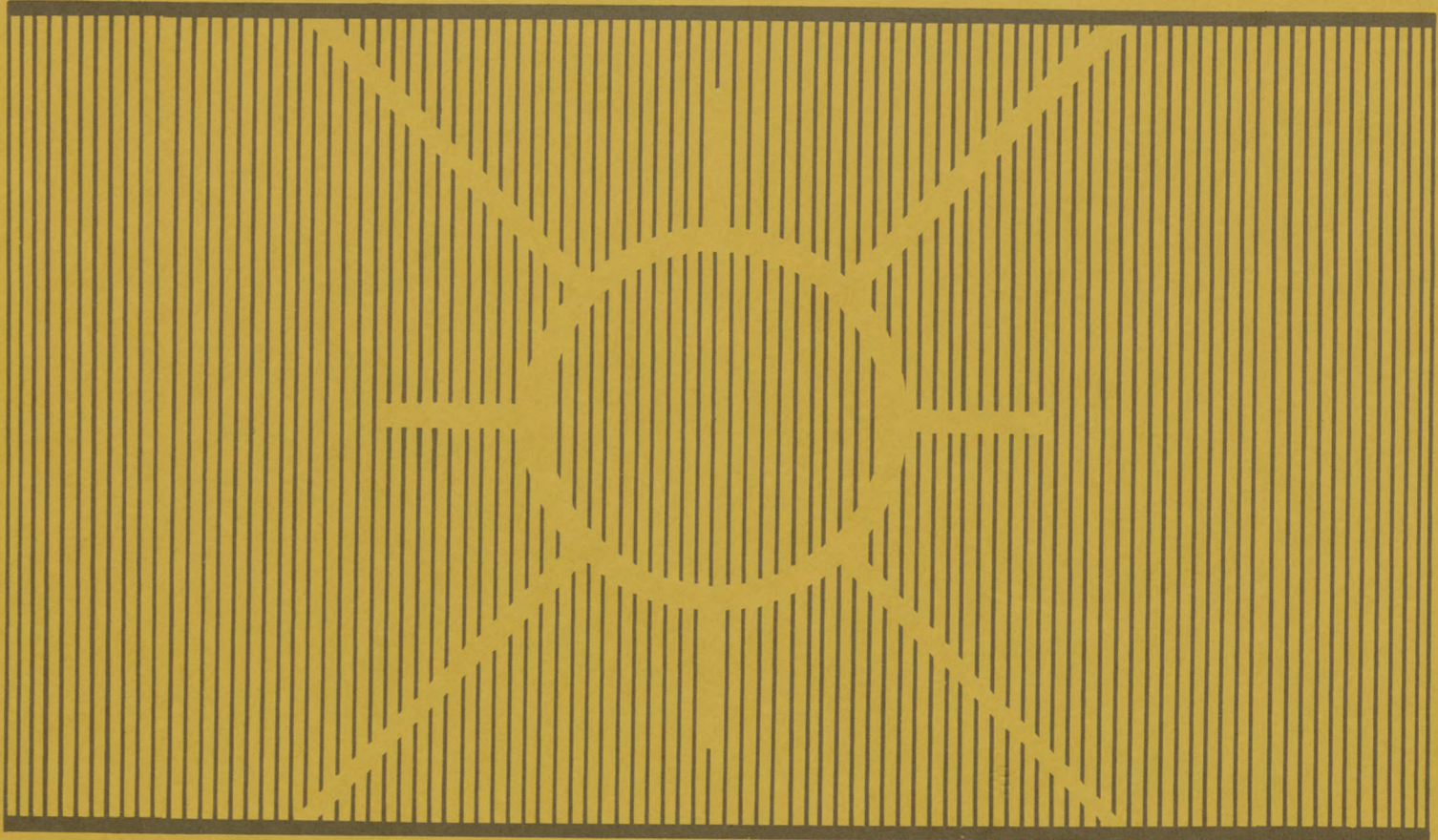
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Thomas W. Paterson is a doctoral candidate, Department of Agricultural Economics, University of Wisconsin-Madison; J.D., University of Wisconsin Law School, 1984.

Willard F. Mueller is William F. Vilas Research Professor of Agricultural Economics, Professor of Economics, and Professor of Law, University of Wisconsin-Madison.

State Sales-Below-Cost Laws:
A Legal-Economic Analysis of Effectiveness

Thomas W. Paterson^{*} and Willard F. Mueller^{**}

I. Introduction

Common to all societies is the need to organize productive assets to satisfy the society's consumption objectives. In a capitalistic society operating with democratic institutions, citizens have the right to establish rules to guide how the economic system functions and to what ends.

Competition policy in the United States is the device chosen to organize various sectors of the economic system.¹ The expectation is that in the long run, competition is likely to provide "the most effective means of promoting economic progress, economic justice, and the general welfare."² By proscribing unfair competition in state and federal competition laws, we seek to preserve the competitive processes we expect will deliver desirable economic performance and keep the process itself consistent with our notions of what is fair and equitable.³

A hallmark of competition is price competition. When sellers compete on price, they attempt to sell more products or services at lower prices than rivals are charging. Price competition benefits consumers because it allows them to purchase more desirable bundles of goods and services with their fixed number of dollars.

Recognizing the general desirability of price competition, the focus in this paper is on the statutory restrictions certain states have placed on price cutting conduct. As usually enacted, state unfair sales or sales-below-cost or minimum markup laws prohibit retailers from offering to sell or selling a product or service at a price less than cost, where

either the seller intended to destroy competition, eliminate a competitor, or mislead consumers or the sale had this effect.⁴

As summarized in Table 1, most states passed their sales-below-cost laws during the late 1930's and early 1940's. In 1984, 22 states had sales-below-cost laws of general application, all of which covered both retail and wholesale sales.⁵ The law applied to products and services in 5 states. Otherwise the laws applied only to products. Thirty states had laws of limited application in 1984. These more narrow laws mainly covered cigarettes and milk.

From 1970 to 1984, ten states repealed their sales-below-cost law. Enforcement officials, retailers, and commentators who conclude that the law is unacceptable have several common criticisms.⁶ They argue that the law is too crude or that it is too capable of being manipulated by competitors bent on price fixing or that a lack of public enforcement discriminates against those trying to comply with it. These critics say that the law interferes with hard competition which they believe involves selling below cost at times. They would not impose "artificial" restraints on pricing conduct since they cherish the notion that it is always the swift and the efficient who will win the competitive race. Other officials, retailers, and commentators support the law. They maintain that the law serves to deter predatory price cuts and to deter attempts to deceive consumers by creating a false image of low prices across the board. Absent the law, some think large retailers would have a license to cut price to levels below cost, weather the losses with reserves or profits from other operations, and when those unable to take the losses have exited from business, to raise prices above initial levels.⁷ Others are concerned that without the law consumers will pay more when they patronize sellers

Table 1

State Sales-Below-Cost Laws, 1984

<u>State</u>	<u>Sales-Below-Cost Laws of General Application</u>		<u>Products Covered by Sales-Below-Cost Laws of Limited Application</u>
	<u>Year Passed (Repealed)</u>	<u>Applicable to Products Services</u>	
Alabama			
Alaska			
Arizona	1939 (1982)		
Arkansas	1937	X X	cigarettes, milk
California	1935	X	milk, cream, dairy products
Colorado	1937	X X	
Connecticut	1939 (1973)		cigarettes, drug products, liquor
Delaware			cigarettes
Florida			
Georgia			cigarettes ^a
Hawaii	1937	X X	
Idaho	1939	X	dairy products
Illinois			
Indiana			cigarettes
Iowa			cigarettes

Table 1 (cont.)

State Sales-Below-Cost Laws, 1984

<u>State</u>	<u>Sales-Below-Cost Laws of General Application</u>		<u>Products Covered by Sales-Below-Cost Laws of Limited Application</u>
	<u>Year Passed (Repealed)</u>	<u>Applicable to Products Services</u>	
Kansas	1941 (1961) ^a		dairy products ^b
Kentucky	1936	X X	cigarettes, milk, dairy products
Louisiana	1940	X	drugs, dairy products ^a
Maine	1939	X	cigarettes, ^c milk
Maryland	1941	X	cigarettes
Massachusetts	1938	X	alcoholic beverages, cigarettes, motor fuel
Michigan			bakery products, petroleum products
Minnesota	1937	X	cigarettes, dairy products
Mississippi			cigarettes
Missouri			milk, milk products
Montana	1937	X X	cigarettes
Nebraska	1943 (1972) ^a		cigarettes

Table 1 (cont.)

State Sales-Below-Cost Laws, 1984

<u>State</u>	<u>Sales-Below-Cost Laws of General Application</u>		<u>Products Covered by Sales-Below-Cost Laws of Limited Application</u>
	<u>Year Passed (Repealed)</u>	<u>Applicable to Products Services</u>	
Nevada			
New Hampshire	1941 (1977)		
New Jersey	1938 (1975) ^a		cigarettes, gasoline
New Mexico			alcoholic beverages, ^a cigarettes ^c
New York			liquor and wine, milk and milk products
North Carolina			milk
North Dakota	1941	X	
Ohio			cigarettes
Oklahoma	1941	X	cigarettes and tobacco products, milk and dairy products
Oregon	1937 (1975)		
Pennsylvania	1941	X	cigarettes, brewed and malt beverages

Table 1 (cont.)

State Sales-Below-Cost Laws, 1984

<u>State</u>	<u>Year Passed (Repealed)</u>	<u>Applicable to</u>		<u>Products Covered by Sales-Below-Cost Laws of Limited Application</u>
		<u>Products</u>	<u>Services</u>	
Rhode Island	1939	X		milk, tobacco products
South Carolina	1930	X		milk
South Dakota				
Tennessee	1937	X		cigarettes, milk
Texas	1907 (1983)			grocery stores ^b
Utah	1937	X		motor fuel
Vermont				
Virginia	1938 (1984)			
Washington	1939 (1983)			cigarettes, fresh fruit
West Virginia	1939	X		cigarettes ^a
Wisconsin	1939	X		dairy products
Wyoming	1937	X		

Source: 4 Trade Reg. Rep. ¶¶ 30,201 - 35,585 (CCH).

- a Law repealed after being held unconstitutional.
- b Law held unconstitutional.
- c Law no longer covers the product.

who cut prices on highly visible products, distorting the consumer's perception of what are actually higher prices on the overall product mix.

Sensitive to the controversy surrounding sales-below-cost laws, our objective is to assess whether sales-below-cost laws offer a reasonable alternative for deterring predation and deception. To do this we summarize and respond to the various criticisms of the laws. In Part II we establish the context in which limiting price cutting conduct may be compatible with competition and whether the laws address these situations. Concluding that they do, we assess the effectiveness of the laws in Part III, looking particularly at statutory and institutional constraints on effectiveness. In Part IV we summarize our analysis from Parts II and III to make recommendations to state legislators and those charged with enforcing the laws. We confine our analysis to laws of general application, focussing on retail product sales, particularly retail grocery sales.⁸ Unlike prior studies of state sales-below-cost laws, this study depends on empirical information about the laws. Throughout the paper, we rely on the responses to questionnaires sent to enforcement officials in states having the laws,⁹ to members of the Wisconsin Association of Food Dealers,¹⁰ and to Wisconsin grocery warehouse-type store operators.¹¹

II. Legislative Objectives for Sales-Below-Cost Laws

A. Introduction

State sales-below-cost statutes almost uniformly declare that selling at prices below cost is an unfair trade practice. It is unfair because it injures competitors and destroys competition.¹² A few states add that selling below cost to attract patronage is deceptive advertising. It is unfair because it misleads consumers by implying that all prices are generally that low.¹³

Attorneys general survey responses are consistent with legislative declarations of the statute's purposes. All states but Washington agreed that their legislature sought to deter predatory pricing. California, Idaho, and Wisconsin observed that their legislatures also sought to deter wholesalers and retailers from making implied misrepresentations of generally lower prices. Only Washington noted a different objective, namely, protecting small retailers from large firms having advantageous buying power.¹⁴

Prior to evaluating the objectives of deterring both predation and misrepresentation, we consider the context in which limiting price cutting conduct may be compatible with fairness notions and with maximizing consumer welfare. This framework will guide subsequent analysis of the desirability of sales-below-cost laws.

B. Limiting price cutting conduct

An analysis of market performance is a normative assessment of the social quality of the resource allocation resulting from market conduct.¹⁵ When a market for a particular commodity performs well, consumers are satisfied with how goods and services are provided--fairness--and with the goods and services.¹⁶ In addition to fair competitive processes, good

performance involves four goals: factors of production should be applied to their most valued use; there should be progress with respect to the stock of factors of production, production techniques, and product choice and quality; factors of production should be fully employed; and real output should be distributed equitably among society members.¹⁷

Market performance is tied to market conduct. A market participant's policies toward the market and market rivals represent market conduct. These policies concern price, product characteristics, and other terms of market transactions.¹⁸ The price a firm charges is a manifestation of pricing policy; it also bears on market performance.

In a competitively structured market economy, product price is established by the independent give and take of supply and demand.¹⁹ A few firms with market power do not manipulate the quantity of a product that is supplied. Instead, there is a sufficiently large number of independently competing firms in the market, none of which can exact a price higher than is necessary to meet the cost of production and return a normal profit.²⁰ Nor can consumers dictate the price at which they will purchase. As a large number of producer-suppliers meets a large number of consumer-buyers in the marketplace for the product, price is set impersonally.

Impersonally set prices in a competitive market economy serve as signals for resource allocation. If a price is higher than necessary to cover production cost and a normal profit on a product, resources will be attracted to the production of that commodity and supply will increase. With a greater supply, price will decrease. But as price decreases to the point where it no longer returns even a normal profit, resources will be withdrawn from the production of that commodity and directed to other products in the economy.

Guiding resource allocation through the impersonal interaction of producer-suppliers and consumer-buyers in the marketplace promotes the allocatively efficient use of these resources. Factors of production will be allocated to those commodities for which consumers are willing to pay a price which covers cost and returns a normal profit. Since what a consumer will pay is an indication of the subjective value the consumer places on a variety of products, price serves to convey this information to resource owners who can then allocate resources to the uses consumers value most. When scarce resources are allocated to their highest valued uses, the allocation is efficient.

In a static perfectly competitive market, pricing policy with respect to rivals is straightforward. If a firm sets price above that of competitors, the firm will have no sales. If the firm sets price below that of competitors, the firm will have sales but the price received will not cover cost and return a normal profit. Hence, all firms in a given market sell a certain commodity at the same price, a price which covers cost and returns a normal profit.

With the exception of a few industries, such as with some agricultural products, modern markets are imperfectly not competitively structures. Firms in an imperfectly structured market are usually able to exert some perceptible influence over price or industry output. The more imperfectly the market is structured, the more likely it is that a dominant firm can influence product price or market output.

In an imperfectly competitive market, pricing policy can be significant. The price a firm charges for a product is a powerful device in competing for consumer purchases. Through the price it charges, a firm may also seek to maintain or enhance its market power or to exploit its market power or both.

Pricing policies designed to restructure a market through the elimination of rivals and pricing policies otherwise having that effect may violate notions of fairness; they may also undermine structural conditions still conducive to promoting allocative efficiency. Each is clearly the case when a firm sells below cost, incurring short-term losses in anticipation of enhanced profits to be realized in a relatively more imperfectly structured market. The market becomes more imperfectly structured when rivals who cannot withstand losses are forced to exit, doing so not because they are less efficient competitors but just less powerful. In a relatively more imperfectly structured market, the price controlling resource allocation is more a product of individual decisionmakers than of a large number of producers and consumers. Unless the information directing these few decisionmakers matches the store of information inherent in a price set in a perfectly competitive market, allocative efficiency will be disrupted. Relative to perfect competition, market performance will be impaired because price will not direct resources to their most valued uses. The political choice of a competitively structured market economy over either an imperfectly structured or an administered economy indicates that, ideally, an impersonally set price arrived at through competition on the merits is more compatible with promoting desirable market performance.

When price cutting conduct detracts from long-run consumer welfare, there is a justification for limiting the conduct. Predatory price cutting, price cuts aimed at eliminating equally or more efficient competitors in order to dominate a market, might have this effect.²¹ More obviously, selective price cutting which misleads the consumer negatively affects consumer welfare if absent the conduct the consumer would have

realized greater utility. In the following sections we consider the predation and deception objectives attributed to sales-below-cost laws.

C. Deterring predation

The objections to predatory price cutting are two-fold. It may not conform to notions of competition on the merits. It may also adversely affect consumer welfare if it leads to a more imperfectly structured market. For brief episodes, any seller might engage in sales at prices below cost. But aside from those who do this blindly, there are several criteria which must be satisfied if predation is a calculated, profit-oriented attempt to restructure a market or to discipline rivals. These criteria characterize who, if anyone, will engage in this deliberate action and the likelihood of it occurring at all.

To be a rational predator, a firm must have the expectation that the present discounted value of any additional net revenues in the restructured or disciplined market will be greater than the present discounted value of any anticipated losses during the predatory period. Otherwise it would not be profitable to engage in the predation. And even if the net difference is positive, the firm needs financial resources to survive any temporary losses, especially if retaliation is anticipated. The survival resources commonly pointed to in predation analyses are existing reserves and profits from other operations.²² Because a firm operating in many markets or having multiple products is usually expected to have these resources, the predation argument anticipates large established or entering firms preying on firms with fewer resources, particularly small established and new entrant firms.²³ According to the argument, if predation will be profitable in the long run, the large firm will use its resources to cover its losses during a price war.²⁴

If a firm sells at prices below cost with the intention of eliminating rivals, established competitors and new entrants have two choices besides drawing on their own reserves or going out of business immediately. They can follow suit and sustain losses to the extent revenues are less than costs or they can maintain their existing or a break-even pricing policy, trusting that the competitor's lower prices will not attract the customers on whom they depend at least to break even. Neither alternative is appealing. Sales-below-cost laws label below-cost selling as unfair. The laws are designed to keep competitors from having to choose a course of action when the price cutter's new product price is indeed below the cost of selling the product. As we shall see in Part III, the laws do not prohibit selling below the cost of the least efficient competitor in the market or even a relatively less efficient competitor. Those who are less efficient receive no protection in theory from the laws since it is the price cutter's cost that determines whether the conduct is unlawful.²⁵ The cost associated with selling a given product is critical. It is also irrelevant to the law's operation whether the firm selling below cost operates on a larger scale or has more extensive economic resources on which to rely during a price war.²⁶

Commentators criticizing the predation deterrence objective in the sales-below-cost literature tend to focus not so much on the laws but on the assumptions underlying the predation argument.²⁷ If the assumptions are untenable, this weakens the economic justification for the laws.

At the heart of the predation argument is the assumption that the firm will be able to raise prices in a restructured market. Leeman, among others, asserts that even if a predator eliminates a competitor, the predator will not be able to block the new entry that will result if the

predator raises product prices.²⁸ Raising prices to levels sufficient to recoup prior losses will be an open invitation to new entry or for remaining competitors to expand.²⁹ If the predator cannot successfully prevent new entry or competitor expansion, there would be no long run adverse consequences from the price war.

This criticism of the predation argument has several shortcomings. First, it may overstate the predator's actual intentions. A predator may be content with disciplining rivals in this and other markets where they meet so they will accept the predator's price leadership. While market shares may not change, the prices consumers pay might increase or remain high. The criticism also ignores the notion that subsidizing losses is not competition on the merits and the fact that there is economic waste in the process of eliminating one set of competitors and having another enter. In the final analysis, however, whether the criticism is valid in an empirical question. In some markets predation might lead to anticompetitive performance results; in other markets it might not. As such, the criticism does not end the predation argument, it merely focuses attention on which markets will in practice lend themselves to predatory activities.

Our focus here is on the relevance of this argument in the grocery retailing industry. A number of empirical studies indicate that there exist substantial barriers to entry in grocery retailing.³⁰ For new entrants attempting to establish a number of competitively viable firms, these barriers include real and pecuniary advertising and promotional economies of well-established, multi-store firms; the large share of a trading area a new store must capture; the scarcity of new store sites, especially in shopping centers whose operators tend to favor firms already well-known in the market; and the cost disadvantages new firms experience

in supplying and monitoring new stores from their established but distant warehouses.³¹ These entry barriers, especially those associated with scale, are magnified if powerful established firms engage in strategic entry forestalling conduct. Observations from members of the Wisconsin Association of Food Dealers indicate the significance of strategically created entry barriers. Forty-three percent of 84 respondents indicated that the Wisconsin sales-below-cost law had helped them start their business or open new stores.³² The explanation offered was that other stores could not cut their prices to drive the new entrant out of business. In a separate survey of Wisconsin food warehouse store operators by the authors,³³ respondents frequently answered similarly with respect to encountering below cost selling.³⁴ At least for grocery retailing in Wisconsin, the argument that there is no incentive for successful predatory pricing is not persuasive. And there is no reason to expect Wisconsin is atypical.³⁵

The second assumption critical to the predation argument is that the rational predator will have the resources to survive his below-cost selling or the price war he stimulates. Two commonly expected sources for these funds are other operations or existing reserves. Adelman considers it absurd to maintain that when it cuts prices in market X, a firm will raise prices in market Y to prevent any overall loss. He notes that if the firm had not raised prices in market Y already, it cannot do so once it starts cutting prices in market X.³⁶ If the firm can exploit customers in market Y, it will not wait for price cuts in market X before doing so. Using market Y to preserve profit margins is not an available option.³⁷ Leeman similarly downplays the assumption that funds may be available from existing reserves.³⁸ He notes that the larger firm with its larger

resources also has greater demands on those resources. The large firm's losses will be proportionally greater than for the small firm; the multi-market firm has other territories to defend and other commitments for its funds. The apparent advantage the large firm has may therefore be illusory.³⁹

Because Adelman and Leeman find that the firms usually considered most likely to prey probably lack the financial resources to survive, the necessary inference is that these firms will not engage in predation.⁴⁰ At least in grocery retailing, experience contradicts this inference.⁴¹ The flaw in the Adelman analysis is that he creates a straw man. The relevant argument is not that the predator must raise prices elsewhere to survive. Rather, the relevant argument is that if he holds powerful positions elsewhere, he already possesses the resources to finance predatory conduct in a particular market.⁴² As to incentive, Posner notes that if

a firm operates in a number of markets and faces actual or potential competitors each of whom is limited to one of its markets, it may find it worthwhile to expend considerable resources on crushing a single competitor in order to develop a reputation (for willingness to use predatory pricing) that may enable the firm to exclude other potential competitors without any additional below-cost selling. Stated otherwise, the costs incurred by the firm in using predatory pricing in one market may generate greater deterrence benefits in other markets. Knowing that the dominant firm might act in this way, a competitor may be reluctant to enter any market in which the firm operates, and if he is already in such a market he may refrain from price competition or agree to sell out to the dominant firm at a low price.⁴³

Deterring successful predatory price cutting is compatible with preserving competition on the merits and with promoting consumers' economic welfare. On both fairness and economic grounds, deterring predatory

pricing is a legitimate objective for sales-below-cost laws. Arguments to the contrary at least in grocery retailing are too broad or lack empirical support or are irrelevant.

D. Deterring implied misrepresentations of generally lower prices

Implied misrepresentations of generally lower prices refers to the situation where a firm seeks to attract customers by advertising certain products at prices below cost. These products, called loss leaders, are not chosen randomly.⁴⁴ Rather, they will be products which consumers purchase so frequently that they can recall the general prices for the products. If consumers assume that the truly lower prices on the selected items are representative of all product prices in the store, products for which consumers are not so aware of price, the consumers may respond by patronizing the store for all purchases. If the assumption of generally lower prices is false, consumers have been deceived.⁴⁵ If the products consumers buy other than loss leaders have prices relatively higher than the prevailing level in the market, consumers may end up paying more for all the products than if they had not patronized the store.

The economic objection to consumer deception is straightforward: Deception can adversely affect consumer welfare. If consumers base their purchase decisions on misrepresentations, the utility from the bundle of goods and services they receive may be inferior to what they would have received by purchasing elsewhere. If the deception continues to be successful, consumers may suffer more than short-term losses. To the extent consumers respond positively to the firm responsible for the deception, competing firms suffer. If competitors cannot successfully counter the deception, in the limit the deception can have predatory consequences. The ultimate result may be the development of market

structures where consumers have little choice but to patronize the firm or firms most successful at the deceptive advertising.

As with the predatory pricing analysis, identifying the criteria essential to the successful use of deception indicates who is most able to engage in the conduct and the likelihood of the conduct. Any seller can attempt to create an effective implied misrepresentation of generally low prices. For deception to be a profitable endeavor, though, the present value of returns directly traceable to deceived consumers must exceed the present value of the firm's expense in creating and maintaining the deception. While trying to minimize advertising costs, the firm must still establish the representation. Firms at an advantage will be those with relatively larger advertising budgets--which in practice means those already with the largest market shares--and those which can bargain more effectively with manufacturers or upstream suppliers on advertising allowances or with the media concerning cost.⁴⁶ To maintain the representation or to reinforce it periodically, the same factors seem relevant.

If a firm advertises loss leaders, competitors can adopt a wait and see attitude or they can respond immediately with loss leaders of their own.⁴⁷ No response enhances consumers' economic welfare if the firm is not successful in raising other prices or if consumers selectively purchase only the loss leaders. No response adversely affects consumer welfare if the deception is successful and consumer expenditures on average are greater than they would have been absent the deception. If competitors respond, consumers benefit in the short run from lower price on the specials, and on other products if price competition eliminates the ability to raise their prices. This benefit has its costs, however. To the extent

market shares do not change, the firms have wasted advertising dollars. There is also a misallocation of resources if upstream suppliers of products used as loss leaders respond to an increased demand for the products.⁴⁸

Sales-below-cost laws prohibit below cost selling and hence loss leader sales where a firm is offsetting losses with higher prices on other products. The laws proscribing loss leaders label the conduct unfair because it misleads consumers.⁴⁹ But whether the firm is offsetting losses with higher prices is incidental to the law's proscription. Indeed, when predatory intent or effect is required, the law would not even be directed at the consumer deception. This is because the intent in the deception scenario is to induce the purchase of other merchandise instead of to eliminate competitors, although this might be a consequence.

For those states where the deception objective is apparent,⁵⁰ commentators offer a number of criticisms. These criticisms dispute the likelihood of loss leader selling or its success or, conceding that loss leader selling occurs, argue that it is desirable.

Clark argues that if a seller could charge higher prices on non-leader items he would, regardless of whether he was using loss leaders.⁵¹ Another commentator maintains that consumers would not be so gullible as to pay the higher prices on the non-leader products.⁵² Rodgers asserts that even if loss-leader selling occurs, it is not altogether undesirable. For the small retailer, he finds it no more objectionable than advertising or nonprice competition.⁵³ If successful in expanding volume, Rodgers points out that it might lead to such a reduction in unit overhead costs that the loss at the initial volume becomes a profit at the higher volume. Prohibiting loss leaders may hamper a move to lower cost operations.⁵⁴

Clark's argument is not particularly relevant to the deception scenario. Even if the seller usually charged the most he could for non-leader products, the concern is that he is now using loss leaders to induce new patrons to buy these higher priced, non-price sensitive goods. Whether consumers are never so gullible that they pay the higher prices on non-leader goods assumes all consumers are equally perceptive and that they closely monitor prices. In the grocery supermarket, the consumer is faced with an average of 8,000 items, frequent price changes, and a variety of weekly specials.⁵⁵ Empirical studies demonstrate that, absent the dissemination of grocery store price information by public or private parties, consumers are not able to determine the relative prices of a supermarket's total product offering.⁵⁶ Recognizing that consumers are not identical, what is deceptive has traditionally been up to the legislatures to define as in the sales-below-cost laws or has been left to judicial interpretation or policy statements in the administrative agency charged with enforcement.⁵⁷ Rodgers implies that advertising is a substitute for loss leader selling. But attracting new patrons depends on advertising; they are not substitutes but joint elements in a particular merchandising strategy. Rodgers also indicates that the law somehow disadvantages sellers who only engage in price competition. The laws prohibit selling below cost, therefore requiring those who undertake non-price competition to include those expenses in their costs. As between two otherwise identical competitors, one can change lower prices because he does not have the expenses from non-price competition. Instead of a disadvantage, the laws make prices correspond to selling expenses regardless of whether one firm has substantial resources to subsidize nonprice competition. Rodgers offers no empirical support for his final point regarding lower costs at an

expanded volume. And besides advocating consumer deception, his proposition suffers from a logical inconsistency: If all sellers engage equally in the practice, it will likely be a zero-sum game. Advertising and counteradvertising result in economic waste.⁵⁸

Survey responses from Wisconsin grocery warehouse store operators indicate that most respondents view below cost selling as a form of deception most useful to competitors with large advertising budgets.⁵⁹ For a competitor, though, it would not matter much whether the price cutter has a predatory intent or if he seeks to induce the purchase of products other than loss leaders. In either case, competitors face the prospect of losing business. When faced with below cost specials, warehouse store respondents indicated that they often match the offers.⁶⁰ What begins as conduct fitting the deception scenario may therefore rapidly evolve into predatory advertising or advertising with a neutral effect on final market shares. In terms of the effect on consumers, one respondent noted that

[i]f loss leaders are employed, a warehouse operation is compelled to raise other prices in order to achieve a product/profit mix. Once this occurs, the retailer is attempting to outguess the consumer by marking up merchandise. ... [U]nless the consumer is knowledgeable in all pricing, she will be paying more for her merchandise than she would if there were a uniform margin across the board.⁶¹

These limited responses undercut arguments that loss leader selling does not occur or that the deception is without cost to consumers.

The economic justification for the deception objective for sales-below-cost laws depends on the welfare consequences from deterring price cutting to levels below cost. If sales-below-cost laws are effectively used to deter the first below-cost price cut, certain welfare

costs are avoided at the expense of consumers not receiving an immediate windfall. But the windfall of a below-cost purchase is incompatible with the basic function of price in our economy, guiding resource allocation. Even if a particular consumer only shops the specials, a price below cost is not an appropriate signal for the allocation of resources to satisfy consumer wants. For this reason, the "cost" to consumers from preventing below cost selling does not keep the deception deterrence objective from being consistent with good economic performance.

On balance, both the predation and deception deterrence objectives for sales-below-cost laws have fairness and economic justifications. As reasonable as these objectives may be, however, the bottom line is whether the laws are or can be effective in satisfying these objectives, the topic in Part III.

III. The Effectiveness of State Sales-Below-Cost Laws.

A. Introduction

Since initial passage of most sales-below cost laws in the late 1930's and early 1940's, commentators have reached considerably different conclusions about the laws. Those arguing against the laws have contended that the statutes represent special interest legislation. While the statutes may indeed seek to deter predatory pricing or deception, these commentators observe that the laws only protect small retailers.⁶² Other commentators have been even less generous, asserting that the laws were designed to protect small retailers from rigorous and complex competition⁶³ or that by providing small retailers with price floors,⁶⁴ the laws improved and secured their economic position.⁶⁵ And even if the laws were passed with honorable intentions, certain commentators maintain that they are too crudely fashioned or casually enforced to be effective⁶⁶ and serve instead as a device for price fixing among competitors.⁶⁷

Empirical data have rarely informed commentator discussions of the merits of sales-below-cost laws. Arguments for or against the laws have instead been confined to theory or party assertions.⁶⁸ The empirical information on effectiveness in this study comes from several sources: econometric studies on effectiveness,⁶⁹ survey responses from state attorneys general or those charged with enforcement in the various states,⁷⁰ survey responses from members of the Wisconsin Association of Food Dealers,⁷¹ survey responses from Wisconsin warehouse-type grocery store operators,⁷² and statements from industry representatives appearing before a Wisconsin legislative committee studying the Wisconsin sales-below-cost laws.⁷³

B. Empirical assessments of effectiveness

Assuming that sales-below-cost laws were intended to enhance small-firm viability, Houston tested the effectiveness of the laws for small firms in 1977.⁷⁴ He did this at an aggregate retail level for each state and then for grocery stores, apparel stores, variety stores, automobile dealers, furniture stores, and liquor dealers.⁷⁵ Houston found that sales-below-cost laws had no statistically significant effect in enhancing small firm viability in 1977. He tempered his conclusion that the laws are ineffective, however, by noting that he had only tested the predation deterrence objective, not the deception deterrence objective.⁷⁶

Houston's conclusions are in contrast to those from an earlier study of the sales-below-cost law. Concentrating on the Wisconsin sales-below-cost law, researchers studied the law's effect on competitive market structure in grocery retailing, on grocery retailers' gross and net margins,⁷⁷ and on Wisconsin food store prices in 1970.⁷⁸ The authors found that supermarket operators with fewer than 11 stores fared better in Wisconsin than in other states.⁷⁹ Their examination of gross and net profit margins for independent supermarket operators showed these margins to be lower than in other states. From this they concluded that, at minimum, the law had not protected small chain store operators⁸⁰ from competitive forces to such a degree that there were excessive profit margins.⁸¹ They finally noted that from 1967 to 1972 average food store prices in Milwaukee increased less than in all but one of the 23 largest U.S. cities. With several qualifications, they concluded that their findings were not inconsistent with the law contributing to a more competitively structured and performing grocery retailing industry in Wisconsin.⁸²

Using 1977 data for 240 standard metropolitan statistical areas, SMSA's, the authors of this study further tested the effect sales-below-cost laws have had on concentration in retail grocery sales.⁸³ The results support the Cook, Deiter, and Mueller conclusions. Sales-below-cost laws were shown to have a significant negative effect on the level of retail grocery concentration in 1977. The more aggressively states having the law had enforced the law, the lower was the share of grocery sales controlled by the largest firms in the SMSA.⁸⁴

Enforcement official assessments of the pro- and anti-competitive consequences of the respective laws were mixed.⁸⁵ Most states were not certain of any procompetitive consequences; four states answered there were none; Washington⁸⁶ and Wisconsin⁸⁷ answered there were some. Five states did not know if the laws had any anticompetitive effects; Arkansas and California indicated there were none; Hawaii,⁸⁸ Minnesota,⁸⁹ Montana, Washington,⁹⁰ and Wisconsin⁹¹ answered that there were some anticompetitive effects.⁹² Only rarely did these respondents cite evidence for their views. Many respondents appeared to reflect a preconception that all such laws are inconsistent with the kind of "hard competition" the Sherman Act contemplates.

Members of the Wisconsin Association of Food Dealers generally came down in favor of the Wisconsin sales-below-cost law. Sixty-one of 99 respondents from the Association of Food Dealers answered that they benefited from the Wisconsin law.⁹³ Frequent answers to the question of whether the law created problems included "no;" "it lacks enforcement;" "it provides more help for large stores than for small." Thirty-six of 84 respondents said the law helped them start their business or open new stores. To the question of whether they supported the law, 64 of 103

respondents said yes; 28 of 103 said yes, with changes.⁹⁴ If the law were repealed, respondents foresaw different consequences. Some noted that large stores would benefit and "small businesses would go under." Others thought repeal would allow "more flexibility in advertising methods" or "would be more fair."

The warehouse-type store operators answering the authors' confidential survey basically expressed approval of the Wisconsin sales-below-cost law.⁹⁵ Virtually all believed that the law affected the amount of below cost selling by respective competitors. But most observed that the law reduced only some of the below cost selling that occurs, particularly in recent years.⁹⁶ On this, many emphasized a dissatisfaction with the law which reflected their perception that in recent years non-compliance has become widespread. Despite any dissatisfaction, however, most said the law should be maintained, not repealed. All but one respondent thought that the law neither reduced pricing flexibility nor prevented the operator from competing by prohibiting the most effective use of advertised specials. Instead, they generally agreed that the law permitted the operator to compete more effectively because it prevented large competitors from using advertised specials as loss leaders. None believed that the law prevented meeting a competitor's price. Only one respondent felt that the law interfered with efficient operations.⁹⁷ A majority agreed that the law permitted the operator to compete more effectively because it prevented large competitors from selling below their costs. On balance, most respondents felt the law had helped his firm compete successfully in its Wisconsin warehouse operations.⁹⁸

Whether sales-below-cost laws are or can be effective apparently depends to some degree on who is answering the question. As with commentators, empirically based reactions to the laws are mixed. Those

closest to the law where there has been some enforcement indicate that it serves the objective of deterring predation, but perhaps not as well as they would like. Certainly in Wisconsin it has served to prevent full-fledged across-the-board price cutting although its success with selective price cutting has been more modest, especially in recent years. Still, commentator, enforcement official, industry member, and litigant criticisms indicate a number of problems with the laws or undesirable consequences deriving from them.

The following sections in Part III focus on factors limiting the effectiveness of sales-below-cost laws. In section C we look at the public enforcement record from 1960 to 1982. The last four sections in Part III focus on specific provisions in the laws which have been continuing sources for litigation or scholarly challenge.

C. Public enforcement of sales-below-cost laws, 1960-1982

A recurring theme among Wisconsin food dealer and warehouse operator respondents was that the Wisconsin sales-below-cost law would be more effective if it were enforced better.⁹⁹ The notion is generalizable: Effectiveness depends to some degree on enforcement. Attorneys general or others charged with public enforcement were therefore surveyed on their respective enforcement records from 1960 to 1982.

Survey questions sought data on investigations conducted, complaints issued, and overall assessments of enforcement effectiveness. Of the 13 states responding with information concerning investigations, little data were available for the period from 1960 to 1969. From 1970 to 1979, six states with information indicated having investigated instances of selling below cost. Hawaii investigated twice, each time in grocery retailing. Wisconsin recorded 530 investigations for 1978 and 1979, 371 of which were

in grocery retailing.¹⁰⁰ The pattern was much the same for 1980 to 1982.¹⁰¹ From 1970 to 1979, only Montana, West Virginia, and Wisconsin reported formal complaints against alleged violators of the respective laws.¹⁰² Only West Virginia and Wisconsin reported formal complaints from 1980 to 1982.¹⁰³ When asked to assess the effectiveness of their enforcement effort from 1960 to 1980, Idaho, Minnesota, Montana, and Wisconsin indicated that they had been fairly successful. For 1980 to 1982, only Minnesota, Montana, Wisconsin, and Wyoming felt they had been at least moderately effective in enforcing their law.¹⁰⁴

The generally negative assessments of enforcement effectiveness among the respondent states have a variety of explanations. Enforcement budget is a starting point. Hawaii, Idaho, Massachusetts, and Minnesota were the only states indicating that they had ever had a sufficient budget to enforce the law.¹⁰⁵ Most states either were unable to say what money was budgeted to enforcement in 1981 and 1982 or said none was budgeted. Of the respondent states, Minnesota and Wisconsin allocated or spent the most on enforcement in 1981 and 1982.¹⁰⁶

In 1984, twenty-two states had sales-below-cost laws. Enforcement data reveals that only two--Minnesota and Wisconsin--are doing much to enforce the laws. In the following sections, we consider the statutory provisions which enforcement officials criticized in the survey responses as limiting their ability or willingness to enforce the laws. For each provision we also identify repeated areas of litigation and commentator criticisms.

D. Intent

Each sales-below-cost law has an intent, a purpose, or an effect element. Table 2 summarizes these various requirements. Thirteen states

TABLE 2

Treatment of Intent in State Sales-Below-Costs Laws
of General Application, as Applied to Retail Sales, 1984

	<u>Purpose is to Injure Competitors and Destroy Competition</u>	<u>Purpose and Intent of Inducing Purchase of Other Merchandise, Unfairly Diverting Trade, or Injuring Competitors to Destroy Competition</u>	<u>Intent or Effect of Inducing Purchase of Other Merchandise, Unfairly Diverting Trade, or Injuring Competitors to Destroy Competition</u>	<u>Purpose or Effect of Injuring a Competitor or Destroying Competition</u>	<u>Statutory Presumption, Given Proof of Advertising, Offer to Sell, or Sale Below Cost</u>
Arkansas	X				none
California	X		X (loss leaders)		prima facie evidence of purpose or intent given proof of injurious effects or quantity limits on what may be purchased at retail
Colorado	X				prima facie evidence of a violation for purposes of an injunction or a temporary restraining order but only if there has been an actual sale
Hawaii	X (intent)				prima facie evidence of intent given proof of injurious effect but only for an injunction
Idaho			X ^a		prima facie evidence of a violation if in contravention of policy
Kentucky	X				none
Louisiana			X		prima facie evidence of a violation
Maine	X				prima facie evidence of intent provided acts are consistent and repeated
Maryland	X (intent)				prima facie evidence of intent

TABLE 2 (cont.)

Treatment of Intent in State Sales-Below-Costs Laws
of General Application, as Applied to Retail Sales, 1984

	<u>Purpose is to Injure Competitors and Destroy Competition</u>	<u>Purpose and Intent of Inducing Purchase of Other Merchandise, Unfairly Diverting Trade, or Injuring Competitors to Destroy Competition</u>	<u>Intent or Effect of Inducing Purchase of Other Merchandise, Unfairly Diverting Trade, or Injuring Competitors to Destroy Competition</u>	<u>Purpose or Effect of Injuring a Competitor or Destroying Competition</u>	<u>Statutory Presumption, Given Proof of Advertising, Offer to Sell, or Sale Below Cost</u>
Massachusetts	X (intent)				prima facie evidence of intent
Minnesota				X	prima facie evidence of a violation if sale made at less than 8% above manufacturer's published list price, or, absent that, at less than 8% of cost as defined
Montana	X				none
North Dakota				X	none
Oklahoma		X ^a			prima facie evidence of intent
Pennsylvania			X		prima facie evidence of a violation if in contravention of policy
Rhode Island	X (intent)				prima facie evidence of intent
South Carolina	X (or intent)				none
Tennessee			X		prima facie evidence of a violation
Utah		X			none
West Virginia	X				prima facie evidence of a violation in injunction or misdemeanor proceedings

TABLE 2 (cont.)

Treatment of Intent in State Sales-Below-Costs Laws
of General Application, as Applied to Retail Sales, 1984

	<u>Purpose is to Injure Competitors and Destroy Competition</u>	<u>Purpose and Intent of Inducing Purchase of Other Merchandise, Unfairly Diverting Trade, or Injuring Competitors to Destroy Competition</u>	<u>Intent or Effect of Inducing Purchase of Other Merchandise, Unfairly Diverting Trade, or Injuring Competitors to Destroy Competition</u>	<u>Purpose or Effect of Injuring a Competitor or Destroying Competition</u>	<u>Statutory Presumption, Given Proof of Advertising, Offer to Sell, or Sale Below Cost</u>
Wisconsin			X		prima facie evidence of intent or effect given evidence of a sale below cost
Wyoming	X				none

Source: Compiled from 4 Trade Reg. Rep. ¶¶ 30,201 - 35,585 (CCH).

^a where the result is to do these things

proscribe sales below cost when the purpose is to injure competitors and destroy competition. Oklahoma and Utah prohibit below cost sales when made with the purpose and intent of inducing the purchase of other merchandise, unfairly diverting trade, or injuring competitors to destroy competition. Six states are concerned with instances where there is the intent or effect of inducing the purchase of other merchandise, unfairly diverting trade, or injuring competitors to destroy competition. Minnesota and North Dakota prohibit the sales when there is the purpose or effect of injuring a competitor or destroying competition.

The statutory treatment of intent, purpose, or effect in sales-below-cost laws reflects the case law.¹⁰⁷ In early cases, courts held statutes defective when prohibiting below cost sales regardless of the seller's intent.¹⁰⁸ Courts disallowed legislative attempts to prohibit below cost sales lacking sinister objectives¹⁰⁹ or where the only legislative purpose was to make such sales illegal.¹¹⁰ The Arizona Supreme Court held similarly when it interpreted "intent or effect" always to require "intent."¹¹¹ In 1965, the Rhode Island Supreme Court observed that it could find not a single instance of a party successfully challenging a statute on this point if the statute had as a prerequisite to criminal punishment or equitable relief the element that the seller intended to injure competitors or to destroy competition.¹¹²

Attorneys general surveyed on the element of intent, purpose, or effect had a range of reactions. Some indicated that proving the element had been no problem. Colorado noted that a purpose to injure competitors had been a very difficult standard to meet in most cases. Generally,

however, most suggested that they had insufficient experience with the law to have an opinion.

Commentators have criticized the intent requirement in the laws. They assert that courts only require an unlawful intent because most statutes impose criminal as well as civil sanctions.¹¹³ McCarthy argues that if courts paid less attention to inbred case law, intent might not be so critical.¹¹⁴ And eliminating the intent requirement from the statutes would make the laws more effective.¹¹⁵ Besides eliminating this from a case, McCarthy observes that requiring "bad" intent allows the price cutter to make self-serving claims that he did not mean to hurt anyone when he sold below cost, he merely wanted more customers.¹¹⁶ Clark also considers the intent requirement unnecessary.¹¹⁷ Focusing on predation deterrence, he points out that the sales-below-cost laws seek to deter conduct having anticompetitive consequences. Intent has no bearing. All that is relevant is the effect the price cuts have or could have and this depends on existing market structure or other economic variables.¹¹⁸

States have responded to the asserted difficulty in proving intent by creating presumptions of the intent or purpose or effect element. As shown in Table 2, 15 states have some statutory presumption. Generally these presumptions are based on proof of advertising, an offer, or an actual sale at prices below cost.

The statutory presumptions serving to facilitate proof of purpose or intent or effect have not been without constitutional problems.¹¹⁹ Criticism has focused on whether the presumption removes the presumption of innocence in criminal cases and on whether there is a sufficient connection between the fact proved and the fact presumed.¹²⁰

Courts have split on whether the presumptions unconstitutionally require the defendant to prove a lack of intent. A recent Arizona case finding the presumption constitutional held that the burden of proof remained with the state.¹²¹ A Maine decision went the other way on the same language, holding that the presumption of intent to injure competitors and destroy competition was an unconstitutional denial of fourteenth amendment due process.¹²² Relying on an early Minnesota case,¹²³ the Maine court evaluated whether the presumption would assist the state without subjecting the defendant to unreasonable hardship or oppression. Both the Minnesota and Maine courts found the hardship unreasonable.¹²⁴ From the case law, these presumptions are more likely to withstand constitutional attack if they are rebuttable.¹²⁵

The Minnesota and Maine cases also addressed the rational connection between the evidence giving rise to the presumption and the presumption of intent. Both courts were troubled by the notion that a sale below cost could be traced to reasons far removed from predation or deception, such as the necessity to pay an unrelenting creditor's claims.¹²⁶ Legislatures have generally responded to these concerns by recognizing a number of instances where the sale at a price below cost will not have the requisite unlawful intent. That is, these instances provide complete defenses to a charge of selling below cost.¹²⁷

E. Statutory exceptions to the sales-below-cost proscription

Commentators and courts refer to the provisions exempting below cost sales from being unlawful as defenses¹²⁸ or as instances where the requisite unlawful intent cannot be proved.¹²⁹ Functionally, the effect is the same.¹³⁰

Table 3 summarizes exceptions from the sales-below-cost laws. Only South Carolina does not have statutory exceptions. For the other states, the exceptions come within one of two categories. In the first category, the primary motivation for the sale below cost is not predation or deception but involves in-store merchandising or a response to competition. Included here are bona fide clearance or liquidation sales, sales of perishable merchandise, isolated sales not made in the usual course of business, and sales made as a result of a good faith endeavor to meet competition. Most states allow some of the exceptions in this category provided notice is given to purchasers. Exceptions in the second category have in common some overriding social value connected to the sale that makes it unobjectionable. Here we include sales to charitable or relief organizations, sales to the government on contract, and court-directed sales.

Of the various exceptions, that covering sales made in a good faith endeavor to meet competition has generated the most controversy. Twenty states have this exception in some form. Statutorily, it is treated in one of two ways. Price is set in a good faith endeavor to meet either the existing price of a competitor¹³¹ or the legal price of competitors.¹³² For each, this price may be specified to be for the same product¹³³ or for a product of comparable quality.¹³⁴

The confusion on this exception has centered on what is a "good faith" endeavor to meet a competitor's legal price. In Safeway Stores, Inc. v. Oklahoma Retail Grocers Association,¹³⁵ the United States Supreme Court affirmed an Oklahoma decision on what is good faith in the context of meeting a competitor's legal price. The state court had treated the issue by drawing a connection between "good faith" and a "legal price." A good

TABLE 3

Exceptions to Retail Sales Below Cost Under
State Sales-Below-Cost Laws of General Application, 1984

	<u>Bona Fide Clearance or Liqui- dation Sale</u>	<u>Perishable Merchandise</u>	<u>Imperfect, Damaged, or Discontinued Merchandise</u>	<u>Isolated Transactions Not in Usual Course of Business</u>	<u>Merchandise Sold to Charitable or Relief Organizations</u>	<u>Sales to Govern- ment on Contract</u>	<u>Sold by an Officer under Court Direction</u>	<u>Price Is Set in a Good Faith Endeavor to to Meet the</u>		
								<u>Existing Price of a Compet- itor</u>	<u>Legal Price of a Compet- itor</u>	<u>On same Product</u>
Arkansas	X ^a	X ^a	X ^a				X	X	X	
California	X ^a	X ^a	X ^a				X	X	X	
Colorado	X ^a	X ^a	X ^a				X	X	X	
Hawaii ^c	X ^a	X ^a	X ^a				X	X	X	
Idaho	X ^a	X	X ^a			X	X	X		X
Kentucky	X ^a	X ^a	X ^a				X	X	X	
Louisiana ^d	X ^a	X	X ^a		X	X	X	X		
Maine	X ^a	X	X ^a	X	X	X ^b	X	X		
Maryland ^e	X ^a		X ^a		X	X	X	X		
Massachusetts	X ^a	X	X ^a	X	X	X	X	X		
Minnesota	X ^a	X ^a	X ^a				X	X	X	
Montana	X	X ^a	X ^a			X ^b	X	X	X	
North Dakota	X ^a	X	X ^a		X	X	X	X		
Oklahoma ^f	X ^a	X	X ^a		X	X	X	X	X	X
Pennsylvania	X ^a	X	X ^a		X	X	X	X		

TABLE 3 (cont.)

Exceptions to Retail Sales Below Cost Under
State Sales-Below-Cost Laws of General Application, 1984

	Bona Fide Clearance or Liqui- dation Sale	Perishable Merchandise	Imperfect, Damaged, or Discontinued Merchandise	Isolated Transactions Not in Usual Course of Business	Merchandise Sold to Charitable or Relief Organizations	Sales to Govern- ment on Contract	Sold by an Officer under Court Direction	Price Is Set in a Good Faith Endeavor to to Meet the		
								Existing Price of a Compet- itor	Legal Price of a Compet- itor	On same Product
Rhode Island	X ^a	X	X ^a	X	X	X ^b	X			
South Carolina										
Tennessee	X ^a	X	X ^a	X	X	X	X		X	X
Utah	X ^a		X ^a				X		X	X
West Virginia	X ^a	X	X ^a		X	X	X		X	X
Wisconsin	X	X	X		X	X	X	X		
Wyoming	X ^a	X ^a	X ^a				X		X	X

Source: 4 Trade Reg. Rep. ¶¶ 30,201 - 35,585 (CCH).

- ^a Notice of the reason for the price must be given to purchasers.
- ^b Expressly limited to government units in the state.
- ^c Also excluded are government sales, as in a commissary.
- ^d Also excluded are manufacturer and producer sales.
- ^e Also excluded is merchandise sold promptly to avoid a loss.
- ^f Also excluded is merchandise sold at a bona fide auction.

faith meeting of prices does not include meeting prices the seller knew or had reason to know were illegal. The Supreme Court agreed.¹³⁶ Courts have also rejected any notion that meeting a competitor's legal price requires knowing that competitor's costs.¹³⁷ Good faith controls whether a price can reasonably be considered to be legal.¹³⁸ Enforcement officials and commentators object, though, arguing that all of this is too broad.¹³⁹ McCarthy observes that the only case the exception would not cover is that where a competitor's price is ridiculously low.¹⁴⁰ But LaRue notes that some courts have considered the timing of price cuts, the duration and amount of the costs, and other relevant factors in assessing good faith.¹⁴¹

In contrast to the provision authorizing sellers to match a legal price, Idaho, Maryland, Pennsylvania, and Wisconsin authorize sellers to meet a competitor's existing price. This provision allows a seller to meet a price below his own costs. Less efficient sellers and sellers engaging in non-price competition--advertising not related to price, trading stamps, services--are able to match prices with rivals who are more efficient or who, like grocery warehouses, compete principally on price. A seller can set price below his cost so long as a competitor does so first. This exception therefore provides predators with an excuse to sell below cost and for that reason is objectionable.¹⁴²

F. Cost

1. Status

Table 4 summarizes how the states define the cost for each seller below which he is not to set price.¹⁴³ With only slight deviations, all states define the basic component of cost on a product as the lesser of invoice or replacement cost. The invoice or replacement price may be that within some specified period prior to the challenged or challengeable

TABLE 4
 Definition of Cost at Retail Under State
 Sales-Below-Cost Laws of General Application, 1984

	Lesser of Invoice or Replacement Cost (1)	Plus Cost of Doing Business ^a (2)	Less Trade Discounts Except for Cash (3)	Plus Freight Not Included in Invoice or Replacement Cost (4)	Plus Cartage Not Included in Invoice or Replacement Cost (5)	Plus Excise or Sales Taxes (6)	Plus a Markup of x% or Proof of Lesser Cost of Doing Business (7)	Cost Survey is Com- petent Evidence of Cost (8)	Bona Fide Cost Does Not Include Prices Which Cannot be Justified by Prevailing Market Con- ditions in the State (9)	Bona Fide Invoice or Replacement Price Does Not Include Purchases Made Outside Ordinary Channels of Trade (10)
Arkansas	X	X						X		x ^b
California	X						6% of column 1, or ^a	X		x ^b
Colorado	X	X						X		x ^b
Hawaii	X		X	X	X		6% of columns 1,3,4, and 5; or ^a	X		x ^b
Idaho ^c	X (actual or replacement cost)		X	X	X		6% of columns 1,3,4, and 5		X	
Kentucky	X	X						X		x ^b
Louisiana	X		X	X	X		6% of columns 1,3,4, and 5		X	
Maine	X		X	X	X		6% of total cost at retail outlet		X	
Maryland	X		X	X	X		5% of columns 1,3,4 and 5			
Massachusetts	X		X	X	X	X	6% of total cost at retail		X	

TABLE 4 (cont.)

Definition of Cost at Retail Under State
Sales-Below-Cost Laws of General Application, 1984

	Lesser of Invoice or Replacement Cost (1)	Plus Cost of Doing Business ^a (2)	Less Trade Discounts Except for Cash (3)	Plus Freight Not Included in Invoice or Replacement Cost (4)	Plus Cartage Not Included in Invoice or Replacement Cost (5)	Plus Excise or Sales Taxes (6)	Plus a Markup of x% or Proof of Lesser Cost of Doing Business (7)	Cost Survey is Com- petent Evidence of Cost (8)	Bona Fide Cost Does Not Include Prices Which Cannot be Justified by Prevailing Market Con- ditions in the State (9)	Bona Fide Invoice or Replacement Price Does Not Include Purchases Made Outside Ordinary Channels of Trade (10)
Minnesota	X (delivered)	X	X	X	X	X		X ^c		X ^b
Montana	X	X	X					X		X ^b
North Dakota	X		X (no exceptions)	X	X			X ^c		
Oklahoma	X		X	X	X	X	6% of columns 1,3,4, and 5			X
Pennsylvania	X		X (no exceptions if service related)	X			4% of total cost at retail outlet			
Rhode Island	X		X	X	X		6% of total cost at retail outlet		X	
South Carolina	X (open market cost)			X	X					
Tennessee	X		X	X	X		6% of columns 1,3,4, and 5		X	
Utah	X		X	X	X		6% of columns 1,3,4 and 5	X ^f		X ^b

TABLE 4 (cont.)

Definition of Cost at Retail Under State
Sales-Below-Cost Laws of General Application, 1984

	Lesser of Invoice or Replacement Cost (1)	Plus Cost of Doing Business ^a (2)	Less Trade Discounts Except for Cash (3)	Plus Freight Not Included in Invoice or Replacement Cost (4)	Plus Cartage Not Included in Invoice or Replacement Cost (5)	Plus Excise or Sales Taxes (6)	Plus a Markup of x% or Proof of Lesser Cost of Doing Business (7)	Cost Survey is Com- petent Evidence of Cost (8)	Bona Fide Cost Does Not Include Prices Which Cannot be Justified by Prevailing Market Con- ditions in the State (9)	Bona Fide Invoice or Replacement Price Does Not Include Purchases Made Outside Ordinary Channels of Trade (10)
West Virginia	X		X	X	X		7% of columns 1,3,4 and 5			X ^b
Wisconsin	X		X	X	X	X	6% of columns 1,3,4,5 & 6 ^d		X ^e	
Wyoming	X	X						X		X ^b

Source: 4 Trade Reg. Rep. ¶¶ 30,201 - 35,585 (CCH).

- ^a To the lesser of invoice or replacement is added the costs involved in doing business. These include: labor(including salaries); rent (except in Minnesota), interest on borrowed capital (only legal interest in Wyoming), depreciation, selling cost, equipment, maintenance, delivery cost, credit losses (except in Minnesota), license fees, taxes, insurance, advertising, and other fixed and incidental expenses (only in Minnesota). In California and Hawaii cost can be calculated either way.
- ^b Unless notice is given to purchasers that these goods were purchased at forced sales such as bankruptcy sales and so long as the goods are kept separated from other merchandise.
- ^c Manufacturer's published list price less published discounts is prima facie evidence of cost when in effect.
- ^d Cost before markup includes other charges not otherwise included in invoice or replacement cost or the other costs identified.
- ^e Bona fide cost does not include price less than what the manufacturer or producer sells at to other retailers in the state.
- ^f Cost survey is prima facie evidence of cost.

act--say, 30 to 90 days. Replacement cost may also be restricted to that paid on an order similar in size to the one from which the advertised, offered, or sold merchandise came.

To this basic component of price, statutes require adding certain other costs. These costs are generally represented as the costs of doing business or overhead costs or the cost of getting a product to the retail outlet. The statutes provide either of two formulas or both for calculating this cost. Eight states enumerate the specific costs of doing business. These costs almost always include labor (and salaries), rent, interest on borrowed capital, depreciation, selling cost, equipment maintenance, delivery costs, credit losses, license fees, taxes, insurance, and advertising. Sixteen states require that to the lesser of invoice or replacement the retailer add freight or cartage or both expenses, after subtracting trade discounts except for cash, and perhaps specifically require the inclusion of excise or sales taxes the retailer paid on the merchandise. To the sum of this is added a percentage markup of the sum or certain elements of it to cover the cost of doing business unless proof of a lesser cost is shown. Percentage markups at retail tend to be about six percent. Of the 14 states with markups, only the California and Hawaii statutes define these (lesser) costs of doing business explicitly; they are the same costs that the seven state statutes enumerate. The North Dakota and South Carolina statutes follow the same basic formula as the 14 percentage-markup states but have a zero percentage markup.

Besides defining the cost below which price is not to be set, 10 state statutes allow cost surveys as competent evidence of a retailer's cost. Montana authorizes its enforcement agency to conduct public hearings to

determine the cost of doing business.¹⁴⁴ Other states expect trade associations dealing in the product line at issue in a case to have compiled the cost surveys.

Statutes usually indicate that the retailer's invoice or replacement cost is to be a bona fide cost. In seven states bona fide costs do not include prices which cannot be justified by prevailing market conditions in the state. Eleven statutes specify that bona fide invoice or replacement costs do not include costs of products purchased outside ordinary channels of trade. This refers to purchases made at forced sales such as bankruptcy or close-out sales. Ten of these statutes contain an exemption to this prohibition on using purchase price at forced sales as a basis for computing replacement costs. These prices can be used if, among other things, notice is given to purchasers of these products that the merchandise came from outside ordinary channels of trade and the merchandise is kept separate from other merchandise.

Alternative definitions of cost mean that different states define cost to be different things. Those states enumerating the components in the cost of doing business are using a total-cost concept. For those states substituting a percentage markup for the specific overhead costs represented in the markup, the cost is not necessarily total cost. It is total cost if the percentage markup actually reflects all other expenses in selling the product. It is less than total cost if the markup is less than these other costs expressed as a percent of invoice or replacement, discounts, freight, and cartage. It is greater than total cost if the markup exceeds the costs involved in selling an item. For states which do not make any provision for the costs involved in selling but not reflected in invoice or replacement, discounts, freights, or cartage,¹⁴⁵ total cost is not the relevant standard.

2. Problems with cost definitions

Asked whether the definition of cost made their statute difficult to enforce or comply with, attorney general, enforcement agency, and retailer responses differed among respondents in the same class. Arkansas said that the "definition of 'cost' and what it entails can be hard for the private bar to work with."¹⁴⁶ Colorado indicated that there is "[s]ome ambiguity on the allocation of overhead costs."¹⁴⁷ California, on the other hand, said "[t]he definition of cost is simple."¹⁴⁸ Wisconsin food dealers and warehouse store operators almost uniformly indicated no technical problems with compliance. The only specific complaint from one warehouse operator was the paperwork needed to document pricing.

When sellers charged with selling below cost have challenged a definition of cost, they have often asserted that the definition is so indefinite and uncertain as to be an unconstitutional denial of due process. Courts, however, have not been very receptive to this argument.¹⁴⁹ In the absence of contrary statutory provisions, courts have held that the legislatures did not expect a seller to have exact cost calculations. Rather, they expected a seller to adopt a reasonable accounting method to arrive at a reasonable indication of cost. Cost means the approximate cost calculated using a reasonable accounting method. A court will look for a good faith attempt to comply with the relevant statutory definition of cost.¹⁵⁰

Regardless of any judicial or industry faith in sellers' ability to comply reasonably with statutory definitions of cost, commentators have criticized the definitions as being impractical to apply. These commentators challenge what they see as a judicial assumption that businesspersons have anything close to detailed knowledge on the cost of

individual items.¹⁵¹ They also charge that when retailers use a variety of merchandising schemes to sell products, the cost associated with a particular item may be difficult to determine.¹⁵²

Clark identifies several obstacles preventing the full and accurate determination of the total cost of an article.¹⁵³ He argues that there is only an arbitrary connection between handling certain products and certain classes of expenses. This holds particularly for joint costs, costs incurred in selling two or more products but not attributable to any product with any degree of exactness. Even if there is some logical connection, it may be impossible to determine how much of the cost should be allocated to an item. Clark acknowledges that statutory markups relieve the retailer of some of this burden and will guide the retailer as to whether the statute is being violated. But there are problems with the markup approach as well. The markups may have absolutely nothing to do with the cost of selling an item. This is apparent in the case of two products having the same cost upon arrival at the retail outlet but with vastly different handling expenses after that. The percentage markup definition of cost implies that equal costs with invoice, freight, cartage, or discounts mean equal costs of doing business. He argues that this is just not the case in practice.¹⁵⁴

A further criticism of the cost definition focuses on markup statutes disallowing deductions from cost when the seller has paid cash for his merchandise. That is, when the minimum markup is applied to invoice and delivery costs, statutes more often than not allow a seller to exclude from this delivered cost any trade discounts but disallow discounts received for paying cash.¹⁵⁵ Commentators criticize statutes not allowing for cash discounts when given to a buyer because he does not use the seller's credit

services.¹⁵⁶ They argue that the cost to the wholesaler-seller differs when selling on credit as opposed to cash. Not allowing the retailer-purchaser buying on a cash basis to subtract an allowance for cash overstates his cost. Relative to the retailer buying on credit, the cash purchaser's cost is overstated by the amount of the discount for cash.¹⁵⁷

The statutory provisions directed towards proving cost have also been a source for criticism. A definitional criticism addresses the requirement in some statutes that bona fide cost does not include prices which cannot be justified by prevailing market conditions in the state.¹⁵⁸ When challenged constitutionally for vagueness, generality, and indefiniteness this provision has almost always been held void.¹⁵⁹ Courts object to the clause because even if a retailer made a good faith attempt to identify prevailing market conditions, he may be in violation of the statute if the trier of fact disagrees with the conclusions he reached.¹⁶⁰ The cases do not reveal similar problems when the legislative concern is clarified to mean sales made outside ordinary channels of trade.¹⁶¹

The more significant criticisms of statutory cost provisions center not so much on the definitions but on alleged anticompetitive consequences of minimum markups and cost surveys. Fourteen states specify a minimum markup sellers can use as a proxy for costs net of invoice and delivery expenses.¹⁶² That is, a percentage of generally the sum of invoice and delivery costs is used as evidence of the other costs associated with selling a product. The seller can rebut the presumption of these costs by showing the other costs were less than the markup would indicate.¹⁶³

Courts almost uniformly reject arguments that minimum markup provisions turn sales-below-cost laws into price fixing statutes.¹⁶⁴ The courts quickly point out that the respective minimum markup statutes allow

evidence of a lower cost.¹⁶⁵ The only sense in which sales-below-cost laws fix a price is for each individual, based on costs, with the most efficient seller setting the market price floor.¹⁶⁶

Clark argues that minimum markup provisions are still objectionable.¹⁶⁷ He maintains that because cost is otherwise so intractable, the markups do guide seller pricing decisions. And because they control pricing, they lead to a number of anticompetitive consequences. He asserts that the provisions keep retailers from passing on lower prices to consumers and efficient merchants from competing with less efficient competitors. Efficient retailers are therefore forced to attract business from competitors through non-price competition: trading stamps; advertising; in-store music; and other gimmicks. The consequence, he concludes, is disruption of the lower prices and efficient allocation of resources attributed to performance in a competitive market system.¹⁶⁸

The validity of Clark's arguments concerning anticompetitive consequences hinges on the relative efficiencies of competitors, and the size of applicable minimum markups. His analysis only applies to statutes specifying a minimum markup. And even in these instances, the minimum markup will only be presumptive evidence of cost--useful absent proof of a lesser cost. Given these qualifications, whether a minimum markup provision "protects" the inefficient and "punishes" the efficient depends on whether the relatively efficient firm's costs of doing business net of delivered cost,¹⁶⁹ expressed as a percent of delivered cost, are less than the minimum markup.¹⁷⁰ If a firm's costs of doing business net of delivered costs expressed as a percent of delivered cost exceed the minimum markup, there is no protection. Instead, the law merely functions as a loss-limitation device.¹⁷¹ That is, the statute only prohibits firms from selling at a price so much below actual cost.

Empirically, sales-below-cost laws with minimum markups do not appear to punish the efficient. For seven major retail industries in 1982,¹⁷² a six percent markup¹⁷³ over delivered product cost consistently understated expenses associated with product sales. As a percent of the costs of doing business net of delivered cost, the markup ranged from a low of 11.9 percent with department stores to 23.3 percent with groceries to 36.5 percent with automobiles to a high of 43.1 percent with gasoline.¹⁷⁴ Even though the cost data are the average for the industry and thus would hide the most efficient firm's efficiency, the extent of the understatement supports the claim that the markups, at best, are loss limitation devices. Evidence from Wisconsin warehouse grocery stores supports this conclusion: With gross margins generally in the 12 to 14 percent range, the respondents were nearly unanimous in stating that the law did not hinder their flexibility in setting prices.¹⁷⁵

In grocery retailing this empirical evidence on the relationship between markups and firm costs demonstrates that six percent markups do not punish the efficient seller. Indeed, the evidence shows that the markups do not proscribe a certain amount of predatory pricing. For example, if a conventional supermarket grocery store with a gross margin of 20 percent sells at prices approaching or below a markup of six percent of delivered cost, the supermarket is most likely selling below its average total cost.¹⁷⁶ At these levels, the supermarket is also probably selling below its marginal cost,¹⁷⁷ which is presumptive evidence of predation in Sherman Act section 2 cases.¹⁷⁸

In addition to minimum markup complaints, commentators generally criticize cost surveys. Ten states allow cost surveys as evidence of a retailer's cost.¹⁷⁹ A number of these states authorize using trade

association surveys. In most states, the cost survey is competent evidence of cost. The survey is not determinative, it is merely useful for establishing cost.¹⁸⁰ Commentators criticize statutory provisions for surveys, arguing that even if only supposed to be competent evidence of cost, they allow trade associations to fix prices.¹⁸¹

The key element in commentator assertions that cost surveys allow price fixing is the "cost" trade associations calculate. Given the general absence of legislative direction on developing cost estimates or judicial monitoring, trade associations have significant leeway to conduct their surveys and set a figure for the industry cost of doing business.¹⁸² If average cost becomes the industry cost figure, by definition the average obscures performance on each side of the average. In this case, the survey hides the costs of the most efficient and inefficient. Again asserting that exact cost calculations are too intractable, commentators expect that sellers will follow the cost guideline in setting price. If sellers do, this can lead to at least some relatively efficient firms raising their prices. This protects the less efficient from some price competition. Efficiency is not rewarded; consumers end up paying higher prices.¹⁸³

To the extent sellers do in fact rely on cost surveys reflecting anything more than the cost of the most efficient seller, these commentators seem correct. Unlike percentage minimum markups which are tied to each seller's ever changing costs, the survey cost approach to establishing cost would lend itself to abuse, especially in markets which are not competitively structured. Deciding cost democratically is at the heart of federal prohibitions on price fixing.¹⁸⁴ This result seems improbable in an industry such as grocery retailing, however. Firms

involved in grocery retailing have a wide assortment of service-product differences among types of stores and a range of margins. No single price would be possible.

G. Penalty Structure

1. penalties

Table 5 summarizes the public and private penalty structure under state sales-below-cost laws. Nineteen statutes specify that fines can be imposed upon conviction. The fines range up to \$5,000 but commonly are between \$100 and \$1,000. Wisconsin has a separate fine schedule based on whether the instant conviction is the first or a subsequent offense. Imprisonment is possible upon conviction in 14 states. Generally, terms are for less than six months. The Massachusetts and Rhode Island statutes specifically make imprisonment applicable only to offenders who are natural persons, not to corporations. Presumably, corporate agents are not subject to imprisonment for the violations of the principal. Other relief which state attorneys general or district attorneys¹⁸⁵ can seek includes injunctions and the forfeiture of a corporate charter or the privilege to do business in a state after so many convictions.

Twenty-one statutes allow private causes of action for alleged violations of the relevant sales-below-cost law. Twelve statutes provide that any person can bring an action; nine statutes limit the ability to sue to those damaged by or threatened with damage from sales below cost. In 21 states a private litigant can seek injunctive relief. Four of these states grant attorney's fees to the successful plaintiff. California, Maine, Oklahoma, Utah, and Wisconsin allow the plaintiff to seek costs. A party suffering damages can seek actual damages in four states and treble damages in nine states.

TABLE 5

Criminal or Civil Liability and Private Remedies Under State
Sales-Below-Cost Laws of General Application, as Applied to Retail Sales, 1984

	Criminal or Civil Liability			Private Actions						
				Private Standing to Sue		Remedies				
	Fine (\$)	Imprisonment (months)	Other	Any Person	Damaged or Threatened Persons	Injunctive Relief	Attorney Fees	Costs	Actual Damages	Treble Damages
Arkansas	100<x<1000	x<6	a	X		X				X
California	100<x<1000	x<6	c	X		X	X	X		X ^b
Colorado	100<x<1000	x<6	c	X		X				X
Hawaii			a, c	X		X				X
Idaho ^d	x<500	x<6 ^e	c	X		X			X ^b	
Kentucky	100<x<1000	x<6		X		X				X
Louisiana	25<x<500		c		X	X	X			
Maine	x<500				X	X	X	X		X
Maryland					X	X				
Massachusetts	x<500	1<x<1 year ^e		X		X				
Minnesota	f	f			X	X			X	
Montana ^d	100<x<1000	x<6	a, c		X	X				X
North Dakota ^d			c		X	X				
Oklahoma	x<500				X ^g	X		X	X	
Pennsylvania	50<x<200 ^g	x<30 days		X		X				
Rhode Island	x<500	1<x<1 year ^e	c	X		X				
South Carolina	500<x<5000 ^j		a							
Tennessee	5<x<50 ^k 50<x<500 ^l		c		X	X				

TABLE 5 (cont.)

Criminal or Civil Liability and Private Remedies Under State
Sales-Below-Cost Laws of General Application, as Applied to Retail Sales, 1984

	Criminal or Civil Liability			Private Actions						
				Private Standing to Sue		Remedies				
	Fine (\$)	Imprisonment (months)	Other	Any Person	Damaged or Threatened Persons	Injunctive Relief	Attorney Fees	Costs	Actual Damages	Treble Damages
Utah	x<5000	x<12	c	X		X		X		X ^j
West Virginia	100<x<1000	x<90 days	a,c	X		X				X
Wisconsin ^d	50<x<500 ^k 200<x<1000 ^l	1<x<6	c		X	X	X	X		
Wyoming	100<x<1000	x<6	a	X		X			X	

Source: 4 Trade Reg. Rep. ¶¶ 30,201 - 35,585 (CCH).

- ^a On the third conviction, the state can seek forfeiture of a corporate charter or the right to transact business in the state. In South Carolina and Wyoming, this is on the first conviction or complaint.
- ^b The plaintiff can also recover for the damages sustained by a person assigning his or her claim to the plaintiff. Hence, a trade association can recover treble damages for a member who has assigned his or her claim to the association.
- ^c Injunctive relief is expressly provided for in the statute.
- ^d Authority under the act is also granted to a state department or commission.
- ^e Imprisonment applies only to individual natural persons who are violators, not to corporate agents.
- ^f misdemeanor
- ^g A trade association can also sue but it can only seek an injunction and costs.
- ^h plus costs
- ⁱ The attorney general is to order one-half of any fine to go to the person conducting the suit.
- ^j or \$2,000, whichever is greater
- ^k first offense
- ^l second and subsequent offenses

2. problems

Criticism of the penalty provisions in sales-below-cost laws is limited. Commentator criticisms of criminal sanctions generally are made in the context of the intent requirement.¹⁸⁶ With the exception of Wisconsin, enforcement authority survey responses were generally quiet on the criminal provisions in this respective laws.¹⁸⁷ Wisconsin observed that the criminal penalty in its law significantly limited the statute's effectiveness. The reason given was that selling below cost "is not a 'criminal' offense in most persons' minds." A further disadvantage is that a "criminal conviction can have unanticipated side effects on retailers, particularly if they hold an alcoholic beverage license." These factors make elected district attorneys charged with enforcement reluctant to enforce the law. But while there are problems with criminal sanctions, Wisconsin recommended retaining and perhaps enhancing the criminal penalty for the truly wilful violation.

A second criticism of the penalty structure in the statutes is directed at sales-below-cost laws not allowing private damage awards. Colorado, which provides for the treble damages, noted that it makes more sense to leave enforcement to private parties.¹⁸⁸ Wisconsin, which does not provide for private damages, saw this as a limitation on the law's effectiveness. According to Wisconsin, a damage award would enhance private enforcement and would also provide more legitimacy for public enforcement activity. Commentators reaching the issue tend to agree that the incentive of private damage awards would enhance statutory effectiveness.¹⁸⁹

IV. Recommendations

Sales-below-cost laws prohibit unfair competition. With respect to rival firms, it is not fair when one firm pursues a policy of systematically selling below cost for reasons not justified by temporary circumstances such as moving perishable merchandise. Firm B may have the resources to sustain the losses from such sales but it is not fair to Firm A which might not. Absent a sales-below-cost law or some equivalent, Firm A will be punished but not because it is necessarily less efficient than Firm B. Rather, Firm A will be punished because it does not have Firm B's access to resources or lacks the desire to use the resources needed to subsidize losses from selling below cost. With respect to consumers, it is not fair to them when sellers use deception to compete for their patronage.

Economic theory provides a further analytical framework for discussing sales at prices below cost. Looked at in terms of long run effects on market structure, there is not much economic distinction between predation and deception, particularly if loss leader selling greatly favors the large seller using extensive advertising or if it deteriorates into matching price cuts.¹⁹⁰ If predation or deception is successful, consumers may find themselves paying higher prices in the long run in restructured markets. Predation and deception are unacceptable in economic terms because of their potential for disrupting allocative efficiency and consumer welfare.

If deterring predatory pricing is taken as the principal objective of all sales-below-cost laws and deterring deception is a further objective in some laws, the next question is whether predatory or deceptive pricing conduct occurs. Despite commentator assertions that this conduct does not occur,¹⁹¹ empirical evidence indicates otherwise, at least in grocery retailing.¹⁹² Indeed, industry representatives in Wisconsin credit the

sales-below-cost law with curbing across-the-board price cutting.¹⁹³ Because there is no compelling reason to expect that competition in Wisconsin retail grocery sales differs from conduct in other states, we conclude that there is a need for some mechanism to deter predatory and deceptive pricing.

Legislators and enforcement officials need to concentrate on effectively deterring predatory and deceptive pricing conduct. It is not particularly important whether they do this with a sales-below-cost law or with some other statute. Some states indicated that other statutes have proved more effective in dealing with predatory price cutting.¹⁹⁴ For predatory pricing, section 2 of the Sherman Act,¹⁹⁵ section 5 of the Federal Trade Commission Act,¹⁹⁶ the Robinson-Patman Act,¹⁹⁷ and their state counterparts can be used to deter the pricing conduct each is interpreted to treat as predatory.¹⁹⁸ To the extent sales-below-cost laws define a cost which is less than actual cost, the laws do not prohibit all predatory pricing. Instead, the laws set a loss-limitation floor, with the level of the floor being a function of the most efficient firm's costs. When enforced, evidence indicates that the laws can be effective in deterring that pricing which the cost definition defines as predatory or conducive to misrepresentations.¹⁹⁹

While sales-below-cost laws offer an alternative to deterring predation and deception, the public enforcement record for respondent states does not exhibit much commitment to enforcing the laws. Effective public enforcement depends on an enforcement budget and on a willingness to enforce. Effective private enforcement depends on giving private parties the authority and the incentive to enforce. Effective enforcement also depends on the process and end result being acceptable. For this reason,

Part III is an evaluation of the specific statutory provisions which have led to judicial challenges--a cost the litigant must bear--and to alleged anticompetitive consequences.

Commentators advocating repeal of sales-below-cost laws express hopelessness with the entire statute because of problems with specific provisions.²⁰⁰ Our review of the statutory provisions convinces us that repeal is neither necessary nor desirable, especially at this time of minimal federal antitrust enforcement.²⁰¹ Any statutory provisions truly limiting effectiveness can be modified. In addition to the points raised in Part III,²⁰² we recommend that legislators consider the following amendments when applicable to provisions in the respective statutes.

Intent requirements and criminal sanctions are the basis for much of the criticism of sales-below-cost laws. We recommend that the penalty structure in statutes be modified so that civil forfeiture is the principal penalty for public enforcement. Only in cases where the seller has clearly intended to sell below cost, proved without reliance on presumptions, should criminal sanctions apply. And then, sanctions for such wilful violations might include forfeiture of the right to transact business in the state after so many violations within a given period of time. This would curb the publicity for low prices which chronic violators might actually seek by violating the law.²⁰³ Principally, however, eliminating the criminal sanction as the thrust for public enforcement should allow legislatures to remove the intent element from the laws as well. This would have the effect of making it more acceptable for elected officials to enforce the law and easier to prove a violation. Removing intent would also make the laws consistent with the economic objections to selling below costs--which do not necessarily depend on intent.²⁰⁴

One alternative to the debate on cost definitions and on methods of proving cost would be to forget about the cost of doing business and make "cost" equal invoice or delivered cost.²⁰⁵ Sales below this cost would be unlawful. The advantages from this would be several. Clearly, time-consuming courtroom presentations of the cost of doing business would be foregone. Also gone would be debate on the reasonableness of the accounting method used to calculate cost. The effect in minimum markup states would be to lower the loss limitation floors further and to deny any argument that the markup protects the inefficient and harms consumers. For the deception deterrence objective, the markup being at zero percent--invoice--or at six percent or eight percent of delivered cost does not matter, at least in grocery retailing. Loss leaders need steep price cuts below invoice to be effective.²⁰⁶

While we recognize the possible advantages from an invoice definition of cost, we reject this cost standard on theoretical, practical, and policy grounds. From the standpoint of economic theory, a seller's cost includes all expenses attributable to the final sale of a product. Minimum markups are an alternative to proving costs net of invoice and delivery expenses. A standard markup for all industries is crude. But criticism should depend on whether retailers have selling expenses less than, say, six percent of delivered cost. Evidence suggests that this is unlikely.²⁰⁷ In those instances where cost is less than the markup, the statutes allow the seller to prove this. In effect, retail markups--at their 1984 levels--most likely function to limit the loss a seller can lawfully make on a sale. Because costs will exceed the minimum markup--and when they do not the seller can establish that--the alleged anticompetitive consequences from minimum markups do not materialize.

A more basic reason for rejecting the invoice cost standard is that it is a move in the wrong direction for competition policy. Price below marginal cost is presumptive evidence of predatory conduct in Sherman Act cases.²⁰⁸ Most economic and legal authorities maintain that predatory pricing can occur at prices in excess of marginal cost.²⁰⁹ The marginal cost standard is therefore too harsh and has worked to emasculate federal antitrust enforcement in predatory pricing. Six percent markups, at least in grocery retailing, are probably below marginal cost; invoice cost is clearly below marginal cost. To recommend a standard more severe than marginal cost would cripple the sales-below-cost laws as an alternative mechanism for reaching predatory pricing. Minimum markups at minimum levels are acceptable.

Notes

* Doctoral candidate, Department of Agricultural Economics, University of Wisconsin-Madison; J.D., University of Wisconsin Law School, 1984.

** William F. Vilas Research Professor of Agricultural Economics, Professor of Economics, and Professor of Law, University of Wisconsin-Madison.

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1. Competition policy is a way to regulate market performance indirectly. At various times we have directly regulated performance in areas such as transportation, safety, pollution, and wages and prices. Mueller, "Food Industry Structure and Performance," 61 Amer. J. Agri. Econ. 798 (1979).

2. J. Dirlam and A. Kahn, Fair Competition: The Law and Economics of Antitrust Policy 17 (1970 reprint).

Competition policy has its social and political dimensions as well. Just as a democracy is suspicious of individual assertions of political power, competition policy is suspicious of concentrations of economic power. Id.

3. Id. at 18. See also F. Scherer, Industrial Market Structure and Economic Performance 491 (2d. ed. 1980) [hereinafter cited as Scherer].

Lande notes that while there is unanimous agreement that Congress passed the antitrust laws to encourage competition, there is much less agreement as to Congress' ultimate goals. Lande concludes that the federal antitrust laws represent a congressional desire "to define and protect consumers' property rights, an antipathy toward corporate aggregations of economic, social, and political power, and a concern for small entrepreneurs." In particular, Congress sought to prevent unfair wealth

transfers from consumers to firms with market power. "Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged," 34 Hastings L.J. 65, 67-69, 150 (1982). Bork, on the other hand, argues that antitrust laws were designed to enhance economic efficiency as the means of promoting consumer welfare. The Antitrust Paradox ch. 2 (1982).

4. The discussion in Part III shows that sales-below-cost laws are substantially alike. We will refer to these laws as sales-below-cost laws because that label more generally covers all laws. It also avoids any confusion that might come from thinking that minimum markup laws require all sellers to mark up merchandise by a given amount. In this paper we do not trace the historical forces responsible for the sales-below-cost laws. Others have done this well. And, too often, the attention to Depression origins detracts from looking at the laws in their current context. E.g., Henderson, "Selling Below Cost in Wyoming," 1 Land & Water 235 (1966) [hereinafter cited as Henderson]; Comment, "Sales Below Cost Prohibitions: Private Price Fixing under State Law," 57 Yale L.J. 391 (1948); Grether, "Experience in California with Fair Trade Legislation Restricting Price Cutting," 24 Cal. L. Rev. 640 (1936) [hereinafter cited as Grether].

5. Ark. Stat. Ann. § 70-303 (1979);
 Cal. Bus. & Prof. Code §§ 17000-17100 (West 1964 and Supp. 1984);
 Colo. Rev. Stat. §§ 6-2-101 - 6-2-117 (1973 and Supp. 1983);
 Hawaii Rev. Stat. §§ 481-1 - 481-11 (1976);
 Idaho Code §§ 48-401 - 48-413 (1977 and Supp. 1984);
 Ky. Rev. Stat. §§ 365.020 - 365.070 (1971);
 La. Rev. Stat. Ann. §§ 51:412 - 427 (West 1965);
 Me. Rev. Stat. Ann. tit. 10 §§ 1201 - 1207 (1980 and Supp. 1984);
 Md. Com. Law Code Ann. §§ 11-401 - 406 (1983);

Mass. Gen. Laws Ann. ch. 93, § 14E-K (West 1974);
Minn. Stat. §§ 325D.01 - 325D.08 (1981);
Mont. Code. Ann. §§ 30-14-201 - 30-14-224 (1983);
N.D. Cent. Code §§ 51-10-01 - 51-10-14 (1981);
Okla. Stat. tit. 15, §§ 598.1 - 598.11 (1965);
73 Pa. Cons. Stat. §§ 211 - 217 (1971);
R.I. Gen. Laws §§ 6-13-1 - 6-13-8 (1969);
S.C. Code Ann. § 39-3-150 (Law. Co-op. 1976);
Tenn. Code Ann. §§ 47-25-201 - 47-25-206 (Supp. 1979);
Utah Code Ann. §§ 13-5-1 - 13-5-18 (1972 and Supp 1983);
W. Va. Code §§ 47-11A-1 - 47-11A-7 (1980 and Supp. 1983);
Wis. Stat. § 100.30 (1982);
Wyo. Stat. §§ 40-4-101 - 40-4-116 (1977 and Supp. 1984).

6. See discussion in Parts II and III infra.

7. Id.

8. In 1982 consumers spent \$255 billion for food-at-home. This represented 11.7 percent of their disposable personal income. United States Department of Agriculture, Food Consumption, Prices, and Expenditures: 1962-82 Table 85 at 98 (1983). Grocery store sales in 1982 were \$233 billion. United States Bureau of the Census, Revised Monthly Retail Sales and Inventories: January 1974 through December 1983 Table 1 at 6 (1984).

9. Questionnaires on enforcement and effectiveness of state sales-below-cost laws were sent in 1983 to the 25 states having the law in 1983. Some response was received from all states but Louisiana, Rhode Island, and Tennessee. Oklahoma, South Carolina, and Virginia declined to provide any response due to limited staff time. The most complete

responses and hence those to which we refer most were received from Arkansas, California, Colorado, Hawaii, Idaho, Minnesota, Montana, Washington, West Virginia, Wisconsin, and Wyoming. Copies of the questionnaires are available from the authors on request.

10. Approximately 100 members of the Wisconsin Association of Food Dealers responded to their Board of Directors' 1983 survey on the Wisconsin sales-below-cost law. The results were shared with the authors of this study.

Members of the Wisconsin Association of Food Dealers, now the Wisconsin Grocers Association, Inc., operated about 1,100 food stores in 1983. Nine hundred members operated one store; 65 to 75 operated two to ten stores; and 15 to 17 operated 11 or more stores. Letter from John H. Ellingson, President of WGA, Inc., to Willard F. Mueller (August 31, 1984).

11. Confidential questionnaires on the Wisconsin sales-below-cost law were sent in 1983 to 18 grocery warehouse-type store operators in Wisconsin. Seven operators responded. These seven operators ran 47 retail warehouse grocery stores in Wisconsin in 1982 with total sales of about \$680 million annually. Of the 11 warehouse operators not responding, nine were single-store operators with annual sales between \$10 million and \$20 million. The remaining two were large warehouse operators with sales per store exceeding \$20 million annually. Copies of the questionnaire are available from the authors on request.

12. See, e.g., Ark. Stat. Ann. § 70-303 (1979);
Cal. Bus. & Prof. Code § 17043 (West 1964 and Supp. 1984);
Minn. Stat. § 325D.04 (1981).

13. See, e.g., Idaho Code § 48-402 (1977 and Supp. 1984);
Wis. Stat. § 100.30(1) (1982).

14. Since this has no statutory foundation, we treat it in Part III where we assess the effectiveness of the sales-below-cost laws.

15. Caves, American Industry: Structure, Conduct Performance at 14 (4th ed. 1977) [hereinafter cited as Caves].

16. Scherer, supra note 3, at 3.

17. Id.

18. Caves, supra note 15, at 14.

19. A perfectly competitive market has the following structural characteristics: each participant in the market has so small a share of market sales or purchases that no perceptible influence on price can be exerted independently; there is free entry and exit; the product is homogeneous; and all market participants possess complete and perfect knowledge. In an imperfectly competitive market these structural conditions have been violated to some extent. Firms may be able to influence price; there may be barriers to entry or exit; the product may be differentiated; and market participants may not have perfect knowledge.

20. A normal profit is the return a businessperson receives on the personal investment in the firm. This return on investment represents the opportunity cost of the investment, the return on the investment in the next best alternative.

21. This is Posner's definition of predatory pricing. Antitrust Law: An Economic Perspective 188 (1976) [hereinafter cited as Posner].

22. Clark, "Statutory Restrictions on Selling Below Cost," 11 Vand. L. Rev. 105, 108-109 (1957) [hereinafter cited as Clark].

23. For a conglomerate with over a billion dollars in sales a year, the losses from a store involved in a price war will be insignificant in the context of overall profitability. For example, International Telephone

& Telegraph Corporation (ITT) is one of the largest food manufacturers in the United States; its 1980 food sales exceeded \$1.8 billion. ITT owns Continental Baking Company, one of the largest U.S. baking companies. From 1971 through 1974, ITT-Continental lost \$5.3 million in the San Francisco area from selling below cost. This represented less than one percent of ITT-Continental net sales of \$3,774,645,000 for the same period and only a minuscule portion of ITT net sales of \$37.6 billion for the same period. Mueller, "The Food Conglomerates," in Food Policy and Farm Programs 54, 58-59 (Hadwiger and Talbot eds. 1982) and Moody's Industrial Manual (selected years).

24. If predatory conduct in one market serves to discipline rivals or deter entry in other markets where the predator operates, profitability does not depend solely on increased revenues in the long run from the market where the price cutting occurs.

25. McCarthy, "Whatever Happened to the Small Businessman? The California Unfair Practices Act," 2 U.S.F.L. Rev. 165, 174-75 [hereinafter cited as McCarthy]. (The small businessman is not necessarily the inefficient businessman.)

26. Id.

27. E.g., Clark, supra note 22, at 108-109 (1957).

28. Leeman, "The Limitations of Local Price-Cutting As a Barrier to Entry," 64 J. Pol. Econ. 329, 330 (1956) [hereinafter cited as Leeman].

29. Id.

30. B. Marion, R. Parker, and C. Handy, "Organization and Performance of Food Distribution Industries," in The Organization and Performance of the U.S. Food System (forthcoming) [cited hereinafter as "Food Distribution Industries"].

National Commission on Food Marketing, Organization and Competition in Food Retailing 153-58 (Technical Study No. 7, June 1966).

31. B. Marion, W.F. Mueller, R. Cotterill, F. Geithman, and J. Schmelzer, The Food Retailing Industry: Market Structure, Profits, and Prices 26-27 (1979) [hereinafter cited as Food Retailing Industry].

That entry barriers exist and are rising is borne out by the persistent increase in the concentration of grocery store sales in metropolitan areas. "Food Distribution Industries," supra note 30.

32. "Did the Unfair Sales Act [sales-below-cost law] help you start your business and/or to open new stores?"

33. See note 11 supra.

A grocery warehouse-type store competes for the consumer's dollar at retail on price terms. Whereas conventional supermarkets have gross margins--the difference between selling price and the cost of merchandise, expressed as a percentage of selling price--of about 20 to 22 percent, abstracted from Robert Morris Associates, Annual Statement Studies (1982 ed.), warehouse stores in the authors' survey had gross margins from 12 to 16 percent but concentrated in the 12 to 14 percent range. The warehouse store can operate at a lower unit cost because it provides fewer services than a traditional grocery store. For example, products may not be as attractively arranged or consumers may have to bag their own groceries. In the words of one warehouse store operator, "[t]he theory of a warehouse store is not to sell merchandise below cost, but rather to maintain a low pricing structure on every item carried." Warehouse store operator responses are particularly significant to this study because if sales-below-cost laws inhibit competition by requiring too high margins, as some commentators assert, the laws would especially harm these low margin sellers.

34. "Have you encountered extensive below-cost selling by competitors in any year since you opened your first warehouse store in Wisconsin?"

35. In their study of profit and price performance in the food retailing industry, researchers at the University of Wisconsin calculated the relationship during the early 1970's between market structure and firm profits for leading retail grocery firms. Their results illustrate a retail grocery firm's incentive to engage in predation. The incentive derives from larger market sales and from enhanced profits in more concentrated markets. With this incentive, a firm will seek to increase its market share or to preserve an existing dominant position.

Private actions alleging predatory pricing in grocery retailing have occurred in recent years in Pueblo, Colorado, *Shoppin' Bag of Pueblo, Inc. v. Dillon Companies, Inc.*, No. 81-Z-1548 (D. Colo. 1979), in San Antonio, Texas, *Deluxe Stores, Inc. v. H.E. Butt Grocery Co.*, Civil Action No. SA81CA117 (W.D. Texas 1981); *Handy Andy, Inc. v. H.E. Butt Grocery Co.*, Adversary Proceeding No. 5-82-0291-T (W.D. Texas 1982); and *Centeno Supermarkets, Inc. v. H.E. Butt Grocery Co.*, Civil Action No. B84-46 (S.D. Texas 1984). Earlier cases occurred in Cincinnati, Ohio, *Parkview Markets v. Kroger Co.*, 1978-2 Trade Cas. (CCH) ¶ 62,373 (S.D. Ohio 1978) and with Safeway in the Southwest, as documented in National Commission on Food Marketing, Organization and Competition in Food Retailing 386-410 (June 1966).

36. Adelman, "Integration and Antitrust Policy," 63 Harv. L. Rev. 27, 59 (1949).

37. Id.

38. Leeman, supra note 28, at 331.

39. Id.

40. Id.

41. See notes 32-35 and accompanying text supra.

42. Mueller has shown that major corporations have devoted considerable resources to ventures sustaining short-term losses: Phillip-Morris, Inc. with Miller Brewing Company; Proctor & Gamble with Folgers Coffee and Pringles Potato Chips. "The Food Conglomerates," in Food Policy and Farm Programs 54, 59-62 (Hadwiger and Talbot eds. 1982). Leeman gives no reason why large firms would not subsidize losses from predatory pricing, too.

43. Posner, supra note 21, at 185-86.

44. A loss leader is an item with a selling price below the purchase cost of the item plus its handling and merchandising expenses. In grocery retailing, loss leaders include items important in the consumer's grocery budget. These items might include fresh meats, coffee, margarine, lettuce, potatoes, pet food, and paper products. Leed and German, Food Merchandising Principles and Practices 124-28 (1973).

45. The deception is implied because the firm never advertised the lowest prices in town, consumers were left to infer this for themselves. Importantly, the attention in the deception analysis is not with firms which base their profit objectives on genuinely low prices coupled with high volume. The deception argument centers on firms which advertise certain highly visible products at prices below cost, attempting to convey the false notion that all prices are relatively low in the store.

46. Empirical studies have shown that large firms enjoy significant economies of scale in advertising. See, e.g., W. Comanor and T. Wilson, "Advertising, Market Structure and Performance," 49 Rev. Econ. & Statistics 423 (1967). See also H.M. Mann, "Advertising, Concentration and

Profitability: The State of Knowledge and Directions for Public Policy," in Industrial Concentration: The New Learning (Goldschmid, Mann, and Weston, eds. 1974) [hereinafter cited as Mann]. The real and pecuniary advantages of large scale advertising are the major cause of increasing concentration in manufacturing industries. Mueller and Rogers, "The Rate of Advertising in Changing Concentration of Manufacturing Industries," 42 Rev. Econ. and Stat. 89 (1980).

47. The response would not necessarily include trying to maintain profit levels by raising the price on other products.

48. Padberg enumerates the costs of price specials in food retailing in "Food Industry Policy" (Cornell Agri. Econ. Staff Paper No. 75-2, January 15, 1975).

49. See text accompanying note 13 supra.

50. E.g., Idaho prohibits sales at less than cost with the intent or effect of inducing the purchase of other merchandise. Idaho Code § 48-404 (1977 and Supp. 1984). California is even more specific, distinguishing between intent to induce the purchase of other merchandise and the effect of misleading or deceiving purchasers. Cal. Bus. & Prof. Code §§ 17030 and 17044 (West 1964 and Supp. 1984). The economic objection from the conduct would be the same.

51. Clark, supra note 22, at 109.

52. Note, "Statutory Bans Against Selling Below Cost: The Latest Antidote for Big Business," 25 Va. L. Rev. 699, 700-701 (1940) [hereinafter cited as "Statutory Bans Against Selling Below Cost"]. ("[I]t is almost inconceivable that the traditionally thrifty American housewife would succumb to a ruse of this sort.")

53. Rodgers, "Unfair Sales Laws: Advantages and Objections," 38 ABAJ 921, 923, 965 (1952).

54. Id. at 965.

55. Food Retailing Industry, supra note 31, at 153.

56. J. Uhl, "Public Provision of Comparative Foodstore Price Information: Problems, Potentials, and Issues," in Advertising and the Food System 323, 343 (N.C. Project 117, Monograph 14, U.W.-Madison, Sept. 1983); Devine and Marion, "The Influence of Consumer Price Information on Retail Pricing and Consumer Behavior," 61 Amer. J. Agri. Econ. 228, 235-37 (1979); Food Retailing Industry, supra note 31, at 152.

57. For example, the meaning of deceptive under Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45 (1976), continues to evolve. In FTC v. Standard Education Society, 302 U.S. 112 (1937), the standard included protecting the ignorant and the credulous. In 1983, the FTC adopted new criteria for determining what is deceptive: An act or practice is deceptive if (1) a reasonable consumer is deceived, (2) to his detriment, (3) on a material fact, (4) which the consumer could not have easily avoided. "Dingell, Miller, Tangle over New Enforcement Policy on Deception," [July - Dec.] Antitrust & Trade Reg. Rep. (BNA) No. 1137, at 664-65 (Oct. 27, 1983).

58. Mann, supra note 46, at 140.

59. Specifically, the respondents answered that when the sales-below-cost law is effectively enforced, it keeps competitors with large advertising budgets from making extensive use of loss leaders.

60. Two respondents commented on this. "We have advertised merchandise below cost where competitors precipitated this action." "We meet all advertised retails by regular supermarkets and match all in-store retails by all warehouse competition."

61. At first blush, this response would seem to contradict the assumption in economic theory that prices would have already been set as high as market conditions warrant. Personal interviews of warehouse operators clarified this observation. In the absence of loss leader selling, warehouse stores generally price practically all grocery items below the prices of conventional supermarkets. However, if they are forced to respond to loss leader selling by competitors, they must raise the average price on the non-leader products. Although this is preferable to not responding to loss leader selling, it does result in a less than optimum price-product mix for the warehouse business format, making these operators less effective competitors. Their resulting smaller market share means a smaller percentage of consumers will enjoy the lower prices available from warehouse stores relative to conventional supermarkets or to those warehouse stores which gradually raise their margins as they gain market power. For the difference between conventional supermarket and warehouse margins, see note 33 supra.

62. Waxman, "Wisconsin Unfair Sales Act - Unfair to Whom?" 66 Marq. L. Rev. 293, (1983) [hereinafter cited as Waxman]; McCarthy, supra note 25, at 175-76.

63. "Statutory Bans Against Selling Below Cost" supra note 52, at 699.

64. Henderson, supra note 4, at 237-38.

65. McNair, "Marketing Functions and Costs and the Robinson-Patman Act," 4 Law & Contemp. Probs. 334 (1937).

66. Clark, supra note 22, at 111.

67. Comment, "Sales Below Cost Prohibitions: Private Price Fixing Under State Law," 57 Yale L.J. 391, 417 (1948).

68. Commentators have continued to observe the absence of empirical information. E.g., Houston, "Minimum Markup Laws: An Empirical Assessment," 57 J. Retailing 98, 101 (Winter 1981) [hereinafter cited as Houston]; Clark, supra note 22, at 127.

69. Houston, supra note 68; Cook, Deiter, and Mueller, "The Effects of Wisconsin's Minimum Markup Law" (Staff Paper No. 62, Dept Ag. Econ., U.W.-Madison) [hereinafter cited as Cook]; Paterson and Mueller, "State Sales-Below-Cost Laws: An Econometric Analysis of Effectiveness" (N.C. Project 117 Working Paper, Sept. 1984) [hereinafter cited as Paterson and Mueller].

70. See note 9 supra.

71. See note 10 supra.

72. See note 11 supra.

73. "Hearings on the Wisconsin Unfair Sales Act," Wisconsin Legislature Council, Special Committee on the Unfair Sales Act (Sept. 22, 1980) (tape recording available from Wisconsin Legislative Council, Room 147 N., State Capitol, Madison, Wisconsin).

74. Houston, supra note 68, at 101-102.

Houston provides no explanation for his hypothesis that sales-below-cost laws protect small business. In grocery retailing, small "Pa and Ma" type retailers have costs considerably higher than conventional supermarkets. The costs are so much higher that they have not been able to survive even when independent and chain supermarket competitors sell at prices covering average total cost.

75. Id. at 103-105.

76. Houston assumed that if a state had a sales-below-cost law, the state enforced it. He further implicitly assumed that all states enforced

the law with equal effectiveness. The enforcement data in the text corresponding to notes 100-106, infra, reveals that only a few states have had any enforcement. This fact casts considerable doubt on the validity of Houston's conclusions, something he appears to have considered but discounted. Houston, supra note 68, at 110.

77. The gross margin is the difference between sales price on an item and invoice cost, usually expressed as a percentage of the sales price. The net margin is the difference between sales price and selling plus invoice costs.

78. Cook, supra note 69.

The emphasis in the present study on Wisconsin data reflects more than the authors' convenient access to information. Enforcement data shows that Wisconsin has been one of the few states enforcing the sales-below-cost law. This means that businesspersons are aware of the law and may have had some experience with it. If the law's performance in Wisconsin where it has been given at least some attention is unacceptable, this would tend to support calls for repeal in Wisconsin and elsewhere.

79. Cook, supra note 69, at 22.

80. Firms having 11 or more outlets are called chain stores. Firms with from two to 10 stores are called small chains.

81. Id. at 25.

82. Id. at 25-26.

83. Paterson and Mueller, supra note 69.

84. Id. The study uses alternative measures to gauge the effectiveness of the laws. These measures include whether the SMSA was in a state having the law during the 1970's and budgetary commitment to enforcement.

85. The survey questions were: "Do you think the law has had any procompetitive (anticompetitive) effects in any of the areas covered by it?"

86. "In isolated cases, the statute has been used to prevent acquisition of regional monopolies by large interstate operations with the power to sustain predatory prices long enough to eliminate competition."

87. The enforcement agency expressed the belief that the law may have had a procompetitive effect in "groceries, liquor, drugstores, gasoline marketing, automobiles, and perhaps several other areas"

88. "It may have a chilling effect in the area of meeting competition on a short-term basis."

89. "It may raise consumer prices."

90. An assistant attorney general observed that Washington's prior law may have tended to stabilize prices, justified firms collecting competitors' pricing information, and preserved economically inefficient competitors.

91. "Those who obey the law can be hurt badly when competing with those who do not."

92. Most of the respondent states had no opinion on their respective law's pro- or anti-competitive effects in food retailing. Wyoming answered that the law had no effect.

93. Answers included: "helps keep small business surviving;" "acts as a deterrent;" "keeps large chains from driving me out of business."

94. Recommended changes were to increase enforcement and to change the law from a criminal to a civil offense.

95. There was some overlap between respondents in the authors' survey and those in the Wisconsin Association of Food Dealers survey. Fifteen to

20 percent of the Association's members operated warehouse stores in 1983. But whereas most members of the Association operated a single store, the seven warehouse respondents in the authors' survey operated 47 grocery warehouse stores. These operators had sales ranging from \$10 million to \$288 million in 1982 with gross margins generally between 12 and 14 percent. It is these warehouse operators who would most likely be hurt if the sales-below-cost law prevented them from competing by offering low prices. See notes 10, 11, and 33 supra.

96. A representative from a major grocery wholesaler noted in 1980 that the Wisconsin sales-below-cost law had "not stopped below cost selling completely but has acted as a deterrent to full scale price wars." "Hearings on the Wisconsin Unfair Sales Act," supra note 73 (statement of Robert Pavlik, Copps Corp.).

97. "Lots of paperwork is necessary to document pricing."

98. Explanations included the following:

"We can live with the law but it would help to have it enforced. I'm sure we could also live without it but with greater difficulty." "It would be helpful if [the law] were enforced, thus eliminating loss leaders and enabling a warehouse operation to maintain a low profit margin on all items." "The law has kept big chains from using A&P [Great Atlantic and Pacific Tea Company] methods of hitting operators in one place at a time." "It doesn't really change the prices that get out into the marketplace, it only adds to your paperwork load because you have to continually document your pricing in case the state comes after you a few months down the road."

99. See notes 93-98 and accompanying text supra.

100. Investigations for other states overall and in grocery retailing (overall/grocery retailing) were Idaho (100/20); Minnesota (86/5); Montana (12/6); West Virginia (15/0); Wyoming (0/0). Some states indicated these were estimates.

101. Colorado (0/0); Hawaii (2/2); (Idaho 0/0); Minnesota (46/1); Montana (6/3); West Virginia (4/0); Wisconsin (1155/679); Wyoming (0/0).

102. Montana reported one complaint; West Virginia estimated 15 complaints; Wisconsin had 10 complaints, 9 of which were in grocery retailing.

103. West Virginia estimated between 4 and 5 complaints. Wisconsin had 25 complaints; 11 were in grocery retailing.

104. Idaho observed that its former success depended on funding its legislature removed effective in 1979. The funding source had been a \$6.00 annual tax imposed on retailers and used for enforcement.

105. But see id.

106. Minnesota budgeted \$21,000 in 1981 and \$23,000 in 1982. Wisconsin spent \$30,291.37 in 1981 and \$37,360.89 in 1982.

107. Early challenges to sales-below-cost laws almost invariably charged that the state legislature had exceeded the police power of the state in passing the statute. E.g., *State v. Walgreen Drug Co.*, 57 Ariz. 308, 113 P.2d 650 (1941); *Lief v. Packard-Bamberger & Co.*, 123 N.J.L. 180, 8 A.2d 291 (1939); *State v. Langley*, 53 Wyo. 332, 84 P.2d 767 (1938). State courts have continued to reject these challenges, largely on authority from *Nebbia v. New York*, 291 U.S. 502 (1934). Early on, the courts held that sales-below-cost laws represent a valid exercise of police power if the legislature intended to promote the general welfare. *Avella v. Almac's, Inc.*, 100 R.I. 95, 103, 211 A.2d 665, 671 (1965). Preventing monopoly, fostering competition, and prohibiting unfair competition are reasonably designed to promote the general welfare. *State v. Consumers Warehouse Market*, 183 Kan. 502, 508, 339 P.2d 638, 644 (1958). Deterring predation and deception are consistent with promoting the general welfare,

Consumers Warehouse Market, 183 Kan. at 508, 339 P.2d at 644; Blum v. Engelman 190 Md. 109, 115, 57 A.2d 421, 423-24 (1948), and therefore are within the police power of the state. These challenges no longer seem to have much significance.

108. E.g., Lief v. Packard-Bamberger & Co., 123 N.J.L. 180, 185, 8 A.2d 291, 293 (1939); Commonwealth v. Zasloff, 338 Pa. 457, 461, 13 A.2d 67, 70 (1940).

109. Blum v. Engelman, 190 Md. 109, 115, 57 A.2d 421, 423 (1948).

110. W.M. Wiley v. Sampson-Ripley Co., 151 Me. 400, 402, 120 A.2d 289, 290 (1956).

111. State v. Walgreen Drug Co., 57 Ariz. at 317, 113 P.2d at 654-55
See also Baseline Liquors v. Circle K Corp., 129 Ariz. 215, 221, 630 P.2d 38, 44 (Ct. App. 1981).

112. Avella v. Almac's, Inc., 100 R.I. 95, 104, 211 A.2d 665, 671 (1965).

113. McCarthy, supra note 25, at 188-89; Henderson, supra note 4, at 243; Clark, supra note 22, at 114.

114. McCarthy contends that, contrary to the case law on point, there is no constitutional requirement for intent in sales-below-cost laws. Id. at 188-89.

115. Id.

116. Id. at 190.

117. Clark, supra note 22, at 114.

118. Id.

119. See LaRue, "Pitfalls for Price Competitors: State and Federal Restrictions on Below Cost or Unreasonably Low Prices," 15 W. Reserve L. Rev. 35, 46 (1963) [hereinafter cited as LaRue].

120. Id.
121. *Baseline Liquors v. Circle K Corp.*, 129 Ariz. at 221, 630 P.2d at 44 (1981).
122. *W.M. Wiley v. Sampson-Ripley Co.*, 151 Me. at 404, 120 A.2d at 291.
123. *Great Atlantic & Pacific Tea Co. v. Ervin*, 23 F. Supp. 70, 82 (D. Minn. 1938).
124. *Wiley*, 151 Me. at 407, 120 A.2d at 292-93.
125. *LaRue*, supra note 119, at 46-47. McCarthy observes that the evidence sufficient to rebut a presumption of intent has consisted of a chief executive officer merely answering at trial that there was no intent to hurt or injure a competitor. McCarthy, supra note 25, at 192.
126. *Great A&P*, 23 F. Supp. at 80; *Wiley*, 151 Me. at 406-407, 120 A.2d at 292.
127. The Minnesota and Maine courts did not consider the statutory exceptions each state had to the prohibition of sales at prices below cost.
128. McCarthy, supra note 25, at 193-94.
129. *Cohen v. Frey & Son, Inc.*, 197 Md. 586, 590, 80 A.2d 267, 269 (1951).
130. We call the provisions exceptions.
131. Idaho, Maryland, Pennsylvania, and Wisconsin specify this.
132. Sixteen states are in this group.
133. Eleven states specify the same product.
134. Idaho, Oklahoma, and Tennessee specify a product of comparable quality.
135. 360 U.S. 334 (1959).
136. Id. at 336.

Safeway complained that this meant it could not meet the price of competitors selling below cost. The Supreme Court held that there is no constitutional right to retaliate against action the state has outlawed. A seller can meet competition; a seller cannot beat competition. Id. at 336-37.

137. E.g., State v. Sears, 4 Wash. 2d 200, 216-17, 103 P.2d 337, 345 (1940).

138. Id.

139. The California Attorney General's Office responded to the question of which factors limit effectiveness by noting that a firm will usually defend its actions saying it is meeting competition. See McCarthy, supra note 25, at 194. Henderson complains that this exception allows a merchant to violate the statute if a competitor does so first. Henderson, supra note 4, at 263.

140. McCarthy, supra note 25, at 194.

141. LaRue, supra note 119, at 49.

Although not treated much in the principal cases, commentators have anticipated some confusion concerning what are the same products. Specifically, can competitors meet a price cut on a product which is a substitute but is not identical. LaRue urges courts to allow competitors some latitude when dealing with the infinite variety of distinguishing characteristics in a single product line. LaRue, supra note 119, at 50.

142. For a discussion of the meeting competition defense in the context of the Robinson-Patman Act, 15 U.S.C. § 2(b) (1976), see Sullivan, Handbook of the Law of Antitrust 702-703 (1977).

143. Like Tables 1, 2, 3, and 5, Table 4 presents an overview. While the tables are fairly accurate, we do not intend them to be a guide for defining causes of action in the various jurisdictions.

144. Mont. Code Ann. § 30-14-211 (1983).

145. North Dakota and South Carolina make no provision for selling costs.

146. See Table 4 supra.

147. To the lesser of invoice or replacement cost, Colorado adds the specific costs of doing business.

148. California allows for either adding the specific costs of doing business or a 6 percent markup. See Table 4 supra.

149. The principal case is State v. Langley, 53 Wyo. 332, 84 P.2d 767 (1938).

150. Langley, 53 Wyo. at 365, 84 P.2d at 769. See also State v. Sears, 4 Wash. 2d at 212-13, 103 P.2d at 342-44; Associated Merchants of Montana v. Ormesher, 107 Mont. 530, 549, 86 P.2d 1031, 1036 (1939).

151. LaRue, supra note 119, at 65.

152. The concern here is with promotions where a customer receives a "gift" upon purchasing another product. Waxman, supra note 62, at 299; Henderson, supra note 4, at 240-41. Wisconsin requires the price charged on the second product to cover its cost as well as the cost of the "gift." Wis. Stat. § 100.30(2)(1) (1982). Waxman points out some inconsistency in the Wisconsin law: The loss leader is always unlawful; the gift is unlawful only if price does not cover the cost of all products. Waxman, supra note 62, at 299 n.44.

153. Clark, supra note 22, at 121-23.

154. Id. See also McCarthy, supra note 25, at 179-80; LaRue, supra note 119, at 44-45. But whether this really presents a problem depends on the size of the markup. See text accompanying notes 172-75 infra.

155. Trade discounts are often not defined in the statutes. E.g., Hawaii Rev. Stat. §§ 481-1 - 481-11 (1976). Wisconsin Statute § 100.30 (2)(n) defines trade discounts in terms of what they are not.

The term trade discount shall not include advertising, display or promotional allowances in the absence of a statement in writing from the grantor that receipt of such allowance is not conditioned on the performance of any service or expenditure of any money for promotion, advertising or any other purpose.

The Wisconsin attorney general interprets this to mean "a deduction from a manufacturer's (or other supplier's) list price which ostensibly relates solely to the terms and conditions of sale to the retailer unless some other form of deduction is explicitly included or excluded by the statute itself." 72 Op. Att'y Gen. 126, 128 (1983). See also State v. Eau Claire Oil Co., 35 Wis. 2d 724, 740, 151 N.W.2d 634, 642 (1967).

156. Minnesota pointed to the exclusion of cash discounts in its cost definition as a factor limiting the effectiveness of its sales-below-cost law. See also Cohen v. Frey & Son, Inc., 197 Md. at 607-10, 80 A.2d at 276-79; Clark, supra note 22, at 120.

157. Clark, supra note 22, at 120.

Statutes not allowing cash discounts do allow for evidence of a lesser cost of doing business than the statutory formula for cost would indicate.

158. See Table 4, column 9, supra.

159. Avella v. Almac's, Inc., 100 R.I. at 106-108, 211 A.2d at 672-73; State v. Consumers Warehouse Market, Inc., 183 Kan. at 511-13, 329 P.2d at 646-47; State v. Walgreen Drug Co., 57 Ariz. at 314-17, 113 P.2d at 653-54.

160. E.g., State v. Walgreen, 57 Ariz. at 314-17, 113 P.2d at 654.

161. See Table 4, column 10, supra.

162. See Table 4, column 7, supra.

163. Wisconsin is typical: "to which shall be added a markup to cover a proportionate part of the costs of doing business, which markup, in the absence of proof of a lesser cost, shall be 6%" of the delivered cost to the retailer. Wis. Stat. § 100.30(2)(b) (1982).

164. See, e.g., *Baseline Liquors v. Circle K Corp.*, 129 Ariz. at 218-20, 630 P.2d at 42-43; *State v. Sears*, 4 Wash. 2d at 218-21, 103 P.2d at 345-46. Courts also vigorously reject arguments that sales-below-cost laws and fair trade laws are identical. See, e.g., *Baseline Liquors*, 129 Ariz. at 222, 630 P.2d at 45; *Rice v. Alcoholic Beverage Control Appeals Board*, 21 Cal. 3d 431, 458, 146 Cal. Rptr. 585, 603, 579 P.2d 476, 494 (1978).

165. *Baseline liquor*, 129 Ariz. at 219, 630 P.2d at 42.

166. *Ivan's Tire Service Store v. Goodyear Tire & Rubber Co.*, 86 Wash. 2d 513, 514-15, 546 P.2d 109, 110 (1976); *Rust v. Griggs*, 172 Tenn. 565, 576-77, 113 S.W.2d 733, 737 (1938). *Grether*, supra note 4, at 687.

167. *Clark*, supra note 22, at 124-25.

168. Id. at 125.

169. Delivered costs refer to invoice costs and any costs associated with delivering the product to the store for sale.

170. It is important to note that minimum markups are expressed as a percentage of delivered costs--the cost of a product delivered to the store. The markups are not expressed as a percent of sales price. As a percent of delivered cost, markups will be less than when expressed as a percent of sales price. For example, if price equals 100 and delivered cost equals 80, a markup of 6 percent of sales price to cover selling costs net of delivered cost would be 6. But 6 percent of delivered cost is $.06(80) = 4.8$.

171. Grether, supra note 4, at 689.

172. The industries included automobiles, building materials, department stores, drugs, gasoline, groceries, and liquor. Robert Morris Associates, Annual Statement Studies (1982 ed.).

173. Six percent is the most frequently occurring markup at retail. See Table 4, column 7, supra.

174. The remaining percentages were building materials at 18.2 percent; drugs at 12.8 percent; and liquor at 26.2 percent.

175. See note 33 and text accompanying notes 95-98 supra.

176. Average total cost is total cost divided by output. In the short run, when some costs are fixed, it is the sum of average variable and average fixed cost.

177. Marginal cost is the addition to total cost attributable to the addition of one unit to output.

178. There has been an extensive debate on the appropriate legal-economic rules for defining when a price is predatory. Among the contributions are Areeda and Turner, "Predatory Pricing and Related Practices under Section 2 of the Sherman Act," 88 Harv. L. Rev. 697 (1975); Posner, supra note 21, at 184-96; and Joskow and Klevorick, "A Framework For Analyzing Predatory Pricing Policy," 89 Yale L.J. 213 (1979).

Most courts have now agreed that sustained sales at prices below average variable cost--the proxy for marginal cost--should be rebuttably presumed to be predatory. Prices equal to or greater than average variable cost are not necessarily predatory. E.g., D.E. Rogers Associates, Inc. v. Gardner-Denver Co., 718 F.2d 1431, 1437 (6th Cir. 1983), cert. denied, 52 U.S.L.W. 3886, 3891 (U.S. June 12, 1984); William Inglis & Sons Baking Co. v. ITT Continental Baking Co., 668 F.2d 1014, 1035-36 (9th Cir. 1981),

cert. denied, 459 U.S. 825 (1982); *Northeastern Tel. Co. v. AT&T Co.*, 651 F.2d 76, 88 (2d Cir. 1981), cert. denied, 455 U.S. 943 (1982); *International Air Industries, Inc. v. American Excelsior Co.*, 517 F.2d 714, 724 (5th Cir. 1975), cert. denied, 424 U.S. 943 (1976). The FTC announced its similar rule in *International Telephone & Telegraph* [July-Dec.] Antitrust & Trade Reg. Rep. (BNA) No. 117, at 283, 286 (Aug. 9, 1984).

179. See Table 4, column 8, supra.

180. Challenges based on indefiniteness or uncertainty have not succeeded. Courts generally have held that the cost survey provision is not unconstitutionally indefinite or uncertain if the legislature has made the survey competent evidence of cost. *State v. Sears*, 4 Wash. 2d at 214-16, 103 P.2d at 344-45; *Associated Merchants of Montana v. Ormesher*, 107 Mont. at 548, 86 P.2d at 1035-36. The Minnesota Supreme Court held part of an early version of its sales-below-cost law unconstitutional because the law made cost surveys prima facie evidence of everyone's cost, disallowing rebuttal. *Great Atlantic & Pacific Tea Co. v. Ervin*, 23 F. Supp. 70, 82-83. (D. Minn. 1938).

181. Henderson, supra note 4, at 257-59; Comment, "Sales Below Cost Prohibitions: Private Price Fixing Under State Law," 57 Yale L.J. 391, 417 (1948).

182. Henderson, supra note 4, at 256.

183. Id. at 257-59.

184. Section 1 of the Sherman Act prohibits conspiracies to restrain trade. 15 U.S.C. § 1 (1976). The Supreme Court has treated horizontal price fixing as a per se violation of § 1. *United States v. Socony-Vacuum Oil Co., Inc.*, 310 U.S. 150, 223 (1940). If abused, the cost survey would seem to serve as the policing device for a price fixing conspiracy.

185. Idaho, Montana, North Dakota, and Wisconsin give some enforcement authority to state agencies or boards.

186. See text accompanying notes 113-18 supra.

187. This may reflect a lower level of enforcement in the other states. See notes 100-106 and accompanying text supra.

188. This is also apparently because an injunction is the best that public enforcement achieves.

189. E.g., Waxman, supra note 62, at 301-302.

190. See note 60 and accompanying text supra.

191. See notes 28-29 and 51-52 and accompanying text supra.

192. See notes 32-35 and accompanying text supra.

193. See note 96 supra.

194. Washington attributed the 1983 repeal of its sales-below-cost law legislation it considered to have easier standards of proof, no intent requirement, and a relatively more attractive penalty structure. Wash. Rev. Code § 1986 (Supp. 1983). Maine responded that it uses its antitrust laws when it confronts predatory pricing, but it cited no instances of enforcement.

195. 15 U.S.C. § 3 (1976).

196. 15 U.S.C. § 45 (1976).

197. 15 U.S.C. § 13(a) (1976).

198. See note 178 supra.

199. See notes 93-98 and accompanying text supra.

200. E.g., Henderson, supra note 4; Clark, supra note 22.

201. Mueller describes diminishing federal antitrust enforcement in the food system in J. Connor, R. Rogers, B. Marion, and W.F. Mueller, The Food Manufacturing Industries ch. 8 (1984).

202. In particular, we recommend that states allowing sellers to meet a competitor's existing price amend their statutes to authorize, at most, meeting in good faith a competitor's legal price. See text accompanying note 142 supra.

203. A grocery retail warehouse operator observed that violators "love the publicity" when charged with selling below cost.

204. See note 117 and accompanying text supra.

205. A majority of the members of the Special Committee on the Wisconsin Unfair Sales Act made this recommendation to the Wisconsin Legislative Council in 1980. "Hearings on the Wisconsin Unfair Sales Act," Wisconsin Legislative Council (December 15, 1980) (tape recording available from Wisconsin Legislative Council, Room 147 N., State Capitol, Madison, Wisconsin). The legislature did not adopt the recommendation. See Table 4, column 7, supra.

206. A loss leader's effectiveness in grocery retailing depends to some extent on market conditions. In a market where there is already extensive price cutting, a markdown below cost of 50 percent may be needed to attract consumers. In a relatively more stable market, markdowns to 70 to 80 percent of wholesale cost may be sufficient to attract consumers. Telephone interview with Robert Park, Compliance Officer, Wisconsin Dept. of Agriculture, Trade, and Consumer Protection, Madison, Wisconsin (Aug 20, 1984).

207. See notes 172-74 and accompanying text supra.

208. See note 178 supra.

209. Id.

