SB 140

F007890

FEDERAL TRADE COMMISSION
Chicago Regional Office

AUTHORIZED

Suite 1437
55 East Monroe Street
Chicago, Illinois 60603
Area Code 312 353-8156

April 22, 1987

The Honorable John Norquist
State Senator
State Capitol
P.O. Box 7882
Madison, WI 53707-7882

Dear Mr. Norquist:

The Federal Trade Commission staff is pleased to have this opportunity to respond to your letter of March 6, 1987, requesting our comments on Senate Bill 140.[1] In essence, SB 140 would have the effect of repealing Wisconsin's Unfair Sales Act,[2] which prohibits sales below cost and encourages fixed profit margins for certain items of merchandise. We support SB 140. By removing the pricing restraints contained in the present Act, SB 140 will enable consumers to benefit from lower and more competitive prices.

Our interest in this legislation stems from the Commission's mandate to enforce the antitrust and consumer protection laws of the United States. Section 5 of the Federal Trade Commission Act prohibits unfair methods of competition, and unfair or deceptive acts or practices. In enforcing this statute, the Commission staff has gained substantial experience in analyzing the impact of various restraints on competition and the costs and benefits to consumers of such restraints. The Federal Trade Commission has been specifically involved in "below-cost" pricing issues and has expressed opposition to anticompetitive state and federal pricing legislation during recent years. In 1985 the Commission staff submitted comments in opposition to legislation in South

---

1 The views presented in this letter are those of the Chicago Regional Office and Bureaus of Competition, Consumer Protection, and Economics and are not necessarily those of the Commission itself nor of any individual Commissioner, although the Commission has authorized the presentation of these comments.

2 Wis. Stat. § 100.30 (1985-86).

Carolina[3] and North Carolina[4] which would have banned so-called "below-cost" pricing. The Commission also filed an amicus brief in Snider v. Wal-Mart Stores, No. 84-C-436-E (N.D. Okla. 1986), arguing that an Oklahoma statute, which prohibited retailers from selling goods at discounted prices, would result in harm to competition and to consumers in general. These matters, coupled with the Commission's familiarity with and responsibility for the enforcement of the federal antitrust laws, have provided Commission staff with substantial experience in analyzing the potential competitive consequences of below-cost pricing provisions.

1. Brief Description of the Wisconsin Unfair Sales Act

Under the Wisconsin Unfair Sales Act, the selling of merchandise below cost to attract patronage is deemed a form of deceptive advertising and an unfair method of competition.[5] This Act goes far beyond federal prohibitions against predatory pricing. It also encourages a uniform mark-up to be included for overhead in the "cost" of tobacco products, alcoholic beverages, and gasoline.[6] For these three categories of merchandise, the statute requires that retailers include a markup of six percent[7] for overhead, in the absence of proof of lesser overhead costs. For the same three categories of merchandise, wholesalers are presumptively required to add an overhead allowance of three percent.[8] For all other items of merchandise, overhead need not be included in the calculations of cost.[9]

---

3 Comment Letter on South Carolina House Bill 2663, May 14, 1985.

4 Comment Letter on North Carolina Senate Bill 73, March 27, 1985.

5 Wis. Stat. § 100.30(1).

6 Id. at § 100.30(2)(a) 1 and § 100.30(2)(c) 1.a.

7 Id. at § 100.30(2)(a) 1.

8 Id. at § 100.30(2)(c) 1.a.

9 Id. at § 100.30(2)(a) 2 and § 100.30(2)(c)(2).

Under the Act, neither a retailer nor a wholesaler may sell any item of merchandise at less than cost with the "intent or effect of inducing the purchase of other merchandise or of unfairly diverting trade from a competitor."[10] If a retailer or wholesaler violates this provision, the Department of Agriculture, Trade, and Consumer Protection or a district attorney may sue for injunctive relief or to recover a forfeiture.[11] The Act establishes a rebuttable presumption of intent to injure a competitor once the defendant has been shown to have sold merchandise at less than the statutory "cost."[12] Thus, the burden of proof is shifted to the defendant.

---

10 The Act contains certain limited exceptions to its prohibition against below cost sales. There is no violation of the Act if:

1. Merchandise is sold in bona fide clearance sales.
2. Perishable merchandise must be sold promptly in order to forestall loss.
3. Merchandise is imperfect or damaged or is being discountinued.
4. Merchandise is sold upon the final liquidation of any business.
5. Merchandise is sold for charitable purposes or to relief agencies.
6. Merchandise is sold on contract to departments of the government or governmental institutions.
7. The price of merchandise is made in good faith to meet an existing price of a competitor and is based on evidence in the possession of the retailer or wholesaler in the form of an advertisement, proof of sale or receipted purchase.
8. Merchandise is sold by any officer acting under the order or direction of any court.

Id. at § 100.30(6).

11 Id. at § 100.30(4) and § 100.30(5)(a) and (b).

12 Id. at § 100.30(3).

2. Anticompetitive Effects of the Current Law

a. Requirement that Sales be Above Cost Unnecessarily Raises Consumer Prices

The Wisconsin Unfair Sales Act was enacted in 1939 for the purpose of preventing large retailers from selling merchandise below cost.[13] Despite the existence of the antitrust laws, some retailers were thought to need additional protection from predatory pricing schemes.[14] However, recent economic literature indicates that predatory pricing is a very rare phenomenon. As a result, Wisconsin's prohibitions on sales below cost operate primarily to deprive consumers of lower and more competitive prices without offering them any compensating benefits.

One major problem with the statute is that predatory pricing is not easily identified. As stated by the Commission in its ITT Continental Baking Company decision:

> Price is the "central nervous system of the economy" and vigorous and healthy competition engenders economic efficiency which redounds to the benefit of consumers. By contrast, overly zealous efforts to prevent sales at prices below cost are likely to reduce competition and increase prices. Therefore, we must carefully avoid adopting a predatory pricing rule that will deter legitimately competitive pricing conduct.[15]

The Commission has adopted a standard for analyzing predatory pricing allegations that raises a strong presumption that sales at prices equal to or exceeding average variable cost are

---

13 Waxman, Wisconsin's Unfair Sales Act -- Unfair to Whom?, 66 Marq. L. Rev. 293 (1983).

14 Id.

15 ITT Continental Baking Company, Inc., 104 F.T.C. 280 (1984) (Bailey and Pertschuk, Commissioners concurring in part and dissenting in part).

legal.[16] In contrast, Wisconsin has adopted a broad predatory pricing standard that would tend to prohibit some sales that are clearly above average variable cost. Thus, in its attempt to prevent predatory pricing, Wisconsin runs an undesirable risk of suppressing legitimate, pro-competitive pricing activity.

In addition to the difficulties and risks associated with defining a predatory pricing standard, it has become increasingly clear that predatory pricing activities are unlikely to occur. As the Supreme Court noted in Matsushita Electric Industrial Co. v. Zenith Radio Corp., a firm that is planning on predation must make a substantial investment with no assurance of a payoff.[17] For a predatory pricing scheme to be successful, the predator must be able to sustain losses for a significant period of time, and there must be substantial barriers prohibiting the entry of new firms into the industry once the predator seeks to raise prices and recoup the losses.[18] For these reasons the United States Supreme Court has stated that "there is a consensus among commentators that predatory pricing schemes are rarely tried, and even more rarely successful."[19] The Wisconsin Unfair Sales Act therefore may deter legitimate, competitive pricing for the purpose of prohibiting an activity that is thought to occur only rarely.

Even if predatory pricing activity occurred, it could be attacked under the Sherman Act, the Clayton Act, or the Federal Trade Commission Act, as well as under Wisconsin's antitrust laws. The enforcement standards developed over the years in antitrust prosecutions should deter firms from engaging in predatory behavior, without correspondingly evoking the anticompetitive effects that result when sales are generally required to be above cost.

---

16 For a more in-depth discussion of the Commission's predatory pricing standard, see ITT Continental Baking Company, supra note 14, at 402-6 and General Foods Corporation, 103 F.T.C. 204, 342-5 (1984).

17 106 S.Ct. 1348, 1357 (1986).

18 Id.

19 Id. at 1357-8. See generally predatory pricing studies cited therein.

Another purpose and effect of the Wisconsin Unfair Sales Act is that it prevents a type of below cost pricing that involves the use of loss leaders. A "loss leader" is a popular and quite ordinary form of promotion in which the seller takes a loss on one or several items in order to induce customers to patronize his or her store. From the retailer's standpoint, loss leaders represent a profitable investment in goodwill that may ultimately increase patronage. Loss leaders are not a type of predatory pricing, but rather are a temporary loss on selected items of merchandise. Accepting a lower profit margin or even a loss on certain merchandise is a classic and effective method of price competition. For new entrants that need to develop a patronage, loss leaders may be particularly useful. Moreover, from the standpoint of consumers, loss leader advertising and other types of selective discounting are desirable because they result in lower prices on selected goods. Under the Wisconsin Act, however, the use of this particular procompetitive selling device is prohibited.

Moreover, the Wisconsin Unfair Sales Act is not necessary to prevent deception. Some have argued that prohibiting below cost sales might suppress bait-and-switch merchandising schemes. In such schemes, the seller advertises a low-priced item to lure customers into his or her store, but then attempts to induce buyers to purchase higher-priced substitute models. As with predatory pricing schemes, it is often difficult to distinguish bait-and-switch schemes from legitimate competitive activity. In any case, the FTC Act, as well as Wisconsin law, already prohibits deceptive sales practices. Bait and switch schemes may be effectively prosecuted without broadly prohibiting below-cost pricing.

b. Minimum Markup Presumptions Chill Price Discounting

The provisions of the current Act further may have the effect of discouraging efficient efforts to minimize overhead in both wholesale and retail distribution. For example, by defining cost for retailers of cigarettes, liquor, and gasoline as generally including a markup of six percent for overhead, the Wisconsin statute chills discount pricing and encourages fixed profit margins for these items. Even when a retailer has an overhead of less than six percent, the retailer may be reluctant to lower his price accordingly for fear that he may have to bear the substantial costs associated with a lawsuit. The Act may

also impose unnecessary costs on retailers by requiring them to set up accounting systems that specifically allocate overhead expenses among the three categories of merchandise. Finally, there appears to be no sound empirical basis for specifying three percent and six percent as the appropriate mark-up.

3. Conclusion

We believe that the Wisconsin Unfair Sales Act is contrary to the public interest because, by prohibiting sales below cost, it unnecessarily restrains competition. The minimum markup provisions further restrain competition and appear to have no countervailing benefits to consumers. Apparently, the Act is intended to protect small retailers and wholesalers, but does so at the expense of consumers.

For all of the above reasons, the staff of the Federal Trade Commission urges that Wisconsin repeal its Unfair Sales Act by passing SB 140. In removing these restraints, we believe that Wisconsin will be continuing its tradition of progressive consumer legislation. We appreciate having had this opportunity to provide our views on these issues.

Very truly yours,

John M. Peterson
Director
Chicago Regional Office

JMP:jd