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Opinion No. 01-047

Constitutionality of SB 1547--Amendment to Tennessee Petroleum Trade Practices Act

QUESTIONS

Does SB1547 violate either the state or federal constitutions?

OPINION

Case law from other jurisdictions suggests that SB 1547 is vulnerable to constitutional attack if it is construed to eliminate any requirement to prove predatory intent and "antitrust injury" in order to make out a violation of the Tennessee Petroleum Trade Practices Act.

ANALYSIS

1. Introduction

At the outset, a review of state and federal court decisions decided since the General Assembly last amended the Tennessee Petroleum Trade Practices Act ("TPTPA") in 1988 and the effect SB1547 and its amendments will have on the enforcement of the TPTPA is appropriate. On August 10, 1988, this Office issued Attorney General Opinion 88-141. That opinion analyzed in detail the Unfair Gasoline Sales Amendment to the TPTPA, then known as Public Chapter 1033 and now codified in Tenn. Code Ann., Title 47, Chapter 25. The subject of Public Chapter 1033 as well as SB 1547 and its amendments is the below-cost sale of petroleum or related products at retail. The specific sections of the TPTPA related to below cost sale of petroleum include sections, or portions thereof, of Tenn. Code Ann. §§ 47-25-602, 47-25-603 and 47-25-611.

As noted, both the 1988 amendments and SB 1547 and its amendments deal with the below cost sale of petroleum or related products, as defined in Tenn. Code Ann. § 47-25-602(7). Below cost sales legislation generally falls under the rubric of unfair trade practices or antitrust, more specifically, that category of unfair trade practices known as predatory pricing. Despite the longstanding existence of predatory pricing legislation at both the federal and state levels, the term has never been precisely defined by the courts. In *Ghem, Inc. v. Mapco Petroleum, Inc.*, 850 S.W.2d 447, however, the Tennessee Supreme Court, quoting from *Matsushita Electric Industrial Company, Ltd. v. Zenith Radio*

Corporation, 475 U.S. 574, 106 S.Ct. 1348 (1986), noted that the term "has been used chiefly in cases in which a single firm, having a dominant share of the relevant market, cuts its prices in order to force competitors out of the market, or perhaps to deter potential entrants from coming in. (Citations omitted)." *Ghem, Inc. v. Mapco Petroleum, Inc.* at 454.[1]

2. TPTPA Court Decisions

Since passage of the amendments to TPTPA in 1988 the courts have decided a number of cases under the TPTPA which assist in understanding SB 1547 and its amendments. In *Ghem, Inc. v. Mapco Petroleum, Inc.*, 992 F.2d 1216 (6th Cir. 1993), the plaintiff alleged that the defendant had violated the TPTPA by selling gasoline at below cost with the intent to injure competitors and thereby lessening competition. The United States District Court for the Middle District of Tennessee ruled in favor of the defendant, and the case was appealed to the United States Sixth Circuit Court of Appeals. Because the issues before the Court of Appeals involved questions of state law, the Court "certified" three questions to the Tennessee Supreme Court. Those questions were:

1) What are the necessary elements to a cause of action under the below cost sales provisions of the TPTPA?

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[1] In a further discussion of predatory pricing in that same opinion, the Tennessee Supreme Court quoted from *Cargill, Inc. v. Monfort of Colorado*, 479 U.S. 104, 107 S.Ct. 484 (1986), a case in which

> The [U.S.] Supreme Court again declined to attach a precise definition to the term "predatory pricing." The Supreme Court stated as follows regarding the use of the term "predatory pricing" and its potential for causing antitrust injury:
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> > Predatory pricing *may* (emphasis added) be defined as pricing below an appropriate measure of cost for the purpose of eliminating competition in the short run and reducing competition in the long run. It is a practice that harms both competitors *and* (emphasis in original) competition. In contrast to cutting aimed simply at increasing market share, predatory pricing has as its aim the elimination of competition. Predatory pricing is thus a practice "inimical to the purposes of [the antitrust] laws." *Brunswick*, 429 U.S. at 488, 97 S.Ct., at 697, and one capable of inflicting antitrust injury. 479 U.S. 104, at 117-118, 107 S.Ct. 484, at 493.
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> In a footnote to the immediately foregoing quoted language, the Supreme Court stated as follows:
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> > Most commentators reserve the term predatory pricing for pricing below some measure of cost, although they differ on the appropriate measure.... No consensus has yet been reached on the proper definition of predatory pricing in the antitrust context, however....
> > Although neither the District Court nor the Court of Appeals explicitly defined the term predatory pricing, their use of the term is consistent with a definition of pricing below-cost. Such a definition is sufficient for purposes of this decision.
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> 850 S.W. 2d, at 455.

2) Is an actual adverse effect on competition, as opposed to an adverse effect on a competitor, a necessary prerequisite to a cause of action under the below cost provisions of the TPTPA?

3) Is an "antitrust injury" an essential element to a cause of action under the below cost provisions of the TPTPA?

In answering these questions for the Court of Appeals, the Tennessee Supreme Court set out six elements for a cause of action under the below cost provisions of the TPTPA.[2] Only two of those elements are relevant to the current discussion.

a) Is an actual adverse effect on competition, as opposed to an adverse effect on a competitor, a necessary prerequisite to a cause of action under the below cost provisions of the TPTPA?

In answering this question, the Supreme Court held that

> [t]he effect of the below-cost sale must be "to injure or destroy competition or substantially lessen competition." Thus, there must be an actual, or threatened, adverse effect on competition in the relevant market. For purposes of this element, the inquiry must be focused on the effect on competitors in the aggregate, and not on the effect on an individual competitor. Ordinarily an injury to, or destruction or substantial lessening of competition would require that there be an actual or threatened net decrease in the number of competitors competing in the relevant market.

850 S.W.2d 447 at 457.

In its discussion of this element, described by the Court as an "adverse effect on competition," the Court set out the following analytical framework, based on well-established antitrust principles, to determine if below-cost sales under the TPTPA meet this element:

> To determine whether there has been an injury to, or a destruction or substantial lessening of competition, it will be necessary, in any given case, to define the geographic and product line market in which an accused violator operates. It will then be necessary to determine, at least approximately, the number of competitors operating in the relevant market and the approximate market shares of the competitors. A prerequisite to a finding that the fourth element of the cause of action exists will be, at least ordinarily, an actual or

[2] In summary, these elements are: that the violator must be a "dealer" as defined in the TPTPA; that the dealer must make, offer to make "sales at retail;" the sale must be at a price that is below the "cost to the retailer;" that the effect of the below-cost sale must be "to injure or destroy competition or substantially lessen competition;" that the same must not be exempt under the statute; and that the plaintiff must suffer an "antitrust injury."

> threatened net decrease in the number of competitors; the required number of competitors eliminated (and their respective market shares) would vary, on a case by case basis.

850 S.W.2d 447 at 452-453.

b) Is an "antitrust injury" an essential element to a cause of action under the below cost provisions of the TPTPA?

The second element of a below-cost TPTPA violation discussed at some length by the Tennessee Supreme Court is that of a requirement of "antitrust injury." This principle, as noted by the Court, originated with the United States Supreme Court decision in *Brunswick Corp. v. Pueblo Bowl-O-Matic, Inc.*, 429 U.S. 477, 97 S.Ct 690 (1977).

In *Brunswick Corp.*, the plaintiff brought suit under two sections of the Clayton Act that prohibit acquisitions where the effect of such acquisition "may be substantially to lessen competition" and allowing recovery by "any person who shall be injured in his business or property by reason of" violation of the antitrust laws. In holding that the defendant's conduct *even though it violated a provision of the Clayton Act* did not give rise to a claim by the plaintiff, the U.S. Supreme Court articulated the "antitrust injury" requirement:

> We therefore hold that (for) the plaintiffs to recover treble damages on account of [a Clayton Act violation] they must prove more than injury causally linked to an illegal presence in the market. Plaintiffs must prove *antitrust* injury, which is to say injury of the type the antitrust laws were intended to prevent and that flows from that which makes defendants' acts unlawful. The injury should reflect the anticompetitive effect either of the violation or of anticompetitive acts made possible by the violation.

(emphasis in original). 429 U.S. 477, at 488-489.

The U.S. Supreme Court's holding was immediately followed by dictum which the Tennessee *Ghem* court found particularly *apropos* to the issue of below-cost sales:

> This does not necessarily mean . . .that . . . [under the Clayton Act] plaintiffs must prove an actual lessening of competition in order to recover. The short term effect of certain anticompetitive behavior--predatory below-cost pricing, for example--may be to stimulate price competition. But competitors may be able to prove antitrust injury before they are actually driven from the market and competition is thereby lessened.

490 U.S. 477, at 490, footnote 14.

The Tennessee Supreme Court continued its analysis of the "antitrust injury" requirement by reviewing additional United States Supreme Court cases in which the "antitrust injury" requirement was affirmed. Significantly, included in this analysis is a decision from the Tennessee Court of Appeals, *Kerr v. Hackney*

Petroleum, 775 S.W.2d 600 (Tenn.App.1988), which involved allegations of discriminatory pricing under the TPTPA. Adopting the rationale of the federal courts in their interpretation of the Clayton Act, the *Kerr* court likewise held that a plaintiff seeking damages under the price discrimination portion of the TPTPA also must prove antitrust injury.

In answering the "antitrust injury" question of the Sixth Circuit United States Court of Appeals, the Tennessee Supreme Court held that

> "antitrust injury" is a prerequisite to a cause of action under [the below-cost provisions of the TPTPA]. Inasmuch as there is a violation of this statute only in cases in which there is pricing (1) that is below cost and (2) that has the effect "to injure or destroy competition or substantially lessen competition," the requirement of "antitrust injury" is satisfied, for purposes of this statute, whenever the plaintiff demonstrates that the injury, destruction or substantial lessening of competition has harmed, or is likely to harm, the plaintiff. This holding is consistent with the definition attributed to the term "antitrust injury" by the U.S. Supreme Court in *Brunswick Corporation v. Pueblo Bowl-O-Matic, Inc., supra,* which is:
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> > Injury of the type the antitrust laws were intended to prevent and that flows from that which makes defendants' acts unlawful. The injury should reflect the anticompetitive effect either of the violation or of anticompetitive acts made possible by the violation.

(citation omitted). 850 S.W.2d 447, at 457.

The Court of Appeals, having received answers to the questions certified to the Tennessee Supreme Court, in an unpublished opinion (992 F.2d 1216) then affirmed the decision of the District Court which had granted summary judgment to the defendant, Mapco Petroleum. In so doing, the Court found that the District Court's decision was

> consistent with the dictates of the Tennessee Supreme Court. The district court's decision turned, in part, on Ghem's failure to prove an injury to competition. The district court found that although Ghem alleged harm to itself, a mere *competitor*, it did not offer any evidence of harm to *competition*, as required by the Tennessee Supreme Court. Further, the district court found that Ghem failed to offer any evidence regarding the relevant market for petroleum distillates. This failure was crucial, because according to the Tennessee Supreme Court, the "injury to competition" inquiry demands a threshold examination of the geographic and

product line markets as well as the number of competitors and their approximate market shares.

(emphasis in the original). 992 F.2d 1216, at _____.

The most recent case to consider the TPTPA is another unpublished opinion from the Sixth Circuit, *Gowan Car Care Center v. Murphy Oil USA, Inc.*, 230 F.3d 1358 (6th Cir. 2000). While at first blush this decision appears to introduce a new element into the requirements to successfully proceed under the TPTPA, the Court of Appeals decision makes clear that this is not the case.

Factually similar to the below-cost sales cases already discussed, *Gowan Car Care Center* merely affirms the court's previous holding in *Ghem*, by finding that the plaintiff in *Gowan* was unable, as a matter of law, to sustain a claim that the defendant's conduct resulted in an adverse effect on competition. Although the District Court did introduce the notion of "recoupment"[3] into this case, the Court of Appeals found that a recoupment analysis was unnecessary and that the plaintiffs could not have prevailed under the standards previously articulated by the Tennessee Supreme Court in *Ghem* and adopted by the Sixth Circuit in its own *Ghem* decision.

3. SB 1547 and Its Amendments

a) Summary

SB 1547 and three amendments to the bill amend the TPTPA in several respects. Most of these changes to current law appear to overrule both the Tennessee Supreme Court and the federal courts' decisions respecting the TPTPA as well as the legal principles and economic underpinnings that form the basis of predatory pricing as discussed above. First, SB 1547 itself amends Tenn. Code Ann. § 47-25-623 by changing the penalty for violation of the price discrimination portion of the TPTPA from a Class C misdemeanor, which carries a punishment of not more than thirty (30) days in jail or a fine not to exceed $50.00, to a Class A misdemeanor, but limits the punishment thereunder to a fine not to exceed $5,000. That provision raises no state or federal constitutional issue and will not be considered further herein. Second, Amendment No. 1 to SB1547 adds a new definition, that of "competition." In addition, this amendment would appear to direct that the TPTPA should be construed and applied without regard to the court decisions "under the federal antitrust laws pertaining to predatory pricing, injury to competition or antitrust injury." Third, Amendment No. 3 to SB1547 amends Tenn. Code Ann. § 47-25-611(h) by adding certain additional transactions exempt from the TPTPA to the so-called "good faith, meeting

[3] Approximately three months after the decision of the Tennessee Supreme Court in *Ghem*, the United States Supreme Court decided *Brooke Group, Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993), in which it established an element of recoupment required to successfully prosecute a predatory pricing case under federal antitrust law. Recoupment requires the plaintiff to show (1) that the prices complained of were below the appropriate measure of the defendant's cost; and, (2) that the defendant had a reasonable prospect of recouping its investment in below-cost pricing. In its decision, the District Court in *Gowan* stated that it was unclear whether the recoupment element was necessary under the TPTPA but predicted that the Tennessee Supreme Court, if called upon to decide, would adopt the analysis of the U.S. Supreme Court in *Brooke Group*.

competition" defense currently contained in subsection (h). Amendment No. 2 to SB1547 is identical to Amendment No. 1.

b) Definition of Competition

Amendment No. 1, Section 1 to SB 1547 adds a new definition to Tenn. Code Ann. § 47-25-602 of the TPTPA, that of "competition." Amendment No. 1 defines "competition" as "any person who competes with another person in the same relevant geographic market." The effect of this addition to the TPTPA appears to significantly broaden the pool of potential plaintiffs who would be allowed to sue under the TPTPA by eliminating the requirement discussed above in section 2.a. that the effect of a below-cost sale be "to injure or destroy competition or substantially lessen competition," as well as the Tennessee Supreme Court's direction in *Ghem* that "the inquiry must be focused on the effect on competitors *in the aggregate, and not on the effect on an individual competitor*." (Emphasis added.) As we previously stated in Attorney General Opinion No. 88-141:

> The United States Supreme Court and other courts have oft repeated the phrase that antitrust and price discrimination laws "protect competition and not competitors." *See*, e.g., *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962); *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 1090 (1977) (Under anti-merger provisions of federal antitrust law, a competitor may not recover damages due to increased competition and lower prices resulting from unlawful merger.); *Cargill, Inc. v. Monfort of Colorado, Inc.*, 107 S.Ct. 484 (1986). That a particular trade practice results in "merely an adverse effect on a . . . competitor" does not rise to an "inference" of a "substantially adverse effect on competition." *Edward J. Sweeney & Sons, Inc. v. Texaco, Inc.*, 637 F.2d 105, 1980-81 Trade Cas. (CCH) P63, 611 at 77,239-240 (3rd Cir. 1980), cert. denied 451 U.S. 911 (1981). In short, the loss of competitors, in and of itself, is not necessarily an injury to competition.

c) Preemption of Previously-Decided TPTPA Case Law

Amendment No. 1, Section 2 sets forth the remedial purpose of the TPTPA "without regard to judicial decision under the federal antitrust laws pertaining to predatory pricing, injury to competition or antitrust injury." The purpose of this amendment to the TPTPA appears, at a minimum, to instruct the courts to construe and apply the TPTPA without regard to those state and federal court decisions interpreting the TPTPA, including both the Tennessee Supreme Court's and Sixth Circuit's decisions in *Ghem, Inc. v. Mapco Petroleum, Inc.*, the Tennessee Court of Appeals decision in *Kerr v. Hackney Petroleum*, and the recent Sixth Circuit decision in *Gowan Car Care Center v. Murphy Oil USA, Inc.*, all of which applied well-founded principles predatory pricing, injury to competition and antitrust injury developed over a substantial period of time.

c) Exemptions

Amendment No. 3 to SB 1547 adds two categories of transactions that are exempt from the TPTPA. In addition, it preserves the current "good faith-meeting competition defense" to a charge of below-cost sales under the TPTPA. The exempt transactions include:

> (2) Sales at retail, or offering or advertising to make sales at retail, for promotional purposes to introduce a new, remodeled or newly acquired retail outlet, provided such promotion does not exceed ten (10) days and occurs within sixty (60) days of the date when the new, remodeled or newly acquired outlet begins operation; or
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> (3) Sales at retail, or offering or advertising to make sales at retail, at prices based on isolated or inadvertent conduct that does not represent a pattern of business practice.

4) Constitutionality of SB 1547 and Its Amendments[4]

As we previously stated in Attorney General Opinion 88-141, the original provisions of the below-cost sale legislation enacted by the 1988 General Assembly do not appear to violate either the federal or state constitutions. Below-cost sales legislation generally has been upheld by the courts, including Tennessee courts. *See Rust v. Griggs*, 172 Tenn. 165 (1938); *Walker v. Bruno's Inc.*, 650 S.W.2d 357 (Tenn. 1983) (Unfair Milk Sales Act upheld as not violative of Supremacy Clause of the U.S. Constitution); *State v. Mapco Petroleum, Inc.*, 519 So.2d 1275 (Ala 1987) (Constitutionality of Motor Fuel Marketing Act upheld after certain unconstitutional provisions severed).

While a majority of below-cost sales legislation, including statutes related to the below-cost sale of petroleum, has been upheld, some states have found specific provisions of such legislation to violate various provisions of a state's constitution or of the U.S. Constitution. Over the years, such statutes have been challenged as exceeding the police power of the state, as providing an inadequate definition of "cost," as unconstitutionally lacking the element of "intent" and as containing unconstitutional burden-shifting and evidentiary presumptions. In light of the evolving case law in the area of below-cost petroleum sales, some concern may exist with respect to SB 1547. These concerns focus on two areas: the elimination of the requirement that a plaintiff in a TPTPA case prove "antitrust injury" and the lack of an intent requirement in order to find a violation of the below-cost sale provisions of the TPTPA.

In *Ports Petroleum Company, Inc. of Ohio v.Tucker*, 916 S.W.2d 749, the Arkansas Supreme Court faced these two issues. In *Ports*, the plaintiff challenged the Arkansas Petroleum Trade Practices Act and alleged that the Act violated both the state and U.S. Constitutions because it does not require an antitrust injury or a showing of predatory intent. The Arkansas Supreme Court agreed and held that the Act's failure to require proof of predatory intent rendered the legislation "overbroad in that it prohibits

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[4] For an in-depth discussion of below-cost sales legislation in the marketing of motor fuel, including an analysis of the various constitutional issues raised by such legislation, *see* Samuel L. Perkins *et al., A Place for Fair Competition Acts in Motor Fuel Marketing*, 26 N. Ky. L. Rev. 211 (1999).

legitimate and innocent competition fostered by below-cost sales" and therefore violated the constitutional due process provisions of the Arkansas and U.S. Constitutions. *Ports*, 916 S.W.2d, at 755. In light of its holding regarding the intent requirement, however, the Court found it unnecessary to address the "antitrust injury" argument. In its discussion, the Court reviewed an earlier case involving a challenge to the Unfair Sales Act in which it discussed the difference between predation and competition in the context of lowering prices:

> The difficulty, of course, is distinguishing highly competitive pricing from predatory pricing. A firm that cuts its prices or substantially reduces its profit margin is not necessarily engaging in predatory pricing. It may simply be responding to new competition, or to a downturn in market demand. Indeed, there is a real danger in mislabeling such practices as predatory, because consumers generally benefit from the low prices resulting from aggressive price competition.

Ports, 916 S.W.2d, at 754.[5]

The TPTPA does not appear to require proof of intent before one may be found to have violated its below-cost sales prohibition. The operative provision of Tennessee's act simply prohibits below-cost sales "where the effect is to injure or destroy competition or substantially lessen competition. . ." Tenn. Code Ann. § 47-25-611(a)(1). Because Amendment 1 to SB 1547 defines "competition" so as to allow a single competitor to claim a violation of the TPTPA and because that amendment also appears to overrule existing case law with respect to "antitrust injury," the effect of the amendment may well be to render the TPTPA applicable to conduct that amounts to nothing more than hard nosed competition, precisely the vice that led the Arkansas Supreme Court to invalidate that state's petroleum below-cost sales legislation in *Ports Petroleum*.

> [T]here is a laudable purpose stated in [the] Act . . . to foment competition by prohibiting subsidized below cost pricing at the retail level, which can have a deleterious impact on competition. But is [the] Act . . . reasonably designed to accomplish that purpose? We think not. Indeed, in some instances the Act appears to have exactly the opposite effect from its stated purpose, and the plight of Ports Petroleum is a case in point. The flip side of prohibiting below-cost pricing is that smaller enterprises and single retail outlets (the mom and pop stores) are not able to use this strategy as a means of attracting customers and, thereby, competing with larger firms. Though completely free and innocent of predatory intent, these smaller outlets are foreclosed by the Act from engaging in a pricing mechanism that is one of the few competitive tools they have at their disposal.

916 S.W.2d, at 755.

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[5] *See also, Strickland v. Ports Petroleum, Inc.*, 256 Ga. 669, 353 S.E.2d 17, in which the Georgia Supreme Court found that state's Below Cost Sales Act unconstitutional, albeit on specific state constitutional grounds only.

The Arkansas *Ports Petroleum* case appears to be the only case that addresses this issue directly. While the Alabama Supreme Court upheld the constitutionality the below-cost sales statute that does not require proof of intent, it did so by allowing lack of intent to serve as an affirmative defense. *State v. Mapco Petroleum* 519 So.2d 1275 (1987). Over the years, Minnesota courts have both upheld and struck down various fair competition statutes which lack the intent requirement. We are aware of no Tennessee decision that indicates whether either the Arkansas or Alabama rationale would be adopted in this state. Because the Arkansas *Ports Petroleum* court took a straightforward approach to the issue by analyzing it in the context of the philosophical underpinnings of the below-cost sales statute, its reasoning is not obviously flawed, thereby suggesting that SB 1547 and its amendments make the TPTPA vulnerable to a constitutional challenge.

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