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PERSPECTIVE

Price gouging: A hidden danger of the pandemic

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The whole state is in quarantine due to Gov. Gavin Newsom's stay-at-home order in response to the COVID-19 pandemic. If your company is not labeled "essential," no customers can come to your place of business. Or if you own a restaurant, the dining rooms are closed and you are limited to takeout or delivery. Even if your business is deemed "essential," your customers are weary of coming out so traffic is way down. As a result, your company's revenue is down at least 60%. What can you do to weather the storm and stay in business? You might be tempted to raise prices to try to recoup some of your lost revenue. But be careful — if you do raise prices, you might unwittingly commit the crime of price gouging under California law.

Price Gouging

California Penal Code Section 396 prohibits price gouging. The California Legislature passed the law in 1995 to protect against merchants taking unfair advantage of consumers by greatly increasing prices for essential consumer goods and services in

the wake of an emergency. Through its several sections, the law prohibits increasing prices by more than 10% on a wide variety of goods and services during and shortly after a declared state of emergency.

What Goods and Services Are Covered?

The Legislature intended that the price gouging statute be "liberally construed so that its beneficial purposes may be served." Penal Code Section 396(a). It prohibits increasing the price on any: consumer food items or goods; goods or services used for emergency cleanup; emergency supplies; medical supplies; home heating oil; building materials; housing; transportation, freight, and storage services; or gasoline or other motor fuels for 30 days after the declaration of a state of emergency. It also prohibits increasing the price of a hotel room or rent charged for residential housing to an existing or prospective tenant for the same time period. It also prohibits evicting a residential tenant and charging a new tenant more than the landlord could have charged the prior tenant under the law. Finally, it prohibits increasing the price of any repair or reconstruction services or any services used in emergency cleanup for a

period of 180 days following the state of emergency declaration.

So what does this mean? What's covered by the statute? The first category, any consumer food items or goods, is especially broad. "Consumer food items" essentially means anything that is intended to be eaten or drunk, by a person or by an animal. "Goods" is defined to mean virtually anything you buy primarily for personal, family, or household purposes. The example of toilet paper comes to mind in light of the current COVID-19 event, and the frenzied buying that came as a result. "Emergency supplies" includes, but is not limited to, water, flashlights, radios, batteries, candles, blankets, soaps, diapers, temporary shelters, tape, toiletries, plywood, nails and hammers. Pretty much anything you might find useful in case of an emergency. "Building materials" means lumber, construction tools, windows and anything else used in the building or rebuilding of property. It's hard to imagine anything a consumer would buy that is not covered by the price gouging statute.

What Constitutes an Emergency Under Penal Code Section 396(a)?

Again, the Legislature intended the law to be liberally construed. To that end, the statute defines "state of emergency" broadly, as any "natural or manmade emergency resulting from an earthquake, flood, fire, riot, storm, drought, plant or animal infestation or disease, or other natural or manmade disaster for which a state of emergency has been declared by the President of the United States or the Governor." Penal Code Section 396(j) (1). In addition, the law also applies to local emergencies declared by an official board or other government body vested with the power to declare an emergency on behalf of any city, county or city and county in California. As a result, the definition of "state of emergency" is extremely broad. It can encompass anything from the president of the United States declaring a national emergency in response to the pandemic that is COVID-19 to a small-town mayor declaring a local emergency in response to a wildfire. Any declared "state of emergency" will trigger the statute.

What's the Risk?

Violation of Section 396 is a misdemeanor that carries a maximum criminal

penalty of imprisonment for not more than one year, or a fine of not more than \$10,000, or both fine and imprisonment. Violation of Section 396 also constitutes an unlawful business practice under California Business and Professions Code Section 17200, so in addition to criminal prosecution, you could face a lawsuit from the State, a city or county, your competitors, and/or your customers. If the suit is brought by the attorney general or by a city or county, the court can impose civil penalties of \$2,500 per violation. In sum, potential violations of this statute should be taken very seriously.

This is not a hard violation to prove, either. Simply look at prices just before the emergency, and if they went up at any time during the period of the emergency, there's a presumption that it's price gouging. The quintessential example of price gouging is easy — in an emergency, there is a perceived shortage of a product, say toilet paper, and everyone rushes to buy as much as they can. Sensing the spike in demand, and

trying to make a quick buck, the merchant doubles (or triples, or quadruples) the price of toilet paper. That is textbook price gouging.

But the California law is not limited to textbook cases. Here, in the midst of the global pandemic that has everyone locked in their homes, your revenue has plummeted. You're struggling to keep your company afloat. So you raise prices to try to stay in business. This is hardly the same nefarious, greedy motive as the toilet paper price gouger. But it's just as much a violation of the statute, and could it could land you in the same hot water.

There Is a Safe Harbor — Price Increase Justified By Increased Costs

Section 396 creates a dilemma — go out of business due to drastically reduced revenue or commit a crime under the price gouging statute. But all hope is not necessarily lost. Section 396 provides a safe harbor to raise prices when the increase is caused by an increase in costs resulting from the emergency. If your price increase was

“directly attributable” to additional costs you incur as a result of the emergency, then a price increase will not be price gouging. However, this safe harbor is a defense, and it would be your burden to establish the increase is directly attributable to increased costs. This can mean your suppliers raising prices in response to the emergency, or additional costs you incur, such as costs incurred to continually clean and sanitize your business. (Keep in mind, if your suppliers are increasing prices, they might

themselves be price gouging under Section 396.)

There is a limit to the protection offered by this safe harbor, however. The increased price cannot be more than 10% greater than the total of the cost to the seller plus your customary markup for that good or service immediately prior to the onset of the state of emergency or local emergency. So, the safe harbor allows you to offset the additional costs you are incurring due to the emergency, but it does not allow you to increase profit substantially. ■

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