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Report of the Attorney General's Task Force On Motor Fuel Pricing in Nebraska

Ernest P. Goss

Creighton University, ernieg@creighton.edu

Edward A. Morse

Creighton University

Eric Thompson

University of Nebraska - Lincoln, ethompson2@unl.edu

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Report of the Attorney General's Task Force On Motor Fuel Pricing in Nebraska

**Ernest P. Goss
Professor of Economics
Creighton University
Department of Economics and Finance
MacAllister Chair of Economics
<http://www.outlook-economic.com>**

**Edward A. Morse
Professor of Law
Creighton University
School of Law
McGrath, North, Mullin & Kratz Chair in Business Law
<http://culaw2.creighton.edu/morse>**

**Eric C. Thompson
Associate Professor of Economics
University of Nebraska–Lincoln
Bureau of Business Research
Department of Economics
www.bbr.unl.edu**

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INTRODUCTION AND OVERVIEW

In the wake of the devastation of Hurricanes Katrina and Rita, Nebraskans experienced a dramatic increase in the price of motor fuels. Although Nebraska was not impacted directly by the physical effects of these storms, damage to critical production, refining, and transportation facilities in the Gulf Coast region sent shock waves throughout the country. Attorney General Jon Bruning convened this task force for the purpose of studying these price movements and to analyze whether price-gouging activity may be occurring.

Motor vehicle fuels are a vital commodity. Businesses and consumers depend on a network of oil producers, refiners, and retailers and an extensive transportation system to provide these fuels for daily use. This network extends far beyond Nebraska borders and links oil producers, refiners, retailers, and consumers across the entire globe.

Careful scrutiny of the pricing and delivery of petroleum products is not a singular phenomenon limited to Nebraska. On a federal level, the Federal Trade Commission (FTC) regularly examines the petroleum industry to address concerns about concentration in production and refining and issues affecting retail pricing. Other states also have undertaken investigations, with Florida recently concluding a study addressing antitrust concerns in that state. These studies have not found violations of law, and they generally have found competitive markets affected by worldwide conditions. Growing global demand has led to increasing dependence on imported crude oil products, and disruptions in supplies—whether from political or natural causes—quickly are assimilated into market prices on a worldwide scale.

This study is unique in focusing on Nebraska markets. No refineries currently operate in Nebraska. Motor fuels for sale in retail establishments in Nebraska come primarily through pipelines, which depend heavily on refinery operations in the Gulf Coast region for supplies. An

extensive network of retail establishments serves Nebraska consumers and businesses, but these retailers generally can be characterized as price takers dependent upon other suppliers for their inventory. After laying a foundation for understanding national price trends, this study analyzes price data from a sample of establishments throughout different geographic regions of the state. This analysis focuses on price and gross margin behavior during a period of approximately one year, including the months immediately preceding and following Hurricanes Katrina and Rita.

This study begins with a discussion of legal questions that are basic to defining price gouging. After analyzing the general principles for price determination in a market economy, Part 1 outlines legal constraints from both federal and state law that affect price-setting functions. It compares statutes from other states with Nebraska law and examines the concept of unconscionability in proscribing certain commercial behavior. It concludes that retail price behavior in Nebraska is unlikely to meet a standard of unconscionability under the current Nebraska statute.

Part 2 examines U.S. Energy Information Agency data to determine factors contributing to volatility in oil and refined gasoline prices. Additionally, we investigate the profitability of twenty-one major independent oil companies during the period before and after the hurricanes struck.

Part 3 examines gasoline and diesel price fluctuations in individual Nebraska cities both before and after Hurricanes Katrina and Rita struck the Gulf Coast region. We examine how prices in Nebraska react to the natural disasters in the Gulf Coast. We also examine whether any particular brands (or stations) commonly led price increases and declines in Nebraska cities.

EXECUTIVE SUMMARY

Laws Affecting Motor Fuel Pricing

- Motor fuel prices generally are unregulated. Various state and federal laws, including antitrust and consumer protection laws, affect the environment in which price setting occurs. These laws facilitate the interaction of supply and demand forces in a competitive market.
- So-called price gouging presents special concerns in defining the appropriate scope of government intervention in the price-setting function. Disrupting price changes through restrictions or controls can adversely affect the flow of goods and services. On the other hand, disruptions in the supply chain associated with emergency situations implicate other policy considerations beside allocation inefficiencies, which may justify some form of intervention.
- Whether government intervention is justified is debatable, and that debate involves competing value claims. In some states, specific statutes provide a basis for governmental intervention to address “price gouging” in emergency situations. Congress also is considering proposed legislation in this area. Definitional concerns about “price gouging” make implementation problematic. Antitrust laws provide the basis for consumer protection over the longer term.
- Nebraska law leaves considerable doubt as to whether any remedial action is justifiable in response to increased motor fuel prices. Nebraska law relies on the general constraint of unconscionability, which long has been a matter for legal uncertainty in contract matters.
- To the extent the Unicameral wishes to adopt more specific legislation, some lessons may be drawn from the laws of other states. Such legislation should ensure that changes in replacement costs are considered in formulating a safe harbor for sellers. This is particularly important in a business such as gasoline retailing, where volatility in prices affects the profitability of firms in up and down markets. Limiting the context of any legal constraints on price setting to situations involving emergencies where natural disasters or similar disruptions directly are affecting Nebraska consumers is advisable. Sellers and consumers deserve fair notice of the rules that will be applied.

Analysis of Motor Fuel Markets and Firms

- Based on advanced statistical techniques, increases in the price of a barrel of oil accounted for 62.5 percent of the rise in the gasoline prices between June 2004 and October 2005. Declines in refinery capacity utilization and increases in the share of oil imported accounted for the rest of the difference. Other factors accounted for little of the upturn in gasoline prices.
- Nebraska gasoline prices were approximately 10 percent lower than expected between June 2004 and October 2005 based on statistical modeling.

- As a result of production and refinery disruptions, gross refining margin per barrel of oil grew from \$13.46 per barrel in quarter three of 2004 to \$21.30 per barrel in quarter three of 2005.
- Despite the increase in margins and profitability for U.S. operators at major petroleum firms, the price-earnings ratios of the firms have declined. In other words, the stock price of these firms rose much less briskly than did profitability. This indicates that investors expect this profitability to be short-lived. While average earnings per share for these firms rose from \$4.21 in September 2004 to \$7.50 in December 2005, the average price-earnings ratio declined from 12.5 in September 2004 to 8.7 in December 2005.
- In other words, hurricanes in Fall 2005 functioned similarly to OPEC supply restrictions, producing higher prices, lower output, and elevated profits. In contrast, Hurricane Ivan in 2004 had a less significant impact on gasoline prices. Ivan did not substantially disrupt refining operations as was the case with Katrina and Rita.

Retail Prices in Nebraska Cities

- Nearly all of the increase in Nebraska regular unleaded gasoline and diesel retail prices was due to an increase in wholesale prices.
- Relative to wholesale prices, retail prices for unleaded gasoline rose faster nationally than in Nebraska cities during September and October of 2005.
- As wholesale and retail prices began to fall after peaking, retail prices were sticky in a downward direction in most smaller Nebraska cities and for the United States overall.
- Our analysis of the data suggests that individual retailers did not base costs simply on wholesale prices plus a margin, but instead based prices on what the market would bear.
- Further, there was no substantial indication of a pattern in the individual brands leading prices upward or downward in individual Nebraska cities.

PART ONE: LAWS AFFECTING MOTOR FUEL PRICING

I. The Legal Environment for Price Determination

Motor fuel prices are generally unregulated. However, various state and federal laws affect the environment in which price-setting occurs. These laws perform important functions which facilitate and support the interaction of supply and demand forces in a competitive marketplace.

A market-based economic system is deeply rooted in our country's legal and economic history. More than two centuries ago, Adam Smith identified the essential roles of self-interest and the quest for profit in the satisfaction of human needs:

Whoever offers to another a bargain of any kind, proposes to do this. Give me that which I want, and you shall have this which you want, is the meaning of every such offer; and it is in this manner that we obtain from one another the far greater part of those good offices which we stand in need of. It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest.¹

The freedom to make private economic decisions is thus part of the foundation of our market economy.²

Public confidence in the integrity of markets is important, and both federal and state governments have important functions in this regard.³ From time to time, supply and demand functions may be temporarily disrupted or destabilized. In these circumstances, government has

¹ Adam Smith, *AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS*, Book 1, Chapter 2 (1776), reprinted in 36 *GREAT BOOKS OF THE WESTERN WORLD* 8 (2d ed. 1990).

² See 44 *Liquormart, Inc. v. Rhode Island*, 517 U.S. 484, 496-97 (1996) ("So long as we preserve a predominantly free enterprise economy, the allocation of our resources in large measure will be made through numerous private economic decisions.") (quotation omitted).

³ See, e.g., *F.T.C. v. Ticor Title Ins. Co.* 504 U.S. 621, 632 (1992) ("The preservation of the free market and of a system of free enterprise without price fixing or cartels is essential to economic freedom. [Citation omitted.] A national policy of such a pervasive and fundamental character is an essential part of the economic and legal system within which the separate States administer their own laws for the protection and advancement of their people. Continued enforcement of the national antitrust policy grants the States more freedom, not less, in deciding whether to subject discrete parts of the economy to additional regulations and controls.")

intervened to restore normal competitive market functions. For example, antitrust laws are designed to address harmful effects of unlawful collusion or restraints of trade that can undermine the beneficial effects of competition in the marketplace. As the Supreme Court has stated:

Antitrust laws in general, and the Sherman Act in particular, are the Magna Carta of free enterprise. They are as important to the preservation of economic freedom and our free-enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms. And the freedom guaranteed each and every business, no matter how small, is the freedom to compete—to assert with vigor, imagination, devotion, and ingenuity whatever economic muscle it can muster.⁴

State and federal laws also address unfair trade practices, and these laws reflect efforts to police the marketplace of conduct that is inimical to consumer interests. The Federal Trade Commission is charged with enforcing federal laws addressing both consumer protection and competition.⁵ At the state level, this enforcement authority is typically invested in the Attorney General. Government enforcement efforts may also be supplemented by private actors, who are incentivized by provisions allowing the recovery of treble damages or attorney's fees.

The matter of so-called “price gouging” presents special concerns in defining the appropriate scope of government intervention in the price-setting function. On one hand, price changes help to allocate scarce resources among those who desire them. Disrupting this function through restrictions or controls on prices can adversely affect the flow of goods and services to those who want them. Price controls may benefit some individuals who purchase at lower prices, but they also potentially impact the broader public welfare in a negative way. In particular, customers willing to pay more to acquire a good or service may be unable to do so because the

⁴ *United States v. Topco Assoc., Inc.*, 405 U.S. 596, 610 (1972).

⁵ See, e.g., *The FTC in 2005: Standing Up for Consumers and Competition* (FTC April 2005), available online at <http://www.ftc.gov/os/2005/04/0504abareportfinal.pdf>.

supply of the good is constrained at those price levels. In effect, an allocation problem solved by price is resolved by other means, such as queuing.

On the other hand, disruptions associated with emergencies such as natural disasters can implicate other policy considerations besides allocation efficiencies. Shopping costs in such environments can be high. Ordinary consumer options to seek out other suppliers, to defer a purchase, or to choose substitutes, may be impractical or even impossible in emergency situations. As a result, consumers may be willing to pay higher prices for essential goods, but that willingness is born of necessity. In an emergency context, firms may thus be able utilize these conditions of necessity to appropriate consumer surplus (*i.e.*, the net benefit to consumers who previously paid less than the price otherwise justified by their personal demands) by raising prices and reaping above-normal profits on existing stocks of goods.⁶ Considerations of fair play, coupled with strong political incentives to address community interests, may gravitate toward intervention on behalf of consumers in these circumstances. However, doing so involves a political decision to place consumer interests ahead of seller interests in freely setting prices for their property.

Other policy considerations, including public safety, may also counsel some form of intervention, particularly in times of emergencies such as natural disasters. Emergency situations typically endure for limited times, after which normal supply functions are soon restored. One might question whether the supply constraints would indeed materialize over a short time frame on account of price constraints alone. Concerns about public peace, orderly and efficient evacuations from endangered areas, and the prompt restoration of order and safety may be served

⁶ See Frank P. Darr, *Unconscionability and Price Fairness*, 30 HOUSTON L. REV. 1819, 1834 (1994) (“In customer markets, shopping itself is a cost and that cost may prevent the buyer from securing the best deal for a particular item. The lack of complete information due to shopping costs leads to monopoly profits for sellers and multiple prices for the same items ... Moreover, prices may stabilize at less than optimal levels.”)

by the operation of price constraints in the short run, while leaving the longer-term competitive climate free from such constraints, though within the purview of antitrust laws.

Whether government intervention is desirable in this context is thus debatable, and that debate is fraught with competing value claims. Nevertheless, the laws of several states provide a clear legal basis for intervention in matters of pricing during emergency contexts. In the laws of other states, including Nebraska, the legal basis for intervention is much less clear. Congress is currently considering proposed legislation to address “price gouging”, but as of the time this report is being prepared, none of this legislation has been enacted.⁷

As will be discussed in some detail below, Nebraska law leaves considerable doubt as to whether any remedial action would be justifiable in the face of recent motor fuel price increases. Although Nebraska consumers have experienced significant price changes, these price changes appear to be a consequence of broader market forces affecting the supply chain. Variations in retail prices reflect a combination of changes in gross margins and cost structures, but much of that variation depends on changes in the wholesale or “rack” prices charged to those retailers.

We have found evidence that gross margins by retailers have grown slightly during the market disruption following Hurricanes Katrina and Rita. Profits by major oil companies grew substantially during this period. However, we find no evidence of a systematic attempt by retailers to capture consumer surplus by substantially increasing the prices they charge above the wholesale costs of refined motor fuels. These price conditions do not provide a basis for

⁷ A search of proposed legislation for the terms “price gouging” at www.thomas.loc.gov (the Library of Congress website) produced 33 legislative bills with these terms. The first six of these bills are as follows:

1. Treat Emergency Victims Fairly Act of 2005 (Introduced in Senate)[\[S.1854.IS\]](#)
2. Protection From Price Gouging Against Disaster Victims Act of 2005 (Introduced in Senate)[\[S.1640.IS\]](#)
3. Price Gouging Act of 2005 (Introduced in Senate)[\[S.1744.IS\]](#)
4. Protection Against Gouging Activities Act (Introduced in House)[\[H.R.3705.IH\]](#)
5. Prohibiting Reprehensible Increases in Costs of Essentials (PRICE) Act of 2005 (Introduced in House)[\[H.R.3808.IH\]](#)
6. Gasoline Price-Gouging Act of 2005 (Introduced in House)[\[H.R.3782.IH\]](#).

intervention under any established legal theories involving unconscionability. In particular, policies rooted in deterring unconscionable behavior may be harder to justify in this context, where citizens are not directly impacted by a natural disaster or similar emergency.

II. Overview of Federal Laws Affecting Price Competition in Petroleum Products

The Federal Trade Commission has been active in addressing competitive conditions in the petroleum industry. Associate General Counsel for Energy, John H. Seesel, recently appeared before the House Committee on Energy and Commerce for the purpose of explaining the FTC's recent initiatives in this area.⁸ Within the past year, the FTC has engaged in significant studies involving gasoline price changes⁹ and mergers in the petroleum industry.¹⁰ These studies illustrate the extent of federal government resources directed toward monitoring competitive conditions in this industry, not only in the general context of its competitive structure, but also in the matter of prices charged at the consumer level.

Economists from the FTC monitor gasoline price movements in 360 cities in the United States, investigating any "unusual" price movements to see whether they result from a "natural" cause or from anticompetitive behavior.¹¹ For this purpose, "unusual" price movements refer to those "significantly out of line with the historical relationship with the price of gasoline in that area and the gasoline prices prevailing in other areas."¹² The United States Department of Energy also maintains a "gas price hotline", which invites consumers to report incidents of "price gouging" or "price fixing" which are then collated and passed along to the appropriate

⁸ See John H. Seesel, Prepared Statement of the Federal Trade Commission, Market Forces, Competitive Dynamics, and Gasoline Prices: FTC Initiatives to Protect Competitive Markets (September 7, 2005), *available online at* <http://www.ftc.gov/os/testimony/109hearings.htm>.

⁹ See Federal Trade Commission, Gasoline Price Changes: The Dynamic of Supply, Demand, and Competition (2005), *available online at* <http://www.ftc.gov/reports/gasprices05/050705gaspricesrpt.pdf>.

¹⁰ See Federal Trade Commission, The Petroleum Industry: Mergers, Structural Change, and Antitrust Enforcement (August 2004), *available online at* <http://www.ftc.gov/be/econrpt.htm>.

¹¹ See *id.* at 3-4.

¹² *Id.* at 3, n. 6.

federal authorities or states' attorneys general.¹³ Recent legislation directs the FTC to engage in further study of these issues.¹⁴

In the event that the FTC finds that an “unusual” price movement is not explained by a “natural” cause, the basis for their action is found in various provisions of Title 15 of the United States Code. First, the Federal Trade Commission Act empowers the FTC to address “unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce.”¹⁵ Unfair methods of competition include behavior in violation of federal antitrust legislation, including applicable provisions of the Sherman Act,¹⁶ the Clayton Act,¹⁷ and the Robinson-Patman Act.¹⁸

Despite the expansive scope of its prescribed power to address “unfair ... acts ... affecting commerce”, the FTC has not formally exercised that power in circumstances when only a disparity in the price typically charged for a good or service formed the basis for dispute. Legislation has been introduced to permit such power, but this legislation has not been enacted.¹⁹ Such legislation contains provisions similar to those found in states with “price gouging” statutes, which as discussed below focus specifically on the problems of price increases in the context of emergency conditions.²⁰ Moreover, this legislation, if enacted, would not preempt otherwise applicable state laws.

¹³ See <http://gaswatch.energy.gov/>.

¹⁴ See Energy Policy Act of 2005, Pub. L. No. 109-58, § 1809, 119 Stat. 594, 1125-26 (2005).

¹⁵ 15 U.S.C.A. § 45(a)(1).

¹⁶ See 15 U.S.C.A. §§ 1-7.

¹⁷ See 15 U.S.C.A. §§ 12-27; 29 U.S.C.A. § 52-53.

¹⁸ See 15 U.S.C.A. §§ 13. The United States Department of Justice shares antitrust enforcement authority with the FTC through its Antitrust Division. See generally <http://www.usdoj.gov/atr/>. It should also be noted that Nebraska law also contains antitrust legislation, which is similar to its federal counterparts. Nebraska courts are bound to follow federal law interpretations in this context. See generally *Arthur v. Microsoft Corporation*, 267 Neb. 586 (2004).

¹⁹ See, e.g., Protection from Price Gouging Against Disaster Victims Act of 2005, S. 1640, 109th Cong., 1st Sess., September 8, 2005.

²⁰ See Part IV, *infra*.

In recent testimony before a senate committee, Federal Trade Commission Chairwoman Deborah Platt Majoras expressed the agency's concern regarding federal legislation involving price gouging.²¹ She explained that the FTC has launched an investigation (under §1809 of the recently enacted Energy Policy Act) of gas price increases after Hurricane Katrina. However, she strongly advised against passing any federal legislation that would deal directly with price gouging. Reasons offered in support of this position are summarized as follows:

- In a free-market economy where the prices of goods are determined by the relationship between supply and demand, a federal anti-price gouging statute may actually hurt consumers instead of help them. Producers should be free to determine their own prices, and the consumers retain the option of reducing purchases if the prices are too high. The government should not interfere with this process unless there is clear evidence of unlawful conduct.
- A federal anti-price gouging law would be difficult to enforce fairly, partly because "price gouging" itself is hard to define. State statutes on this point contain vague descriptions of what constitutes price gouging, leaving the courts with little guidance. Any federal legislation would most likely have the same effect.
- Higher retail prices are usually caused by factors such as worldwide supply, demand, and competition for crude oil, rather than by excess oil company profits. The Chairwoman pointed out that gasoline prices have been relatively low and stable during the period between 1984 and 2004. Therefore, any further federal legislation in this area may not only be difficult to implement, but it may also be unjustified.

²¹ FTC Provides Joint Senate Committee Testimony on Gasoline Prices and Competition in the U.S. Petroleum Industry, Nov. 9, 2005, at <http://www.ftc.gov/opa/2005/11/gastest.htm>.

- At least 28 states already have some sort of anti-price gouging legislation in place, and any regulatory action in this field should be left to them. As far as the FTC's efforts are concerned, enforcing existing antitrust laws is the best way to protect consumers.

State laws that can be used to addressing concerns about high prices arise from both the common law of contract, as well as statutory provisions that draw upon the concept of unconscionable behavior. These laws are discussed below in the next two sections.

III. The Constraint of Unconscionability

Contract law addresses the legal conditions for enforceability of private agreements.

Although the free and voluntary determination of contract terms is an important value,²² significant legal constraints may also apply to inappropriate behavior. As the Supreme Court has recognized:

[F]reedom of contract is a qualified, and not an absolute, right. There is no absolute freedom to do as one wills or to contract as one chooses. The guaranty of liberty does not withdraw from legislative supervision that wide department of activity which consists of the making of contracts, or deny to government the power to provide restrictive safeguards. Liberty implies the absence of arbitrary restraint, not immunity from reasonable regulations and prohibitions imposed in the interests of the community.²³

The fact that most modern consumer contracts involve standardized agreements, rather than specifically bargained terms, adds further complexity to the freedom of contract ideal. These form contracts facilitate efficient distribution of goods and services by avoiding the give and take of negotiation.²⁴ Instead, consumer choices are effectuated through movement among suppliers in an effort to find a desired product at an acceptable price. The fact that these

²² See, e.g., *Greene v. Oliver Realty, Inc.*, 526 A.2d 1192 (Pa. Super. 1987) ("Voluntary agreements are the foundation of our society's freedom and prosperity.")

²³ *Chicago, B. & Q.R. Co. v. McGuire*, 219 U.S. 549, 567 (1911).

²⁴ See, e.g., *Estrin Const. Co. v. Aetna Cas. and Sur. Co.* 612 S.W.2d 413, 422-23 (Mo.App. 1981) ("The legitimacy of an adhesion contract derives, not from the social value of a transaction freely negotiated, but from the social value of goods produced more abundantly and cheaper from the reduced cost of legal and other distribution services.")

agreements are contracts of adhesion may provide additional reasons for constraining terms imposed by sellers that may affect the public good.²⁵

One of the constraining principles in the common law of contract was the concept of unconscionability, which provides an equitable basis for a court to refuse to enforce an agreement.²⁶ This concept has found its way into modern commercial and consumer protection statutes. For example, it inspired section 2-302 of the Uniform Commercial Code (UCC),²⁷ which allows courts to police the terms of commercial bargains for unfair practices.²⁸ Commentary to the UCC explains in part:

In the past such policing has been accomplished by adverse construction of language, by manipulation of the rules of offer and acceptance, or by determinations that the clause is contrary to public policy or to the dominant purpose of the contract. This section is intended to allow the court to pass directly on the unconscionability of the contract or particular clause therein and to make a conclusion of law as to its unconscionability.²⁹

The UCC does not define unconscionability, though comments provide this guidance:

The basic test is whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract.³⁰

²⁵ See, e.g., *Strand v. U.S. Bank*, 693 N.W.2d 918, 924 (N.D. 2005) (noting that courts give special scrutiny to contracts of adhesion).

²⁶ See generally *Maxwell v. Fidelity Financial Services, Inc.*, 184 Ariz. 82, 88, 907 P.2d 51, 57 (Ariz., 1995) (discussing history of unconscionability as equitable remedy).

²⁷ See Neb. Rev. Stat. U.C.C. § 2-302, which provides:

- (1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.
- (2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.

²⁸ See generally E. Allan Farnsworth, *CONTRACTS* § 4.28 (1982).

²⁹ Neb. Rev. Stat. U.C.C. § 2-302, Comment 1.

³⁰ *Id.*

The parameters of this test are left to development in case law, though comments draw upon prior cases as examples.³¹

Other consumer protection statutes, such as the Uniform Deceptive Trade Practices Act,³² also invoke unconscionability as a basis for imposing legal sanctions upon sellers who engage in unfair trade practices.³³ In this context, a statutory definition is also lacking. Thus, courts must fashion relief on an *ad hoc* basis from developing case law.

Unconscionability provides an uncertain basis for relief because of its amorphous character.³⁴ As one prominent commentator has noted, “That the term is incapable of precise definition is a source of both strength and weakness.”³⁵ On the side of strength, an uncertain and malleable term may allow a court to intervene in circumstances where equity would prefer a means for intervention. Some commentators have suggested that unconscionability may be used to address cases in which other contractual defenses, such as fraud or duress, were not effectively plead or proven, but where the interests of justice indicate a need for relief.³⁶

On the side of weakness, intervention based on unconscionability may upset settled expectations, thus creating ancillary and unintended consequences in the larger economic environment that may, in fact, be inimical to public welfare.³⁷ It may also result in wrong results in particular cases, as one court has noted:

³¹ See *id.*

³² See Neb. Rev. Stat. §§ 87-301 to -306.

³³ See *id.* § 87-301.01.

³⁴ See *Maxwell, supra*, which states in part:

Although U.C.C. § 2-302 recognized and codified the amorphous equitable doctrine, it did little to provide a set of rules for analyzing claims of unconscionability. Also lacking in the statutory recognition of unconscionability is a definition of that term. Courts and respected commentators alike have grappled with defining and applying unconscionability under the Code since its adoption. To this day, both groups remain divided on the proper method for doing so, though they share some common ground on defining such a test.

184 Ariz. at 88, 907 P.2d at 57.

³⁵ Farnsworth, *supra*, at § 4.28, p. 310.

³⁶ See, e.g., Richard A. Epstein, *Unconscionability: A Critical Reappraisal*, 18 J. L. ECON. 293, 303-05 (1975).

³⁷ See Richard A. Posner, *ECONOMIC ANALYSIS OF LAW* 129 (5th ed. 1998).

The doctrine's flexibility, however necessary to its use as a judicial "safety valve" to prevent gross injustice, creates the risk courts may intervene to deprive one contracting party of his or her bargain simply because the contractual obligations of the dissatisfied party proved more burdensome than originally anticipated.³⁸

Disputes invoking unconscionability based on the contract price have been particularly difficult for courts to analyze on a principled basis. Generally courts have been hesitant to find unconscionability based solely on the disparity between price and cost or market value.³⁹ In one of the leading cases in this area, *Perdue v. Crocker National Bank*, the California Supreme Court summarizes the law as follows:

To begin with, it is clear that the price term, like any other term in a contract, may be unconscionable. Allegations that the price exceeds cost or fair value, standing alone, do not state a cause of action. Instead, plaintiff's case will turn upon further allegations and proof setting forth the circumstances of the transaction. The courts look to the basis and justification for the price, including "the price actually being paid by ... other similarly situated consumers in a similar transaction."⁴⁰

This court thus suggests that there are no clear rules about prices and unconscionability.

According to the court, prices that exceed cost or even fair market value may not necessarily be unconscionable. Elsewhere, the court also stated that a high profit margin does not, of itself, result in unconscionability, although it may indicate a need for judicial scrutiny.⁴¹

Facts and circumstances are thus important – but deciding which ones arise to the level of unconscionable behavior promotes uncertainty. The California Supreme Court was careful to preserve this facts-and-circumstances approach from encroachment, going so far as to reject a categorical statement that a competitive market price could not be unconscionable:

The cases, however, do not support defendant's contention that a price equal to the market price cannot be held unconscionable. While it is unlikely that a court would find a

³⁸ *Morris v. Redwood Empire Bancorp*, 128 Cal.App.4th 1305, 1316, 27 Cal.Rptr.3d 797, 804 (Cal. App. 4 Dist.,2005).

³⁹ See Farnsworth, *supra*, at § 4.28, p. 311.

⁴⁰ *Perdue v. Crocker National Bank*, 38 Cal.3d 913, 926, 702 P.2d 503, 512, 216 Cal. Rptr. 345, 354 (Cal., 1985) (citations omitted), *appeal dismissed*, 475 U.S. 1001 (1986).

⁴¹ See *id.*

price set by a freely competitive market to be unconscionable (see *Bradford v. Plains Cotton Cooperative Assn.* (10th Cir.1976) 539 F.2d 1249, 1255 [cotton futures]), the market price set by an oligopoly should not be immune from scrutiny. Thus courts consider not only the market price, but also the cost of the goods or services to the seller, the inconvenience imposed on the seller, and the true value of the product or service.⁴²

This court's willingness to consider unconscionability for a market price is puzzling, to the extent that one would be at a loss to determine an appropriate alternative price.⁴³ No case holds that a competitive market price is unconscionable. However, this language might also be appropriately understood by reference to the possibility that other aspects of the agreement besides the price may merit relief from enforcement.

The possibility that unconscionability may arise from other conditions associated with the formation of the contract is countenanced by recognition of procedural aspects of unconscionability. On this point, the California Supreme Court further explained:

In addition to the price justification, decisions examine what Justice Weiner in *A & M Produce* called the "procedural aspects" of unconscionability. Cases may turn on the absence of meaningful choice, the lack of sophistication of the buyer (compare *Geldermann & Co., Inc. v. Lane Processing, Inc.* (8th Cir.1975) 527 F.2d 571, 576 [relief denied to sophisticated investor]) with *Frostifresh Corporation v. Reynoso, supra*, 274 N.Y.S.2d 757 [relief granted to unsophisticated buyers]), and the presence of deceptive practices by the seller.⁴⁴

Other courts have suggested that the procedural aspects may be more appropriately considered in claims of duress, undue influence, fraud, or similar defenses, rather than through unconscionability.⁴⁵ Courts also differ as to whether procedural unconscionability may form a basis for relief without also requiring a showing of some substantive unconscionability.⁴⁶ For example, the fact that a contract of adhesion contains terms that are not subject to negotiation

⁴² Id. (citations omitted).

⁴³ See Mark Klock, *Unconscionability and Price Discrimination*, 69 TENN L. REV. 317, 342 (2002) ("In [the world of perfect competition] it is impossible for unconscionable transactions to occur.")

⁴⁴ Id., 702 P.3d at 513, 216 Cal.Rptr. 355 (citations omitted).

⁴⁵ See, e.g., *Maxwell, supra*, 184 Ariz. at 89, 907 P.2d at 59.

⁴⁶ See *Strand, supra*, 693 N.W. 2d at 922-93.

suggests that the buyer was at a disadvantage, but to suggest that this alone makes the agreement unconscionable would go beyond the scope of accepted legal theory.⁴⁷

However, procedural problems such as an unequal bargaining power may be evidence of substantive unconscionability arising from a “grossly excessive” price.⁴⁸ As one prominent treatise states:

[A]n unreasonably high or exorbitant price at the very least is a factor to be considered in determining whether a particular provision is harsh and whether one party has in fact been imposed upon by another party in an inequitable or unconscionable manner. This observation represents a middle ground between the position that requires that a substantively abusive or harsh term be the result of a procedural abuse and the view that a gross price disparity is itself sufficient to warrant relief, even in the absence of other inequitable factors.⁴⁹

IV. States with “Price Gouging” Statutes.

In an attempt to provide a more certain basis to address price behavior during emergency situations, some states have enacted specific statutes in order to deter “price gouging.” These “price gouging” statutes share many similarities. Most of them apply specifically to sellers in conditions involving an emergency as declared by the state or local government. They invoke either considerations of unconscionability or public welfare as an operative principle. They function primarily as price control statutes, limiting current prices based on those occurring before the state of emergency. Nearly all include provisions allowing sellers to recoup additional costs incurred during the emergency, but the nature and extent of those costs is a disputed matter. Some states may also provide safe harbors to protect sellers from being challenged for only modest price increases above their costs.

⁴⁷ See *id.*

⁴⁸ See *Maxwell, supra.*

⁴⁹ WILLISTON ON CONTRACTS, § 18:15 (Indicia of Unconscionability – Price).

Significantly, these statutes provide the basis for civil and sometimes criminal penalties against sellers, as well as an obligation of restitution. (In contrast, unconscionability under the common law or the UCC typically involves a defense to enforcement of a provision, rather than a source of additional damages.⁵⁰) Thus, they involve significant economic consequences to affected sellers who run awry of their provisions.

New York, an early adopter of modern “price gouging” legislation, has left its mark on legislation in several other states. New York also has a unique advantage of extensive case law interpreting its “price gouging” statute, whereas other states have no reported decisions to date. Thus, the discussion below leads off with an extensive analysis of New York law and its manner of applying the unconscionability concept in this context. In the interests of brevity, this study does not cover every extant price gouging statute; only major comparative differences are mentioned for illustrative purposes. However, a table summarizing significant features of these state laws can be found in Appendix A.

A. New York.

New York provides one of the earliest examples of modern legislation to address the issue of “price gouging” during emergency situations.⁵¹ Section 396-r of the New York General Business Laws was enacted in 1979 to deal with concerns about rising consumer costs for home heating oil.⁵² Section 396-r states the following legislative finding:

[D]uring periods of abnormal disruption of the market caused by strikes, power failures, severe shortages or other extraordinary adverse circumstances, some parties within the chain of distribution have taken unfair advantage of consumers by charging grossly excessive prices for essential consumer goods and services.⁵³

⁵⁰ See *Arthur v. Microsoft Corporation*, 267 Neb. 586 (2004).

⁵¹ Of course, price control legislation has previously existed during national emergencies, including World War II. A detailed analysis of the history of this legislation is beyond the scope of this study.

⁵² See *State v. Strong Oil Co.*, 433 N.Y.S.2d 345, 347 (N.Y. Sup. Ct. 1980) (discussing legislative history).

⁵³ See New York General Business Law § 396-r(1) (McKinney 2005).

In response to this concern about “unfair advantage”, the legislature effectively imposed price controls on sellers during the period following a declaration of a state of emergency by the Governor.⁵⁴ During this period, “no party with in the chain of distribution of ... consumer goods or services or both shall sell or offer to sell any such goods or services or both for an amount which represents an unconscionably excessive price.”⁵⁵ Covered goods included “consumer goods and services vital and necessary for the health, safety, and welfare of consumers,” as well as any repairs made “on an emergency basis.”⁵⁶

This statute empowers the Attorney General to proceed against alleged violators seeking injunctive relief, restitution, and civil penalties of up to ten thousand dollars.⁵⁷ The statute provides that the question whether a price is “unconscionably excessive” is a question of law for the court to determine, and that this determination shall be based on these factors:

(i) that the amount of the excess in price is unconscionably extreme; or (ii) that there was an exercise of unfair leverage or unconscionable means; or (iii) a combination of both factors⁵⁸

Though these factors share a tautological flavor due to their repeated invocation of unconscionability as a measuring point, they also suggest an inquiry into both substantive price terms and the context for extracting that price.

The statute goes on to define the *prima facie* case (i.e., a case which, unless rebutted by the defendant, establishes the government’s claim) could be made by evidence showing a “gross disparity” between the “price” and the “value” of the goods. For this purpose, value is measured by reference to the price offered “by the defendant in the usual course of business immediately

⁵⁴ See id. § 396-r(2).

⁵⁵ Id.

⁵⁶ See id.

⁵⁷ See id. § 396-r(4).

⁵⁸ Id. § 396-r(3).

prior to the onset of the abnormal disruption of the market.”⁵⁹ Alternatively, a *prima facie* case could be made by showing that “the amount charged grossly exceeded the price at which the same or similar goods or services were readily obtainable by other consumers in the trade area.”⁶⁰ The defendant may also rebut the Attorney General’s case by showing evidence that “additional costs not within the control of the defendant were imposed on the defendant for the goods or services.”⁶¹

Case law has arisen involving the application of this statute to sales of home heating oil,⁶² electrical generators,⁶³ and roof repair services.⁶⁴ Perhaps the most significant of these cases is *People v. Two Wheel Corporation*,⁶⁵ which reached the Court of Appeals in New York, that state’s highest appellate court. This case involved a price-gouging claim against a retailer selling generators following the devastation of Hurricane Gloria, which left much of Long Island without electrical power between September 27 and October 8, 1985.⁶⁶ The defendant sold about 100 generators at prices ranging from 4 percent to 67 percent over those charged immediately before the hurricane.⁶⁷ The trial court had ordered defendant to pay a civil penalty of \$5,000, as well as to make restitution. The Appellate Division affirmed, and the Court of Appeals ultimately heard this important case.

The Court of Appeals first determined that the generators sold here were squarely within the scope of the statute as intended by the legislature, stating in part:

⁵⁹ Id. § 396-r(3)(b)(i).

⁶⁰ Id. § 396-r(3)(b)(ii).

⁶¹ Id.

⁶² See *State v. Strong Oil Co.*, 433 N.Y.S.2d 345 (Sup. Ct. 1980), reversed on other grounds, *State v. Strong Oil Co.*, 451 N.Y.S.2d 437 (N.Y.A.D. 1982).

⁶³ *People v. Chazy Hardware, Inc.* 675 N.Y.S.2d 770 (Sup. Ct. 1998); *People v. Two Wheel Corp.*, 525 N.E.2d 692 (NY Ct. App. 1988).

⁶⁴ *People v. Dame*, 734 N.Y.S.2d 789 (Sup. Ct. 2001).

⁶⁵ 71 N.Y.2d 693, 525 N.E. 2d 692 (Ct. App. NY 1988).

⁶⁶ See *id.*, 71 N.Y.2d at 696.

⁶⁷ See *id.*

The situation is ripe for overreaching by the merchant, who enjoys a temporary imbalance in bargaining power by virtue of an abnormal level of demand, in terms of both the number of consumers who desire the item and the sense of urgency that increases that desire.⁶⁸

The court found that some consumers needed the generators to power medical equipment or to keep food from spoiling, which undoubtedly lent support to the government's position.

Consequently, the merchant's typical prerogative of ownership was effectively deemed subservient to the interests of consumers. The merchant could presumably refuse to sell at all, but if he/she did choose to sell, the sale would be subject to the price limitation of the statute.

The heart of this case is the discussion of whether the sales prices in this case are "unconscionably excessive." The defendant pointed to the fact that some of the sales in this period exceeded the base price by less than five percent, and the majority involved price increases of less than thirty percent. It alleged that these sales could not satisfy the "gross disparity" standard.⁶⁹

The court rejected this argument, finding that "the term 'unconscionably excessive' does not limit the statute's prohibition to 'extremely large price increases', as [the defendant] would have it."⁷⁰ Instead, the court looked to unconscionability as interpreted in the common law and under the Uniform Commercial Code, and in particular to the substantive and procedural elements as traditionally applied.

As the court explained, the substantive element focuses on whether a contract term is "unreasonably favorable" to one party, whereas the procedural element looks to the process of forming the contract. In particular, the procedural element looks to

such factors as inequality of bargaining power, the use of deceptive or high-pressure sales techniques, and confusing or hidden language in the written agreement Thus, a price

⁶⁸ See id. at 697.

⁶⁹ See id. at 698.

⁷⁰ See id. at 698-99 (citations omitted).

may be unconscionably excessive because, substantively, the amount of the excess is unconscionably extreme, or because, procedurally, the excess was obtained through unconscionable means, or because of a combination of both factors.⁷¹

In this context, the Court found that all of the alleged price increases were unconscionably obtained, due to the context of the market disruption: “The evidence ... makes the inference inescapable that all of the price increases were tainted by [the seller’s] use of the superior bargaining position attributable to the power outage.”⁷² Moreover, the seller also failed to prove that the cost increases were due to a higher cost structure, which would have otherwise been an adequate defense. As a result, the court upheld the sanctions imposed by the lower court, including a requirement of restitution.

This decision was controversial, as reflected by a vigorous dissent joined by two justices. The majority’s approach effectively means that any sales above the base price charged before the disruption are subject to sanction on the basis of procedural concerns about sales under emergency situations. Under this sweeping approach, unconscionability could thus be found based on any effort to raise prices to extract additional profit from consumers that was not supported by higher costs.

Subsequent cases involving the price gouging statute have involved substantial price increases. For example, in *People v. Chazy Hardware*,⁷³ which also involved the sale of electric generators during a power outage, the markups at issue were even higher than those in the *Two Wheel* case. In this case, an ice storm struck Clinton County, New York, causing severe power outages. The local hardware store (the seller), which had only one generator in stock (which had been in inventory for nearly two years), sought out additional supplies from a wholesaler in Vermont. After taking orders from customers covering 42 generators, the seller sent its truck to

⁷¹ See *id.* at 699.

⁷² See *id.*

⁷³ 675 N.Y.S.3d 770 (Sup. Ct. NY 1998).

Vermont for the purpose of acquiring 56 generators at a cost of \$533 for a smaller unit and \$636 for a larger unit. To these costs the seller added its customary margin of 28 percent, making the selling prices \$683 and \$840, respectively.

Seller opened its business later that day — on a Sunday — to distribute the generators to the customers who had preordered them. The remaining fourteen generators (one large unit and thirteen small ones) were then offered for sale to the public at \$1,190 for all units, reflecting a substantial additional markup. These sales, and not the pre-ordered sales, were the subject of the Attorney General's action under the price gouging statute.

The court agreed that these prices were unconscionably excessive, even after considering the impact of “extraordinary costs” of over \$5,065 or \$93 per unit. The opinion did not explore the nature of these costs, however. The fact that the seller assumed risks associated with acquiring this inventory (i.e., driving its truck through icy conditions to another state) as well as holding that inventory without preexisting customers orders (recall that the seller's previous inventory of one generator had been in stock for nearly two years) was apparently not considered in connection with the calculus of cost.

The sale of generators was also challenged in *People v. Beach Boys Equipment Company*,⁷⁴ which also arose from an ice storm in 1998. In this case, the seller charged \$1200 for generators which were sold in the region for less than half this amount. Although the seller alleged that it paid its supplier \$1000 for the generators, the court found that this was not an arm's length transaction. The supplier cost was shown to be \$480, which would suggest that, if the seller's allegation of a \$1000 price was true, the supplier may have violated the price-gouging statute.

⁷⁴ 709 N.Y.S.2d 729 (2000).

The seller also alleged that it had extraordinary costs, including “truck rental, payroll, gas cans, plugs, cords, and telephone calls.”⁷⁵ However, the court rejected the possibility that these costs could have subsumed the entire margin. Significantly, the court also noted:

Indeed, even a small increase in price may be unconscionably excessive under General Business Law § 396-4 if “the excess was obtained through unconscionable means” ... which was the case here.⁷⁶

Thus, the New York Supreme Court in this case (a lower court than the Court of Appeals in *Two Wheel*) suggests continuing validity for unconscionable means resulting from the state of emergency to taint even modest price increases that are not justified by cost differentials.

The price gouging statute in New York was also used in a case involving home heating oil, which is closely analogous to the issue of gasoline pricing. In *State v. Strong Oil Company*,⁷⁷ the Attorney General brought a complaint based on a sale to a customer of home heating oil at a price of \$1.009 per gallon. Prices surveyed several days prior to this sale ranged from \$.879 to \$.969 with an average of \$.923, and prices several days after this sale ranged from \$.959 to \$.991 with an average of .973. Thus, the amount of the excess in this case (which is indeed hard to determine, as there was no evidence of contemporaneous prices, only prices before and after) would appear to be quite modest.

However, this case was ultimately decided in favor of the seller on other grounds, which do not involve the matter of an unconscionably excessive price. The court found that the New York statute was preempted by the Federal Emergency Petroleum Allocation Act of 1973.⁷⁸ Since this 1973 Act has since expired, it has no continuing preemptive effect with regard to the application of the price gouging statute to petroleum products, including motor fuels.

⁷⁵ Id. at 731.

⁷⁶ Id. (quoting *Two Wheel Corp.*, *supra.*).

⁷⁷ 433 N.Y.S. 3d 345 (Sup. Ct. 1980), *affirmed*, 451 N.Y.S.2d 437, 438 (Sup. Ct., App. Div. 1982).

⁷⁸ See *State v. Strong Oil Co.*, 451 N.Y.S.2d 437, 438 (Sup. Ct., App. Div. 1982).

Nevertheless, the fact that this court did not reject small price increases out of hand, and that the *Two Wheel* case implies that even a small increase could be actionable, presents the possibility of expanded application of this provision.

Significantly, no cases involving motor fuel prices have ever been decided in New York. Although it might be argued that motor fuel sellers may be subject to price gouging allegations based on the context of sales within a state of emergency, as suggested in the *Two Wheel* case, several additional factors need to be considered. First, an emergency declaration is a necessary precondition for invoking the statute. The fact that petroleum trades in a global market means that events impacting markets in other areas can have local price effects. Sellers move their products to seek out the higher priced demand, which translates into higher prices.

Hurricane Katrina's impact on global gasoline markets is evident from the fact that, once news of the hurricane reached petroleum exporters, vessels in the Atlantic bound for European markets turned around to return to the United States with their cargoes of gasoline.⁷⁹ That change in plan was presumably made in response to the prospect of higher prices and profits, rather than because of altruistic considerations.

Thus, even if an emergency declaration was made, the matter of higher supplier costs must still be considered. The price gouging statute does not prevent a seller from making a profit. As illustrated in *Chazy Hardware*, the seller was allowed to add its typical markups on the new generators it purchased. The initiative to travel in icy conditions to pick up new generators would have been eliminated if no profit was allowed. Moreover, gasoline is fungible and not capable of specific identification, as in the case of a generator. To the extent replacement stocks of gasoline come in at higher prices, those higher costs should arguably be allowed to be recouped under the

⁷⁹ See International Energy Agency, Oil Market Report 3 (9 September 2005), *available online at* www.oilmarketreport.org.

New York statute, as well as under any system of commercial fair play. It should be noted, however, that the laws of other states may not permit these higher replacement costs to be taken into account in evaluating whether price gouging occurs. Such issues are discussed below.

B. Other States.

Price gouging statutes in other states show many similarities with the New York statute. However, no reported cases have arisen under any of them. Their impact, if any, would be limited to the deterrent effect associated with the hypothetical threat of prosecution under these provisions, as well as any actual prosecutions which may not have produced a reported case.

Some state laws have specifically targeted petroleum products. Connecticut enacted a statute in 1991 that does not invoke unconscionability, but instead proscribes any sales at a price that “exceeds the price at which such energy resource was sold or offered for sale by such person in the usual course of business immediately prior to the declaration of the emergency.”⁸⁰ However, as in New York, sellers are protected for cost increases: “Nothing herein shall prohibit an increase in the price of an energy resource which is attributable to additional costs incurred by such person in connection with the acquisition, production, distribution or sale of such energy resource.”⁸¹

Georgia’s statute makes it unlawful during a state of emergency “to sell or offer for sale at retail any goods or services necessary to preserve, protect, or sustain the life, health, or safety of persons or their property at a price higher than the price at which such goods were sold or offered for sale immediately prior to the declaration of a state of emergency”⁸² As for costs

⁸⁰ C.G.S.A. § 42-232.

⁸¹ *Id.*

⁸² Ga. Code Ann., § 10-1-393.4(a). This statute was apparently enacted after a series of natural disasters, including floods and tornados, affected different parts of the state. See John A. Creasy, Comment, *Selling and Other Trade Practices*, 12 GA. ST. U. L. REV. 31 (1995).

incurred by the seller, the statute provides relief: “such price may be increased only in an amount which accurately reflects an increase in cost of the goods or services to the person selling the goods or services or an increase in the cost of transporting the goods or services into the area.”⁸³

As for the matter of how inventory replacement costs affect pricing, the statute makes a special provision for lumber:

Notwithstanding the provisions of subsection (a) of this Code section, a retailer or installer of lumber, plywood, and other lumber products may increase the price of such products as may be necessary to replenish his or her existing daily stock at current market rates, maintaining the same markup percentage he or she applied prior to the state of emergency.⁸⁴

By implication, the omission of other products from this statute suggests that higher replacement costs should not be considered in pricing one's current inventory.

Iowa has adopted a similar rule ignoring increased replacement costs in its regulations on unfair price terms, which provide in part:

An “excessive price” is one that is not justified by the seller's actual costs of acquiring, producing, selling, transporting, and delivering the actual product sold, plus a reasonable profit. In calculating the seller's actual costs, no allowance shall be made for the replacement costs of merchandise if the seller is reasonably assured of recouping the replacement costs as a part of the price of subsequent sales of the merchandise.⁸⁵

Here, the seller would typically not be able to charge a higher price for existing stocks unless the seller is “reasonably assured” that the existing stock can be sold at least the same price. In an environment of significant price fluctuations, query whether anyone could meet the “reasonable assurance” standard. Such a rule would presumably induce sellers to purchase lower than normal quantities to be assured that they would, indeed, be able to recoup the replacement cost in subsequent sales. Unfortunately, this behavior would also potentially lead to more shortages of needed goods.

⁸³ Id.

⁸⁴ Id. § 10-1-393.4(b).

⁸⁵ Iowa Admin. Code. § 61-31.1(714).

Rules like those found in Iowa and Georgia create potentially significant problems for motor fuel retailers, who often have significant inventories on hand to meet customer demands. In an environment involving disruptions in supplies, higher costs associated with replacement stocks are very real costs for retailers who wish to continue in business. Consider a simple example with a gasoline retailer having a 10,000 gallon supply purchased at \$2. If replacement costs are now \$3, a retailer required to continue selling existing stocks based on its historical markup from \$2 would not generate enough capital to replace those stocks with new gasoline. In an economic sense, the seller is worse off than before, as the price constraint effectively prevented the seller from continuing the same level of business.⁸⁶

Moreover, in situations with volatile prices, these retailers face the double-edged sword of potentially falling prices and their impact on profits. To the extent that competing firms drop their prices to take into account the lower costs of incoming supplies, a retailer with existing stocks acquired at a higher historical cost is left with the difficult choice of (a) keeping prices higher than competitors to recoup those costs and losing significant sales to competitors, or (b) dropping prices and taking a loss on existing inventories. The profits earned during times of price increases thus compensate for the losses incurred when prices are declining.

Thus, depriving sellers of the ability to replace their inventory by charging current replacement costs to customers not only prevents them from maintaining their economic capital, but also could ultimately result in lower inventory levels with potential adverse effects on consumer wellbeing.

⁸⁶ See generally Edward A. Morse, *Demystifying LIFO: Towards Simplification of Inflation-Adjusted Inventory Valuation*, 2 FLORIDA TAX REVIEW 559, 567-72 (1995) (discussing physical capital maintenance approaches to measuring taxable income).

Indiana's "price gouging" statute seems to recognize these concerns, as it makes a specific allowance for replacement costs in determining whether an unconscionable price has been charged:

For purposes of this chapter, "price gouging" means charging a consumer an unconscionable amount for the sale of fuel. Price gouging occurs if:

- (1) the amount charged grossly exceeds the average price at which fuel was readily obtainable within the retailer's trade area during the seven (7) days immediately before the declaration of emergency; and
- (2) the increase in the amount charged is not attributable to cost factors to the retailer, including replacement costs, taxes, and transportation costs incurred by the retailer.⁸⁷

Louisiana approaches this issue in a different way, but also arguably allows sellers to take into account these costs. It allows the seller to include "reasonable expenses and a charge for any attendant business risk, in addition to the cost of goods and services which necessarily are incurred in procuring the goods and services during the state of emergency."⁸⁸ The provision for business risk could take into account many kinds of costs, leaving considerable room for price increases.

Other states, such as Arkansas and California, provide a safe harbor for price increases on motor fuels and certain other goods only if the increase exceeds a stated amount, which presumably takes these attendant risks into account. In Arkansas, an unfair pricing practice does not arise during a state of emergency unless the seller charges "a price of more than ten percent (10%) above the price charged by that person for those goods or services immediately prior to the proclamation of emergency."⁸⁹ However, the statute further limits unfair prices from arising as follows:

a greater price increase shall not be unlawful if that person can prove that the increase in price was directly attributable to additional costs imposed on it by the supplier of the goods or directly attributable to additional costs for labor or materials used to provide the

⁸⁷ Ala. Code § 8-31-3.

⁸⁸ Louisiana Stat. Ann. § 29:732(A).

⁸⁹ Arkansas Code Ann. § 4-88-303 (a)(1).

services, provided that in those situations where the increase in price is attributable to additional costs imposed by the seller's supplier or additional costs of providing the good or service during the state of emergency, the price represents no more than ten percent (10%) above the total of the cost to the seller plus the markup customarily applied by the seller for that good or service in the usual course of business immediately prior to the onset of the state of emergency.⁹⁰

California law contains an essentially identical provision.⁹¹

Oklahoma has enacted a "Price Stabilization Act"⁹², which also provides a safe-harbor provision allowing a ten-percent price change, but it contains no express reference to higher costs as a defense.⁹³ West Virginia and the District of Columbia also utilize a ten-percent limitation in their statutory schemes.

Although the ten percent limitation gives some breathing room to sellers who raise prices, the definitions adopted in Arkansas and California leave some uncertainty about who might be affected based on increased replacement costs. Higher prices up the supply chain can only provide a justification for a retailer to charge higher prices if the costs incurred from its suppliers were, in turn, either no more than ten percent higher (taking into account the customary markup) or they were justified by higher costs. This means that a seller could technically be subjected to penalties even though the seller was only passing along costs it incurred, if another member in the supply chain had violated the rule. This kind of rule might explicitly address the problem presented in the New York case of *Beach Boys Equipment Company*, discussed above, where a question about arm's-length pricing was raised. However, this arguably creates other problems in enforcement which are not in accord with a standard of unconscionable behavior.

Florida's statute addressing price gouging takes a slightly different tack in dealing with replacement costs. It uses an ambiguous "gross disparity" standard for evaluating whether a price

⁹⁰ Id. § 4-88-303(a)(2).

⁹¹ See California Penal Code § 396(b).

⁹² See 15 Okla. Stat. Ann. §§ 777.1-.5.

⁹³ See id. § 777.4.

charged is unconscionable, using as the basis for comparison the average prices charged during the 30 days preceding the emergency.⁹⁴ However, it also provides for a defense to the extent that any increase in the amount charged is “attributable to additional costs incurred in connection with the ... sale of the commodity ... or national or international market trends.”⁹⁵

This reference to “national or international market trends” recognizes that forces outside the current trade area may affect the price at which commodities are available. In effect, this recognizes that markets for many important consumer goods, including petroleum products, are impacted by events in other geographic or product markets. This would apparently take into account the realities of replacement costs to retailer pricing, which as discussed above was problematic in Iowa and Arkansas. However, it would also allow potentially significant price increases to consumers within the scope of the statute.

V. Legal Standards for Unconscionable “Price Gouging” in Nebraska

Nebraska’s Uniform Deceptive Trade Practices Act⁹⁶ contains a general provision that could potentially be applied to “price gouging” behavior: “An unconscionable act or practice by a supplier in connection with a consumer transaction shall be a violation of sections 87-301 to 87-306.”⁹⁷ The statute also provides the following guidance as to the nature of unconscionability:

The unconscionability of an act or practice shall be a question of law for the court. If it is claimed or appears to the court that an act or practice may be unconscionable, the parties shall be given a reasonable opportunity to present evidence as to its setting, purpose, and effect to aid the court in making its determination.⁹⁸

⁹⁴ Florida Stat. Ann. § 501.160.

⁹⁵ Id.

⁹⁶ See Neb. Rev. Stat. §§ 87-301 to -306.

⁹⁷ Id. § 87-303.01(1).

⁹⁸ Id. § 87-303.01(2).

This “setting, purpose, and effect” provision is similar to that found in Nebraska’s version of the Uniform Commercial Code.⁹⁹ Other Nebraska statutes also invoke unconscionability as a basis for legal relief from the enforcement of agreements, without providing a specific definition.¹⁰⁰

The challenge in this context is to ascertain how a court might interpret unconscionability in the context of motor fuel price increases as recently experienced after Hurricane Katrina. Nebraska law embraces the traditional doctrine of consideration in contract law, as recently reaffirmed by the Nebraska Court of Appeals:

Generally, a court will not inquire into the adequacy or value of the stated consideration so long as the performance or the promise of performance is one that the promisor considers of value. The Nebraska Supreme Court has stated that even a ‘peppercorn’ or other nominal consideration may be sufficient consideration as long as the promisor deems it of value. *Pruss v. Pruss*, 245 Neb. 521, 534, 514 N.W.2d 335, 345 (1994). “The monetary value of the performance or the promise of performance is irrelevant. It is sufficient that the promisee did something he or she was not otherwise required to do or that the promisor received something he or she was not otherwise entitled to receive.” *Id.* See, also, *Omaha Nat. Bank v. Goddard Realty, Inc.*, 210 Neb. 604, 316 N.W.2d 306 (1982). “Generally, a court will not inquire into the adequacy of consideration for a contract, inasmuch as consideration based on value of property or performance of a promise is a matter of personal judgment by parties to a contract.” *Buckingham v. Wray*, 219 Neb. 807, 809, 366 N.W.2d 753, 756 (1985).¹⁰¹

This court also noted the importance of liberty of contract, stating: “[i]t is not the province of courts to emasculate the liberty of contract by enabling parties to escape their contractual

⁹⁹ See Neb. Stat. U.C.C. § 2-302 (“When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.”)

¹⁰⁰ See, e.g., Neb. Stat. U.C.C. § 2-719 (unconscionability as to limitation of consequential damages); Neb. Rev. Stat. § 25-414 (forum selection allowed unless agreement obtained by :misrepresentation, duress, the abuse of economic power, or other unconscionable means”); id. § 25-2913 (mediator allowed to terminate process if agreement would be unconscionable); id. § 42-366 (granting judicial authority to disallow marital property settlement deemed unconscionable). See also Neb. Const. Art. XV, § 9 (granting authority to make laws for “the prevention of unfair business practices and unconscionable gains in any business or vocation affecting the public welfare.”)

¹⁰¹ *James Neff Kramper Family Farm Partnership v. Dakota Indus. Development, Inc.* 8 Neb.App. 893, 893, 603 N.W.2d 463, 468-69 (Neb.App. 1999).

obligations on the pretext of public policy unless the preservation of the public welfare imperatively so demands.’”¹⁰²

An older case involving the matter of specific performance of a land sale contract likewise states this hesitation to intervene, except in extreme cases suggesting fraud or some other basis for intervention:

Inadequacy of price alone is not sufficient to prevent a decree, unless the disparity is so great as to shock the conscience of all reasonable men and thus afford an irresistible inference of fraud. Such a case was *Byers v. Surget*, 19 How. (U. S.) 303, 15 L. Ed. 670, where defendant attempted to sustain a public sale for \$9.75 of land worth from \$40,000 to \$70,000. That was an extreme case, but serves to illustrate the general rule, which arose partly from the difficulty of determining by any definite standard what amount of inadequacy must exist to constitute the exception.

The general rule is announced in the cases cited by plaintiff, inter alia, *Heyward v. Bradley*, 179 Fed. 325, 102 C. C. A. 509; *Boyce v. Holloway*, 45 Ind. App. 535, 91 N. E. 34; *Sweeney v. Brow*, 35 R. I. 227, 86 Atl. 115, Ann. Cas. 1915C, 1075. In all of these cases, however, and in all coming to our attention, it is recognized that the rule is applicable only in the absence of fraud, oppression or mistake. Where inadequacy of price is shown, though insufficient in itself, if accompanied by circumstances fairly establishing fraud or mistake, a case is presented for the exercise of a sound judicial discretion by the court.¹⁰³

These cases suggest judicial restraint as to interference with price terms under Nebraska law. The standard suggested for an inadequate price – “so great as to shock the conscience of all reasonable [persons]” – erects a serious barrier to finding unconscionability. Though one might point to the fact that consumers have great needs for fuel, and that they do not have the opportunity to negotiate those prices specifically as evidence of procedural elements of unconscionability, such a position would prove too much. As noted above, such a position would call into question the prices charged by retailers for virtually every consumer good.¹⁰⁴

¹⁰² Id., 8 Neb. App. at 898, 603 N.W. 2d at 468 (quoting *Occidental Sav. & Loan Assn. v. Venco Partnership*, 206 Neb. 469, 480, 293 N.W.2d 843, 848 (1980)).

¹⁰³ *Moore v. McKillip*, 194 N.W. 465, 467-68 (Neb. 1923).

¹⁰⁴ See *Strang*, *supra*.

Though the Legislature may decide whether to enact a more specific basis for intervening in matters of “price gouging” in the context of an emergency or otherwise,¹⁰⁵ it is far from clear whether the current statute grants that authority. No Nebraska cases have ever interpreted the unconscionability constraint in the Uniform Deceptive Trade Practices Act to cover a seller’s act of raising prices for a standard commodity, such as motor fuels. This is not a case where the price term is hidden in complex and deceptive language of a form agreement; instead the price is openly stated to consumers in advance of their purchases.

An attempt to use the context of price increases after the impact of a natural disaster outside the boundaries of Nebraska, such as in the case of Hurricane Katrina, raises other problems due to the general terms of this statute. First, there is the matter of notice to sellers of their potential obligations, which are unclear under this law. Unlike sellers in states with specific price-gouging statutes, sellers in Nebraska have comparatively little notice as to the potential application of this law to price changes that are openly advertised to consumers. It is unclear whether this rises to the level of violating a constitutional right to due process, but even if it did not, the practical barriers to developing a consistent basis for enforcement appear to be significant.

Second, the emergency context giving rise to relief in other states invokes considerations of the protection of human life and welfare against the impact of a common threat from a natural disaster or other similar calamity. In those situations, constraints on prices may be more easily justified in relation to those particular goals. Consider, for example, the matter of the sinking ship negotiating services of a salvage vessel. The traditional rule in admiralty law would allow the price term of a contract negotiated in these circumstances to be challenged subsequently

¹⁰⁵ Cf. *State v. Kinney*, 313 U.S. 236, 246 (1940) (“We are not concerned, however, with the wisdom, need, or appropriateness of the legislation. Differences of opinion on that score suggest a choice which ‘should be left where * * * it was left by the Constitution—to the states and to Congress.’” (citation omitted)).

based on the fair value of the salvage services.¹⁰⁶ In these circumstances, interests of fair play provide a basis for renegotiation due to the duress resulting from circumstances on the sinking ship, even though the duress was not caused by the other party to the contract.

Nebraska consumers have not faced conditions comparable to those in regions directly affected by a natural calamity. For example, consumers fleeing an oncoming hurricane under an evacuation order may be effectively required to purchase fuel wherever it is available. A decision to defer a purchase or shop around for a lower price could generate deadly results, particularly in the face of uncertain supplies at other locations. Although Nebraska consumers may consider gasoline or diesel fuel to be important to their personal wellbeing, market conditions still permit them to shop around for their fuel. Driving on to the next station is still generally an option in the event that they encounter a truly egregious price differential based on comparable market transactions.

The absence of price behavior rising to the level of unconscionable “price gouging” is further supported by analysis of the basis for price level changes of gasoline and diesel fuels in the state. As discussed above, laws of other states dealing with “price gouging” generally treat increases in the supplier’s costs as a justifiable basis for raising prices, which is outside the scope of unconscionability. As will be discussed below, the information from a survey of Nebraska retailers of gasoline and diesel fuel presents a clear case of increasing costs contributing significantly to price increases. Though margins did increase slightly during the volatile price conditions during this period, they do not reflect an egregious price differential that might support a finding of unconscionable behavior.

¹⁰⁶ See William M. Landes & Richard A. Posner, *Salvors, Finders, Good Samaritans, and Other Rescuers: An Economic Study of Law and Altruism*, 7 J. LEG. STUD. 83, 100-105 (1978); Richard A. Posner, *ECONOMIC ANALYSIS OF LAW* 129-30 (5th ed. 1998) (citing article).

PART TWO: ANALYSIS OF MOTOR FUEL MARKETS

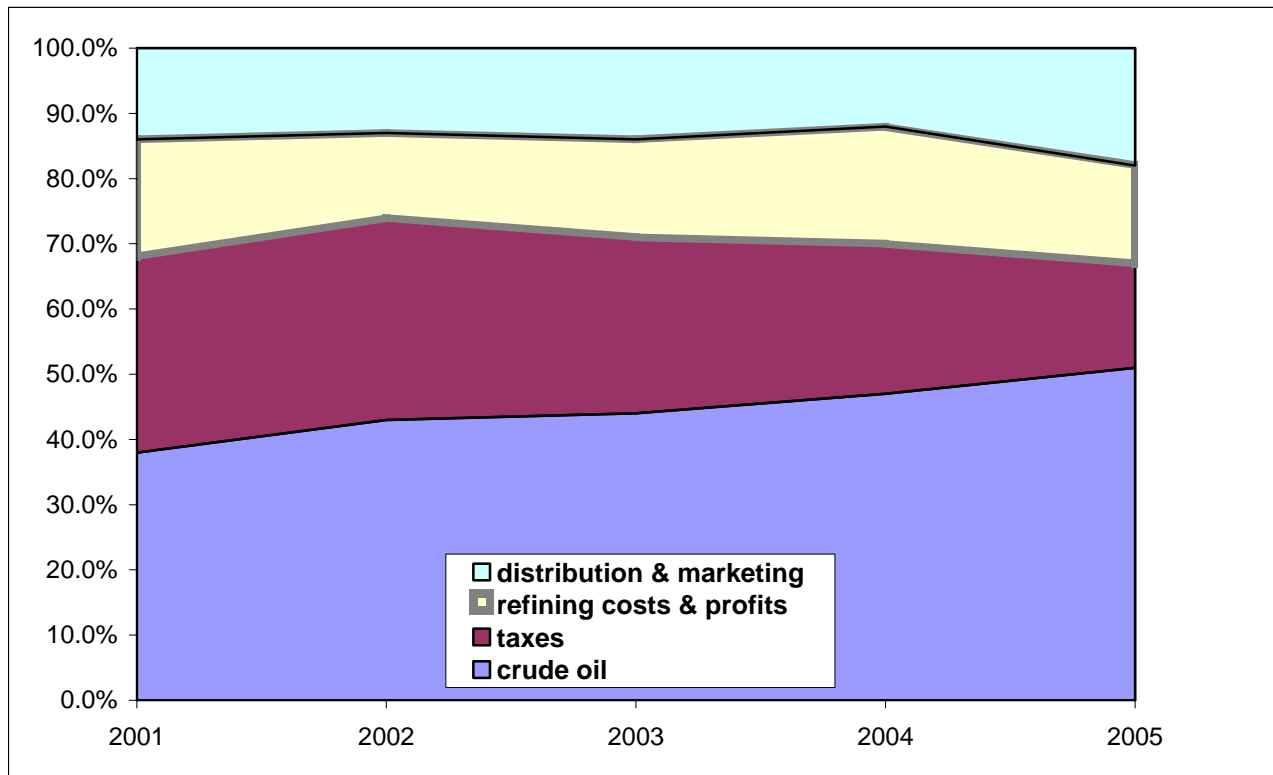
Gasoline accounts for roughly 17 percent of the energy consumed in the United States.¹⁰⁷

Autos, light trucks, and trucks consume the lion's share of this gasoline usage, with boats, recreational vehicles, airplanes, and farm vehicles consuming the remainder. Oil companies deliver gasoline throughout the nation through pipelines with final connection to the consumer via 167,000 gasoline service stations and convenience stores.

Figure 2.1 shows the composition of the price of gasoline from 2001 to 2005. Oil's share of the price of a gallon of gasoline grew from 38 percent in 2001 to 51 percent in 2005. During this same period of time, as a share of price of gasoline, taxes declined from 30 percent to 16 percent, refining costs and profits dropped from 18 percent to 15 percent, and distribution, marketing, and profits rose from 14 percent to 18 percent. (The decline in the share of gasoline spending going to taxes can be explained by the fact that gasoline taxes are levied at a fixed amount per gallon. Thus, as prices rise, the effective tax rate declines.)

¹⁰⁷ Source of all petroleum industry data in Part Two is the Energy Information Administration, available online at www.eia.doe.gov.

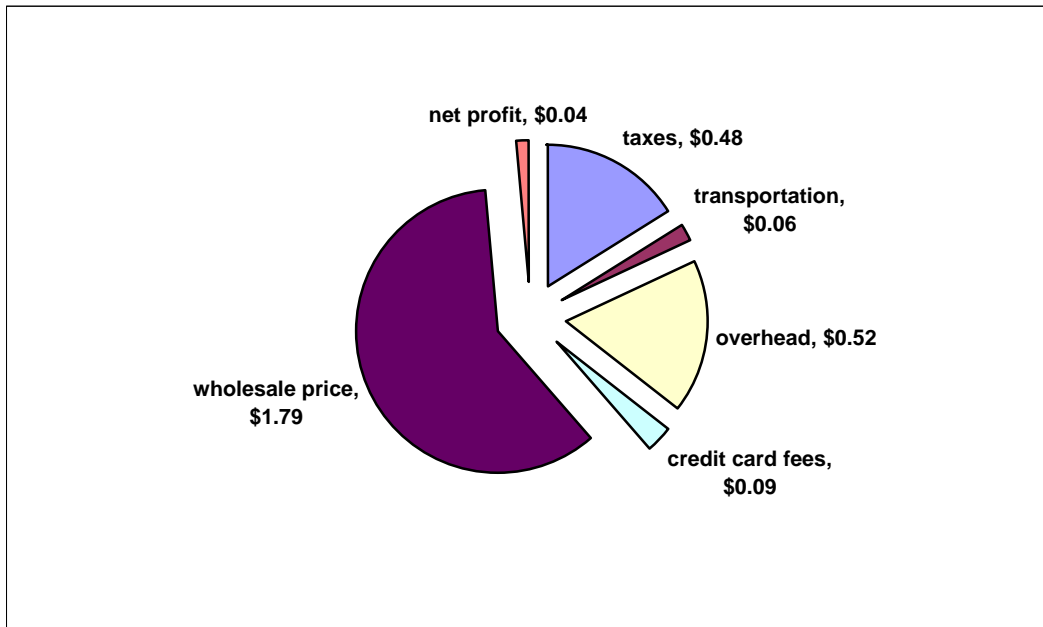
Figure 2.1: Components of Gasoline Prices, 2001-2005 (Source: EIA)



According to estimates from the EIA, gasoline prices rose \$1.03 between 2004 and 2005. The EIA found that crude oil producers were responsible for \$0.53 of the increase, distributors and marketers collected \$0.19 of the upturn, federal, state, and local government agencies obtained \$0.16 of the change, and refiners collected \$0.15 of the rise in gasoline prices.

Figure 2.2 shows how the retail price of a gallon of gasoline was divided in 2005. According to the data, for each gallon of gasoline, wholesalers received \$1.79 (60 percent), government entities collected \$0.48 (16.0 percent), transporters obtained \$0.06 (2.0 percent), credit card companies received \$0.09 (3.0 percent), and other vendors collected \$0.52 (17.5 percent). This left \$0.04 (1.5 percent) for retailers' profit.

Figure 2.2: Components of the Pump-Price of Gasoline (2005) (Source: EIA)



I. What Causes Gasoline Price Fluctuations?

Prices of basic energy (gasoline, electricity, natural gas, heating oil) are generally more volatile than prices of other commodities. One reason is that consumers are limited in their ability to substitute between fuels when the price for gasoline, for example, fluctuates. There are five fundamental factors that explain variations in the pump-price of gasoline.

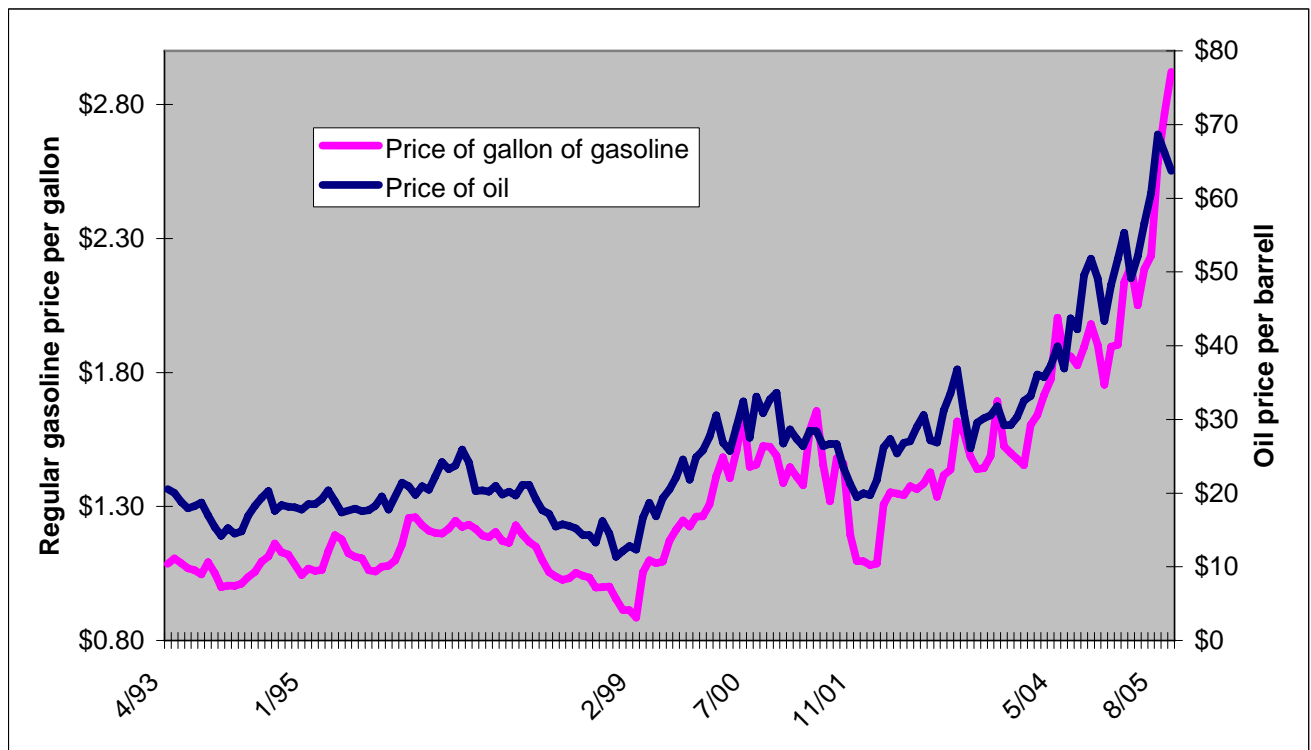
A. Changes in Crude Oil Prices

According to the National Petroleum Council, disruptions in crude oil markets were a major factor in all but one of the five rapid increases in gasoline prices between 1972 and 1997. Brisk increases in gasoline prices followed events such as the Arab oil embargo in 1973 (prices up 184 percent), the Iranian Revolution in 1978 (prices up 119 percent), the Iran/Iraq War in 1980 (prices up 17 percent), and the Persian Gulf War in 1990 (prices up 63 percent). Finally, crude

oil prices have risen 111 percent since 2001 due primarily to the rapid expansion in the global economy, particularly China.

Figure 2.3 shows that, in general, there is a strong and positive linkage between oil prices and gasoline prices. Since 2001 the relationship changed somewhat, however, with gasoline prices increasing 100.2 percent and oil prices growing 122.7 percent.

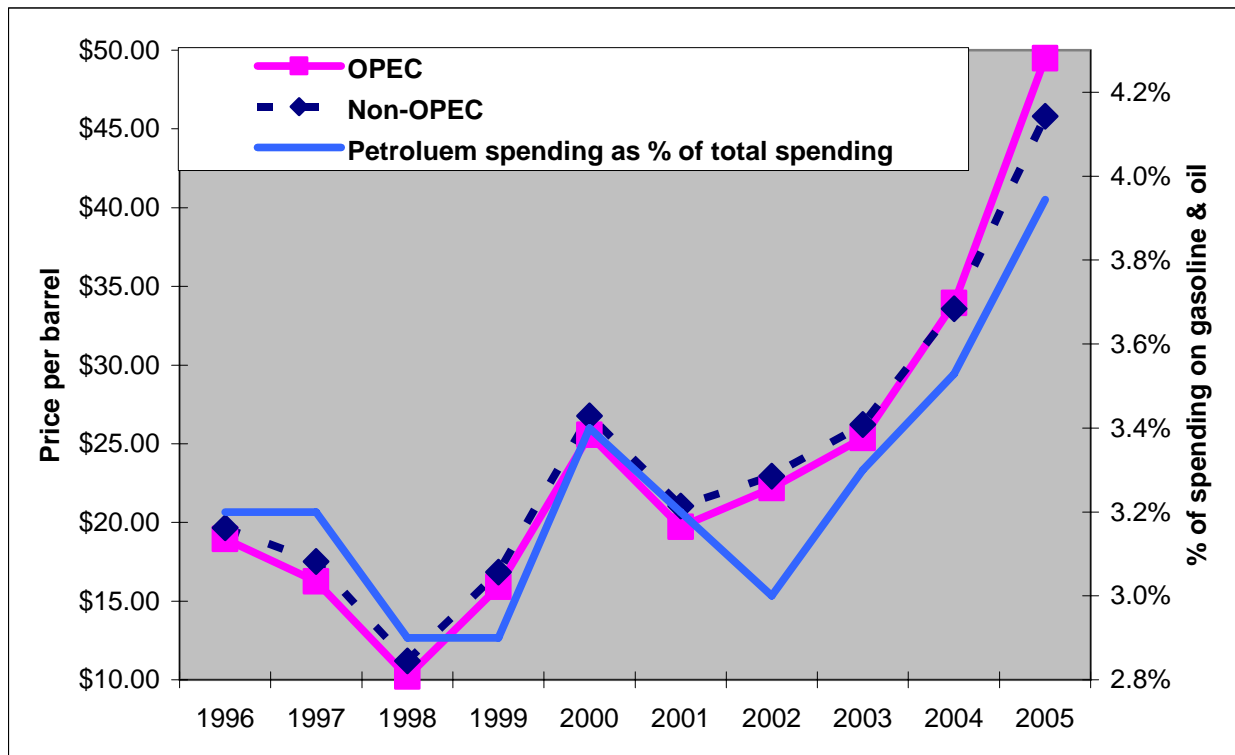
Figure 2.3: Price of Oil and Gasoline, 1993 to 2005



As a result of the rapid increase in the price of petroleum products since 2001, the share of the family budget spent on petroleum products increased dramatically, rising from approximately 3 percent in 2002 to almost 4 percent in 2005. Figure 2.4 shows the trend in oil prices and the share of the family budget spent on petroleum and oil products. According to *BLS Consumer Expenditure Surveys*, the average U.S. consumer spent \$1,333 on gasoline and motor oil in 2003. This represented a 26.4 percent increase from 1999 spending. Over this same period

of time, the price per barrel of oil grew 59.5 percent and 55.6 percent for OPEC and non-OPEC oil, respectively.

Figure 2.4: Trends in the Price of Oil and Percent of Budget Spent on Petroleum and Motor Oil, 1996 – 2005¹⁰⁸



B. Seasonality in Consumer Demand

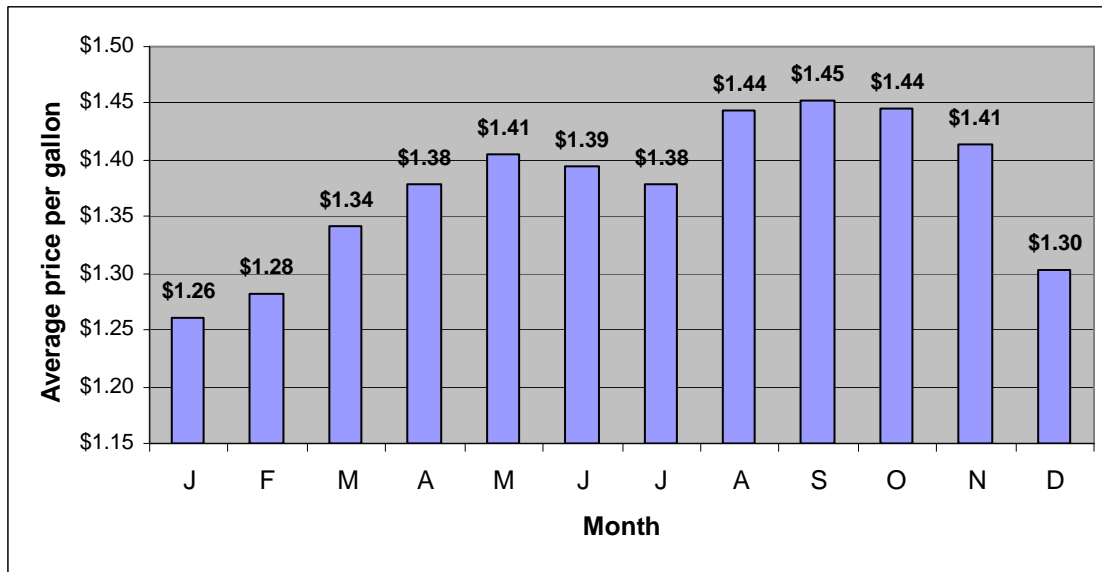
Even when crude oil prices are stable, retail gasoline prices tend to rise gradually before and during the summer and decline in the winter months. If crude oil prices remain unchanged, gasoline prices typically would increase 10 to 20 cents per gallon from January to the summer.

Figure 2.5 shows the average price per gallon by month from 1994 to 2005. Prices are highest in January at \$1.26 and most expensive in September at \$1.45 per gallon. These price differentials

¹⁰⁸Percentage of budget spent on petroleum and motor oil for 2004 and 2005 are projected based on oil prices in 2004 and 2005.

result from increases and decreases in gasoline demand with demand growing significantly in the summer months due primarily to vacation driving.

Figure 2.5: Average Price per Gallon of Gasoline by Month, 1994 to 2005



C. Product Demand and Supply Imbalances

Rapid changes in demand and supply due to refinery production problems, or lagging imports, can produce significant changes in gasoline prices. When stocks are low and falling, some wholesalers bid up the price of gasoline to insure adequacy of supply. Such imbalances have occurred when a region has changed from one fuel type to another (e.g., to cleaner-burning gasoline) as refiners and marketers adjust to the new product.

Oil imports currently account for an ever-rising share of the nation's consumption. In 1973 at the beginning of the first oil crisis, imports represented only 36 percent of overall oil consumption in the U.S. American oil production is declining, however, due to the rapidly dwindling U.S. oil reserves and the ease of importing foreign supplies. Imports reached more

than 10 million barrels a day in April of 2005. They may decline again when the peak summer-driving season ends, but for the first half of the year they averaged 9.9 million barrels a day, according to the American Petroleum Institute, the industry's trade association. In contrast, imports were less than two-thirds as large, about six million barrels a day, in the last two oil crises, in 1973-74 and 1979, both of which provoked recessions because crude oil prices soared.

Figure 2.6 profiles U.S. oil imports per day between 1920 and 2005. Since 1991, imports have grown fairly consistently from 5.8 million barrels per day in 1991 to 10.2 million barrels per day in 2005.

Figure 2.6: Oil Imports per Day, 1920-2005 (Source: EIA)

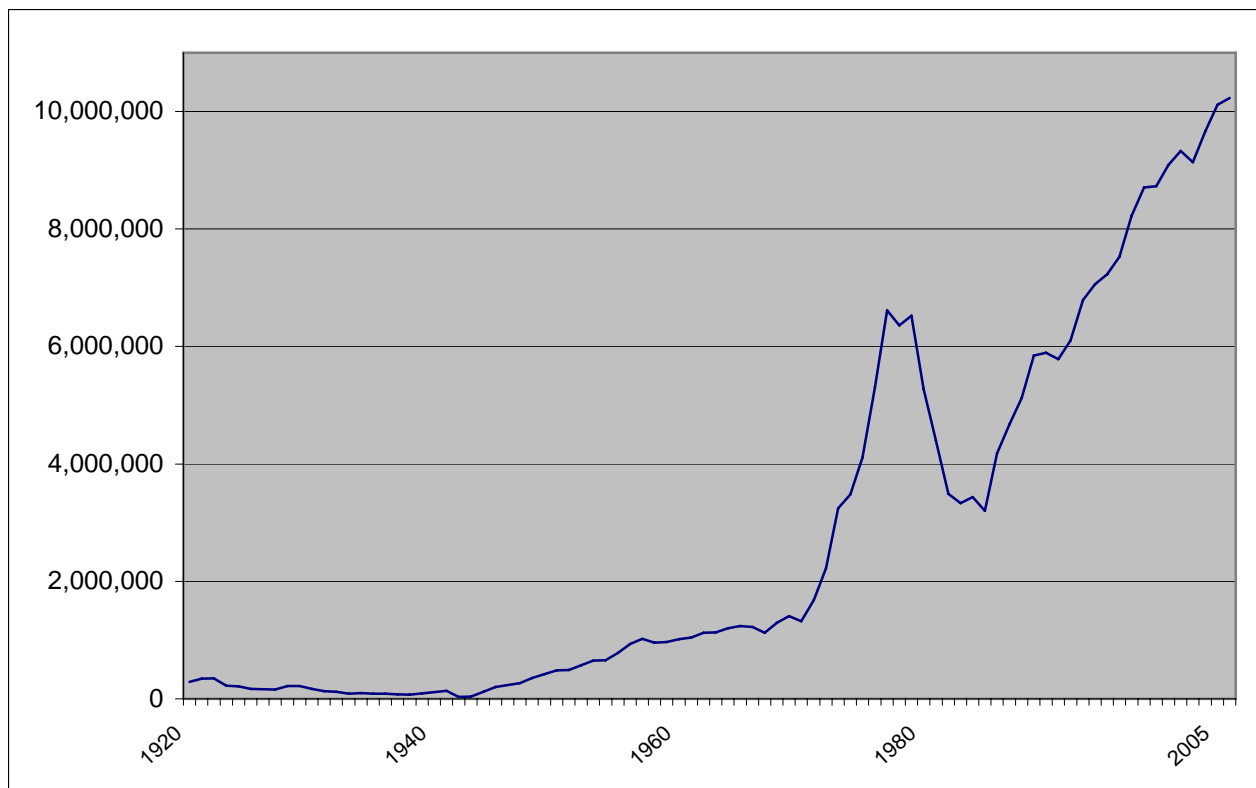
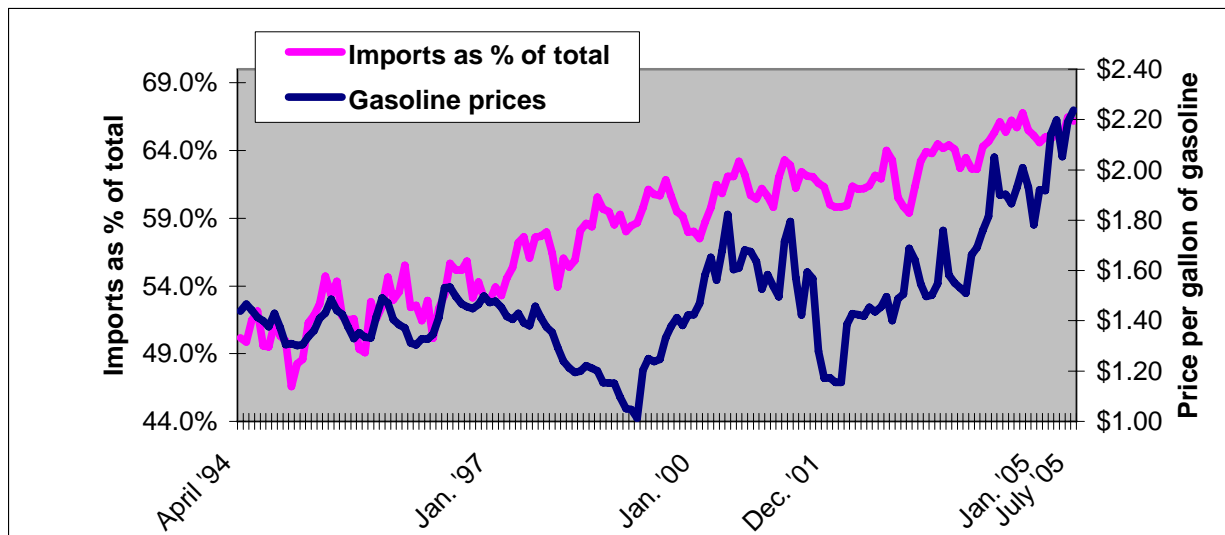


Figure 2.7 shows the relationship between imports as a percentage of total oil production and the price of a gallon of gasoline. In general, a rising import percentage tends to increase the price of a gallon of gasoline. Between April 1994 and July 2005, the correlation coefficient between the two was 0.680, indicating a very strong and positive relationship between the two factors.¹⁰⁹

Figure 2.7: Imports as Percentage of Total and Gasoline Prices, April 1994-July 2005



D. Environmental Programs

Various sections of the country require motorists to use special gasoline. Programs in these areas are aimed at reducing carbon monoxide, smog, and air toxins. Other environmental programs restrict transportation and storage. These reformulated fuels cost more to produce, thus increasing the per gallon price of gasoline to the consumer.

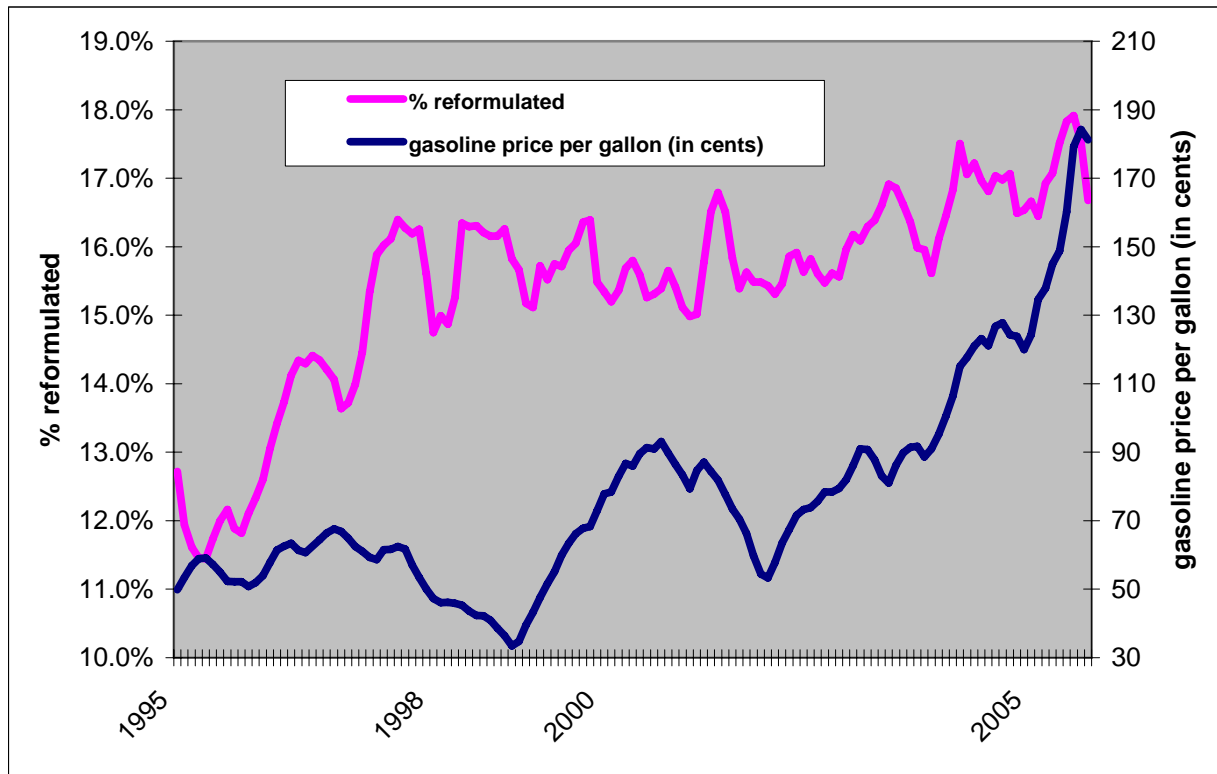
¹⁰⁹ A correlation coefficient may range between -1 (perfectly and inversely related) and +1 (perfectly and directly related).

Twenty-five states have passed legislation to restrict the use of the gasoline additive MTBE. Only California, Kentucky, Missouri, New Hampshire, New Jersey, New York, and Rhode Island, however, relied on the additive. The Energy Policy Act of 2005, signed into law in August 2005, also allows refiners to discontinue use of oxygenates (including MTBE) in reformulated gasoline. This change in production will mean large changes in the production and distribution of gasoline. For example, in the summer of 2003 California endured temporary supply dislocations and price volatility due to the removal of MTBE from gasoline. On the other hand, New York and Connecticut experienced few disruptions as they phased out the use of MTBE in gasoline in 2004.

The Renewable Fuel Standard (RFS) program began in January 2004. Most refineries must comply with the 30 parts per million (ppm) low-sulfur gasoline standards beginning in January 2005 and ultra-low-sulfur diesel fuel beginning in June 2006. Nearly all refiners must produce gasoline if they are to stay in business, but a refiner does not necessarily have to produce on-road diesel fuel, which is what the ultra-low-sulfur diesel fuel program regulates. Refiners can produce only high-sulfur distillate fuel that is used in home heating, electricity generation, and other off-road applications.

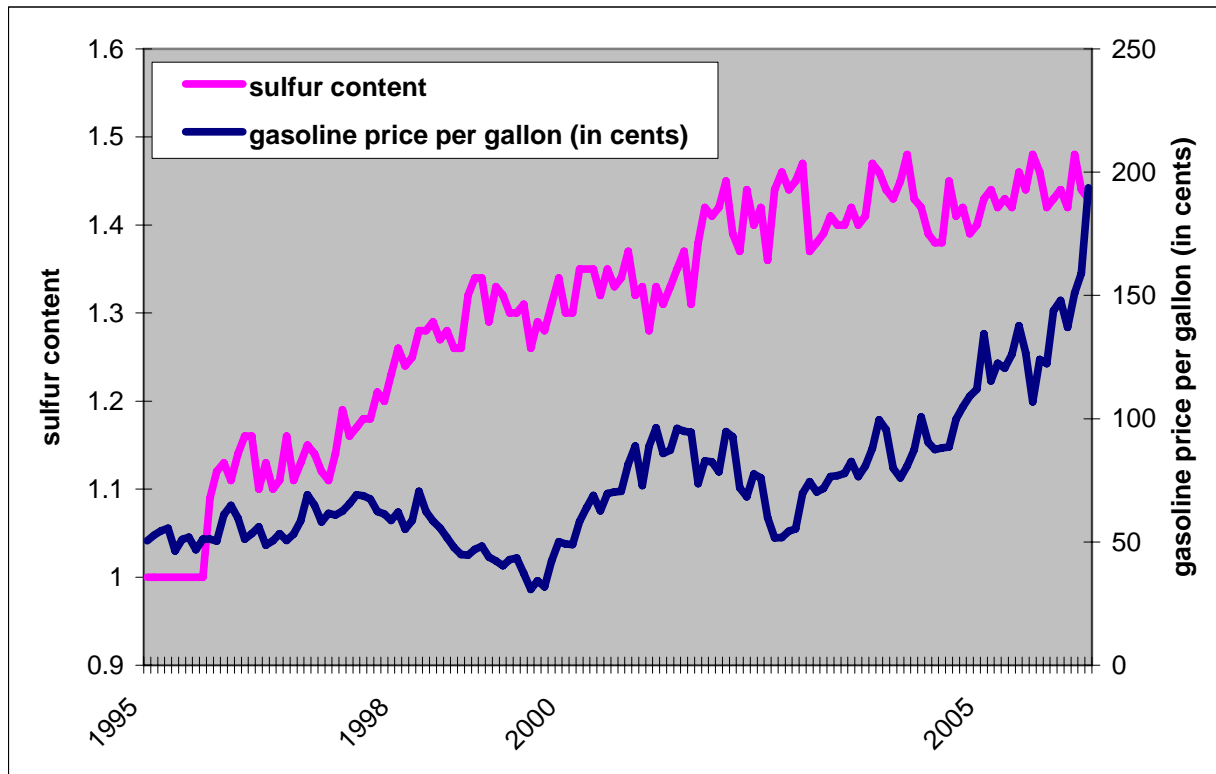
Figure 2.8 shows the percentage of gasoline production devoted to reformulated gasoline and the price per gallon of gasoline. The relationship appears to be positive. That is, as refineries devote more of their capacity to reformulated gasoline, the price per gallon tends to rise. The correlation coefficient between the two was 0.135 from 1994 to 2001 and 0.515 from 2001 to 2005. Thus, the impact of reformulation on gasoline prices has risen significantly since the end of the recession in November 2001.

Figure 2.8: Percentage of Production Devoted to Reformulated Gasoline¹¹⁰ vs. Price per Gallon of Gasoline (in cents), 1995 - 2005



¹¹⁰ “Finished gasoline formulated for use in motor vehicles, the composition and properties of which meet the requirements of the reformulated gasoline regulations promulgated by the U.S. Environmental Protection Agency under Section 211(k) of the Clean Air Act. It includes gasoline produced to meet or exceed emissions performance and benzene content standards of federal-program reformulated gasoline even though the gasoline may not meet all of the composition requirements (e.g., oxygen content) of federal-program reformulated gasoline. *Note:* This category includes Oxygenated Fuels Program Reformulated Gasoline (OPRG). Reformulated gasoline excludes Reformulated Blendstock for Oxygenate Blending (RBOB) and Gasoline Treated as Blendstock (GTAB).” (EIA, 2005).

Figure 2.9: Sulfur¹¹¹ Content vs. Gasoline Prices per Gallon (in cents), 1995-2005



E. Weather-related Problems

Besides seasonality, hurricanes produce abrupt increases in oil and gasoline prices due to the closure or cutbacks of oil wells or refineries. With the U.S. relying more heavily on Gulf Coast oil production and on refineries in Gulf Coast states, hurricanes have become a more significant source of price volatility. Additionally, the ports in the Gulf of Mexico serve as major distribution points for petroleum products.

¹¹¹ "Sulfur is a yellowish nonmetallic element, sometimes known as 'brimstone.' It is present at various levels of concentration in many fossil fuels whose combustion releases sulfur compounds that are considered harmful to the environment. Some of the most commonly used fossil fuels are categorized according to their sulfur content, with lower sulfur fuels usually selling at a higher price. *Note:* No. 2 Distillate fuel is currently reported as having either a 0.05 percent or lower sulfur level for on-highway vehicle use or a greater than 0.05 percent sulfur level for off-highway use, home heating oil, and commercial and industrial uses. Residual fuel, regardless of use, is classified as having either no more than 1 percent sulfur or greater than 1 percent sulfur. Coal is also classified as being low-sulfur at concentrations of 1 percent or less or high-sulfur at concentrations greater than 1 percent." (EIA, 2005)

Three recent hurricanes provide evidence of the contribution of major storms to petroleum price volatility. On Thursday September 16, 2004, Ivan struck the U.S. Gulf Coast. Hurricane Ivan was the ninth named storm and the only Category 5 hurricane of the 2004 hurricane season. It became a hurricane on September 5. It caused an estimated \$13 billion worth of damage in the United States, making it the fourth costliest hurricane to ever strike the U.S. Katrina first made landfall as a Category 1 hurricane just north of Miami, Florida on August 25, 2005. In the Gulf of Mexico it strengthened into a formidable Category 5 hurricane with maximum winds of 175 mph. It weakened considerably as it was approaching land, making its second landfall on the morning of August 29 on the Gulf Coast near Buras-Triumph, Louisiana with 125 mph winds. Hurricane Rita was the fifth major hurricane and second Category 5 hurricane in 2005 and is on record as being the strongest measured hurricane to ever enter the Gulf of Mexico. Hurricane Rita made landfall on September 24, 2005 as a Category 3 hurricane, with windspeeds of 120 mph and a storm surge of 10 feet.¹¹²

Table 2.1 illustrates the impact of Hurricanes Ivan, Katrina, and Rita on the price of oil and gasoline one week before each made landfall to one week after landfall. Over the two week period for Hurricane Ivan, the price of a barrel of oil rose from \$44.61 to \$48.46, or 8.6 percent. During this same period of time, the price of gallon of gasoline increased from \$1.23 to \$1.33 or 7.8 percent. For the two week period for Hurricane Katrina, the price of a barrel of oil increased from \$63.27 to \$69.47, or 9.8 percent while the price of a gallon gasoline advanced from \$1.85 to \$3.26, or 76.6 percent. Over the two week period for Hurricane Rita, the price of a barrel of oil advanced from \$63.00 to \$65.47, or only 3.9 percent as the price of a gallon of gasoline rose from \$1.83 to \$2.06 or 12.7 percent.

¹¹²Information of all hurricanes comes from <http://en.wikipedia.org>.

For Table 2.1, one can conclude that the hurricanes of 2004 and 2005 had approximately the same impact on oil prices but the hurricanes of 2005 had a much larger effect on gasoline prices than did Hurricane Ivan in 2004.

Table 2.1: Percent Change in Price between One Week Before Hurricane and One Week After Hurricane Landfall

		Oil Prices per Barrel	Percent Change	Gasoline Prices per Gallon	Percent Change
Ivan	Sept. 9, 2004	\$44.61		\$1.23	
	Sept. 23, 2004	\$48.46	8.6%	\$1.33	7.8%
Katrina	Aug. 18, 2005	\$63.27		\$1.85	
	Sept. 1, 2005	\$69.47	9.8%	\$3.26	76.6%
Rita	Sept. 16, 2005	\$63.00		\$1.83	
	Oct. 3, 2005	\$65.47	3.9%	\$2.06	12.7%

Figure 2.10 shows the relationship between the increase in the price of a barrel of oil and the number of days since the landfall of Hurricanes Ivan and Katrina. Of course, data for Katrina and Rita are intertwined.

Figure 2.10: Impact of Hurricane Ivan and Katrina on Oil Prices

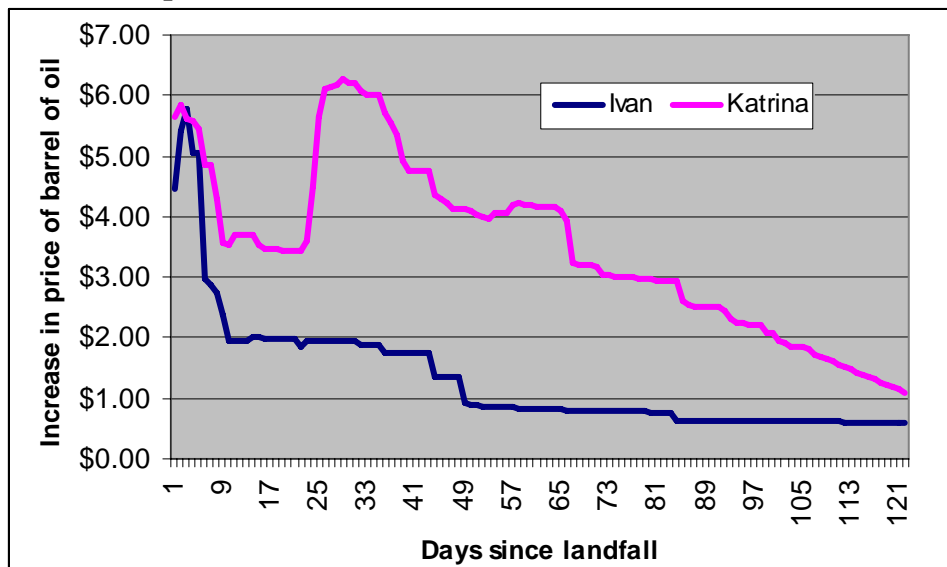
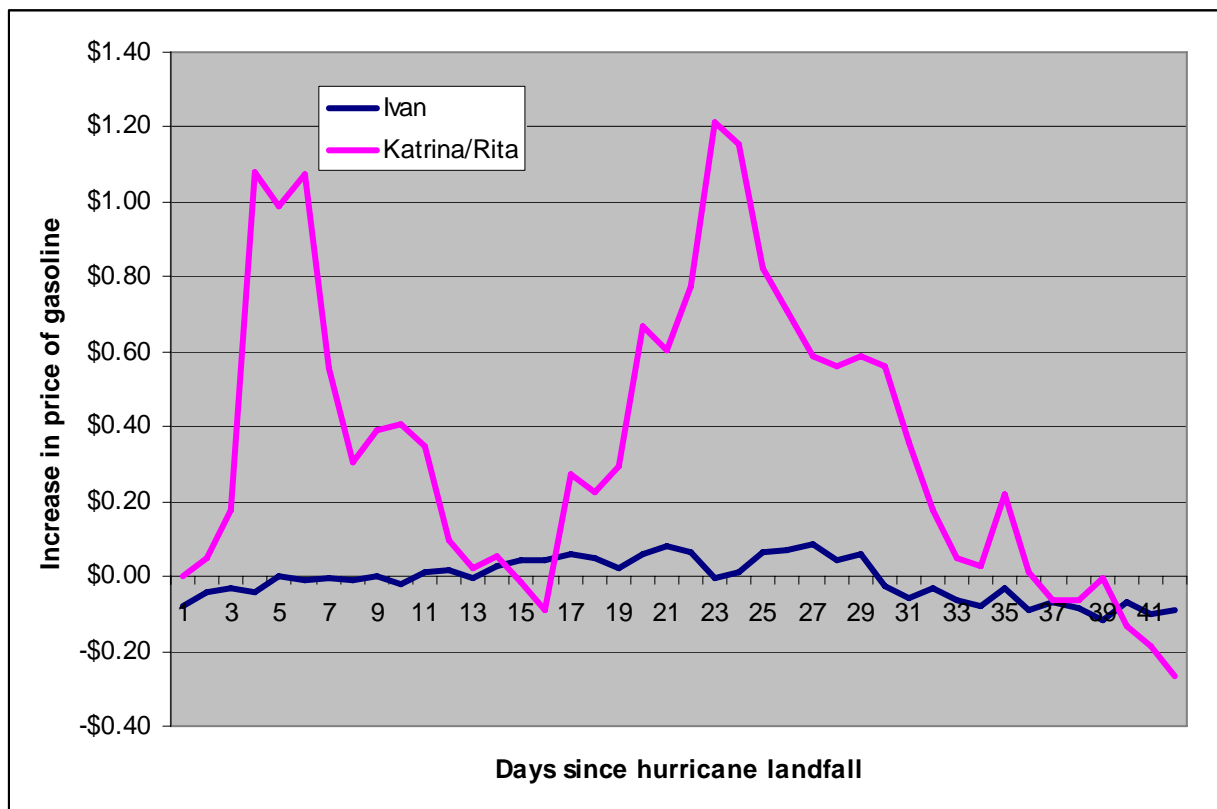


Figure 2.11 profiles the change in gasoline prices after the three hurricanes. Clearly Hurricane Ivan had only minor impacts on gasoline prices, while the combination of Hurricanes Katrina and Rita had substantial affects on the price of a gallon of gasoline. As presented in Figure 2.11, 23 days after Hurricane Katrina made landfall, the price of a gallon of gasoline rose \$1.21 per gallon.

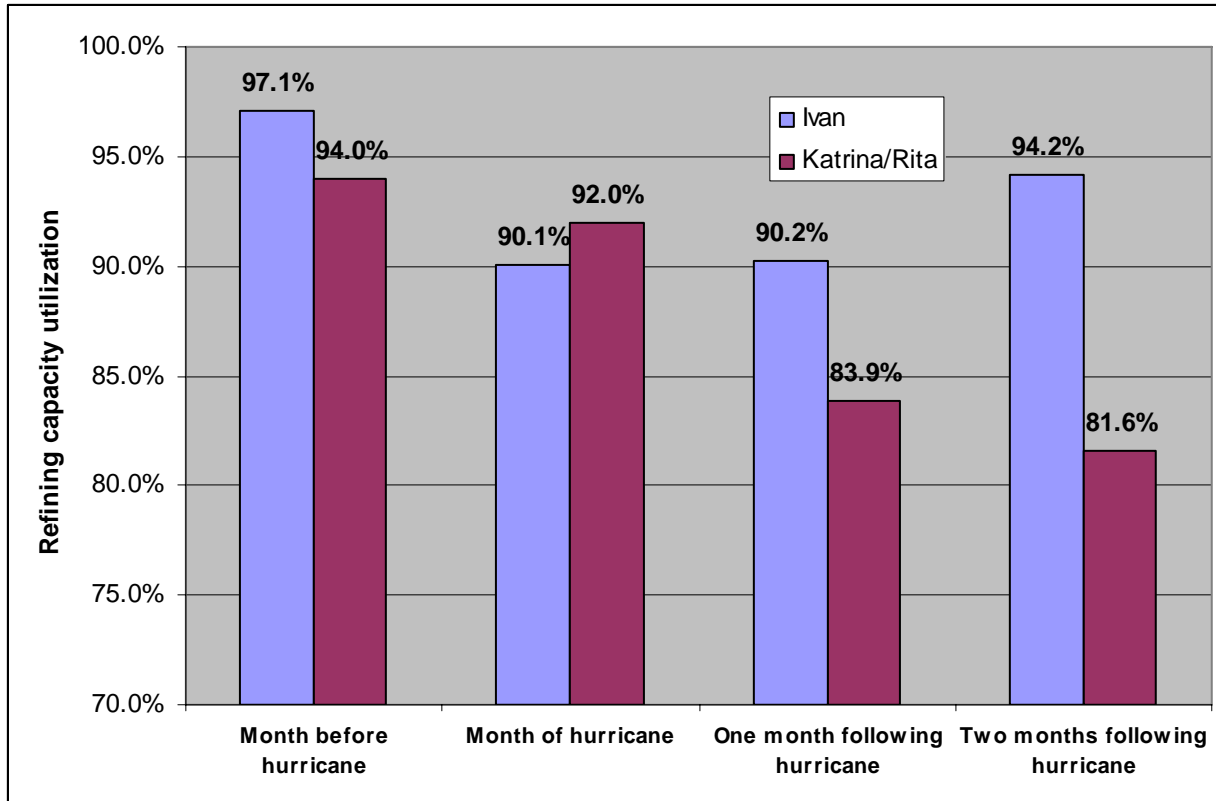
Figure 2.11: Impact of Hurricanes on Gasoline Prices (Gulf Coast)



According to industry and government officials, the difference in impacts of the hurricanes on gasoline prices but not oil stemmed from the fact that Hurricanes Katrina and Rita had a much more significant impact on refineries. Figure 2.12 displays refining capacity utilization one month before the hurricanes, the month of hurricane landfall, one month after hurricane landfall, and two months following hurricane landfall. Capacity utilization declined

from 97.1 percent one month before Hurricane Ivan landfall to 90.2 percent one month after landfall, but rebounded to 94.2 percent two months after landfall. On the other hand, capacity utilization was 94.0 percent one month before Hurricane Katrina, declining to 83.9 percent one month after landfall, and plummeting to 81.6 percent two months after landfall.

Figure 2.12: Refining Capacity Utilization Before, During, and After Hurricanes



Clearly, refining capacity utilization, among other factors, had a major impact on gasoline prices. The next section separates the factors affecting gasoline prices using advanced statistical techniques.

II. Modeling the Factors Influencing the Price of Gasoline

In order to disentangle the factors that influence gasoline prices, we next conduct regression analysis. Regression analysis is a powerful statistical technique that describes the way

in which one important economic variable is related to one or more other economic variables.

Regression analysis is used to perform one of two tasks:

- 1) Predict or forecast a variable based on the values of other variables.
- 2) Determine the impact of one factor (the independent variable) on another factor (the dependent variable).

The analysis that follows will focus on determining the impact of the five factors identified in the previous section. The regression analysis that follows will use the Limdep software package which is widely used by econometricians, statisticians, biometricians, and engineers for statistical applications. The primary strength of Limdep is for the estimation of many types of regression models. The technique used is termed a *random effects model* which accounts for both the time trend in gasoline prices as well as the varying effects by state.

Table 2.2 lists the results from the estimation of the gasoline equation. The first column lists the factors potentially affecting gasoline prices. The next two columns respectively show the estimated impact on gasoline prices and the likelihood that that impact is zero for years before 2000. The last two columns show parallel data for the years after 1999. The random effects model was applied to the panel of 50 states from 1994 to 2005. Results show that the fundamental relationship between gasoline prices and its determinants changed dramatically after 1999, thus the need for separate results.

Table 2.2: Factors Affecting the Price of Gasoline, 1993-2005

	Before 2000		After 1999	
	Impact	Probability Impact is Zero	Impact	Probability Impact is Zero
Oil price per barrel	2.3265 ^a	0.0000	2.1282 ^a	0.0000
Percent of refinery capacity utilization	0.2299 ^a	0.0000	-0.6942 ^a	0.0000
Sulfur content	-13.2025 ^a	0.0001	-10.3507	0.5171
Percentage of oil imported	21.3439 ^a	0.0187	294.9205 ^a	0.0000
Personal income	0.0145 ^a	0.0041	0.0175	0.0604
Personal income growth	-4.6793	0.4908	46.4354 ^a	0.0000
Percent of gasoline reformulated	38.2109 ^a	0.0000	123.1814 ^a	0.0000
After 1999	-86.5636 ^a	0.0000	-86.5636 ^a	0.0000
Spring season	2.7902 ^a	0.0000	2.7902 ^a	0.0000
Summer season	3.0160 ^a	0.0000	3.0160 ^a	0.0000
Fall season	2.3120 ^a	0.0000	2.3120 ^a	0.0000
Each month	-0.0825 ^a	0.0000	-0.0825 ^a	0.0000
Constant	-9.0626	0.1683	-9.0626 ^a	0.1683
R ²	.942		.942	
Number of observations	6,800		6,800	

^aindicates confidence of 95%

As presented in Table 2.2, each of the factors (except sulfur content after 1999, personal income growth before 2000, and personal income growth after 1999) had a statistically significant impact on gasoline prices at the 95 percent level of confidence.¹¹³ Based on the estimates from Table 2.2, we next calculate the contributions of each factor on the increase in the price of a gallon of gasoline between June 2004 and October 3, 2005. During this time period, the price of a gallon of gasoline rose from \$1.72 to \$2.06 or 34.6 percent. Table 2.3 lists the contribution of each factor to the increase in the price of a gallon of gasoline.

¹¹³ A 95 percent level of significance indicates that one is 95 percent confident that the factor has an impact on gasoline prices.

Table 2.3: Contribution of Factors to Rise in Gasoline Prices between June 2004 and October 2005

	Contribution	Percent Contribution
Increase in oil prices	\$0.22	62.5%
Decline in refinery capacity utilization	\$0.07	19.6%
Reduction in sulfur content	\$0.01	2.0%
Increase in percentage of oil imported	\$0.08	22.9%
Increase in personal income	\$0.002	0.6%
Decline in personal income growth	-\$0.005	-1.4%
Increase in percent of gasoline reformulated	\$0.00	0.09%
Seasonal/all other factors	-\$0.04	-6.29%
Total	\$0.34	100.0%

As presented in Table 2.3, increases in the price of a barrel of oil accounted for 62.5 percent of the rise in the price of a gallon of gasoline. Declines in refinery capacity utilization and increases in the share of oil imported accounted for 22.9 percent and 19.6 percent of the increase the price of a gallon of gasoline. Other factors accounted for little of the upturn in gasoline prices between June 2004 and October 2005.

In addition to calculating the contribution of factors to the gasoline price growth, estimates in Table 2.2 are used to calculate the expected price of gasoline versus the actual price of gasoline for the 50 U.S. states from 1994 and 2005. As presented in Table 2.4, gasoline prices in Pennsylvania were 22.3 percent lower than expected over the time period. On the other side, actual gasoline prices were 40.7 percent higher than expected in Alaska. Over the time period, Nebraska gasoline prices were 10.5 percent lower than expectations from the statistical model.

Table 2.4: Gasoline Prices: Percent Difference between Actual Price and Expected Price, 1994-2005 (negative sign indicates expected > actual)

Pennsylvania	-22.3%
Texas	-21.7%
North Carolina	-19.6%
New York	-15.9%
Rhode Island	-15.6%
Connecticut	-13.2%
Tennessee	-12.9%
Ohio	-11.2%
Nebraska	-10.5%
Arkansas	-10.4%
Wisconsin	-10.4%
Maryland	-10.3%
Louisiana	-10.3%
Delaware	-7.2%
West Virginia	-6.5%
Oklahoma	-6.3%
Kansas	-6.2%
California	-5.6%
South Carolina	-5.4%
Virginia	-5.3%
Iowa	-4.3%
Florida	-4.2%
Alabama	-4.1%
Montana	-3.8%
Michigan	-3.5%
Missouri	-3.2%
Utah	-2.9%
Illinois	-2.8%
Massachusetts	-1.0%
Mississippi	-0.9%
Colorado	-0.3%
Indiana	0.3%
Idaho	0.5%
Washington	2.5%
Kentucky	2.8%
Georgia	4.3%
Maine	5.0%
South Dakota	5.1%
Minnesota	5.2%
New Hampshire	6.0%
Oregon	6.6%
New Mexico	6.8%
New Jersey	9.0%
Vermont	9.4%
North Dakota	9.4%
Nevada	11.0%
Arizona	11.6%
Wyoming	18.0%
Hawaii	34.2%
Alaska	40.7%

Figure 2.13 shows the price per gallon of gasoline (less taxes) on actual and expected basis for the period April 1994 through July 1995. For much of this period Nebraska's actual prices were below the expected prices based on the model. Figure 2.14 shows the actual and expected gasoline prices (less taxes) for the period June 2004 to July 2005, showing a similar pattern. For this period, Nebraska's actual prices on average were 5.8 percent less than expected based on the model.

Figure 2.13: Nebraska's Price per Gallon of Gasoline (less taxes)—Expected versus Actual, 1994-2005

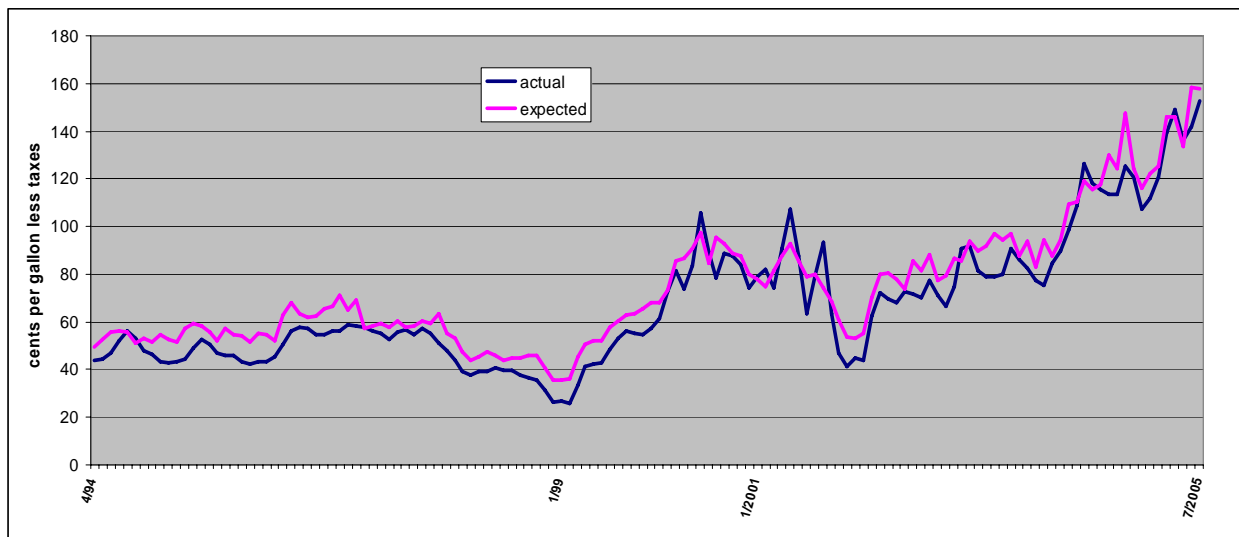
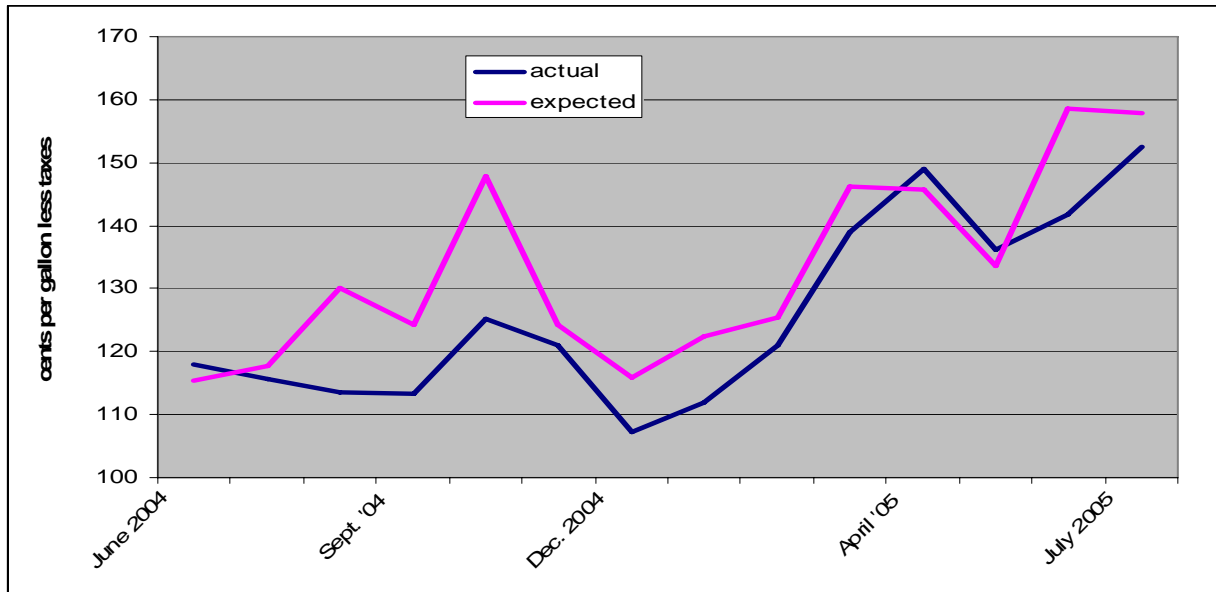


Figure 2.14: Nebraska's Gasoline Price per Gallon (less taxes)—Expected versus Actual, 2004-05



III. Impact of Petroleum Prices on Energy Companies

There is widespread belief that the major oil companies have contributed to recent difficulties among the consuming public by manipulating either oil production, refining capacity, or inventory levels. While there is scant evidence that they have, there are clear indications that they have benefited from recent significant upturns in gasoline and diesel prices. Data presented earlier in this chapter indicate that increases in oil prices and reductions were primarily responsible for the rapid increases in gasoline price increases between June 2004 and October 2005, the period of time marked by Hurricanes, Ivan, Katrina, Rita, and Wilma. There is evidence, however, that the major independent oil companies benefited from the higher oil prices and reduced refining capacity.

According to the EIA, compared to the third quarter for 2004, major independent energy companies increased their earnings from worldwide refining and marketing operations 73

percent for the third quarter of 2005.¹¹⁴ Higher margins¹¹⁵ offset lower throughput as companies were able to expand petroleum prices at a faster pace than oil prices. According to the EIA, major oil companies (hereafter majors) achieved higher earnings from their worldwide petroleum refining and marketing operations which rose from \$5.2 billion for the third quarter of 2004 to \$9.1 billion for the third quarter of 2005. According to the EIA, this growth occurred primarily as a result of U.S. operations. Gross refining margin per barrel of oil grew from \$13.46 per barrel in quarter three of 2004 to \$21.30 per barrel in quarter three of 2005.

Figure 2.15: Gross Margin per Barrel of Oil for Major Domestic Petroleum Firms, 2003 Dollars

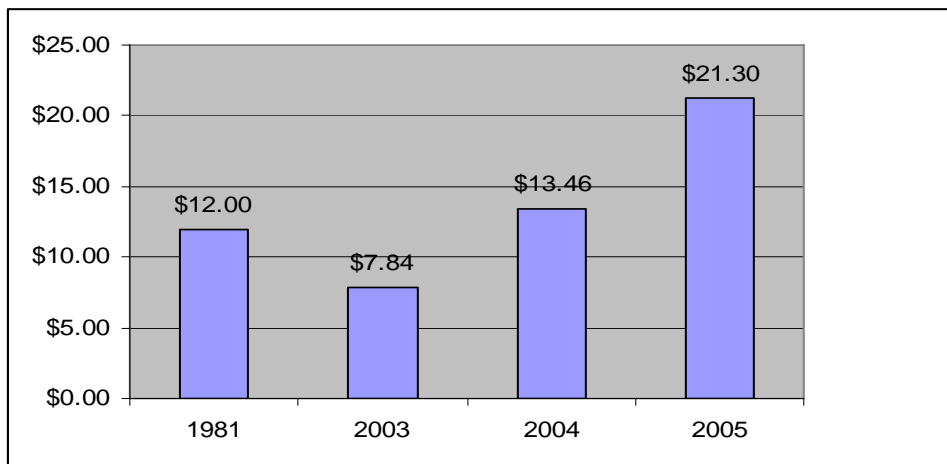
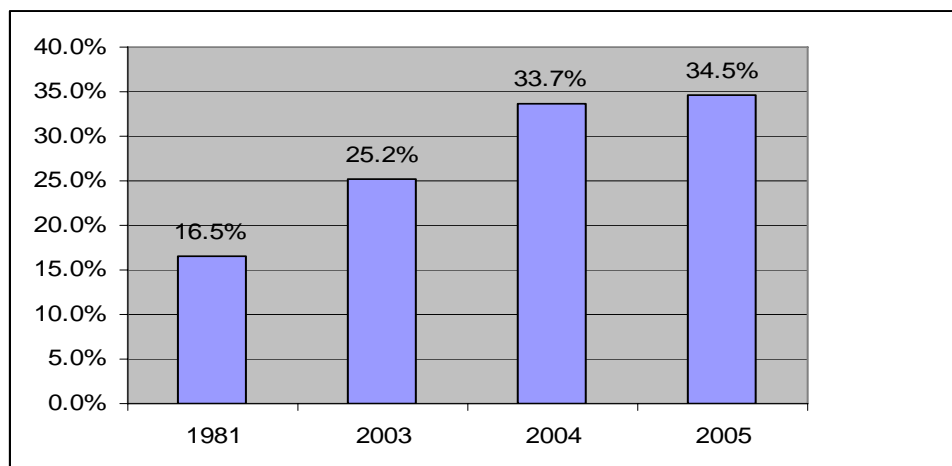


Figure 2.16: Gross Margin as a Percent of Price for Major Domestic Petroleum Firms



¹¹⁴ A list of the major independent energy companies, as designated by EIA, is provided in Table 2.6.

¹¹⁵ The per-barrel composite wholesale product price less the composite refiner acquisition cost of crude oil.

Table 2.5 summarizes how recent oil and gasoline price growth has affected the major oil companies. Revenues grew 29.8 percent from the third quarter of 2004 to the third quarter of 2005 when Hurricanes Katrina and Rita struck the Gulf Coast refineries and oil production facilities. Moreover, Hurricanes Katrina and Rita reduced domestic refinery throughput relative to the third quarter of 2004 which offset the effects of higher U.S. gross refining margins.¹¹⁶ The net effect was a 90.0 percent increase in U.S. refining/marketing earnings from \$3.7 billion in the third quarter of 2004 to \$7.0 billion in the third quarter of 2005. The performance of the 11 companies that reported U.S. refining/marketing earnings was almost uniform. Ten of the companies reported higher third quarter earnings in 2005 than in 2004. The company that reported lower earnings cited higher energy costs and reduced throughput due to Hurricane Rita.

Table 2.5: Percent Growth Q3, 2005 versus Q3 2004 for Majors

	Growth
Overall revenue	29.8%
Refining and marketing net income	37.7%
Petroleum net income	36.4%
Domestic refining and marketing net income	41.4%
Domestic oil production	-4.9%
Foreign oil production	-1.1%
Gross refining margin per barrel of oil	58.2%

Source: U.S. EIA

Despite the increase in margins and profitability for major petroleum firms, the price-earnings ratios of the firms have declined. In other words, the stock price of major petroleum firms rose much less briskly than did profitability. This indicates that investors expect this

¹¹⁶ Gross refining margin is defined as netback crude oil price less spot crude oil price.

profitability to be short-lived. Figure 2.17 shows that average earnings per share for these firms rose from \$4.21 in September 2004 to \$7.50 in December 2005. At the same time, the average price-earnings ratio declined from 12.5 in September 2004 to 8.7 in December 2005.

Figure 2.17: Earnings per Share and Price/Earnings Ratio for Majors, 2004-05

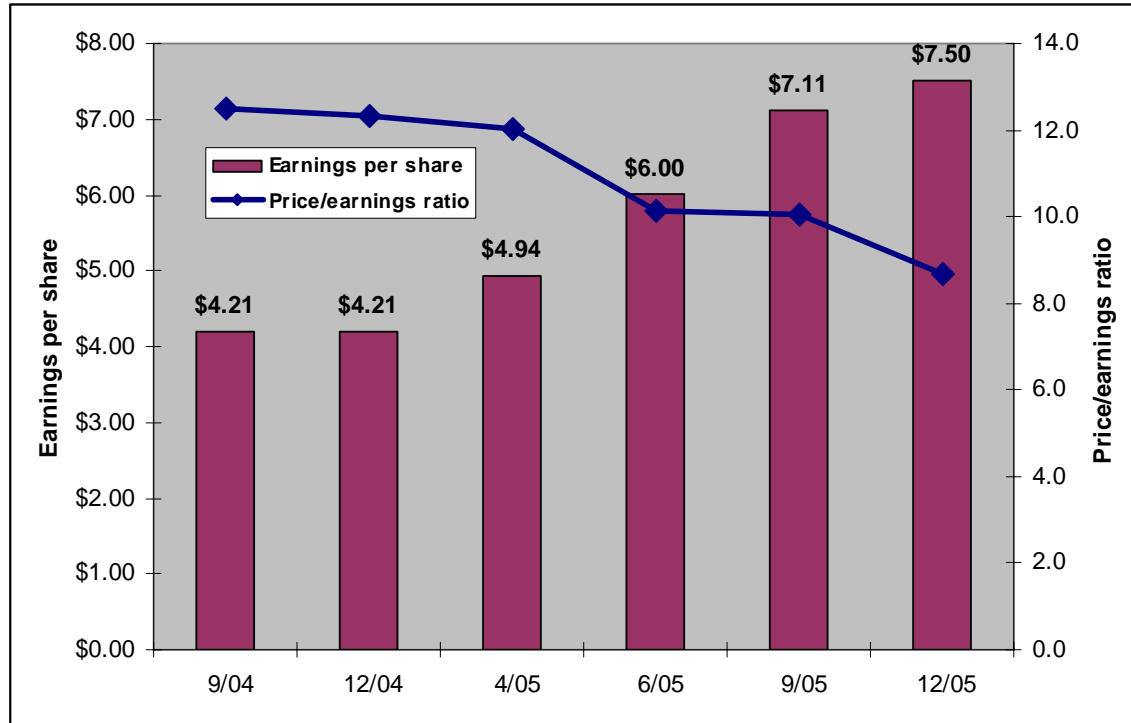


Table 2.6 lists price-earnings ratios for the major petroleum firms in December 2005. This compares to an overall price-earnings ratio for the Standard & Poor's 500 of 17.2. Clearly, despite record profits, investors saw alternative investments as deriving higher rates of return in the long run than will the major energy companies. Only Devon Energy and Williams Company had a higher price-earnings ratio than the S&P 500.

Table 2.6: Price Earnings Ratios of Majors

Amerada Hess Corporation	AHC	10.0
Anadarko Petroleum Corporation	APC	6.9
Apache Corporation	APA	7.3
BP p.l.c. (only U.S. operations included)	BP	9.3
Burlington Resources, Inc.	BR	9.6
Chesapeake Energy Corporation	CHK	10.2
Chevron Corporation	CVX	7.4
ConocoPhillips Inc.,	COP	5.7
Devon Energy Corporation	D	28.1
Dominion Resources, Inc.	DVN	6.8
EOG Resources, Inc.	EOG	10.2
Equitable Resources Inc.	EQT	17.6
Exxon Mobil Corporation	XOM	10.0
Kerr-McGee Corporation	KMG	10.6
Yondell Chemical Company	LYO	7.1
Marathon Oil Corporation	MRQ	5.9
Occidental Petroleum Corporation	OXY	7.2
Royal Dutch/Shell Group (only U.S. operations included)	RDS-B	9.5
Sunoco, Inc.	SUN	9.1
Tesoro Petroleum Corporation	TSO	7.6
Valero Energy Corporation	VLO	6.6
Williams Companies, Inc.	WMB	19.2
XTO Energy, Inc.	XTO	10.4

PART THREE: RETAIL PRICES IN NEBRASKA CITIES

I. Introduction

In this section we examine gasoline price fluctuations for individual Nebraska cities both before and after Hurricanes Katrina and Rita struck the Gulf Coast region. The goal is to examine how retail and rack prices (i.e., public wholesale prices charged at gasoline terminals) reacted to market conditions. One issue involves whether retail prices rose and fell as quickly as rack prices in each market. In this analysis, we also compare price fluctuations in Nebraska cities with national averages. Another issue is the behavior of individual brands and stations. We examine whether any particular brands (or stations) commonly led price increases and declines in Nebraska cities.

II. Data Source

Data for gasoline retailers in 20 Nebraska cities were purchased from the Oil Price Information Service (OPIS). OPIS gathers self-reported price data from approximately 85,000 gasoline stations around the nation, including more than 400 Nebraska stations. Stations do not report price data every day, but many stations report price data on most weekdays, and some also report on most weekends. We purchased weekly average data from OPIS for regular unleaded gasoline and diesel fuel for service stations in 20 Nebraska cities for the period August 2004 through October 2005. This provides us with weekly data for a full-year before Hurricanes Katrina and Rita impacted fuel prices, as well as a two month period in the aftermath of the storms. We also purchased daily price data for the period from August 16, 2005 to October 31, 2005 to facilitate a more specific analysis during the period most affected by the storms.

On average for the 20 Nebraska cities, we received 225 data points per day for regular unleaded gasoline. According to license data kept by the Nebraska Department of Revenue, an

estimated 650 stations are located in these 20 cities. Thus, on any given day we have data from approximately 34 percent of stations.

In addition to reporting retail prices, OPIS also assigns a wholesale rack price to each reporting station each day based on the spot market price charged for the station's brand at the nearest gasoline terminal. OPIS gathers these terminal prices separately. The actual price paid by retailers may differ from these spot prices for several reasons:

- Brand rack prices are based on the prevailing terminal, i.e., the terminal that OPIS believes is most frequently used by retailers in that community. Some retailers may use a different terminal.
- Many retailers have a contractual arrangement with their fuel providers that may differ from the public spot price charged on any given day.

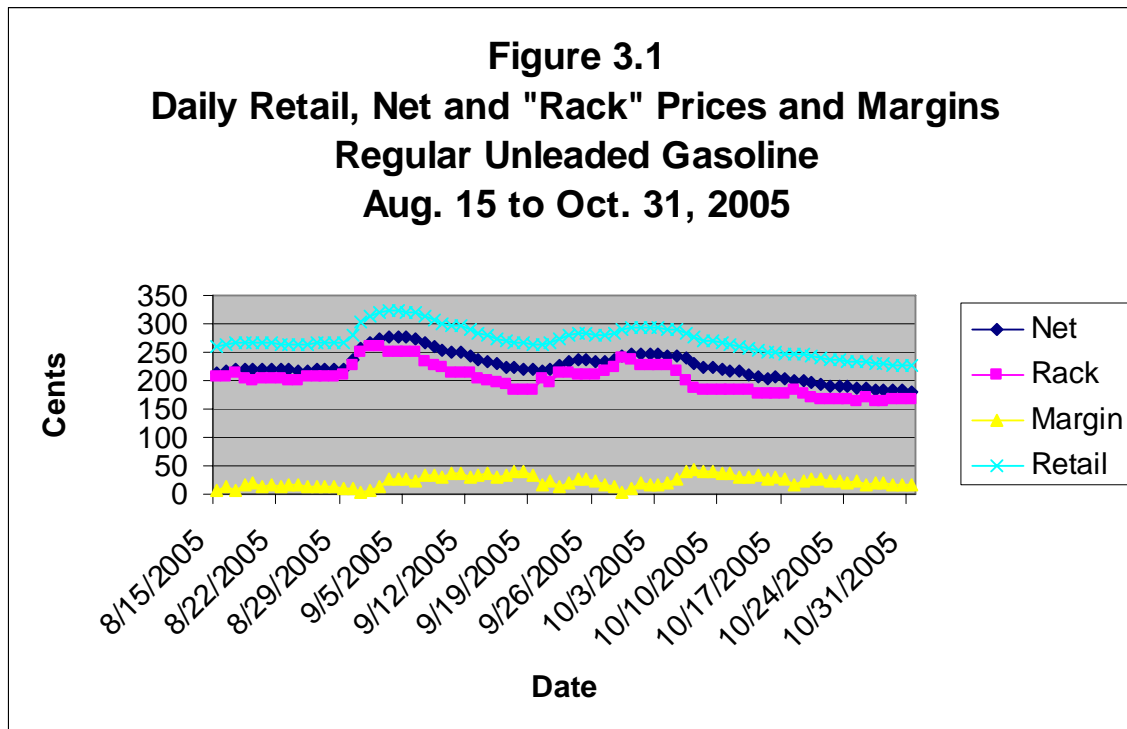
Table 3.1 lists the 20 cities included in this analysis. These cities were chosen based on the source of consumer complaints received by the Attorney General's office. The list includes the 10 largest cities in Nebraska. We report city-specific results for 19 of the 20 cities as few data were available for the city of Holdrege.

Table 3.1
Nebraska Cities for Which Data Were Obtained

Alliance	Holdrege	O'Neill
Beatrice	Kearney	Ord
Broken Bow	Lincoln	Scottsbluff
Columbus	Norfolk	Sidney
Grand Island	North Platte	South Sioux City
Hebron	Ogallala	Valentine
Humboldt	Omaha	

III. General Price Trends

Figure 3.1 illustrates several measures of aggregate price for the Nebraska cities for which data were obtained from August 15, 2005 to October 31, 2005. This two and one-half month period stretches from just before Hurricane Katrina impacted gasoline prices beginning in late August and early September until prices returned to pre-Katrina levels in late October. Daily price data illustrate how the market adjusted to price spikes generated by Katrina at the beginning of September and then by Hurricane Rita later in September and in early October. Figure 3.1 contains data on retail price and the net price received by retailers. Net price is calculated by subtracting state and local fuel taxes and estimated freight costs (from the terminal to the retailer) from the retail price. Margins are the difference between net prices and rack prices.



Source: Oil Price Information Service.

Results in Figure 3.1 show that retail and net prices closely followed the general trends in rack prices. Retail prices rose and peaked in early September just after rack prices rose and peaked. Like rack prices, retail and net prices fell steadily through late September before rising to a second peak in late September/early October. Retail, net, and rack prices then all fell steadily through the end of October. Figure 3.1 illustrates that most of the change in retail gasoline prices was caused by fluctuations in wholesale prices.

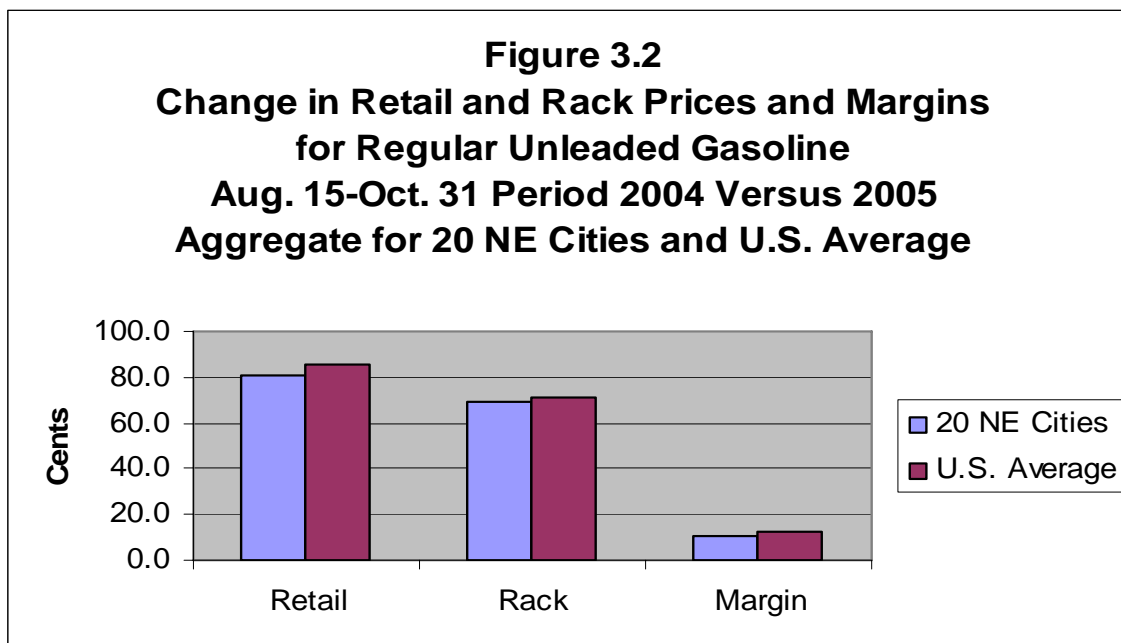
Figure 3.1 also illustrates that estimated margins fluctuated during this period. Margins are the difference between net prices and rack prices and, therefore, represent the revenue available to service stations after paying for gasoline. Significantly, these margins clearly rose during much of the period.

Caution must be used when interpreting these estimated margin data, however. In particular, estimated margins for a particular day are not the same as profits. First, a large share of the margins must go to cover the costs of operating a service station, costs including capital costs such as mortgage payments on pumps, tanks, station buildings and land. There are also operating costs such as fees when customers make credit card purchases (these are a percentage of the value of the purchase) or costs for service station employees. Second, the reported margin data compare the estimated net price of fuel sold retail on a given day with the reported rack price of fuel sold at a fuel terminal on that same day. In many cases, retailers actually purchased wholesale fuel during a previous day. When rack prices are relatively stable, as is often the case, this point is less important. When prices are rising and falling quickly, as in the period we are examining, however, margins calculated for a particular day may be less informative.

Margins calculated for a longer period such as a week or a month provide a better guide to the amounts available to a gasoline retailer to cover capital and operating costs of a station and

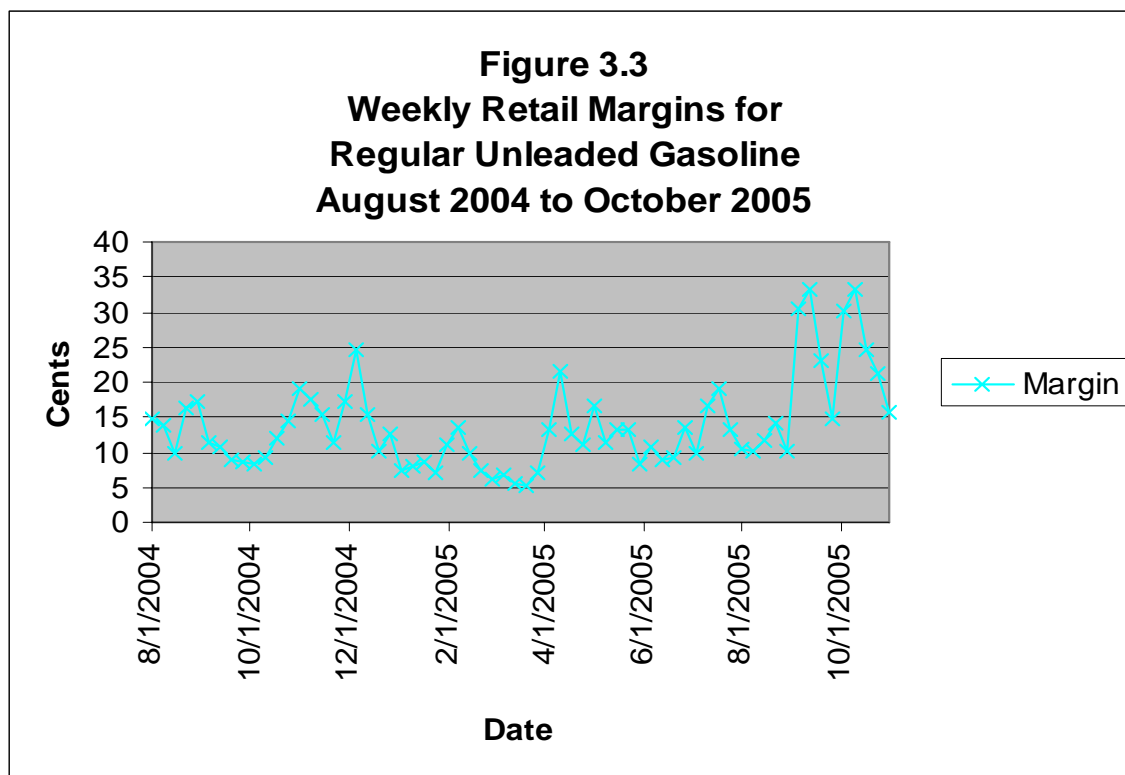
profits to owners. Therefore, the sustained rise in margins evident in Figure 3.1 through much of September and early October (and their subsequent decline through October) are notable, and we examine these more closely.

In the first case, we compare the margins during the August 15, 2005 to October 31, 2005 period with margins during the same period in 2004 (August 15, 2004 to October 30, 2004). Average retail prices for the 2005 period were \$0.81 higher in aggregate across the 20 Nebraska cities. The average rack price rose \$0.70 and the average margin rose \$0.11. Figure 3.2 also shows the change in U.S. average retail prices from August 15, 2005 to October 31, 2005 compared with the same period in 2004. Nationwide, margins were \$0.13 higher in 2005. Like Figure 3.1, Figure 3.2 illustrates that increasing retail prices in the selected Nebraska cities resulted primarily from the effects of the twin hurricanes and other factors that increased rack prices. Retail margins, however, also were elevated during the period, though at a lower rate than the national average.



Source: Task Force Analysis of Data from the Oil Price Information Service

Figure 3.3, which shows estimated retail margins in aggregate for the 20 cities over the entire period from August 1, 2004 to October 30, 2005, confirms the impacts of the hurricanes on margins this past fall. This figure shows that margins were higher in September 2005 and October 2005 after the hurricanes hit.



Source: Oil Price Information Service

Table 3.2 shows more detailed results by examining the increase in margins in 19 of the 20 cities. (Holdrege is excluded due to insufficient data.) The margin increase is presented for the period from August 15, 2005 to October 31, 2005 versus the same period in 2004. Margin increases were equal to or within a penny of the \$0.11 aggregate increase in many cities: Omaha, Beatrice, Broken Bow, Kearney, Norfolk, North Platte, Sidney, and Valentine.

Margins rose fastest in Lincoln, Alliance, Humboldt, Ogallala, and South Sioux City.

Margin increases were smaller in Beatrice, Columbus, Grand Island, Hebron, O'Neill, Ord, and Scottsbluff.

Table 3.2 Change in Retail Margins for Regular Unleaded Gasoline From August 15, 2004 through October 31, 2004 versus August 15, 2005 through October 31, 2005

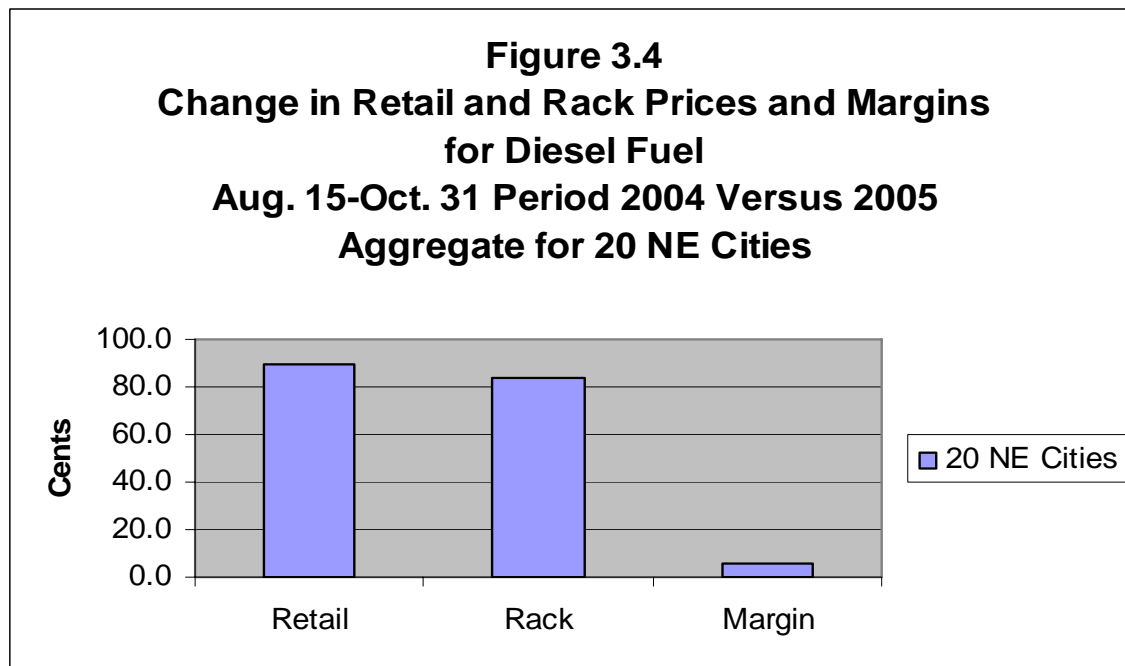
Increase in Margins from Aug. 15 – Oct 31 2004 versus 2005	Cities
\$0.05 to \$0.09	Columbus, Grand Island, Hebron, O'Neill, Ord, Scottsbluff
\$0.10 to \$0.12	Beatrice, Broken Bow, Kearney, Norfolk, North Platte, Omaha, Sidney, Valentine
\$0.13 to \$0.18	Alliance, Humboldt, Lincoln, Ogallala, South Sioux City

Source: Task Force Analysis of Data from the Oil Price Information Service

What accounts for this rise in margins? In part, some increase in margins would be expected in a period of rising fuel prices. For example, charges to vendors from credit cards would rise as the price of gasoline rises. For illustration purposes (actual charges may differ), assuming a service charge of 3%, the charges for a credit sale would move from \$0.06 per gallon to \$0.09 per gallon as gasoline prices move from \$2 to \$3 per gallon. This cost alone may explain a significant portion of the increase in margins in a rising market. Another factor is that the wholesale cost of fuel delivered to a retailer may rise faster than rack prices.

Such factors would be expected to lead to increased margins, but they may not explain the entire \$0.11 increase in margins on average across the 20 cities (or the \$0.13 increase nationwide). For example, as is illustrated in Figure 3.4, average margins for diesel fuel in aggregate across the 20 Nebraska cities were only \$0.05 higher in August 15, 2004 to October 30, 2005 compared with a year earlier.

We examine unleaded gasoline price changes during the period in more detail in order to learn more about why margins rose in the 20 Nebraska cities. It should be noted that the rise in margins in the Nebraska cities was similar to the aggregate increase nationwide. As was evident in Figure 3.1, the period is characterized by significant fluctuation in rack prices. The elevated margins in various communities arose as retail prices reacted to changes in rack prices. The types of reactions differed by community. We illustrate this by examining both upward and downward price trends during the period in the next section.



Source: Task Force Analysis of Data from the Oil Price Information Service

IV. Price Trends by City

A. Upward Price Trends in Nebraska Cities

Data in Table 3.3 show the date and amount for peak prices in 15 Nebraska cities. There was insufficient data for this analysis in the other five cities. The first column shows the peak day for average rack prices in each city. The second column shows the peak day for average

retail prices in each city. The third column shows the difference between the peak average retail price in each city and the peak average rack price (adjusted by a fixed \$0.46 to account for taxes and a freight charge). The data indicate that in most cities the peak average retail price was between \$0.00 and \$0.10 greater than the average peak rack price (after adjusting to account for taxes). The average retail price typically peaked a few days after the average rack price peaked. This suggests that in most cities the peak daily average retail price charged was in line with (or even less than) what would be required based on the peak daily average rack prices plus a typical margin (roughly \$0.10). However, in Omaha, Lincoln (after Katrina only), Sidney, and Ogallala, the peak average retail price was somewhat higher than rack prices, suggesting that retailers in those cities were able to capture higher margins during these periods.

Table 3.3 Retail and Wholesale Price Spikes in Post-Hurricane Periods

City	Date of Peak Average Rack Price	Date of Peak Average Retail Price	Difference Between Peak Retail and Peak Rack Prices (adjusted for taxes)
Early September			
United States	Sept 2, 2005	Sept 2, 2005	\$0.16
Omaha	Sept 1, 2005	Sept 3, 2005	\$0.27
Lincoln	Sept 2, 2005	Sept 2, 2005	\$0.23
Grand Island	Sept 2, 2005	Sept 4, 2005	\$0.10
North Platte	Sept 2, 2005	Sept 3, 2005	\$0.08
Columbus	Sept 1, 2005	Sept 3, 2005	\$0.01
Kearney	Sept 1, 2005	Sept 2, 2005	-\$0.01
Sidney	Sept 2, 2005	Sept 7, 2005	\$0.19
Scottsbluff	Sept 1, 2005	Sept 3, 2005	\$0.01
Ogallala	Sept 2, 2005	Sept 5, 2005	\$0.15
Beatrice	Sept 1, 2005	Sept 2, 2005	\$0.04
Alliance	Aug. 31, 2005	Sept 4, 2005	\$0.05
Broken Bow	Sept 2, 2005	Sept 2, 2005	\$0.07
S. Sioux City	Sept 2, 2005	Sept 2, 2005	\$0.14
Norfolk	Sept 1, 2005	Sept 2, 2005	\$0.10
Late September/ Early October			
United States	Sept 29, 2005	Oct 1, 2005	\$0.04
Omaha	Sept 29, 2005	Sept 29, 2005	\$0.11
Lincoln	Sept 29, 2005	Oct 1, 2005	\$0.05
Grand Island	Sept 29, 2005	Sept 30, 2005	\$0.01
North Platte	Sept 29, 2005	Oct 2, 2005	-\$0.01
Columbus	Sept 29, 2005	Oct 2, 2005	-\$0.01
Kearney	Sept 29, 2005	Oct 1, 2005	\$0.06
Sidney	Sept 29, 2005	Oct 4, 2005 ¹	\$0.29 ¹
Scottsbluff	Sept 29, 2005	Oct 3, 2005	\$0.09
Ogallala	Sept 29, 2005	Oct 1, 2005	\$0.11
Beatrice	Sept 29, 2005	Oct 3, 2005	\$0.05
Alliance	Sept 29, 2005	Sept 30, 2005	\$0.09
Broken Bow	Sept 29, 2005	Sept 30, 2005	\$0.04
S. Sioux City	Sept 29, 2005	Oct 8, 2005	\$0.03
Norfolk	Sept 29, 2005	Oct 1, 2005	\$0.03

Source: Task Force Analysis of Data from the Oil Price Information Service

¹ Result significantly influenced by the particular stations reporting on October 4th. Difference would have been \$0.15 if based on October 2, October 3, October 5, or October 6.

B. Downward Price Trends in Nebraska Cities

Table 3.4 below shows how quickly retail and rack prices dropped from peak levels after the two price spikes illustrated in Table 3.3. Average rack prices fell \$0.60 to \$0.70 in each community two weeks after peaking. But there was great variation in how far retail prices fell.

Retail prices in Omaha dropped as rapidly as rack prices after the price spikes. Margins did not grow as rack and retail prices began to fall. By contrast, margins earned in Lincoln during the price spike period grew further as rack prices began to fall. In particular, retail prices did not fall as rapidly as rack prices. In economics parlance, retail gasoline prices were sticky in a downward direction in Lincoln. Uncertainties as to the future direction in wholesale price, coupled with the desire to recoup the higher costs of existing inventory, may help to explain this downward stickiness. This sticky downward pattern was even more pronounced in smaller Nebraska cities and for the United States overall. Recall that retail outlets in many of these cities had retail prices in line with rack prices (adjusted for taxes) during the two price spikes (see Table 3.3). Retail prices fell less sharply and, in some cases, much less sharply than rack prices. In these cities, sticky downward prices are what generated the jump in margins documented in Table 3.2. Again, this pattern was not unique to Nebraska cities, but was also found nationwide.

Table 3.4 Decline in Retail and Rack Prices Following Two Price Spikes

Decline in Retail Prices Relative to Decline in Rack Prices	Cities
95% to 99% ¹	Omaha
80% to 94%	Lincoln
60% to 79%	Grand Island, Columbus, Sidney, Norfolk
35% to 59%	United States, North Platte, Kearney, Beatrice, Scottsbluff, Alliance, Ogallala Broken Bow, South Sioux City

Source: Task Force Analysis of Data from the Oil Price Information Service

¹ For example, 99% would imply that if rack prices fell \$1.00 two weeks after their peak, then retail prices would have fallen by \$0.99 two weeks after their peak.

C. Summary by City

Table 3.2 indicated that gasoline retailers on average earned higher margins in each of 19 Nebraska cities during the August 15, 2005 to October 31, 2005 period as fuel prices first increased sharply and then declined in reaction to Hurricanes Katrina and Rita. Our analysis indicates that in many cities the retailers on average earned these higher margins not as prices peaked in reaction to the Hurricane, but in the period when retail and wholesale prices were falling. Retail prices were sticky in most cities, not falling as quickly as rack prices. Omaha stations appeared to earn higher-than-average margins during the peak period. Omaha margins, however, did not grow as prices fell. Retailers in Lincoln also earned higher-than-average margins during the peak period, and these margins only grew modestly as prices fell.

V. Price Trend by Brands

The preceding analysis focused mostly on average prices. Naturally some stations would have earned more (or less) than the average margins reported above. We also examined average margins by brand for 1) the entire August 15 to October 31 period, and 2) for the peak price increase periods after Hurricane Katrina from August 28-September 3. For the entire two and one-half month period there was little difference between the average margins of brands. The lowest average margin was \$0.18 and the highest margin was \$0.25.

There were greater differences during the peak price increase period from August 28 through September 3. Brands with the highest rack prices for gasoline earned very low margins (from -\$0.04 to +\$0.10, depending on whether margins were calculated using same-day rack prices or one or two days earlier - thus reflecting a time lag to deplete existing inventory. On the higher end, one brand earned margins during the period from \$0.24 to \$0.36 per gallon, again

depending on how margins were calculated. This suggests that individual retailers did not base costs simply on rack or wholesale prices plus a margin, but instead based prices on what the market would bear. This led to higher margins for retailers selling brands with relatively low rack prices, but to low or negative margins for retailers that paid high rack prices.

Another way to see this same point is to correlate rack prices with the retail prices for the different brands. We examined this correlation during the period of rapid price increases following Hurricane Katrina through September 3. During that period, retail prices across all brands rose as rack prices increased. On any individual day, however, there was no correlation (or even a negative correlation) between average retail prices charged by a brand and the rack prices paid by that brand. In other words, the brands that paid higher rack prices did not charge higher retail prices and perhaps charged lower prices. This was true whether brand retail price averages were correlated with brand rack prices from the same day or from previous days.

Another issue is whether there were individual stations, or whole brands, that led retail prices upward or downward in individual cities. For example, in Omaha, there was little cohesion in which stations were leading prices upward (i.e., consistently charging above average prices on days when prices were rising). A variety of individual stations consistently led prices upward as prices rose rapidly during the August 30 to September 1 period. On the other hand, there was more cohesion in which stations lead the downward march in prices. A number of retail chains selling a single brand of gasoline led prices downward as prices fell in Omaha from September 7 to September 18. Retail prices of these stations were regularly lower than Omaha averages during the period, even though rack prices as reported by OPIS for the brand were no different than those for other brands in Omaha.

Looking at other cities, there was little pattern among the brands leading prices upward and downward. Individual stations from a variety of brands tended to lead prices in any particular city. Further, there was no brand that regularly led prices upward or downward in the individual cities.

APPENDIX A *

State	Covered	Authority	Triggering Event	Prohibited Acts	Safe Harbors	Penalties	Enforced By
AL	Sale or rental of any commodity or rental facility	Ala. Code § 8-31-3 et seq.	Declaration of a state emergency	No seller may impose an unconscionable price (exceeding by 25% or more the price for same or similar commodity 30 days prior to emergency).	None	\$1,000 per violation, not to exceed \$25,000 per 24 hour period. (§8-31-5)	State Attorney General or District Attorney. No private cause of action.
AR	Vital and necessary goods or services, including housing, transportation.	Ark. Code 4-88-301 et seq.	Declaration of a state emergency by the President, Governor, or local official or red condition by the U.S. Dept. of Homeland Security.	No price may be raised more than 10% above the price charged immediately prior to the declaration.	Increases in price directly attributable to additional costs of supply, labor or materials.	Class A misdemeanor. More severe penalties may be imposed by the AG or local ordinance.	State Attorney General and/or private individual
CA	Goods and services vital and necessary for the health, safety, and welfare of consumers.	Cal. Penal Code §396	Declaration of state emergency by President, Governor or county or City Executive Officer.	No price may be raised more than 10% above the price charged immediately prior to the declaration (30 days for goods, 180 for repair and reconstruction services).	Increases in price directly attributable to additional costs of supply, labor or materials.	\$2,500 per violation, plus injunction and restitution. Misdemeanor - up to one year in jail or \$10,000 or both.	State Attorney General, District Attorney, City Attorney, or City Prosecutors. Private parties can get an injunction and restitution but no civil penalties.
CT	Goods and services and Petroleum Products	Conn. Gen. Stat. 42-230 -232 Regulation Conn. Agencies Reg. 42-110b-29	In the course of an abnormal market disruption.	No seller may sell at a price which exceeds the price of such product or service, in the usual course of business, immediately prior to the declaration of the emergency	Increase in price attributable to additional costs in connection with the acquisition, production, distribution or sale of product or service.	Up to \$5,000 per violation (for repeated violations) or imprisonment up to one year, or both.	State Attorney General

* Adapted from National Conference of State Legislatures, Energy and Electric Utilities, State Laws and Regulations: Price Gouging (10/8/2004), available online at http://www.ncsl.org/programs/energy/laws_gouging.htm (visited 11/14/2005).

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State	Covered	Authority	Triggering Event	Prohibited Acts	Safe Harbors	Penalties	Enforced By
DC	Any merchandise or service sold during a state of emergency.	D.C. Code. Ann. §28-4101 to 4103	Declaration of a state of emergency by the mayor.	No seller may charge more than the normal average retail price (within 10% from price charged for same goods 90 days before emergency).	None	Maximum fine of \$1,000 and/or revocation of license permit.	DC Attorney General
FL	Rental or sale of essential commodities	Fla. Stat. Ann. 501.160 and 501.160.	Declaration of a state of emergency.	Prohibition of unconscionable prices - gross disparity between current price and average price 30 days prior to emergency.	Increase in price attributable to additional costs in connection with the rental or sale of the commodity... or national or international market trends.	\$1,000 per violation, up to \$25,000 for multiple violations within 24 hours period.	State Attorney General, local state attorney, Dept. of Agriculture and Consumer Services
GA	Goods or services necessary to preserve, protect, or sustain the life, health, or safety of persons or property	OCGA 10-1-393.4; OCGA 10-1-438	Declaration of a state of emergency by the Governor.	It is unlawful to sell or offer for sale any goods (defined in B) at a price higher than the price immediately prior to the declaration of emergency.	Increase in price due to an increase in the cost of supply and transportation.	\$5,000 per violation, with a possible additional penalty of up to \$10,000 for a disaster related violation.	Governor's Office of Consumer Affairs
HI	Rental or sale of essential commodities	HRS 209-9; 480-3.1	Declaration of a state of disaster by the Governor, or when the state is subject to a "severe weather warning."	Any increase in price in the area subject to the declaration of disaster.	Additional operating expenses incurred because of the state disaster, and which can be documented.	\$500-\$10,000 per violation.	Hawaii Office of Consumer Protection
ID	Water, food, fuel, or pharmaceuticals	Idaho Code §48-603 (19); §48-604	Declaration of a state of emergency by the Governor or President.	A seller of the four items mentioned may not charge exorbitant or excessive prices (comparison of the prices of goods immediately before and after the disaster).	Additional costs of doing business incurred because of the disaster or emergency.	\$5,000 per violation, restitution, and injunctive relief.	State Attorney General

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State	Covered	Authority	Triggering Event	Prohibited Acts	Safe Harbors	Penalties	Enforced By
IN	Sale of fuel	Ind. Code 4.6-9.1 et seq.	The period during which an emergency is declared and 24 hours before the declaration by the Governor.	The price of fuel is unconscionable if it exceeds the average price at which fuel was readily available during the 7 days immediately before the declaration of emergency.	The increase in price attributable to cost factors to the retailer, including replacement costs, taxes, and transportation costs incurred.	Injunctive relief, restitution, and civil penalties of \$1,000 per violation.	State Attorney General
IA	Merchandise needed by disaster victims	Iowa Code 63.31.1 (714); IC 714.16(2)	During time of disaster and subsequent recovery (60 day max), in a declared disaster zone.	A seller may not charge an excessive price.	Increase in price may be justified by actual costs of acquiring, producing, selling, transporting, and delivering products sold, plus a reasonable profit.	Up to \$40,000 per violation, plus additional \$5,000 if elderly was defrauded; restitution, injunctive relief.	State Attorney General
KS	Merchandise needed by disaster victims	Kan. Stat. 50-6,106 Kan Stat. 50-627	Declaration of a state of emergency by the US President or Governor, during the time such state is in effect, or thirty days after the occurrence of the event that triggered the declaration. 50-627 does not require emergency but relates to market price at any time.	Price may not grossly exceed (unconscionable) the price of the same good 1 day before disaster or the price charged for same or similar good by other sellers in the area. An increase of more than 25% is prima facie evidence of gross excess.	Additional costs incurred in connection with the sale of the product or service	\$10,000 per violation, additional \$10,000 if elderly or disabled was defrauded; restitution, injunctive relief.	State Attorney General or District/County Attorney

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State	Covered	Authority	Triggering Event	Prohibited Acts	Safe Harbors	Penalties	Enforced By
KY	Any repair or reconstruction service; consumer food items; emergency cleanup goods or services; emergency supplies; medical supplies; home heating oil; building materials; housing; transportation, freight and storage services; gasoline and motor fuels	Ky. Rev. Stat. 367-372 to -378	Declaration of a state of emergency by the Governor, Condition Red by U.S. Department of Homeland Security.	Prohibition on charging a price grossly in excess of price before triggering event and unrelated to increased costs to seller.	Increased costs to seller.	\$5,000 for first offense; \$10,000 for subsequent offenses; additional remedies such as injunctive relief and restitution.	State Attorney General
LA	Goods and services	LSA-R.S. 29:732; LSA-R.S. 29:734; LSA-R.S. 14:329.6 and 14:329.7	Declaration of emergency by the Governor or Parish President.	The value for goods and services may not exceed prices ordinarily charged. Must prove a gross disparity between the price of the goods or services prior to the event or that the amount charged grossly exceed the price at which the same or similar goods or services were readily obtainable in the trade area.	Reasonable expenses and a charge for any attendant business risk, in addition to the cost of the goods and services which necessarily are incurred in procuring the goods and services during the state of emergency.	Injunctive action, with possible civil penalties and restitution to aggrieved consumers. When violation results in serious bodily injury or property damage in excess of \$5,000, imprisonment at hard labor for not more than 5 years. Violations resulting in death - imprisonment not exceeding 21 years.	Attorney General, District Attorney, or Parish Attorney

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State	Covered	Authority	Triggering Event	Prohibited Acts	Safe Harbors	Penalties	Enforced By
ME	Necessities of life (including fuel) under the profiteering statute (Title 10). All goods or services under Title 5.	10 M.R.S.A. §1105; 5 M.R.S.A. §207	No triggering event needed.	Prohibits unjust or unreasonable profits in the sale, exchange or handling of necessities.	None	\$10,000 under 5 M.R.S.A. §207; \$1,000 or 3 years imprisonment under 10 M.R.S.A. §1105.	Maine Attorney General. Private enforcement available under the UTPA
MA	Petroleum products	Regulation 940 CMR 3.18	Any market emergency/disruption	It is unfair and deceptive to sell at an unconscionably high price (gross disparity as compared to the price in the regular course of business).	Increased wholesale costs.	\$5,000 per violation.	State Attorney General. Private enforcement available.
MI	Property or services	MCL 445.903 (1)(z)	Not specifically targeted at disaster/gouging.	Prohibits charging a price in gross excess of the price for which similar products or services are sold.	None	Up to \$25,000	State Attorney General
MS	Any goods and services sold within the designated emergency area	Miss. Code §75-24-25	Disaster declared by the Governor	It is a crime (misdemeanor or felony) to charge prices exceeding those ordinarily charged for comparable goods or services in the same market area at or immediately before the declaration of a state of emergency.	Any expenses, the cost of the goods and services incurred in procuring such goods and services.	Misdemeanor: up to \$1,000 and 6 months. Felony: 1 to 5 years and up to \$5,000	State Attorney General

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State	Covered	Authority	Triggering Event	Prohibited Acts	Safe Harbors	Penalties	Enforced By
MO	Any necessity including those likely to be provided w/in the area	Regulation 15 CSR 60-8.0101 et seq.	Disaster area declared by the Governor	It is an unfair practice to take advantage of a person's impairment or hardship or charge an excessive price.	Actual cost of acquiring, producing, selling, transporting and delivering the actual product sold plus the seller's usual and customary profit margin prior to the onset of the natural disaster.	\$1,000 per violation, injunctive relief, restitution. A knowing violation is a Class D felony.	State Attorney General, Local prosecutor, Private cause of action.
NJ	Any merchandise used as a direct result of emergency or used to preserve, protect or sustain life, health, safety or comfort	N.J.S.A. 56:8-107 to 8:109	Declaration of emergency by the US President or the Governor	Prohibition of excessive price increase (as compared to the price in the usual course of business immediately prior to the disaster. A more than 10% increase is deemed to be excessive) during or within 30 days of the termination of declared "state of emergency."	The price attributable to additional costs imposed by the seller's supplier or other costs of providing the good or service during the state of emergency.	Up to \$10,000 for first violation; up to \$20,000 for subsequent violations.	State Attorney General; Private Right of Action
NY	Consumer goods and services vital for health, safety, and welfare of consumers	Statute NY Gen Bus 396-R	During market disruptions	It is unlawful to charge an unconscionably excessive price (a gross disparity between the current price and the in the usual course of business immediately prior to the onset of the abnormal disruption of the market.	Additional costs not within the control of the defendant, imposed on the defendant for the goods or services.	Up to \$10,000. Restitution.	State Attorney General

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State	Covered	Authority	Triggering Event	Prohibited Acts	Safe Harbors	Penalties	Enforced By
NC	Any merchandise or service consumed or used as a direct result of an emergency or which are consumed or used to preserve, protect, or sustain life, health, safety, or comfort of persons or their property	NCGS §75-38	Declaration of state of disaster	It is unlawful to charge a price that is unreasonably excessive.	The price charged by the seller is attributable to additional costs imposed by the seller's supplier or other costs of providing the good or service during the state of disaster.	\$5,000 per violation.	State Attorney General and/or private individual
OK	Goods, services, dwelling or storage space	Statute 15 OK Code 777.4	Declaration of emergency by the President or the Governor	No sale lease or rental at more than 10% above the price charged immediately prior.	Not a violation if the increase in the price is attributable to factors unrelated to the emergency and does not include any increase in profit to the seller or owner.	Up to \$10,000 per violation plus reasonable costs. Misdemeanor: up to \$1,000 and/or 1 year in jail. Felony: up to \$5,000 and/or 10 years in jail.	Attorney General or District Attorney as violation of the Consumer Protection Act (15 O.S. 751)
SC	Goods, services, materials, merchandise, supplies, equipment, resources, or other articles of commerce for consumption or use as a direct result of a declared state of emergency	S.C. Code Ann. §39-5-145	Declaration of a state of emergency by the Governor, or declaration of disaster by the President concerning all or a portion of the state.	May not sell at a price that is unconscionable (grossly exceeds the average cost of the commodity during the 30-day period preceding the emergency).	Not a violation if the increase in price is attributable to additional costs incurred in connection with the rental or sale of the commodity, or regional, national, or international market trends.	Civil penalty of \$5,000 per violation. If an injunction is issued, a violator is subject to a fine of \$15,000 for each violation of the injunction. In addition, violation of §39-5-145 is a misdemeanor, punishable with a fine of \$1,000, imprisonment of up to 30 days, or both.	Local solicitor (district attorney) or Attorney General

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State	Covered	Authority	Triggering Event	Prohibited Acts	Safe Harbors	Penalties	Enforced By
TN	Any consumer food item; repair or construction services; emergency supplies; medical supplies; building materials; gasoline; transportation; freight and storage; or housing	TCA 47-18-5101 et seq.	Declaration of a state of emergency and until the state of emergency is terminated.	It is unlawful to charge a price that is grossly in excess of the price charged for the same or similar goods or services in the usual course of business immediately prior to the events giving rise to the state of emergency.	The increase was directly attributable to additional costs imposed on it by the supplier of the goods or services, or was directly attributable to additional costs for labor or materials used to provide the goods or services.	\$1,000 per violation.	State Attorney General
TX	Food, fuel, medicine, or other necessities	Tex. Bus & Com. Code Ann. 17.46(b)(27)	Declaration of disaster by the Governor	It is unlawful to charge exorbitant or excessive prices.		Up to \$20,000 per violation.	State Attorney General, District Attorney, or County Attorney
VA	Sale, lease or license of necessary goods or services	Va. Code §§59.1-525 through 529	Declaration of a state of emergency	No supplier may sell, lease or license necessary goods or services at an unconscionable price (the price which grossly exceeds the price charged for same or similar goods during the 10 days immediately prior to the disaster)	Additional costs in connection with the sale of the goods or services, including costs imposed by the source, during the time of disaster.	Up to \$2,500 per willful violation.	State Attorney General, Commonwealth's Attorneys, City, Town, and County Attorneys

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State	Covered	Authority	Triggering Event	Prohibited Acts	Safe Harbors	Penalties	Enforced By
WV	Goods or services that are vital and necessary for the health, safety, and welfare of consumers	W.V. Code 46A-6J-1 through 3	Declaration of a state of emergency	It is unlawful to sell items at a 10% increase over the price 10 days before the declaration of a state of emergency.	Increase in price directly attributable to additional costs imposed by supplier of goods or additional costs for labor or materials used to provide the services (provided price is no greater than 10% above total cost to the seller plus markup customarily applied for that good or service in the usual course of business on tenth day preceding declaration).	Misdemeanor – up to \$1,000 or one year imprisonment, or both.	State Attorney General