

California's Sweeping Price-Gouging Statute Presents Unique Risks to Manufacturers, Wholesalers, Distributors and Retailers of Food and Consumer Products

by Kent J. Schmidt

Uncharted Waters

State price-gouging laws have come into focus in recent weeks as all 50 states have declared an emergency in the wake of the COVID-19 crisis. There is a relatively underdeveloped body of interpretative case law addressing the contours of price-gouging liability. The dearth of case law stems from the fact that these statutes can only be violated during limited time periods—usually a few days or weeks following the declaration of state of emergency. The lack of guidance from the case law creates uncertainty as courts begin to grapple with these issues, deciding the extent to which free market principles must take a back seat to more immediate concerns of consumer protection.

The California Statute (Cal. Pen. Code § 396)

According to a frequently cited [survey](#) of U.S. jurisdictions, 38 of the 50 states plus the District of Columbia have a price-gouging statute. A review of these statutory schemes shows a variety of approaches to the problem of reining in opportunistic sellers.

California's broad price-gouging statute stands out, unique from all other relatively narrowly tailored statutes. Typical of many California statutes, the statute creates several liability traps for the unwary. Given the vastness of the California market—14% of the U.S. economy and the fifth largest economy in the world—it is prudent for those companies selling covered products and services to consider the vulnerabilities and liabilities arising from the California law.

The California statute is part of the Penal Code and states its purposes as follows:

“While the pricing of consumer goods and services is generally best left to the marketplace under ordinary conditions, when a declared state of emergency or local emergency results in abnormal disruptions of the market, the public interest requires that excessive and unjustified increases in the prices of essential consumer goods and services be prohibited.” Cal. Pen. Code § 396(a). The stated legislative objective is

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advanced by several sector-specific provisions aimed at specific industries and markets. There are no reported California appellate decisions interpreting the statute.ⁱ

Five Features of California Price-Gouging Statute

A plain reading of the statute suggests five features most material to understanding the scope of the law and its application:

1. *Products and Services Covered by the Statute.* The statute is much broader in scope than other state statutes by virtue of the wide variety of products and services it covers. Price gouging is prohibited on all “consumer food items or goods, goods or services used for emergency cleanup, emergency supplies, medical supplies, home heating oil, building materials, housing, transportation, freight, and storage services, or gasoline or other motor fuels.” Cal. Pen. Code § 396(b). The phrase “consumer food items” is not defined but arguably extends to any food or beverage at a local supermarket. No distinction or exemption is made for subtypes of retailers which means that an e-commerce company outside the state is treated the same as a traditional retail establishment located in California. Restaurants are covered by the statute as they are also selling “consumer food items” to consumers.

A plain reading of the statute also reveals that there is no distinction between essential food items that have been in high demand (eggs, dried pasta and canned goods) and luxury items and non-essentials (ice cream and alcohol).

The statute extends to non-food items, including any “consumer . . . goods.” *Id.* There is no requirement that the consumer goods be either essential or subject to an extraordinary temporary demand.

Unlike goods, the statute’s application to “services” is much narrower. Liability extends only to those services associated with emergency responses and other enumerated categories.

One service area that may create unexpected liability is “transportation, freight, and storage service.” *Id.* This is a defined phrase and includes “any service that is performed by any company that contracts to move, store, or transport personal or business property or that rents equipment for those purposes, including towing services.” Cal. Pen. Code § 396(j)(9).

2. *Price Increases that Violate the Statute.* Rather than a subjective determinant as used in other statutes (e.g., “unconscionable” pricing), the California statute provides a specific standard for gouging: 10%. A seller is prohibited from charging “a price of more than 10 percent greater than the price charged by that person for those goods or services immediately prior to the proclamation or declaration of emergency.” Cal. Pen. Code § 396(b). Despite all of the other uncertainties and imponderables in the law, this bright line brings some clarity to at least this issue.ⁱⁱ

3. *Beyond the Consumer Transaction—Supply Chain Transactions.* The statute

makes clear that the gouging prohibitions apply beyond the retailer transaction, extending up the supply chain to encompass business-to-business transactions. The California Attorney General has underscored this in a recent [press release](#), stating that the law “applies to transactions between manufacturers, wholesalers, distributors, and retailers as it does between retailers and consumers.” A retailer or other party in the distribution chain may have a defense if it “can prove that the increase in price was directly attributable to additional costs imposed on it by the supplier of the goods” Cal. Pen. Code § 396(a).

4. Duration of the Price Controls. The price-gouging prohibition extends for 30 days after the state of emergency has been lifted. Cal. Pen. Code § 396(b) and (g). “The prohibitions of this section may be extended for additional 30-day periods, as needed, by a local legislative body, local official, the Governor, or the Legislature, if deemed necessary to protect the lives, property, or welfare of the citizens.” Cal. Pen. Code § 396(g). Unlike most natural disaster state of emergency proclamations which last only a few days or perhaps weeks, it is possible that these prohibitions will extend for many months in the future, whether by the initial proclamation remaining in place or additional 30-day extensions.

5. Potential Claimants. The most important feature of the California statute relevant to assessing this risk of legal action is the fact that enforcement is not left to public prosecutors alone; consumers are empowered to commence a lawsuit. See Cal. Pen. Code § 396(i). Consumer class action plaintiffs are doubtless scouring pricing activities in search of class representatives.

Steps to Implement if a Potential Violation has Occurred

What should a company do if, perhaps unaware of these restrictions, it learns that products or services covered by the statute may have been sold at a price that exceeds the 10% threshold? Consideration should be given to the following five steps:

1. Take Remedial Steps. Terminate the questionable pricing transaction to reduce liability and lower the prices. If a business-to-business transaction is at issue, consider providing a credit or refund to negate an overcharge. Although not a defense to the initial violation, these types of remedial measures may be compelling factors in resolving later civil or criminal matters, whether negotiating a plea agreement with a prosecutor or mediating a consumer class action.

2. Implement Internal Controls. As in any internal investigation that sheds light on a compliance problem, steps should be implemented to prevent future violations. If a pricing issue for one product line or service has been uncovered, an analysis may lead to the conclusion that there is a wider problem.

3. Examine Defenses. A variety of defenses may be triggered by the unique aspects of the transaction at issue, providing a basis to argue that the statute is inapplicable or no violation has occurred.

a. The “additional cost” defense noted above may be available if another participant in the supply chain has raised their prices necessitating an adjustment to the price. Cal. Pen. Code § 396(a).

b. Other defenses may relate to the extra-territorial application of the California statute to transactions occurring outside the state. Suppose a New York food processor sells its product to a grocery wholesaler in New Jersey for an inflated price. Is the mere foreseeability that the product will eventually reach a California consumer who will be charged a higher price sufficient to create liability and is California’s attempt to regulate that New York-New Jersey transaction permitted?

4. Calculate the Exposure. A preliminary review of pricing in the relevant period may provide an estimate of the scope of potential liability and inform a response including voluntary disclosure to a prosecutor and an offer to take remedial steps. The earlier this can be calculated and the potential liability assessed, the better informed the company will be on how to mitigate the liability risks, whether civil or criminal.

5. Preserve Documents. Document preservation is essential to the extent that legal action is reasonably anticipated. In addition to avoiding discovery sanctions, preserving documents early can be vital to ensuring that evidence useful in the defense of a criminal prosecution or civil action is obtained.

By taking early and decisive action, a company can avoid or mitigate this unprecedented risk of criminal and civil liability.

Click [here](#) to read the post on the Left Coast Law Blog.

ⁱ Remarkably, the term “price gouging” appears in only one reported decision. See *Bldg. Permit Consultants, Inc. v. Mazur*, 122 Cal. App. 4th 1400, 1412 (2004).

ⁱⁱ California regulations typically use the misnomer “person” to describe the wide variety of entities covered by the law.