August 2020

The Rise of COVID-19 Price Gouging Class Actions and the Economics of Class Certification

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Originally published in *Law360*, August 2020.

Summary of "Price Gouging" Class Action Lawsuits

In response to the COVID-19 pandemic, governors and mayors across the United States have made emergency declarations aimed to gain access to additional resources, coordinate the emergency response, and protect residents from the virus. In California, Governor Gavin Newsom announced a state of emergency on March 4, 2020 to prepare the state for the spread of COVID-19.[1] As part of declaration, there were provisions for "increased protections from price gouging."[2] The proclamation extended the California Penal Code 396 price protection window of no more than 10 percent for goods and services sold in California from 30 days as of the announcement to September 4, 2020.[3]

While price gouging is often addressed through state or local enforcement efforts, three class actions have recently been filed in the Northern District of California alleging that pricing gouging practices of defendants (in part) violated California's Unfair Competition Law:

- *Adrienne Fraser v. Cal-Maine Foods, Inc.* ("*Cal-Maine*") alleges that egg producers and grocery retailers, including Wal-Mart, Trader Joe's, and Amazon "participated in the price-gouging resulting in a near-tripling of egg prices in the past 30 days." [4]
- *Jeanette Mercado v. eBay, Inc.* ("*eBay*") alleges that the online platform encouraged price gouging by sellers of goods, claiming that eBay benefited from elevated prices and that "Plaintiff and the Class are left with no choice but to purchase essential goods like N-95, N-100 and surgical masks; hand sanitizer and gel; disinfectants like Lysol; disinfecting wipes; toilet paper; gloves; paper towels; baby formula; baby wipes; tampons; and diapers from online marketplaces like eBay."[5]

- *Eleisha Redmond v. Albertsons Companies, Inc.* ("*Albertsons*") brought a suit on behalf of national and California consumer classes that include purchases of "any consumer food items or goods, goods used for emergency cleanup, emergency supplies, medical supplies, home heating oil, or other goods or services…at a price 10 percent greater than the price charged" prior to the state declarations of emergency.[6]

Primer on the Economics of Class Certification

Before a case can proceed to trial, a judge will assess the evidence and determine if it is appropriate to certify the proposed class. It is here where economists are often asked to testify on the issues relating to predominance under the Federal Rules of Civil Procedure 23(b). A key issue that is debated by economists at class certification is whether plaintiffs have proffered a common methodology that is capable of demonstrating all or nearly all class members were impacted by the alleged conduct or if individualized issues for class members predominate over common issues. The other central issue relates to if the methodology is formulaic and reliably estimates damages on a class-wide basis.

The framework to assess if a single class member is injured is an analysis that compares the prices the customer paid in the actual world to the prices paid in the world absent the alleged price gouging—what is referred to by economists as the "but-for" world. Since economists do not observe prices in the but-for world, it is imperative to model what prices would have been if the alleged price gouging had not occurred. If the prices paid by a consumer (or plaintiff) in the actual world are higher than prices paid by the consumer in the but-for world, then the consumer was harmed. If the prices paid in the actual world by a consumer are the same or lower than the prices paid in the but-for world, then that consumer was not impacted. Economic damages are the quantification of the injury to those class members that were impacted by the alleged conduct.

Economic Issues in Price Gouging Class Actions

The determination of impact requires a rigorous analysis of data and information in the case. The economic analysis to determine injury is fact specific and depends on the allegations in each case, the supply and demand conditions in the industry, the nature of the products at issue, and real-world events that occur during the relevant period.

Rigorous Analysis and Testing is Required to Model Impact and Damages

Economists often use a statistical tool, known as regression analysis, to assess impact and quantify a potential elevation in prices from alleged conduct. In the context of price gouging, a regression may be used to mathematically estimate the effects of various relevant market factors (such as costs of the relevant products and changes in the demand) on prices paid by members of the proposed class. If the model is properly specified, the regression can identify the elevation in prices due to alleged price gouging. For example, one approach may be to use an "overcharge" variable that takes on a value of "1" for prices in the period that were subject to the purported conduct and a value of "0" for prices that were in a competitive benchmark (either before or after the alleged price gouging). The regression then estimates the average overcharge for those prices during the conduct period relative to the appropriate benchmark period, controlling for the relevant contemporaneous supply and demand factors unrelated to the allegations.

If price gouging allegations involve multiple levels of the supply chain (e.g., a manufacturer and a retailer) an additional analysis assessing pass-through of the "overcharge" will be required. This analysis must estimate the extent to which price gouging by a manufacturer is passed through the distribution chain to individual consumers.

Some of the issues that must be considered when impact based on common evidence in a price gouging class action case can be framed using the allegations in the recent complaints filed in the Northern District of California. While the regression can be a useful tool for assessing impact and damages, rigorous testing is required to determine the appropriate modeling choices.

Econometric Models Needs to Control for Factors Affecting Prices Paid by Consumers

An appropriate model of but-for prices must distinguish economic factors that affect prices in the normal functioning of the market from the effects of the alleged conduct on prices. To illustrate this issue, consider the *Cal-Maine* case. Here, the allegations are that price gouging by egg producers and grocery retailers resulted "in a near-tripling of egg prices" in the 30 days following the Governor's declaration of a state of emergency.[7] However, it is not clear whether the increase in egg prices was due to price gouging behavior or by other factors in the industry.

Data from the US Department of Agriculture shows that there was a substantial increase in the price per dozen eggs in the spring of 2020 when the COVID-19 pandemic initially spiked in the US.[8] However, the data also show that there was a substantial increase in the price index in 2018 as well, and that this price increase was contemporaneous with an increase in US table egg demand. The indices are one piece of evidence that may be used to assess how supply and demand factors affect the industry. Notwithstanding, national indices have limited value in showing what consumers actually paid retailers in stores located in different regions, states, and counties across the United States.

The Determination of Economic Impact Must Isolate the Alleged Price Gouging

In a price gouging matter, a reliable economic model must not only isolate the purported conduct from other unrelated contemporaneous factors, but also identify the sources of the price elevation. For there to be injury to consumers, it is necessary that some amount of the alleged overcharge from the price gouging is passed through to plaintiff purchasers. A number of factors can affect pass-through, including the number of firms at each level of the supply chain, industry-specific facts, cost or supply factors, and the nature of demand. For example, in industries where pricing is characterized by menu costs (i.e., sticky prices), focal point pricing (e.g., prices that end in $0.99), or extensive bargaining, cost pass-through may not occur at all, much less on a uniform, class-wide basis. As relates to price gouging, under certain state consumer protection laws, entities may defend themselves against price gouging accusations by providing a justification for any price increase, such as by demonstrating that they are passing along cost increases from an upstream entity.

For example, in the *eBay* case, an economist must distinguish between the price increase due to the internet platform from an elevation caused by the third-party seller. If the internet platform did not *cause* all the cost increase, then damages will need to be apportioned between the seller and the platform. For example, class plaintiffs in the *eBay* case may attempt to show that eBay's arrangement with the seller caused that seller to pass on a higher commission to the consumer. To support the allegation, there must be economic evidence and empirical support that the seller increased its price by some amount due to the commission to eBay and determine to what extent that commission was passed on to all or substantially all members of the proposed class.

Average Prices Do Not Necessarily Explain Prices Paid by Consumers

Regression models can be used to estimate average overcharges. A single regression model, by design, combines the experiences of different customers. For example, if Customer A suffered no overcharge but Customer B suffered a 10 percent overcharge, a single regression model would calculate an overcharge of 5 percent for both customers, obscuring the fact that Customer A was not, in fact, injured. If the average overcharge is not representative of the experience of many class members, then it may be the case that more individualized models are required (e.g., one for Customer A and one for Customer B).

Rigorous testing is needed to determine whether the average is a reliable measure of prices to members of the proposed class. If prices paid by purported class members varied widely, the regression model's predictions of prices will be "correct" for an individual purchaser only by chance and potentially highly misleading for many individual purchasers. To illustrate this issue, consider the *eBay* case. Here, the allegations are that consumers were price gouged on a diverse set of items including surgical masks, hand sanitizer, disinfectants, toilet paper, gloves, paper towels, baby formula, baby wipes, tampons, and diapers. Testing is required to determine if all customers should be pooled into one regression model or if multiple models are needed. It is not correct to assume without testing that a single regression model can show that all relevant products, sold to different customers often at different times in different locations, suffered the same overcharge. If different class members face different supply and demand conditions, have different substitution preferences, or have alternative suppliers outside the defendants, a single model may not be capable of reliably measuring an "average" overcharge for all class members.

Assessing Injury from Price Gouging for Different Proposed Classes

States and localities have different standards for measuring price gouging. California Penal Code Section 396 defines price gouging as when the price is greater than 10 percent for the same goods or services relative to the price before the emergency proclamation.[9] In the *Albertsons* case, the allegations are on behalf of two classes, measuring whether all consumers in California and across the country were subject to price gouging. Under the California statute, assessing the 10 percent threshold requires a comparison to prices for the same goods or services.

Given that the proposed classes in the *Albertsons* case includes purchasers of "any consumer food items or goods, goods used for emergency cleanup, emergency supplies, medical supplies, home heating oil, or other goods or services," each item would need to be compared to the same good or service.[10] Can the same economic evidence be used across a wide range of products and customers in different locales to show that all purchasers were harmed by the alleged price gouging? The complexity of the required analysis is substantial, as economic models would need to assess supply and demand conditions across a wide range of products and isolate where in the supply chain price gouging may have occurred *for each good or service*.

Conclusions

Recent price gouging class actions filed in the Northern District of California raise interesting issues relating to the determination of economic impact and estimation of damages. In our view, rigorous analyses are required to show if class-wide impact can be determined based on common evidence and whether damages can be reliably estimated on a formulaic basis. Because of the nature of the allegations and pricing across different levels of supply chain, the inquiry into fact of injury involves modeling the effects of price gouging from upstream entities and retailers and estimating ultimately what overcharge (if any) was passed through to consumers. The determination of pass-through relies on a thorough understanding of the conduct at issue and modeling the factors that affect prices of the alleged price gouged products, which may vary across product dimensions and geographically. As these cases move forward and other cases are filed in the future, it will be imperative for economic experts to apply rigorous analysis and testing to their models in this unique context. ■

Notes

1 "Governor Newsom Declares State of Emergency to Help State Prepare for Broader Spread of COVID-19," Office of Governor Gavin Newsom, March 4, 2020. https://www.gov.ca.gov/2020/03/04/governor-newsom-declares-state-of-emergency-to-help-state-prepare-for-broader-spread-of-covid-19/

2 Ibid.

3 "Proclamation of a State of Emergency," Executive Department State of California, executed on March 4, 2020. See https://www.gov.ca.gov/wp-content/uploads/2020/03/3.4.20-Coronavirus-SOE-Proclamation.pdf. See also, California Penal Code 396, https://leginfo.legislature.ca.gov/faces/codes_displaySection.xhtml?sectionNum=396.&lawCode=PEN

4 *Adrienne Fraser v. Cal-Maine Foods, Inc.,* Case 3:20-cv-02733, United States District Court for the Northern District of California, filed April 20, 2020, ¶1.

5 *Jeanette Mercado v. eBay, Inc.,* Case 5:20-cv-03053, United States District Court for the Northern District of California, filed April 4, 2020, ¶1.

6 *Eleisha Redmond v. Albertsons Companies, Inc.,* Case 3:20-cv-03692-JSC, United States District Court for the Northern District of California, filed June 3, 2020, ¶29.

7 *Adrienne Fraser v. Cal-Maine Foods, Inc.,* ¶1.

8 USDA, https://www.ams.usda.gov/sites/default/files/media/Egg%20Markets%20Overview.pdf.

9 See California Penal Code 396, https://leginfo.legislature.ca.gov/faces/codes_displaySection.xhtml?sectionNum=396.&lawCode=PEN

10 *Eleisha Redmond v. Albertsons Companies, Inc.,* ¶29.

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