TESTIMONY OF THE STAFF OF THE FEDERAL TRADE COMMISSION

before the

COMMITTEE ON THE JUDICIARY

of the

UNITED STATES SENATE

presented by

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on

SENATE BILL 1140, THE

"MOTOR FUEL SALES COMPETITION

IMPROVEMENTS ACT OF 1985"

October 9, 1985

Chairman Thurmond and Members of the Committee: thank you for this opportunity to present the views of the Federal Trade Commission's staff on the effects on competition and consumers of proposed Senate Bill No. 1140, the "Motor Fuel Sales Competition Improvements Act of 1985." This bill is similar to other legislation offered in the Senate and House, and in state legislatures, to rectify purported market failures and antitrust problems in gasoline markets. The Commission has previously approved comments by its staff opposing such legislation. In addition, the Committee has previously received the Commission's July 9, 1985 letter opposing S. 1140 (a copy of which is attached). This statement will summarize the Commission's previously stated opposition.

Summary of Opposition to S. 1140

The bill's stated purpose is to "amend the antitrust laws in order to preserve and promote wholesale and retail competition in the retail gasoline market and to protect the motoring safety of the American public." The Commission endorses these goals, but opposes the specific provisions of S. 1140. There is no credible evidence that the anticompetitive practices the bill purports to correct exist. Present federal laws are sufficient to remedy predatory pricing and collusion should these practices occur. Moreover, legislated lessor-lessee contract alteration and vertical divorcement are unnecessary, and would increase the costs of gasoline distribution, eliminate legitimate price competition, and raise prices for motor fuel to consumers.

1. There is no credible evidence of anticompetitive conduct by refiners and producers to support S. 1140.

If the purpose of S. 1140 is to protect gasoline franchisees of major, integrated refiners from unfair and anticompetitive practices directed against them by their suppliers, the bill is unnecessary. There is simply no credible evidence that such practices are either occurring or could successfully be used to harm gasoline dealers. In fact, a DOE examination of the state of competition in gasoline marketing in the United States, both before and after the decontrol of petroleum refining and marketing in 1981, indicates that gasoline franchisees have not been and are not likely to become targets of anticompetitive practices by refiners. Claims that refiners "subsidize" their own outlets to harm their franchisee dealers are unsubstantiated.

The studies also indicate that refiners have no logical motive to wage war on their franchised dealers. Rather, refiners and their franchised outlets are linked by mutual interest, because lessee-dealers are the predominant distribution system for direct gasoline sales by major, integrated refiners. Only a small percentage of the gasoline stations in the United States are operated by major, integrated refiners.

Moreover, the Commission's September 1982 study, Mergers in the Petroleum Industry, concluded that wholesale and retail gasoline markets were unconcentrated at the national level and, in general, only moderately concentrated in particular geographic regions. Given the continued importance of the branded, franchised marketing distribution system to major refiners, traditional antitrust and economic theory indicate it would be

irrational for an individual refiner to charge its franchisee-dealers prices that would cause them to either secure new sources of supply or go out of business. The likely results of such irrational behavior in the current era of reduced gasoline demand and plentiful supplies would be that the refiner would face a decrease in market share, an increase in excess capacity, and higher per unit costs. Thus, individual gasoline franchisors are not likely to engage in predation against the mainstay of their own retail distribution system, their franchised dealers.

2. Monopolistic and predatory behavior is subject to prosecution under existing federal laws.

Even if predatory or monopolistic behavior by refiners were found to exist, passage of S. 1140 is unnecessary. S. 1140's prohibition against refiner or producer collusion is unnecessary because such conspiracies are subject to the criminal and civil prohibitions of the Sherman Act and Section 5 of the FTC Act.

Section 2(a) of the bill, prohibiting individual refiners or producers from requiring their dealers to buy more than 70 percent of their gasoline from them, and prohibiting limitations by refiners and producers on conversion of existing storage tanks for alternative gasoline supplies, also is unnecessary. There is no evidence of widespread anticompetitive abuses associated with minimum volume requirements and restrictions on usage of refiner-owned storage tanks in current franchise contracts.

3. **Legislated lessor-lessee contract alteration and vertical divorcement are unnecessary and would raise costs, diminish price competition, and raise gasoline prices to consumers.**

Finally, S. 1140 should not be used to redress perceived contractual imbalances between refiners or producers and their lessee-dealers; Congress has already addressed this concern through its earlier passage of the Petroleum Marketing Practices Act of 1978 ("PMPA"). The legislative history of the PMPA shows that it was the intent of the Congress to balance the franchise relationship in a more equitable manner. S. 1140 should not be allowed to alter this balance without a full study of its effects.

Passage of S. 1140 in fact may be injurious to franchisees, because its requirements would appear to lessen the value of a franchised dealer network to an integrated refiner. Therefore, although direct refiner-operated stations presently constitute only a small percentage of all retail gasoline stations, passage of S. 1140 might encourage abandonment of franchised dealer outlets in favor of company-controlled outlets, assuming that the marketing divorcement part of S. 1140 would not be enacted.

The antitrust laws deter firms from engaging in predatory behavior, but, at the same time, allow them to lower their costs through vertical integration. In contrast, the prohibition against refining/marketing integration found in S. 1140 would arbitrarily require marketing divorcement according to the amount of aggregate refinery capacity of certain refiners. By denying firms the possibility of increasing efficiency through vertical integration, this legislation could add costs to the distribution

of gasoline in the United States, costs that would be borne by consumers.

The potential harm of divorcement bills is illustrated by the experience of Maryland, which has already enacted legislation similar to that now being proposed by S. 1140. One study, described by DOE as perhaps "the best empirical analysis of the effects of Maryland's divorcement law," has estimated that Maryland consumers are now paying millions of dollars more per year than they would have been paying if the divorcement law had not been enacted.

Conclusions

Drawing upon an ongoing examination of energy competition issues, the Commission concludes that the proposed (1) alteration of existing gasoline supply contractual obligations, and (2) vertical divorcement of retail gasoline stations, are likely to have harmful consequences for both competition and consumers. In short, S. 1140 would not enhance consumer welfare, but rather would serve to insulate one business segment, retail gasoline dealers, from the rigors of the free market.

As competition among gasoline marketers has intensified in recent years, retail dealers have faced an increasing need to change with the times by operating more efficient, high-volume outlets. Protectionist legislation such as S. 1140 would interfere with this competitive process, and would result in higher consumer prices.

For these reasons, S. 1140 should not be enacted.

Thank you for your attention, Mr. Chairman. I would be pleased to answer any questions you or other members of the Committee may have.