UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

BUREAU OF COMPETITION

AUTHORITY

P874666

April 20, 1987

The Honorable Patrick Johnston
Chairman
Finance and Insurance Committee
California State Assembly
Sacremento, California 45814

Dear Chairman Johnston:

The staff of the Federal Trade Commission* is pleased to submit this letter in response to your request for comments on California Assembly Bill 338, a proposal to regulate gasoline distribution in California through the creation of a "Service Station Dealers Board." We believe that A.B. 338 is anti-competitive and harmful to consumers and that, if it becomes law, California motorists will pay higher prices for gasoline.**

## Description of A.B. 338

A.B. 338 would amend the California Business and Professions Code by inserting additional regulations covering the distribution of petroleum products. It would establish a Service Station Dealers Board and would require all refiner-operated and distributor-operated gasoline stations to be certified by the Board. Termination of non-refiner franchises would be subject to prescribed notice and termination procedures, and could be appealed to the Board. The Board would also enforce a "Fair Practices" Code that would prohibit many terms now common in contracts between retailers and their franchisors, such as requirements that the retailers purchase minimum volumes of gasoline or that they participate in promotional programs. A.B. 338 would also prevent a refiner from competing with any of its own retailers by opening a gasoline station within one mile of a dealer's station.

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* These comments represent the views of the FTC's Bureaus of Competition, Consumer Protection, and Economics, and do not necessarily represent the views of the Federal Trade Commission or any individual Commissioner. The Commission has, however, authorized the staff to submit these comments for your consideration.

** FTC staff comments have opposed passage of divorcement and below cost selling bills in North Carolina, South Carolina, Georgia, Washington, Hawaii, and in the United States Senate and House of Representatives. The Commission's staff has acquired experience in these issues from studies, investigations, and enforcement actions.

## The probable effect of licensing gasoline stations

A.B. 338 states that "the distribution and sale of petroleum products in this state vitally affects the general economy of the state and the public welfare" and that regulation and licensing of retailers and their suppliers is necessary. We believe that no reason exists for imposing such a state regulatory scheme. Gasoline distribution in California and in the United States is characterized by vigorous competition. A.B. 338 would attempt to alter this situation by imposing artificial restraints on entry and insulating gasoline retailers from normal competitive pressures in the marketplace and would result in higher gasoline prices for California consumers and visitors.

We believe that A.B. 338 would not actually benefit the independent dealers. More probably it would diminish their value to the refiner-supplier. Major refiners would have incentives to abandon relatively efficient retail franchised distribution in favor of commodity sales of gasoline at the refinery gate or at wholesale terminals. Because some individual dealers will not normally have the capability to transport gasoline, some may lose the ability to stay in business. Thus, individual dealers would be harmed, not helped by A. B. 388. Consumers would also be harmed to the extent that franchised dealers, who provide a variety of services to their customers, become less prevalent because of government-imposed restrictions on the contracting process.

## No evidence supports claims of predatory or monopolistic activities by refiners against independent dealers in California or in any other State

Legislation to regulate gasoline distribution has often been proposed in both Congress and in state legislatures. Proponents of such legislation have maintained that such laws are necessary to protect the franchised dealers of major, integrated refiners from unfair and anticompetitive practices directed against them by their suppliers. They argue that permitting refiners to operate their own retail gas stations in competition with independent dealers and franchised dealerships of major branded suppliers is unfair. According to this view, the refiners can and do "subsidize" their own retail operations by providing gasoline to those outlets at prices that are both below cost and below the wholesale prices charged to lessee dealers. The alleged reason for such "subsidization" is that major refiners are trying to drive the franchised dealers out of business, so that they can replace them with company-owned stations.

We are not aware, however, of any evidence that such subsidization has occurred in California or in any other state. In fact, an 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 dealers have not been and are not likely to become targets of anticompetitive practices by their suppliers. Following enactment of Title III of the Petroleum Marketing Practices Act in 1978, 15 U.S.C. Sec. 2841, the Department of Energy ("DOE") studied whether the alleged "subsidization" of retail gasoline operations of the major refiners actually existed, and, if it did, whether the practice was predatory or anticompetitive. The final report to Congress, published in January of 1981, was based on an extensive study of 1978 pricing data in several Standard Metropolitan Statistical Areas, including Los Angeles, as well as on internal oil company documents subpoenaed by the DOE investigating staff. The study concluded that there was no evidence of such subsidization.*

In 1984, DOE published an updated study that further substantiated and elaborated on its 1981 findings.** The study also showed that company-operated stations were not increasing as a percentage of all retail outlets, except among smaller refiners. The State of California was actually among the states in which the lowest growth in refiner-owned and operated stations was found.***

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* DOE, <u>Final Report: The State of Competition in Gasoline Marketing</u>, January 1981.

** DOE, <u>Deregulated Gasoline Marketing: Consequences for Competition, Competitors, and Consumers</u>, March 1984.

*** <u>Id.</u> at 18.

The DOE studies have revealed no instances of predatory behavior on the part of major gasoline refiners. Instead, the studies indicate that the fortunes of refiners and their franchised retailers are inextricably merged, and that they "form a mutually supporting system backed by company advertising and promotion."* Franchised retailers have continued to be by far the predominant form of retail outlet for the direct gasoline sales of major, integrated refiners.** Indeed, only 3.3 percent of the gasoline stations in the United States are actually operated by major refiners.*** California has a similarly small proportion of such major refiner-operated stations. Given the importance of the branded, franchised marketing distribution system to major refiners, they would be unlikely to charge their lessee dealers prices that would cause them either to search for new sources of supply or to go out of business. The probable effect of such action would be a decrease in the refiner's market share, an increase in excess refining capacity, and higher per unit costs. Thus, individual refiners are not likely to engage in predation against the mainstay of their own retail distribution system, their franchised retailers.

In sum, the DOE reports conclude that any increased pressures on gasoline retailers since 1981 were not caused by anticompetitive behavior on the part of the oil companies, but resulted from decreased consumer demand for gasoline and a continuing trend toward the use of more efficient, high-volume retail outlets. These reports and industry publications, such as the Lundberg Letter, indicate that since federal controls were removed, the public has been the beneficiary of vigorous price competition.

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* Id. at ii.

** In 1981, the eight largest refiners who, in the aggregate, accounted for about half of all gasoline sales, sold approximately eight times more gasoline through lessee dealers than through company-operated outlets. Id. at 146 (Table A-10).

*** Lundberg Letter, Vol. XI, No. 36, July 6, 1984, at 3. In addition, the largest refiners tend to have far fewer company-operated retail outlets, compared to their smaller refiner rivals. See DOE, Final Report: The State of Competition in Gasoline Marketing, January 1981, at 113.

**Even if monopolistic and predatory behavior were found, it is already subject to prosecution under existing state and federal antitrust laws; new laws are not needed**

Predatory or monopolistic behavior in the petroleum industry is subject to the Sherman Act, the Clayton Act, and the Federal Trade Commission Act. These statutes provide a better way for dealing with anticompetitive practices in the industry than legislation restricting new entry and regulating contractual relationships between suppliers and purchasers of gasoline. The existing antitrust laws deter refiners and other firms from engaging in predatory and monopolistic behavior, but, at the same time, allow them to lower their operating costs through individual decisions on their gasoline distribution systems. In contrast, A.B. 388 would restrict the ability of firms to realize increased market efficiencies and to adjust to changing market conditions. Such legislation is likely to add costs to the distribution of gasoline in California that do not exist in other states, costs that would be borne by California consumers and visitors.

To the extent that A.B. 388 is intended to redress perceived gasoline retailer grievances against their refiner-suppliers, we suggest that you consider the extent to which these concerns have been addressed in the Petroleum Marketing Practices Act of 1978 ("PMPA"), _supra_. The legislative history of the PMPA shows that Congress was concerned over alleged abuses of the franchise relationship, and the PMPA represents a balancing of the rights of the respective parties to retail gasoline franchise agreements.*

**Conclusion: special interest legislation is not necessary in California gasoline distribution**

For the reasons stated above, the staff of the Federal Trade Commission believes that A.B. 388's passage into law would likely have harmful consequences for both competition and consumers. We believe that the bill would serve only to insulate one segment of business entrepreneurs from competition, at the cost of higher gasoline prices for California consumers and visitors.

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* _See_ Senate Report No. 95-731, 95th Cong., 2d Sess., 15-19, 29-43.

For these reasons, the Federal Trade Commission's staff respectfully urges that you reject A.B. 388.

Sincerely,

Jeffrey I. Zuckerman
Director