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UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
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Office of the Regional Director

June 2, 1989

COMMISSION AUTHORIZED

The Honorable Francis C. Heitmeier
Louisiana House of Representatives
Post Office Box 44062
Baton Rouge, LA 70804

Dear Mr. Heitmeier:

The staffs of the Dallas Regional Office and the Bureau of Competition of the Federal Trade Commission[1] are pleased to submit this letter in response to your request for comments on the potential competitive effects of House Bill 444 and House Bill 847, two almost identical bills that, in general, would prohibit "below cost" pricing, as "cost" is defined in the bills, and price discrimination in the sale of gasoline. We believe that both H.B. 444 and H.B. 847 are likely to be anticompetitive and that, if either bill is enacted, Louisiana consumers and visitors could pay higher prices for gasoline.

<u>Interest and experience of the Federal Trade Commission</u>

The Federal Trade Commission is charged by statute with preventing unfair methods of competition and unfair or deceptive practices in or affecting commerce. 15 U.S.C. § 45. Under this statutory mandate, the Commission seeks to identify restrictions that impede competition or increase costs without offering countervailing benefits to consumers. In particular, the Commission and its staff have had considerable experience assessing the competitive impact of regulations and business practices in the oil industry.[2]

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1 These comments are the views of the staffs of the Dallas Regional Office and the Bureau of Competition of the Federal Trade Commission. They are not necessarily the views of the Commission or any individual Commissioner.

2 The Commission's staff has gained extensive experience with energy competition issues by conducting studies, investigations, and law enforcement actions. FTC staff comments
(continued...)

Description of H.B. 444 and H.B. 847

H.B. 847 would add a new Chapter 14-A to Title 51 of the Louisiana Revised Statutes of 1950, entitled "Motor Fuel Marketing Act."[3] Section 1473 of H.B. 847 would, inter alia, prohibit any entity (including refiners, wholesalers, and retailers) engaged in the sale of gasoline at any level in the distribution process from selling gasoline in Louisiana at prices below costs, as defined in Section 1472, "where the effect is to injure competition."[4] Transfers between affiliates within a vertically integrated gasoline marketing organization would be treated the same as sales between unrelated marketing entities.

Cost to retailers and wholesalers is defined as "the invoice or replacement cost of the motor fuel within five days prior to the date of sale, or the quantity last purchased, whichever is less," less most trade discounts, plus other specified costs of

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[2](...continued) and testimony to legislative bodies have identified the costs of proposed gasoline retailing divorcement and "below-cost selling" legislation for Montana, North Carolina, South Carolina, Georgia, Alabama, Tennessee, Washington, Hawaii, Nevada, and for the United States Senate and House of Representatives. The Commission and its staff have also gained considerable experience with gasoline refining and marketing issues affecting consumers from premerger antitrust reviews pursuant to Sections 7 and 7A of the Clayton Act, 15 U.S.C. §§ 18, 18a.

For a more general discussion of the potential anticompetitive effects of statutes that prohibit "below cost selling," please see the attached copy of the Commission staff comment on such a bill which was introduced in the Texas legislature. Letter from Thomas B. Carter, Director, Dallas Regional Office, Federal Trade Commission, to Senator William R. Ratliff, Texas State Senate (May 15, 1989).

[3] La. Rev. Stat. §§ 51:1471-51:1481 (1950). In this letter, the particular provisions of this bill will be referred to by their Chapter 14-A citation, as they are set out in the bill. All references to the provisions of both H.B. 444 and H.B. 847 will be made by use of H.B. 847 citations. The statutes are virtually identical, except H.B. 847 has a few additional provisions and a few structural modifications. Every provision contained in H.B. 444 is also contained in H.B. 847.

[4] Section 1476 specifies exceptions for unusual circumstances, such as sales of damaged fuel, clearance sales, or a sale in final liquidation of a business. H.B. 847 contains an exception not contained in H.B. 444 for grand opening sales, not to exceed three days. Section 1476(A)(5).

doing business, such as taxes, transportation costs, and a share of overhead costs.[5] Cost to a refiner is defined as "that refiner's posted terminal price to the wholesale class of trade," unless the refiner does not have such a price, in which case the cost to the refiner is "the posted price of any other refiner at any terminal within the general trade area."[6]

Section 1473 of the bill would prohibit suppliers or wholesalers of gasoline from discriminating in price, "where the effect is to injure competition." Sections 1479 and 1480 provide for civil penalties, injunctions, and recovery of damages to remedy violations of Section 1473.

Section 1473 would prohibit a producer or wholesaler from selling or transferring motor fuel to any retail outlet at a price lower than the price it charges any competing retailer.[7] Section 1481 would create a presumption of a violation, which would shift the burden of proof to the defendant to justify the price charged, if a plaintiff retailer establishes any of the following circumstances:

(1) The plaintiff's purchase price from a refiner or wholesaler is greater than the refiner's price to its own affiliates;

(2) The plaintiff's purchase price from a refiner or wholesaler plus the plaintiff's cost of doing business is greater than the refiner or wholesaler's posted retail price; or

(3) The plaintiff's cost of purchasing gasoline plus his cost of doing business is greater than the posted sales price at a retail location of a competitor, within the same marketing area, suspected of selling gasoline in violation of the requirements that would be imposed by these bills.[8]

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5 Sections 1472(14) and (15).

6 Section 1472(13).

7 Louisiana currently has an "Unfair Sales Law" which makes illegal sales at a price below the seller's invoice purchase price plus a uniform markup. La. Rev. Stat. §§ 51:421-51:428. This statute does not appear to apply to transfers among corporate affiliates of vertically integrated marketers.

8 These presumptions are extremely broad. A presumption would apply in any market where some gasoline prices are lower than others. This would create an incentive for an inefficient

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Claims of predatory, monopolistic or collusive activities by refiners against gasoline dealers may not be well-founded

The premise of both H.B. 444 and H.B. 847 appears to be that independent and small retailers and wholesalers are being victimized by subsidized pricing by the major gasoline marketers. Several studies of competition in gasoline marketing in the United States since 1981 have concluded that gasoline dealers and distributors have not been and are not likely to become targets of anticompetitive practices by their suppliers, although these studies did not focus on Louisiana. In light of these studies, discussed below, you may wish to examine any claims by Louisiana gasoline dealers to be sure that the claims are well-founded.

Federal studies

Following enactment of Title III of the Petroleum Marketing Practices Act ("PMPA") in 1978, 15 U.S.C. § 2841, the Department of Energy ("DOE") studied whether the alleged "subsidization" of retail gasoline operations by 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, as well as on internal oil company documents subpoenaed by the DOE

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[8] (...continued)
competitor whose costs are higher to initiate a lawsuit, because his burden of proof would be low. However, the defendant would face a difficult and expensive burden to overcome the presumption. If the defendant is unable to overcome the presumption, the plaintiff could be awarded injunctive relief and treble damages under Section 1480.

Because an important characteristic of competitive markets is legitimate price competition, litigation encouraged on the basis of different prices alone may chill vigorous price competition. Deterrence from price competition is a particular problem because firms have an incentive to complain about the successful competitive efforts of their competitors, however proper their efforts may be. A competitor may determine that the risk of facing expensive litigation is too high to permit it to compete on the basis of price. The likely result would be higher prices for consumers.

investigating staff. DOE found no evidence of such "subsidization".[9]

In 1984, DOE published an updated study that further substantiated and elaborated on its 1981 findings.[10] The study showed that company-operated stations were not increasing as a percentage of all retail outlets, except among the smaller refiners. DOE concluded that the increased pressures on gasoline retailers since 1981 were not caused by anticompetitive behavior on the part of the major oil companies. Rather, DOE concluded that the decline in the overall number of retail outlets and the intensification of competition among gasoline marketers were due to decreased consumer demand for gasoline and a continuing trend toward the use of more efficient, high-volume retail outlets.[11]

State studies

In 1986, the Washington state attorney general initiated a study of motor fuel pricing in that state to determine whether subsidization had occurred or was occurring. The study focused on whether major oil companies injured competition by charging lessee-dealers higher prices for gasoline than the companies were charging their own, company-operated retail stations. The study also sought to examine whether the major oil companies injured competition by establishing a structure of retail and wholesale prices that foreclosed the ability of dealers to cover their costs. Information was gathered on the practices of all eight of the major companies in Washington for a three-year sample period. The study covered regions throughout the state where the companies had retail operations and sold to lessee-dealers. The Final Report concluded that instances of significant price variation among lessee-dealers and company-operated retailers were "clearly too infrequent" to support any claim that lessee-dealers' gasoline purchase costs were higher than the retail prices of competing company-operated stations, and that these dealers were being systematically driven from the market.[12]

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9 DOE, Final Report: The State of Competition in Gasoline Marketing (Jan. 1981).

10 DOE, Deregulated Gasoline Marketing: Consequences for Competition, Competitors, and Consumers (Mar. 1984) [hereinafter cited as 1984 DOE Report].

11 Id. at 125-32.

12 Final Report to the Washington State Legislature on the Attorney General's Investigation of Retail Gasoline Marketing, August 12, 1987, at 14.

More recently, in 1987, the Arizona legislature created a Joint Legislative Study Committee on Petroleum Pricing and Marketing Practices and Producer Retail Divorcement. In December 1988, after more than a year of extensive inquiry and analysis, the Final Report recommended that no new legislation be enacted, concluding that "[t]he marketplace for petroleum products is very competitive in Arizona."[13]

The state and DOE studies have revealed no instances of predatory behavior by major gasoline refiners. Rather, they show that the fortunes of refiners and their franchised retailers are closely linked, and that these firms "form a mutually supporting system backed by company advertising and promotion."[14] Independent franchised retailers have continued to be by far the predominant form of outlet for the direct gasoline sales of major, integrated refiners.[15] Indeed, major refiners operate only a small percentage of the gasoline stations in the United

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[13] Final Report to the Arizona Joint Legislative Study Committee on Petroleum Pricing and Marketing Practices and Producer Retail Divorcement, December, 1988, at 35. We are aware of no similar studies in Louisiana analyzing the need for legislation such as H.B. 444 and H.B. 847. However, some data contained in the 1984 DOE study indicate that gasoline markets in Louisiana are unconcentrated. See 1984 DOE Report, supra note 10, at 90-91 (Tables III-25 and III-26). Generally, as a market becomes less concentrated, the likelihood of anticompetitive conduct in the market declines.

[14] 1984 DOE Report, supra note 10, at ii. We do not mean to suggest that the fortunes of refiners and their franchised retailers are perfectly linked, only that the studies have found that in general the refiners and their retailers share common goals. Although our information for these propositions comes from 1984 reports and articles, we have no reason to believe that the distribution structure has significantly changed since that time.

[15] 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. 1984 DOE Report, supra note 10, at 146 (Table A-10). The 1984 DOE Report, supra note 10, at 82, indicates that vertically integrated marketers of gasoline accounted for 18.8 percent of total sales in 1981 in Louisiana.

States.[16] Given the importance of the branded, franchised marketing distribution system, major refiners are unlikely to charge discriminatory prices that would cause their franchised retailers to seek new sources of supply or to go out of business. A refiner that undertook such a course of action would probably face a decrease in market share, an increase in excess refining capacity, and higher per unit costs. Thus, the major integrated refiners are not likely to engage in predation against the mainstay of their own retail distribution systems, their franchised retailers.

Even if predatory behavior were found, it is already subject to prosecution under existing state and federal laws

Predatory conduct in the petroleum industry is subject to the Sherman Act, the Clayton Act, and the Federal Trade Commission Act, and at the state level, the Louisiana antitrust laws.[17] These statutes address possible anticompetitive practices in the industry more effectively than would legislation regulating gasoline markets. The existing antitrust laws deter firms from engaging in predatory behavior, but, at the same time, allow them to lower their costs of operation through vertical integration. In contrast, the price regulation envisioned by H.B. 444 and H.B. 847 would deny firms the flexibility to adjust their prices in response to changing conditions of demand and supply. Such legislation is likely to add costs to the distribution of gasoline in Louisiana that do not exist in other states, costs that would be borne by Louisiana consumers and visitors.

In addition, many of the apparent concerns of the sponsors of H.B. 444 and H.B. 847 in redressing alleged anticompetitive abuses associated with refiner-owned and operated gasoline stations are addressed by the existing federal Petroleum Marketing Practices Act of 1978, _supra_.[18] The legislative

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16 _Lundberg Letter_, Vol. XI, No. 36, July 6, 1984, at 3, where it was reported that the major refiners operated only about 3.3% of all retail stations. Although we have not found more recent comprehensive analyses of the extent of refiner-owned and operated retail stations, we have no reason to believe that substantial changes have occurred.

17 La. Rev. Stat. §§ 51:122-51:152, 51:331-51:337 (1950). In addition, discriminatory pricing is subject to the Robinson-Patman Act.

18 The PMPA establishes certain notice requirements with respect to cancellation and nonrenewal of contracts between (continued...)

history of the PMPA shows that Congress was concerned about these same alleged abuses of the franchise relationship, and that the PMPA was intended to balance the rights of the respective parties to retail gasoline franchise agreements.[19]

The price and allocation regulatory features of H.B. 444 and H.B.847 are likely to lead to higher gasoline prices

Enactment of H.B. 444 or H.B. 847 may have adverse consequences for consumers. Short term price discounts designed to attract new customers would be deterred. Refiners may be prevented from realizing the efficiencies of vertical integration, which can often reduce transaction and search costs and lower prices to consumers.[20]

Lawful price differences often operate to destroy cartel pricing.[21] Moreover, changing market conditions frequently are manifested in temporary discriminatory pricing patterns. If these lawful price differences are prohibited, firms may become insulated from competition, and pricing may become rigid. The bill, therefore, if enacted, may result in higher profits for all gasoline refiners and marketers through higher prices for Louisiana consumers.[22]

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[18](...continued)
franchisers and franchisees, and creates a private claim for violation by franchisers, enforceable in federal courts.

[19] See S. Rep. No. 731, 95th Cong., 2d Sess., 15-19, 29-43 (1978), reprinted in 1978 U.S. Code Cong. & Ad. News 873.

[20] For example, vertical integration can reduce the costs of contracting with various retailers and of coordination problems between different distribution levels.

[21] See generally Schwartz, The Perverse Effects of the Robinson-Patman Act, United States Dept. of Justice, Antitrust Division, Economic Analysis Group Discussion Paper 86-12, July 30, 1986, at 8-10.

[22] Indeed, the 1984 DOE Report, supra note 9, at 122, analyzed the possible effects of "uniform price laws," as follows:

> In a market where there are no restrictions on pricing, price reductions tend to spread throughout the geographic area providing lower prices for consumers. . . . If the geographic area within which the price cutting occurs is limited, it is very likely that the refiners will respond in kind. . . . Thus, a price cut in one area often will lead

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Moreover, the legal presumptions that would be created if either of the bills were enacted may have the effect of inhibiting efficient, pro-competitive pricing practices. Under the legislation, many efficient pricing practices, although legal, may be discouraged by the threat of costly litigation. The presumptions which the bills contain would shift the burden of proof to the defendant to justify its pricing.

Conclusion

For the reasons stated above, we believe that either H.B. 444 or H.B. 847, if enacted, would tend to insulate gasoline refiners and marketers from competition, and thereby could cause gasoline prices in Louisiana to increase.

We appreciate the opportunity to comment on H.B. 444 and H.B. 847. Please feel free to contact us if we can be of further assistance.

Sincerely,

Thomas B. Carter
Director
Dallas Regional Office

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[22](...continued)
to price cuts across broad market areas. In this situation, competition has worked effectively and consumers in all areas affected are better off.

In markets where there are uniform price restrictions, it is more likely that the responses will be different. Again, a refiner may decide to lower prices in a geographic area where sales traditionally have been weak. Refiners' responses must now take into account the uniform price law. . . . [R]efiners must lower prices throughout the area covered by the law. In this situation, the refiners are more than likely to maintain their prices, since they may decide it is less costly to forego some sales in the initial market where price cutting is occurring than lower prices throughout the region. . . . Competition has been adversely affected and most consumers are no better off, since price reductions have not occurred in areas where they would have without the uniform price law.