



BUREAU OF COMPETITION

COMMISSION AUTHORIZED

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

April 22, 1987

The Honorable Randolph J. Townsend
Chairman
Senate Committee on Commerce and Labor
Nevada State Legislature
P.O. Box 20923
Reno, Nevada 89515

Dear Mr. Chairman:

The staff of the Federal Trade Commission* is pleased to submit this letter in response to your request for comments on the potential competitive effects of Assembly Bill 420, a bill to establish divorcement by gasoline refiners of their retail gasoline outlets.** We believe that A.B. 420 is anticompetitive and harmful to consumers and that, if it becomes law, Nevada consumers and visitors will pay higher prices for gasoline.

Description of A.B. 420

A.B. 420 would amend the part of the Nevada Revised Statutes ("NRS") relating to gasoline marketing practices, by adding new provisions 2 through 13. The bill would make it unlawful for a gasoline refiner to open a new retail gas station or to sell gasoline at retail after July 1, 1987 [Sec. 10.1.], or to continue to operate any retail stations after July 1, 1988 [Sec. 10.2.]. A.B. 420 would also restrict the terms of franchise agreements between refiners and dealers. For example, the bill would require that dealers be given notice before they are terminated, would guarantee them a grace period within which to bring themselves into compliance with the agreement, and would prohibit refiners

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

** The Commission's staff has extensive expertise in energy competition issues based on studies, investigations, and enforcement actions. FTC staff comments and testimony have opposed passage of divorcement and "below-cost selling" laws in North Carolina, South Carolina, Georgia, Alabama, Tennessee, Washington, Hawaii, and in the United States Senate and House of Representatives.

from unreasonably restricting dealer activities that are not related to the actual sale of gasoline or oil.

A.B. 420's provisions would be enforceable in civil actions for damages and injunctive relief by retailers, wholesalers, or refiners [Sec. 20].

No evidence supports claims of predatory or monopolistic activities by refiners against independent dealers in Nevada or in any other State in the United States

Legislation to regulate gasoline distribution is often proposed in both Congress and in state legislatures. Proponents of such legislation maintain that its passage is necessary to protect gasoline retailers from unfair and anticompetitive practices directed against them by their suppliers, who are major, integrated refiners. They argue that it is inherently unfair for refiners to operate retail gas stations in competition with franchised, branded retailers who purchase gasoline from such refiners. According to this view, the refiners "subsidize" their own retail operations by providing gasoline to their own outlets at internal transfer prices that are both below cost and below the wholesale prices charged to franchised retailers.

We are not aware of any evidence that such subsidization has occurred in Nevada 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, indicated 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 ("PMPA") in 1978, 15 U.S.C. Sec. 284l, 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 investigating staff. The study concluded that there was no evidence of such subsidization.*

* DOE, Final Report: The State of Competition in Gasoline Marketing, 1981.

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 the smaller refiners. Nevada was actually among the states in which the lowest growth in refiner-owned and operated stations was found.**

In the 1984 report, DOE concluded that the increased pressures on gasoline retailers since 1981 were not caused by anticompetitive behavior on the part of the oil companies. Rather, the decline in the overall number of retail outlets and the intensification of competition among gasoline marketers were attributable to decreased consumer demand for gasoline and a continuing trend toward the use of more efficient, high-volume retail outlets.*** Statistics published by DOE 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.

The DOE studies have revealed no instances of predatory behavior on the part of major gasoline refiners; rather, they show 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 outlet for the direct gasoline sales of major, integrated refiners.***** Indeed, major refiners operate only 3.3 percent of the gasoline stations in the United States.***** Nevada also has a small proportion of such refiner-operated stations.

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

** Id. at 18.

*** Id. at 125-32.

**** 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. 38, July 6, 1984, at 3.

Given the importance of the branded, franchised marketing distribution system to major refiners, such refiners are unlikely to charge their franchised retailers prices that would cause them either to seek new sources of supply or 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 system, their franchised retailers.

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 requiring divorcement. The existing antitrust laws deter refiners and other firms from engaging in predatory and monopolistic behavior but, at the same time, allow them to seek lower operating costs through vertical integration. In contrast, the prohibition against refining/marketing integration found in A.B. 420 would deny firms the possibility of increasing market efficiencies through opening retail outlets. Such legislation is likely to add costs to the distribution of gasoline in Nevada, costs that would be borne by Nevada consumers and visitors.

Divorcement laws have resulted in higher gasoline prices for consumers

The potential harm of divorcement bills is illustrated by the experience of the State of Maryland, which has enacted divorcement legislation similar to that now being proposed by A.B. 420. One economic study, described by DOE as perhaps "the best empirical analysis of the effects of Maryland's divorcement law,"* estimates that Maryland consumers may be paying millions of dollars more per year for gasoline primarily because of that law.** Georgia's Governor recently vetoed a divorcement bill that is markedly

* 1984 DOE Report, supra, at 105, describing a study by Barron and Umbeck.

** See Barron & Umbeck, A Dubious Bill of Divorcement, Regulation, Jan.-Feb. 1983, at 29.

similar to A.B. 420.*

A.B. 420 would lead to higher gasoline prices
but would not protect gasoline dealers

We also believe that the provisions of A.B. 420 that regulate the contractual relationships between refiners and their franchised retailers are unnecessary, anticompetitive, and harmful to consumers. Such restraints would not actually benefit independent and franchised retailers; more likely they would diminish the value of the franchised retailer distribution system to refiner-suppliers. Major refiners would have incentives to abandon relatively efficient franchised retailer operations in favor of commodity sales of gasoline at the refinery gate or at wholesale terminals. Because individual dealers may not have the capability to transport gasoline, some individual retailers might be unable to stay in business. Such retailers would not be helped by A.B. 420; they would be harmed. Franchised retailers who provide a variety of services to consumers may decrease in number because of government-imposed restrictions on the contracting process, and consumers desiring this variety of service would have fewer choices.

To the extent that A.B. 420 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.***

* See veto message of Governor Harris (copy attached).

** 1984 DOE Report, supra, at 97-98. Divorcement legislation has been introduced in forty states as well as in the United States Senate and House of Representatives since 1973. Five States and the District of Columbia have passed divorcement bills. Georgia's law was invalidated.

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

Conclusion: special interest legislation is
not necessary in Nevada gasoline distribution

For the reasons stated above, the staff of the Federal Trade Commission believes that A.B. 420's passage into law would likely have harmful consequences for both competition and consumers. We believe that A.B. 420 would serve only to insulate one segment of business entrepreneurs from competition, at the cost of higher gasoline prices for Nevada consumers and visitors.

For these reasons, the Federal Trade Commission's staff respectfully urges that the Nevada State Legislature not approve A.B. 420.

Sincerely,

Jeffrey I. Zuckerman
Director
Bureau of Competition