COMMISSION AUTHORIZED

PREPARED STATEMENT

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BEFORE THE

JOINT SUBCOMMITTEE STUDYING DIVORCEMENT
OF THE
VIRGINIA SENATE AND HOUSE OF DELEGATES

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Mr. Chairman and Members of the Joint Subcommittee: I am pleased to appear before you today to discuss the analysis by the staff of the Federal Trade Commission of S. 235 and related legislation affecting gasoline distribution markets in Virginia. Although the earlier submission of the staff's analysis and my appearance today were authorized by the Commission, my remarks reflect my own views and do not necessarily reflect the views of the Commission or of any individual commissioner.

I will give a brief summary of our earlier written comment on S. 235. I will also discuss briefly a recent study of a Maryland state agency that confirms our comment's conclusion that the existing Maryland divorcement law has harmed competition and consumers. I will then be glad to answer any questions.

The staff of the Commission opposed S. 235 as anticompetitive and harmful to consumers. The argument that refiner-owned and operated retail service stations are part of a collusive scheme to harm franchised dealers has no factual support in the record before this subcommittee. However, even if it did, existing antitrust laws such as the Sherman Act, the FTC Act, and Section 59 of the Virginia Code address possible anticompetitive practices more effectively than would legislation restricting new entry by potential competitors and regulating contractual relationships between suppliers and purchasers of gasoline.

The Bureau of Competition devotes substantial resources to monitoring the petroleum industry for antitrust violations and anticompetitive behavior. The staff in the Commission's Bureaus of Competition and Economics have considerable experience over the years in analyzing mergers[1] and claims of anticompetitive practices in the petroleum industry. They are presently monitoring petroleum price increases since Iraq's invasion of Kuwait under the Commission's antitrust enforcement authority.

The Antitrust Division of the Department of Justice also has announced that it is investigating claims of gasoline price fixing following Iraq's invasion of Kuwait, under its exclusive authority to seek criminal sanctions, including fines and

[1] The Commission has authorized antitrust challenges to several horizontal oil refinery mergers since 1981 that might have substantially lessened competition and harmed consumers. These included Mobil-Marathon, Gulf-Cities Service, Chevron-Gulf, Texaco-Getty, and Conoco-Asamera (Denver, Colorado refining market). In most of these cases, and in two others, Pacific Resources-Shell, and in Sun-Atlantic, the Commission also acted to prevent concentration increases at the more local distribution level for gasoline and other light petroleum products such as heating oil, downstream from the refinery level.

imprisonment for price fixing, under Section 1 of the Sherman Act.

I would add that present government scrutiny of the petroleum industry focuses on the possibility of a collusive scheme or conspiracy, because the industry's structure is less conducive to single firm monopoly power. Even Exxon, the largest refiner selling gasoline in Virginia, does not have its brand of gasoline in more than 15% of Virginia's gasoline stations. The other leading refiners selling gasoline in Virginia of course have even smaller market positions.

In this context, existing vertical integration between retail gasoline distribution and refining is unlikely to be harmful to competition and consumers, because the relevant stages of production (e.g., refining and distribution) are unconcentrated. As a broad generalization, economic theory says that vertical integration is likely to harm consumers only when market power exists in at least one stage of production.[2]

Moreover, I would conclude my summary of the earlier FTC staff statement by noting that, as a group, the largest refiners have the *lowest* incidence of company-owned and operated retail stations, in Virginia and in other states.[3] In contrast, the

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2 *See* Section 4.21 of the 1984 Department of Justice *Merger Guidelines*.

3 See our letter comment of March 3, 1990, noting that DOE reports in 1981 and 1984 found that the eight largest refiners, who in the aggregate accounted for about half of all gasoline sales, sold most of their refined gasoline through lessee dealers and sold only a very small amount through company-
(continued...)

majority of smaller, independent refiners' outlets *are* company-owned and operated.[4] Virginia's earlier divorcement law (passed in 1979) exempted all refiners' existing retail stations from divorcement requirements but prohibited new stations from being constructed within one and a half miles from existing franchisee-operated stations. Under the requirements of S. 235, all existing retail stations are again exempted from divorcement requirements, but no refiner may construct any *new* stations, regardless of their locations. Therefore, refiner-marketing divorcement in Virginia, which would adversely affect all refiners by limiting their ability to expand, would be most harmful to smaller, independent ones, because their inability to

[3](...continued) operated outlets. The Lundberg Letter confirmed similarly low proportions. Vol. XI, No. 36, July 6, 1984, at 3. A recent study contracted for by the American Petroleum Institute ("API") noted that the 14 largest integrated refiners, representing approximately 67% of the nation's refining capacity, had only about 10% of their gross gasoline sales and 4.5% of their outlets devoted to salary-operated retail stations. Temple, Barker & Sloan, Gasoline Marketing in the 1980s: Structure, Practices, and Public Policy at 2-3 (1988).

According to the National Petroleum News ("NPN") 1989 Factbook, at 34-51, the leading branded refiners in Virginia have the following percentages of their overall branded outlets nationally in company operations: Exxon (5.2%); Texaco (5.7%); Chevron (5.5%); Amoco (2.4%); Unocal (1.3%); Shell (2.6%); BP (14%); Mobil (6.5%).

[4] See the National Petroleum News ("NPN") 1989 Factbook, at 34-51, disclosing that 86% of Crown Central Petroleum Corp.'s outlets appear to be company operated. In 1985, Crown opposed federal divorcement legislation (S. 1140), noting that it would "threaten the survival of our limited presence in . . . Virginia, the Carolinas, Georgia, Florida and Alabama. . ."[Motor Fuel Sales Competition Improvement Act of 1985: Hearings on S. 1140 Before the Senate Committee on the Judiciary, 99th Cong., 1st Sess. 306 (1985)("S. 1140 Hearing"); emphasis added].

expand would prevent them from taking market share away from the major refiners.

In addition to this brief recap of the FTC staff statement last Spring, I would like to note one comment in particular among the broadly based comments already in your record from other representative persons and groups that have opposed either divorcement, open supply, or the asserted premises for such proposals.

Virginia's neighbor, Maryland, has had a divorcement law since 1973. The earlier FTC staff comment discussed the harmful effect of this law. In this regard, you are no doubt aware that a recent report by the Maryland State Department of Fiscal Services ("DFS") for the General Assembly of Maryland, concludes from its analysis of all existing studies, including those discussed in the FTC comment, that the Maryland divorcement law has resulted in higher gasoline prices for consumers. That report has already been submitted to the Joint Subcommittee by William S. Ratchford II, the DFS Director.

In conclusion, there appears to be no factual support for divorcement legislation, but there are compelling reasons to believe that such legislation would be harmful to competition and to Virginia consumers and visitors.

I thank you for your attention, and would be pleased to answer any questions.