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BUREAU OF COMPETITION

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

COMMISSION APPROVED

March 18, 1987

The Honorable Joe Frank Harris
Governor of Georgia
203 State Capitol Building
Atlanta, Ga. 30334

Dear Governor Harris:

The staff of the Federal Trade Commission is pleased to submit this letter in response to a request from Georgia House Minority Leader Johnny Isakson for comments on Senate Bill 177, the gasoline divorcement bill recently passed by the Georgia State Legislature and forwarded to you for your approval.* The Commission's staff** believes that S. 177 is anticompetitive and harmful to consumers and that, if it becomes law, Georgia motorists will pay higher prices for gasoline.

Description of S. 177

S. 177 would amend the part of the Official Code of Georgia relating to the regulation of gasoline marketing practices, by adding at the end a new section, Section 10-1-242. In essence, the bill would make it unlawful for a gasoline refiner to open a new retail gas station after July 1, 1988, or to continue to operate any retail stations after July 1, 1989. [Section 10-1-242(a)]. Violation of this new law would be a misdemeanor. [242(b)]. S. 177 further provides that any dealer injured by a violation of the statute may sue for damages or for an injunction. [242(c)].

The need for S. 177 is not supported by the record

Although no statement exists in the preamble of S. 177 concerning the purpose of the bill, representatives of the gasoline dealer group supporting the bill testified in the hearing that the bill was necessary to prevent "monopolistic" and "predatory" activities by major oil companies. According to their testimony, gasoline stations owned and operated by "big oil companies" are making it increasingly difficult for independent

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* 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 their submission.

** The Commission's staff has extensive expertise in energy competition issues based on studies, investigations, and

enforcement actions.

gas stations to survive. However, during the hearing a factual record was developed that contradicts the underlying premises of S. 177. According to those opposing the bill, including several House members, and small refiner-marketers and convenience stores with gasoline pumps, no major refiner such as Exxon, Shell, Chevron, Standard or Texaco has any significant number of company operated retail gasoline stations. Rather, two smaller refiners, Marathon and Crown, are the principal operators of refiner-operated retail gasoline outlets in Georgia. Only about four hundred stations out of a total of nine thousand stations in Georgia are refiner-owned. In fact the largest number of such stations is the seventy belonging to Marathon. Simple arithmetic reveals therefore that only about four percent of all gasoline stations in Georgia are refiner-operated, and only eight-tenths of one percent are operated by Marathon. Moreover, there is no evidence that this number has significantly increased in recent years. It appears from the legislative record, rather, that virtually all of the growth in new gasoline outlets in Georgia has been in the area of new jobber stations and convenience stores, such as Zippy Mart and Fast Fare.

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

Proponents of S. 177, like the supporters of similar legislation in other states,* maintain that its passage is

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* FTC staff comments have opposed passage of divorcement and below cost selling bills in North Carolina, South Carolina, Georgia (February 18th, before House Industry Committee, on S. 177), Washington, Hawaii, Alabama, Tennessee, and in the United States Senate and House of Representatives.

necessary to protect gasoline franchisees of major, integrated refiners from unfair and anticompetitive practices directed against them by their suppliers. They argue that it is inherently unfair for refiners to operate retail gas stations in competition with non-integrated independent dealers and franchised dealerships of major branded suppliers. 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 lessee dealers.

We are not aware of any evidence that such subsidization has occurred in Georgia 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") was required to study 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, 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.**

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

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

In its 1984 report, DOE concluded that the increased pressures on gasoline retailers since 1981 were not caused by anticompetitive behavior by 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. Instead, the studies indicate that the fortunes of refiners and their franchised dealer outlets are inextricably merged, and that the two groups "form a mutually supporting system backed by company advertising and promotion."** Lessee-dealers have continued to be by far the predominant form of retail outlet for the direct gasoline sales of major, integrated refiners.*** Only 3.3 percent of the gasoline stations in the United States are operated by major, integrated refiners.**** As discussed above, Georgia has an even smaller proportion of such major refiner-operated stations. Given the importance of the branded, franchised marketing distribution system to major refiners, traditional antitrust and economic theory indicates that it would be irrational for an individual major refiner to charge its lessee dealers prices that would cause them either to secure new sources of supply or to go out of business. The likely results of such a course of action in any gasoline market would be that the refiner would face a decrease in market share, an increase

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

in excess refining capacity, and higher per unit costs. Thus, individual gasoline franchisers are not likely to engage in predation against the mainstay of their own retail distribution system, their franchised dealers.

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 more rational scheme for dealing with anticompetitive practices in the industry than legislation requiring divorcement. The existing antitrust laws deter firms from engaging in predatory and monopolistic behavior, but, at the same time, allow them to lower their costs of operation through vertical integration. In contrast, the prohibition against refining/marketing integration found in S. 177 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 Georgia that do not exist in other states, costs that would be borne by Georgia consumers and visitors.

S. 177 would lead to higher gasoline prices

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 S. 177. 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 than they would have been

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

paying had the divorcement law not been enacted.* The adverse effects of divorcement resulted in the recent repeal of one of the few existing state divorcement laws, in Florida, as noted in the public record in the hearing on S. 177.**

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

As you recognized in vetoing a predecessor bill to S. 177, retail gasoline divorcement by refiners is anticompetitive and harmful to consumers. No difference in the language of the present bill would justify a different result here. The Supreme Court of Georgia has stricken all special interest legislation for the petroleum industry. Just last month it struck down the Georgia State legislature's latest attempt to impose a so-called "below-cost" gasoline pricing bill.***

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* See Barron & Umbeck, A Dubious Bill of Divorcement, Regulation, Jan.-Feb. 1983, at 29. See also Testimony of Pester Corp. and Crown Central Petroleum Corp., Hearings on S. 326 before the Senate Committee on the Judiciary, 97th Cong., 1st Sess. (Oct. 21, 1981) divorcement bill.

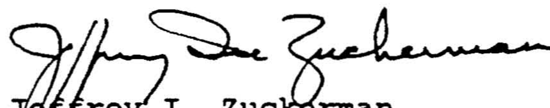
** Divorcement legislation was passed in five states and the District of Columbia in 1974. 1984 DOE Report at 98.

*** See companion cases of Strickland v. Ports Petroleum Company, Inc. and Georgia Association of Petroleum Retailers, Inc. v. Texaco, Inc., et al., Nos. 43435 and 43558. (February 16, 1987)[Slip Op. attached]. The Supreme Court cited its previous opinion in Batton-Jackson Oil Company, Inc. v. Reeves, 255 Ga. 480, 340 S.E.2d 16 (1986), which held such laws to be unconstitutional. The Court stated that it had stricken such laws "unreluctantly" because they "attempted to regulate and fix prices in industries that are not affected with the public interest."

For the reasons stated above, the staff of the Federal Trade Commission believes that S. 177's passage into law would likely have harmful consequences for both competition and consumers. We believe that S. 177 would serve only to insulate one segment of business entrepreneurs from competition, at the expense of causing higher gasoline prices for Georgia consumers.

For these reasons, the Federal Trade Commission's staff respectfully urges that you veto S. 177.

Sincerely,



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