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

Bureau of Competition
Office of Policy Planning

August 8, 2002

Governor George E. Pataki
The State of New York
New York State Capitol
Albany, NY 12224

Re: Bill No.S04522 (New York Motor Fuel Marketing Practices Act); Bill No. A06942 (An Act to Amend the General Business Law, in Relation to the Operation of Retail Service Stations)

Dear Governor Pataki:

The staff of the Office of Policy Planning and of the Bureau of Competition of the Federal Trade Commission welcome the opportunity to submit this letter in response to your request for comments on the "New York Motor Fuel Marketing Practices Act" (the MFMPA"), Bill No. S04522, and the amendment to Section 199-a of the General Business Law (the "Amendment"), Bill No. A06942.[1] The MFMPA would prohibit, *inter alia*, refiners and nonrefiners of motor fuel from selling motor fuels below refiner or nonrefiner cost respectively, where the effect is to injure competition. The Amendment would prohibit a crude oil producer or refiner from directly competing with its own franchised dealers within certain geographic areas.

We believe if both pieces of legislation are signed into law, they have a significant potential to harm consumers. Gasoline is a significant consumer expenditure; given constant demand, even a one cent increase in the retail price of gasoline would cost New York consumers approximately $57 million

[1] This letter expresses the views of the Bureau of Competition and of the Office of Policy Planning of the Federal Trade Commission. The letter does not necessarily represent the views of the Commission or of any individual Commissioner. The Commission has, however, voted to authorize us to submit these comments.

annually.[2]

At best, the MFMPA merely duplicates existing protections against "predatory pricing" found in federal antitrust law; at worst, it may discourage or even prevent competitive pricing. Similarly, considerable economic research shows that laws limiting intrabrand competition in gasoline harm, rather than promote, the competitive process, and can result in significantly higher prices to consumers. Our views can be summarized as follows:

With respect to the MFMPA,

- Low prices benefit consumers. Consumers are harmed only if, as a result of low prices, a dominant competitor is able later to raise the prices to supracompetitive levels.

- Scholarly studies and court decisions indicate that below-cost pricing that leads to monopoly rarely occurs.

- Past studies suggest that below-cost sales of motor fuels that lead to monopoly are especially unlikely.

- Where there is no danger that a monopoly might later be created, consumers are harmed by public policies that have the effect of increasing low prices that are the product of the competitive process.

- If the proposed legislation leads to higher prices in circumstances in which there is no danger of the lower prices leading to monopoly, then consumers will be harmed.

- The federal antitrust laws deal specifically with below-cost pricing that has a dangerous probability of leading to monopoly. The FTC, the Department of Justice's Antitrust Division, state attorneys general, and private parties can bring suit under the federal antitrust laws against anticompetitive below-cost pricing.

With respect to the Amendment,

- Consumers benefit if a private company decides to increase the number of retail outlets selling gasoline. The benefits come from locational advantages for some consumers, potentially increased "variety" (there are a variety of types of gasoline retailers, such as

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[2] *See* U.S. Energy Information Administration data available at http://www.eia.doe.gov/emeu/states/oilsales_trans/oilsales_trans_ny.html (showing New York daily average gasoline sales of 15,615,710 gallons between May 2001 and April 2002).

convenience stores, service stations, high volume stations with car washes, *etc.*), and the potential for increased competition.

- These potential benefits accrue whether new outlets are opened by existing retailers, wholesalers, or refiners.

- Economic research has demonstrated that retail gasoline prices increase when states enact laws prohibiting or limiting refiners' ability to own retail outlets that compete with the retail outlets of their branded dealers.

- Federal antitrust law recognizes that actions by a producer or manufacturer regarding limitations on "intrabrand" retail competition can have substantial procompetitive effects by promoting "interbrand" competition.

- "Interbrand" competition is the principal focus of federal antitrust law because vigorous interbrand competition maximizes consumer welfare.

I. Interest and Experience of the Federal Trade Commission

The Federal Trade Commission is charged by statute with preventing unfair methods of competition and unfair or deceptive acts or practices in or affecting commerce.[3] Under this statutory mandate, the Commission seeks to identify business practices that impede competition or increase costs without offering countervailing benefits to consumers. In particular, Commission staff have had considerable experience assessing the competitive impact of regulations and business practices in the petroleum industry.[4] On numerous occasions, the Commission staff have offered comments on

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[3] Federal Trade Commission Act, 15 U.S.C. § 45.

[4] In recent years, the Commission has investigated, among others, the mergers of Chevron and Texaco, Exxon and Mobil, and BP and Amoco – the three largest oil mergers in history – and the combination of the refining and marketing businesses of Shell, Texaco and Star Enterprises to create what was, at the time, the largest refining and marketing company in the United States. Last fall, the Commission investigated the proposed merger of petroleum refiners Valero Energy and Ultramar Diamond Shamrock. *See Valero Energy Corp.*, C-4031 (Dec. 18, 2001) (proposed consent order), *Chevron Corp.*, C-4023 (Dec. 18, 2001) (consent order); *Exxon Corp.,* C-3907 (Jan. 30, 2001) (consent order); *British Petroleum Company p.l.c.,* C-3868 (Apr. 19, 1999) (consent order); *Shell Oil Co.,* C-3803 (Apr. 21, 1998) (consent order).

The Commission has also conducted nonmerger investigations and workshops involving gasoline markets, and participates in relevant public comment opportunities. In March 2001, the

proposed state laws covering a variety of areas, including laws that would ban sales of motor fuels below cost or prevent "unfair" competition between refiner-owned and independent gas stations.[5] Section II below presents our views on the MFMPA. Section III presents our views on the Amendment.

II. Analysis of the MFMPA

A. Anticompetitive below-cost pricing is already illegal under federal antitrust laws.

Commission, using the competition analysis principles in the Merger Guidelines, completed an investigation of a spike in reformulated gasoline (RFG) prices in several Midwest states in the spring and summer of 2000. Midwest Gasoline Price Investigation, Final Report of the Federal Trade Commission (Mar. 29, 2001). Also in 2001, the Commission concluded its investigation of gasoline price increases in West Coast markets. *FTC Closes Western States Gasoline Investigation,* FTC Press Release (May 7, 2001). In addition, in August 2001, the Commission held an initial public conference to examine factors that affect prices of refined petroleum products in the United States. *FTC to Hold Public Conference/Opportunity for Comment on U.S. Gasoline Industry,* FTC Press Release (July 12, 2001). A second public conference was held in May 2002. *FTC to Hold Second Public Conference on the U.S. Oil and Gasoline Industry in May 2002*, FTC Press Release (Dec. 21, 2001). Commission staff also recently filed public comments with the Environmental Protection Agency concerning "boutique fuel" regulations. Comments of the Staff of the General Counsel, Bureaus of Competition and Economics, and the Midwest Region of the Federal Trade Commission, *Study of Unique Gasoline Fuel Blends ("Boutique Fuels"), Effects on Fuel Supply and Distribution and Potential Improvements,* EPA 420-P-01-004, Public Docket No. A-2001-20 (Jan. 30, 2002).

[5] *See, e.g.*, Letter from Joseph J. Simons, Director, FTC Bureau of Competition, and R. Ted Cruz, Director, FTC Office of Policy Planning to Hon. Robert F. McDonnell, Commonwealth of Virginia House of Delegates (Feb. 15, 2002) at http://www.ftc.gov/be/V020011.htm; Letter from Ronald B. Rowe, Director for Litigation, FTC Bureau of Competition, to Hon. David Knowles, California State Assembly (May 5, 1992); Prepared Statement of Claude C. Wild III, Director, FTC Denver Regional Office, before the State, Veterans, and Military Affairs Committee of the Colorado State Senate (Apr. 22, 1992); Letter from Claude C. Wild III, Director, FTC Denver Regional Office, to Hon. Bill Morris, Kansas State Senate (Feb. 26, 1992); Letter from Claude C. Wild III, Director, FTC Denver Regional Office, to David Buhler, Executive Director, Utah Department of Commerce (Jan. 29, 1992); Letter from Thomas B. Carter, Director, FTC Dallas Regional Office, to Hon. W.D. Moore, Jr., Arkansas State Senate (Mar. 22, 1991); Letter from Jeffrey I. Zuckerman, Director, FTC Bureau of Competition, to Hon. Jennings G. McAbee, Chairman, Ways and Means Committee, Other Taxes and Revenues Subcommittee, South Carolina House of Representatives (May 12, 1989).

If signed into law, the MFMPA would make it unlawful for refiners and nonrefiners of motor fuel to sell motor fuels below refiner or nonrefiner cost respectively, where the effect is to injure competition. "Refiner Cost" is defined as the posted terminal price of motor fuel adjusted for several factors, including taxes, freight charges, direct labor costs, and imputed rents. "Nonrefiner Cost" is defined as the invoice cost of motor fuel, also adjusted for taxes, freight charges, direct labor, rental value of the retail outlet, discounts, and other factors. The Act would also prohibit retail affiliates of a refiner from selling motor fuel at a price below the price charged by that refiner to wholesalers or other retailers within a relevant geographic market. Exceptions are made for inadvertent transgressions and for meeting competition.

We believe that the MFMPA is unnecessary to protect New York consumers. Anticompetitive below-cost pricing is already illegal under federal antitrust laws.[6] At best, therefore, the legislation is duplicative. It also, however, risks chilling procompetitive pricing strategies that would otherwise benefit New York consumers.

i. Antitrust law protects consumers, not competitors

The federal antitrust laws are fundamental to national economic policy. The antitrust laws are instrumental to our free market system because they ensure that markets remain competitive, efficient, and dynamic.

Under these laws, both the Federal Trade Commission and the Antitrust Division of the United States Department of Justice may bring enforcement actions against anticompetitive below-cost pricing. The federal government has launched several predatory pricing investigations and predatory unilateral conduct cases during the past several years.[7] In addition, private plaintiffs and state attorneys general have the right to bring predatory pricing cases. Under Section 4 of the Clayton Act, any person who has been injured in his business or property as a result of conduct forbidden by the antitrust laws can seek treble damages for that injury.[8] State attorneys general, acting as *parens patriae*, may also bring such actions.

Although anticompetitive below-cost pricing is illegal, the United States Supreme Court has

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[6] Predatory pricing claims are brought under Section 2 of the Sherman Act, 15 U.S.C. § 2. Plaintiffs can also claim anticompetitive predation under the Robinson-Patman Act, 15 U.S.C. § 13(a) (as amended).

[7] Notable examples include *American Airlines* and *Microsoft*. *See*, e.g., *United States v. AMR Corp.*, 2001-1 Trade Cas. (CCH) ¶ 73,251 (D. Kan. 2001); *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001).

[8] 15 U.S.C. § 15.

taken great pains to ensure that antitrust law is not used to prevent procompetitive price-cutting. It is axiomatic that the antitrust laws are intended for "the protection of competition, not competitors."[9] That is, the federal antitrust laws are intended to promote and maintain legitimate, vigorous price competition, irrespective of how individual competitors may fare in the face of such competition. Vigorous price competition forces producers to minimize costs and prices and to increase quality. Through this dynamic, consumer welfare is maximized because consumers reap the benefits of lower prices, greater variety, and higher quality goods and services. Indeed, the Court, in several important antitrust decisions, has been absolutely clear that consumer

welfare is the linchpin of the antitrust laws, and that low prices, as a general matter, are "a boon to consumers."[10]

ii. Only below-cost prices can be predatory

Indeed, the Supreme Court has spoken directly and definitively to the lawfulness of low pricing strategies. In *Brooke Group*, the seminal case in this area, the Court left no doubt that a decrease in a plaintiff's profits from a reduction in the defendant's prices, by itself, is not unlawful under the antitrust laws. "Low prices benefit consumers regardless of how those prices are set."[11] Rather, to be unlawful, the low prices, at a minimum, must be predatory. "[S]o long as they are above predatory levels, [low prices] do not threaten competition. . . . We have adhered to this principle regardless of the type of antitrust claim involved."[12] "[W]e have rejected elsewhere the notion that above-cost prices that are below general market levels or the costs of a firm's competitors inflict injury to competition cognizable under the antitrust laws."[13]

The Court has defined predatory pricing, in turn, as "pricing below an appropriate measure of [the defendant's] cost for the purpose of eliminating competitors in the short run and reducing

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[9] *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977) (quoting *Brown Shoe Co. v. United States,* 370 U.S. 294, 320 (1962)).

[10] *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 224 (1993); *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328 (1990); *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986).

[11] *Brooke Group*, 509 U.S. at 224.

[12] *Id.* (quoting *Atlantic Richfield Co.*, 495 U.S. at 340).

[13] *Id.* (citing *Atlantic Richfield Co.,* 495 U.S. at 340).

competition in the long run."[14] Although the Court has not stated what the appropriate measure of cost should be, prominent antitrust scholars and several federal circuit courts have concluded that the price-cutter's marginal costs, or a close proxy such as average variable costs, should be the yardstick.[15]

It is important to note that, whatever cost measure is chosen, the pertinent comparison is to the *price-cutter's* cost, not the costs of its rivals. If the price-cutter has lower costs, and thus is more efficient, than its rivals, no predatory pricing occurs when it prices above its own costs, irrespective of whether those prices are below its rivals' costs. "To hold that the antitrust laws protect competitors from the loss of profits due to such price competition would, in effect, render illegal any decision by a firm to cut prices in order to increase market share."[16]

iii. Not all below-cost pricing harms consumers

Below-cost pricing by itself, however, is insufficient under the antitrust laws to constitute a violation. Under federal law, consumers must also be injured, and consumers are not harmed by below-cost pricing *unless* sustained above-cost prices occur later on:

> [T]he short-run loss is definite, but the long-run gain depends on successfully neutralizing the competition. Moreover, it is not enough simply to achieve monopoly power, as monopoly pricing may breed quick entry by new competitors eager to share in the excess profits. The success of any predatory scheme depends on maintaining monopoly power for long enough

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[14] *Cargill, Inc. v. Monfort of Colorado, Inc.*, 479 U.S. 104, 117 (1986).

[15] *See Kelco Disposal, Inc. v. Browning-Ferris Indus.*, 845 F.2d 404, 407 (2d Cir. 1988), *aff'd on other grounds,* 492 U.S. 257 (1989) (finding that "[p]rices that are below reasonably anticipated marginal cost, and its surrogate, reasonably anticipated average variable cost, are presumed predatory"); *MCI Communications Corp. v. AT&T*, 708 F.2d 1081, 1122-23 (7th Cir.), *cert. denied,* 464 U.S. 891 (1983) (holding that no predatory intent can be presumed from prices at or above long run incremental cost); *International Air Indus. v. American Excelsior Co.*, 517 F.2d 714, 724 (5th Cir. 1975), *cert. denied*, 424 U.S. 943 (1976) (holding that plaintiff must show that "either (1) a competitor is charging a price below its average variable cost . . . or (2) the competitor is charging a price below its short-run, profit maximizing price and barriers to entry are great enough to enable the discriminator to reap the benefits of predation before new entry is possible"); P. Areeda and H. Hovenkamp, *Antitrust Law*, ¶ 724; P. Areeda and D. Turner, "Predatory Pricing and Related Practices under Section 2 of the Sherman Act," 88 *Harv. L. Rev.* 697 (1975). In *Brooke Group*, the parties both agreed that average variable cost should be the appropriate measure.

[16] *Brooke Group*, 509 U.S. at 223 (quoting *Cargill*, 479 U.S. at 116).

both to recoup the predator's losses and to harvest some additional gain.[17]

Thus, even if a below-cost pricing strategy succeeds in temporarily reducing the number of competitors, the price-cutter must be able to find a way to keep competitors from returning after it tries to raise prices again. Otherwise, the below-cost pricing strategy, which requires that the firm incur losses on every sale, will not succeed. When a firm is unable to recoup short-run losses (from sales at below-cost prices) in the long-run, consumers enjoy a windfall. And, without harm to consumers, an antitrust violation does not occur. "The second prerequisite to holding a competitor liable under the [federal] antitrust laws for charging low prices is a demonstration that the competitor had a reasonable prospect, or, under § 2 of the Sherman Act, a dangerous probability, of recouping its investment in below-cost prices. . . . Evidence of below-cost pricing is not alone sufficient to permit an inference of probable recoupment and injury to competition. . . . Although unsuccessful predatory pricing may encourage some inefficient substitution toward the product being sold at less than its cost, unsuccessful predation is in general a boon to consumers. . . . . That below-cost pricing may impose painful losses on its target is of no moment to the antitrust laws if competition is not injured. . . ."[18]

Given the strong stance of the Supreme Court in favor of the benefits of low prices and the care it has devoted to explaining what types of price cutting are illegal under the antitrust laws, it is doubtful that the MFMPA is necessary to prevent the same harms to consumers.[19]

B. Scholarly studies and court decisions suggest that anticompetitive below-cost pricing rarely happens.

To assess further whether this legislation is necessary, it may be helpful to consider the

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[17] *Matsushita Elec.*, 475 U.S. at 589.

[18] *Brooke Group,* 509 U.S. at 224, 226.

[19] The fact that the MFMPA would prohibit conduct only insofar as that conduct is found to "injure competition" would, at best, align the Act with federal law in this respect, and thus make the Act merely duplicative of federal law. Significantly, however, as noted in the discussion above, under federal law, competition is not considered harmed unless consumers are harmed. Mere injury to competitors is insufficient. *See, e.g., Rebel Oil Co., Inc. v. Atlantic Richfield Co.*, 51 F.3d 1421, 1433 (9th Cir. 1995) ("Of course, conduct that eliminates rivals reduces competition. But reduction of competition does not invoke the Sherman Act until it harms consumer welfare."). Whether or not New York state courts would interpret injury to competition similarly is not clear. Courts construing below-cost pricing statutes in other states have not always done so. *See, e.g., Home Oil Co. v. Sam's East, Inc.*, 2002 WL 857391 (M.D. Ala. Apr. 26, 2002). In addition, empirical evidence of the effect of state statutes similar to the MFMPA suggests that their enforcement has been focused more on competitor protection than on protection of competition. See Section II.D. below.

extensive scholarship and court decisions on anticompetitive below-cost pricing. In an exhaustive discussion of the topic, Judge Frank Easterbrook of the U.S. Court of Appeals for the Seventh Circuit noted that "[s]tudies of many industries find little evidence of profitable predatory practices in the United States or abroad. These studies are consistent with the result of actual litigation; courts routinely find that there has been no predation."[20]

More recent analyses largely confirm Easterbrook's conclusion. A leading textbook on industrial organization economics notes, "[g]iven all the problems in identifying predatory pricing, it is not surprising that economists and lawyers have found few instances of successful price predation in which rivals are driven out of business and prices then rise. Although predation is frequently alleged in lawsuits, careful examination of these cases indicates that predation in the sense of pricing below cost usually did not occur."[21] Predation sometimes occurs,[22] but not nearly as frequently as claimed.

Because it is difficult to profit from anticompetitive below-cost pricing, the Supreme Court, in keeping with scholarship on this point, has found that "there is a consensus among commentators that predatory pricing schemes are rarely tried, and even more rarely successful."[23] Therefore, the Court has emphasized the need to take great care to distinguish between procompetitive price cutting and anticompetitive predation because "cutting prices in order to increase business often is the very essence of competition. . . ."[24] "To hold that the antitrust laws protect competitors from the loss of profits due to . . . price competition would, in effect, render illegal any decision by a firm to cut prices in order to increase market share. The antitrust laws require no such perverse result.'[25]

In short, the legislation appears to address a problem that not only is already covered under federal antitrust law, but also is unlikely to occur in any event.

C. Past studies show that anticompetitive below-cost sales of motor fuels are

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[20] Frank H. Easterbrook, "Predatory Strategies and Counter-Strategies," 48 *U. of Chicago L. Rev*. 313 (1981).

[21] Dennis W. Carlton and Jeffrey M. Perloff. *Modern Industrial Organization* 342 (Addison-Wesley, 2000).

[22] *See* Jeffrey Church and Roger Ware, *Industrial Organization: A Strategic Approach* 659 (Irwin McGraw-Hill, 2000).

[23] *Matsushita Elec.*, 475 U.S. at 589.

[24] *Id.* at 594.

[25] *Cargill*, 479 U.S. at 116.

especially unlikely.

A series of studies suggests that anticompetitive below-cost pricing is especially unlikely in gasoline retailing. Laws to prevent anticompetitive below-cost pricing of motor fuels have been debated extensively during the past two decades. The issue originally arose in the 1980s, when various parties expressed concern that major oil companies were selling gasoline below cost in order to drive independent stations out of business. Numerous states considered enacting legislation similar to the MFMPA. The U.S. Department of Energy (USDOE) conducted a comprehensive investigation of predatory pricing allegations in gasoline markets.

In 1984, USDOE released a final report to Congress examining whether vertically integrated refiners were "subsidizing" their retail gasoline operations in a way that might be predatory or anticompetitive. The study was based on an extensive study of pricing data and internal oil company documents subpoenaed by the USDOE. USDOE found that there was no evidence of predation or anticompetitive subsidization. The agency concluded that increased pressures on gasoline retailers were not caused by anticompetitive behavior on the part of the major 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 in some areas and a continuing trend toward the use of more efficient, higher-volume retail outlets.[26]

Since 1996, the Commission has investigated the pricing practices of virtually every major oil company, and Commission staff have found no convincing evidence of predatory pricing in the retail gasoline market. In several recent investigations, the FTC has expressed concern about unduly high concentration levels in certain gasoline markets. In these cases, however, the Commission was concerned that concentration, among other things, could lead to *higher*, not predatory (lower), gasoline prices.

Several states have also conducted their own studies. In 1987, a Joint Legislative Study Committee created by the Arizona legislature recommended that no new legislation be enacted to restrict the pricing of motor fuels in Arizona. "The marketplace for petroleum products is very competitive in Arizona," the committee concluded.[27]

In 1986, the Washington State Attorney General initiated a study of motor fuel pricing to determine whether refiners were engaged in anticompetitive subsidization of company-owned service

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[26] USDOE, *Deregulated Gasoline Marketing: Consequences for Competition, Competitors, and Consumers* (March 1984); USDOE, *Final Report: The State of Competition in Gasoline Marketing* (1981).

[27] Final Report to the Arizona Joint Legislative Study Committee on Petroleum Pricing and Marketing Practices and Producer Retail Divorcement 35 (Dec. 1988).

stations. Information was gathered on the practices of all eight of the major companies in Washington for a three-year sample period. The Washington study found that lessee-dealers paid essentially the same prices as company-owned stations more than 99 percent of the time.[28]

More recently, the Commonwealth of Pennsylvania conducted a study examining a variety of proposals for legislation affecting retail gasoline sales in the state. The report extensively analyzed "sales below cost" laws and declined to recommend that Pennsylvania enact one. In fact, the Pennsylvania study raised significant doubts about the theory that gasoline retailers were engaging in anticompetitive below-cost pricing, and it warned that a "sales below cost" law might harm consumers more than it would help them:

> Unfortunately, such laws may serve to deter, rather than enhance, competition. The reason for such deterrence is that it may open up firms who engage in low, but non-predatory, pricing to litigation. Seeing the threat of litigation, such firms may change strategy and charge consumers higher prices.[29]

Competitors will, of course, sometimes complain that the competition charges prices that are too low. Competitors have an incentive to do so if they believe such complaints will lead to legislation that will allow them to charge higher prices. Thus far, no systematic study has produced evidence that predatory pricing is likely to be a significant problem in retail gasoline markets.

D. If enforced vigorously, the legislation could harm consumers by increasing the price of motor fuels.

As noted above, anticompetitive price-cutting is already illegal under federal antitrust laws. We believe that this legislation could outlaw more types of pricing behavior than federal antitrust laws do, and therefore it runs the risk of penalizing procompetitive price-cutting that benefits consumers.

During the past two decades, a growing body of empirical economic research has assessed the impact of state "sales below cost" laws on retail gasoline prices. Most studies find these laws raise gasoline prices or leave them unchanged. Some suggest that the laws raise retail gasoline prices by one

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[28] Final Report to the Washington State Legislature on the Attorney General's Investigation of Retail Gasoline Marketing 14 (Aug. 12, 1987).

[29] Commonwealth of Pennsylvania, Legislative Budget and Finance Committee, *Factors Affecting Motor Fuel Prices and the Competitiveness of PA's Motor Fuels Market* 35 (Oct. 2000).

or two cents per gallon.[30] One study currently in draft form finds that these laws increase gasoline prices initially and lower them in subsequent years, but it is not clear whether these findings meet economists' customary standards for statistical significance.[31] Many of the studies suffer from methodological problems that make it unclear whether they are measuring the impact of sales below cost laws or something else. The most carefully-controlled study, conducted by a senior economist in the FTC's Bureau of Economics, found that the laws had no effect on retail prices.[32]

The most likely explanation for these varied findings is that such laws are often difficult to enforce or are enforced unevenly. Therefore, it is possible that the mere existence of such a law has a limited effect on retail gasoline prices. Vigorous and sustained enforcement, however, could lead to a significant chilling effect on competition that might increase retail gasoline prices.

III. Analysis of the Amendment to Section 119-a of the General Business Law.

The Amendment to Section 199-a of the General Business Law would make it unlawful for a crude oil producer or refiner to compete directly with its own franchised dealers. A producer or refiner-owned or managed dealer will be considered directly competing with a franchised dealer when the former is located within one and one-half miles of the latter in counties with population in excess of 900,000; and two miles in all other counties. The provision will automatically expire three years after its effective date.

In its seminal case examining the potential competitive effects arising from relationships between a supplier and its dealers, the Supreme Court observed that "[i]nterbrand competition [as opposed to intrabrand competition] . . . is the primary concern of antitrust law."[33] In *Sylvania*, the Court recognized that assessing the overall competitive impact of actions that adversely affect intrabrand

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[30] *See, e.g.*, R. Anderson and R. Johnson, "Antitrust and Sales-Below-Cost Laws: The Case of Retail Gasoline," *14 Rev. of Ind. Org.* 189 (1999); R. Fenili and W. Lane, "Thou Shalt Not Cut Prices! Sales-Below-Cost Laws for Gas Stations," 9 *Regulation* 31; J. Brannon and F. Kelly, "Pumping Up Prices in Wisconsin: The Effects of the Unfair Sales Act on Retail Gasoline Prices in Wisconsin," 12:7 Wisconsin Policy Research Institute Report (Oct. 1999).

[31] M. Skidmore and J. Peltier, "Do Motor Fuel Sales-Below-Cost Laws Enhance Competition and Lower Prices?," unpublished manuscript, University of Wisconsin-Whitewater.

[32] *See* Michael G. Vita, "Regulatory Restrictions on Vertical Integration and Control: The Competitive Impact of Gasoline Divorcement Policies," 18 *J. of Reg. Econ.* 217 (2000).

[33] *Continental TV, Inc., v. GTE Sylvania, Inc.*, 433 U.S. 36, 52 n.19 (1977).

competiton are complex, because such actions can simultaneously stimulate interbrand competition.[34] For this reason, the Court held that in deciding the lawfulness of supplier policies affecting intrabrand competiton, courts should apply a "rule of reason" which weighs the procompetitive effects of an act against the competitive harm, if any.[35]

In so holding, the Court noted that "[t]he degree of intrabrand competition is wholly independent of the level of interbrand competition confronting the manufacturer. . . . But when interbrand competition exists, . . . it provides a significant check on the exploitation of intrabrand market power. . . ."[36] The Court further took note of and relied on the fact that "[e]conomists also have argued that manufacturers have an economic interest in maintaining as much intrabrand competition as is consistent with the efficient distribution of their products."[37] In addition, "[m]arketing efficiency is not the only legitimate reason for a manufacturer's desire to exert control over the manner in which his products are sold and serviced. As a result of statutory and common-law developments, society increasingly demands that manufacturers assume direct responsibility for the safety and quality of their products."[38]

In light of *Sylvania*, the federal courts and the enforcement agencies show considerable deference to business strategies that affect the degree and nature of intrabrand competition. Such strategies are typically efficiency-enhancing. Only when such strategies are a mere guise for horizontal collusion among manufacturers or dealers – thus adversely affecting interbrand competition – are the anticompetitive effects generally likely to outweigh procompetitive effects.

We believe therefore that state statutes that attempt to regulate intrabrand competition risk producing consequences detrimental to consumers. These laws raise costs by forcing continued use of potentially inefficient or outmoded distribution arrangements and limit the ability of manufacturers to find the most effective means to compete across brands. Economic studies, moreover, strongly support this conclusion.

In particular, economic studies of laws limiting refiners' ability to open new or maintain ownership of existing retail gasoline stations have found that these distribution restrictions have the tendency to raise prices and reduce investment in retailing assets. Some such laws completely prohibit

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[34] *Id.* at 51.

[35] *Id.* at 59.

[36] *Id.* at 52 n.19.

[37] *Id.* at 56.

[38] *Id.* at 55 n.23.

refiners from owning any retail outlets; others, like the Amendment to Section 119-a, are "partial" in the sense that they prohibit refiners from establishing new retail outlets within a certain distance of existing branded dealers. Economic research consistently shows that both types of laws harm consumers:

- A National Bureau of Economic Research study found that company-operated stations can be the most efficient form of management for high volume, low service gasoline stations. This suggests that incentives for investment in retailing assets will be reduced in states with restrictive legislation.[39]

- A time series study showed that forced divestiture of refiner-owned stations in Maryland raised self-service prices by 1.4 to 1.7 cents and full service prices by 5 to 7 cents per gallon at stations that were formerly company-operated. Furthermore, these stations reduced their operations by nine hours per week. Other stations in the locale of the divested stations also raised prices.[40]

- A cross-sectional study by an FTC senior economist estimated that statutes prohibiting or limiting refiners from owning retail gasoline stations raised retail gasoline prices by 2.6 cents per gallon compared to states without this legislation.[41] That figure is best interpreted as an average effect for several types of statutes. Some statutes forced refiners to divest stations, while others "grandfathered" existing stations. Different statutes had been in effect for different lengths of time, and it is likely that the older statutes have more significant effects, since they prevent refiners from opening new stations in response to demographic shifts. This study suggests that states sacrifice efficiencies and increase retail gasoline prices when they curtail refiners' ability to open or operate retail outlets.[42]

Based on these studies, we conclude that ultimately the Amendment to Section 119-a likely would increase costs and raise retail gasoline prices in New York.

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[39] A.A. Blass and D.W. Carlton, "The Choice of Organization Form in Gasoline Retailing and the Costs of Laws Limiting that Choice," NBER Working Paper #7435 (1999).

[40] J.M. Barron and J.R. Umbeck, "The Effect of Differenct Contractual Arrangements: the Case of Retail Gasoline Market," 37 *Journal of Law and Economics 313 (1984).*

[41] See Vita, *supra* note 32.

[42] Vita concluded that legislation prohibiting or limiting refiners from owning retail gas stations increased gasoline prices by 2.6 cents per gallon and reduced consumer welfare by approximately $112 million annually in the six states that have such legislation.

IV. Summary and Conclusions

For the reasons stated above, we believe that the MFMPA would be more likely to harm than to promote competition. The legislation addresses a problem that is unlikely to occur. To the extent that anticompetitive below-cost pricing is a danger in the retail gasoline market, federal antitrust laws are sufficient to deal with the problem. Moreover, the additional layer of state law could significantly deter procompetitive price-cutting at the gas pump.

We similarly believe that the Amendment to Section 199-a of the General Business Law would restrain, rather than enhance, retail competition in motor fuels, because it places limits on the ability of individual crude oil producers and motor fuel refiners to develop the most efficient level of intrabrand competition for their products. In so limiting, the Amendment would likely raise costs, restrain interbrand competition, and ultimately raise retail gasoline prices in New York.

In short, in the judgment of the Office of Policy Planning and Bureau of Competition of the Federal Trade Commission, Bill No. S04522 and Bill No. A06942, if signed into law, are likely to raise prices significantly at the gas pump, to the detriment of New York consumers.

Respectfully submitted,

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