COMMISSION APPROVED

FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

OFFICE OF
THE CHAIRMAN

December 23, 1985

Honorable Peter K. Apo
House of Representatives
State of Hawaii
Honolulu, Hawaii 96813

Dear Mr. Apo:

Thank you for your letter dated November 6, 1985, enclosing copies of Hawaii House Bill 1376, "A Bill For An Act Relating To The Retail Sale of Gasoline," and Standing Committee Report No. 273 on that bill, dated March 1, 1985. As your letter states, the purpose of H.B. 1376 is to prohibit producers, refiners, or their affiliates from establishing and operating new retail gasoline operations in Hawaii. Your letter requests the Commission's views on the proposed bill. H.B. 1376 is similar to other legislation offered in the United States Senate and House, and in various state legislatures, to rectify purported market failures and antitrust problems in gasoline markets. As explained in this letter, the Federal Trade Commission and its staff have consistently opposed such legislation as anticompetitive and harmful to consumers.[1] The Commission strongly opposes H.B. 1376 as similarly anticompetitive and harmful.

The bill would prohibit petroleum products producers and refiners from opening or operating new retail motor fuel stations after July 1, 1986; producer or refiner-owned stations in existence prior to that date would not be affected. [Section 1-2] Violation of the proposed Act's prohibition could result in

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1 In response to requests for analysis of proposed legislation, the Commission has previously authorized its staff to file comments opposing passage of South Carolina House Bill 2663 (marketing divorcement and below cost selling); North Carolina Senate Bill 73 (below cost selling); and Washington Senate Bill 3418 (marketing divorcement). The FTC's staff has also been authorized to present testimony in opposition to United States Senate Bill 1140 in 1985 (marketing divorcement); United States House Resolution 5023 in 1984 (below cost pricing); and House Resolution 1362 in 1981 (marketing divorcement and below cost selling).

the imposition of injunctive relief and damages in a civil action in the circuit court of the circuit where the violation allegedly occured. An action may be brought by any person, firm, or corporation engaged in wholesale or retail motor fuel distribution who is injured by a violation of the Act. [Section 1-3]

The copy of Standing Committee Report No. 273 enclosed with your letter states that the bill's prohibition against new refiner-owned operations is designed in part to "protect the retail service station operator," noting that, in recent years, the number of retail gasoline stations has "decreased drastically, while more 24-hour, self-service stations are being opened." The report reflects concern that "if the self-service trend continues in Hawaii, there will be fewer jobs, fewer locations with repair facilities, and inconveniences for consumers unable to pump their own gasoline."

The report premises the bill on the statements of the Hawaii Automotive and Retail Gasoline Dealers Association and the Service Station Dealers of Oahu that dealers are being "driven out of business" by the trend toward reduction in numbers of traditional retail gasoline stations in favor of "more 24-hour, self-service stations . . . ." It concludes that, unless H.B. 1376 is passed, "the current two and three tier system of retail sale of gasoline would be eliminated," resulting in "a one tier monopoly with no service or repair facilities at self service stations. . . ."

The report's concern that the trend toward high-volume, self-service gasoline stations in recent years will result in a monopoly is unwarranted. The self-service trend is nationwide, and is not a result of monopolistic acts or practices by refiners and their company retail operations; rather, it represents a natural evolution in gasoline marketing that is beneficial both to retailers and to consumers.[2]

The report's fear that consumer patronage of gasoline-only stations will result in a lack of available repair facilities is equally incorrect. Automobile repair services can be, and are,

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2 Despite the nationwide shift of gasoline retailing away from provision of related automobile service and repair work, Petroleum Administration Defense District Five ("PADD 5"), or the West Coast, including Hawaii, has the highest percentage of retail stations in the United States with three or more service bays. Lundberg Letter, Vol. XII, No. 43, August 23, 1985, at 3.

offered by a variety of businesses other than retail gasoline stations, such as automobile dealers and department stores. The trend toward gasoline-only stations suggests that many consumers prefer to purchase gasoline and repair services separately, taking advantage of lower prices that may be available.

The report therefore contains no valid support for H.B. 1376, which is simply a protectionist measure designed to exempt one class of business, low-volume gasoline retailers, from the competitive process. Its passage will not protect inefficient gasoline marketers from high-volume, self-service marketers, and will only result in higher prices to consumers for gasoline.

In response to calls for similar protectionist legislation in the 1970's, Congress ordered the Department of Energy to investigate and report on the purported threat of refiner-owned and operated retail service stations.[3] The Department of Energy's ("DOE's") 1981 report[4] was based on an extensive study of pricing data in several Standard Metropolitan Statistical Areas for 1978, as well as on internal oil company documents subpoenaed by the DOE staff. The study concluded that there was no evidence of monopolistic or predatory practices by refiners through use of their company operations.

In 1984, DOE published a report that substantiated and extended the conclusions of its 1981 report.[5] The 1984 report presented DOE's findings that, since the early 1970's, a decrease in the traditional gasoline station population was not the result of anticompetitive behavior by refiners and producers of gasoline. Rather, the decline in the overall number of retail outlets and the intensification of competition among gasoline marketers in all areas of the United States resulted from decreased consumer demand for gasoline and other light refined products through conservation measures and fuel switching, and a continuing trend toward the use of more efficient, high-volume retail outlets.[6] Statistics published by DOE and industry

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3 Title III of the Petroleum Marketing Practices Act ("PMPA"), 15 U.S.C. § 2841 (1976).

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

5 DOE, Deregulated Gasoline Marketing: Consequences for Competition, Competitors, and Consumers, Jan. 1984 draft report.

6 Id. at 125-32.

publications, such as the Lundberg Letter, indicate that since federal controls were removed in 1981, the public has been the beneficiary of vigorous price competition among wholesale and retail gasoline marketers.

To the extent that H.B. 1376 is premised on the perception of anticompetitive practices, DOE case studies have revealed no pattern of predatory behavior on the part of gasoline refiners. These findings are entirely consistent with the plain fact that the fortunes of major refiners and their franchised outlets are inextricably linked, and that the two groups "form a mutually supporting system backed by company advertising and promotion."[7] Indeed, lessee-dealers have continued by far to constitute the largest outlet for direct gasoline sales of the largest refiners,[8] and only 3.3 percent of the gasoline stations in the United States are operated by the major, integrated refiners themselves.[9]

Allegations of oil company anticompetitive practices and behavior are therefore not supported by credible evidence or logic. Certainly, as a group, the major refiners have not been engaged in predation against their branded franchisees, who constitute the mainstay of their distribution network. Nor does it seem reasonable to conclude that individual oil producers and refiners have in any way been attempting to drive their own franchisees out of business by operating company-owned retail outlets.[10]

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7 Id. at ii.

8 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 refiner-owned retail outlets. Id. at 146 (Table A-10).

9 Lundberg Letter, Vol. XI, No. 36, July 6, 1984, at 3. These figures are also consistent with the high incidence of lessee-dealer retailing as the predominant form of gasoline marketing in Hawaii, as noted by your letter. Because Chevron and Unocal reportedly emphasize traditional automobile services through their franchised lessee-dealers (Lundberg Letter, Vol. XXII, No. 43, August 23, 1985, at 3), the prominence of those two companies in Hawaii would appear to discount the concerns underlying H.B. 1376.

10 See notes 6 and 7 supra and accompanying text.

Even if predatory or monopolistic behavior by refiners and producers were to exist, it could be reached under the Sherman Act, the Clayton Act, or the Federal Trade Commission Act. The antitrust laws deter firms from engaging in predatory behavior, but, at the same time, allow them to lower their costs through vertical integration. In contrast, H.B. 1376 would absolutely prohibit refiners from engaging in retail marketing. By denying firms the likelihood of increasing efficiency through vertical integration, this legislation would add costs to the distribution of gasoline in Hawaii, costs that would undeniably be borne by consumers.

The potential harm of legislation to limit vertical integration between gasoline refining and distribution is illustrated by the experience of Maryland, which has required vertical divestiture through retail divorcement legislation. One study,[11] described by DOE as perhaps "the best empirical analysis of the effects of Maryland's divorcement law,"[12] has estimated that Maryland consumers are now paying millions of dollars more per year than they would have been paying if the divorcement law had not been enacted.

The Commission concludes that H.B. 1376's proposed ban on new refiners and producer gasoline retail operations, if enacted, is likely to harm both competition and consumers. As competition among gasoline marketers has intensified in recent years, most retail dealers have recognized the need to change with the times by operating more efficient, high-volume outlets. Protectionist legislation such as H.B. 1376 would interfere with this necessary competitive process; it would unquestionably increase the costs of gasoline distribution, eliminate legitimate price competition, and raise prices for motor fuel to consumers.

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11 See Barron & Umbeck, A Dubious Bill of Divorcement, Regulation, Jan.-Feb. 1983, at 29. See also Hearings on S. 326 Before the Senate Comm. on the Judiciary, 97th Cong., 1st Sess. (Oct. 21, 1981) (Testimony of Pester Corp., and Crown Central Petroleum Corp.); Barron & Umbeck, The Effects of Different Contractual Arrangements; The Case of Retail Markets, 27 J. Law & Econ. 313 (1984).

12 DOE, Deregulated Gasoline Marketing: Consequences for Competition, Competitors, and Consumers, Jan. 1984 draft report at 105.

For these reasons, the Federal Trade Commission urges that H.B. 1376 not be enacted.

By the direction of the Commission.

Terry Calvani
Acting Chairman