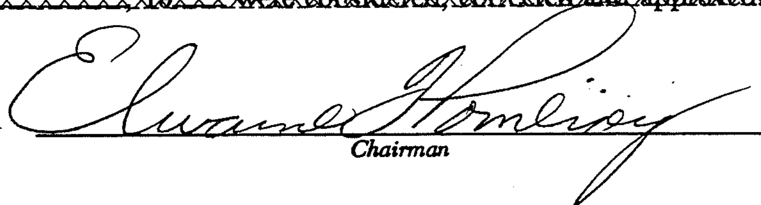
MINUTES OF THE SENATE COMMITTEE ON JUDICIARY

Held in Room 519 S, at the Statehouse at 10:00 a. m./p. m., on February 21, 1979.

All members were present except: Senators Steineger, Gaar and Hein

The next meeting of the Committee will be held at 12:00 a. m./p. m., on February 21, 1979

~~These minutes of the meeting held on ________________, 19___ were considered, corrected and approved.~~



Chairman

The conferees appearing before the Committee were:

Senator Paul Feleciano
Senator Bert Chaney
Tom G. Platis - Highway Oil, Inc.
Jack Quinlan - Independent Committee for Refiners and Marketers
Jack Pester - Pester Refining Company
Steven D. Cox - Pacer Oil Company
Senator Jan Meyers
Jacquelyn Hampton - Kansas Children's Service League, Kansas City
Ed Podmore - Catholic Social Service
Charles Hamm - Social and Rehabilitation Services

Staff present:
Art Griggs - Revisor of Statutes
Jerry Stephens - Legislative Research Department
Wayne Morris - Legislative Research Department

Senate Bill No. 312 - Right to Buy Act, prohibiting certain sales practices. The author of the bill, Senator Berman, waived a hearing on the bill in order to provide more time for the hearing on Senate Bill 314. Since no one had appeared on Senate Bill 312, the request was granted.

Senate Bill No. 314 - Producers and refiners of petroleum products prohibited from operating retail gasoline stations. One of the authors of the bill, Senator Feleciano, testified and explained the bill. A copy of his statement is attached, as well as a copy of a law review article presented to the committee by him.

Senate Bill 327 - Motor vehicle fuel manufacturers, retail service station operations prohibited. Senator Chaney testified in support of this bill, which is identical to Senate Bill 314, although the wording in the titles to the two bills are slightly different. He stated that these bills present a policy decision, and that it is a philosophical question as to what degree of competition in the petroleum industry is desired.

Senate Bill No. 314 - Producers and refiners of petroleum products prohibited from operating retail gasoline stations. Tom Platis testified in support of the bill. A copy of his statement is attached. Also attached is a copy of a statement from the

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

CONTINUATION SHEET

Minutes of the Senate Committee on Judiciary February 21, 1979.

SB 314 continued -

Department of Energy, Office of Competition. Mr. Platis testified that without this legislation, it will be just a matter of time when there will be no independent marketers and no effective competition.

Jack Quinlan spoke in opposition to the bill. A copy of the position paper of the Independent Refiners Marketers is attached. He stated that these bills would absolutely prohibit gasoline manufacturers and retailers from operating salaried retail gasoline service stations in Kansas.

Jack Pester testified in opposition to the bills. A copy of his testimony is attached. He stated that in Kansas there are approximately 3,000 service stations in business; 193 are refiner operator stations; of those only 30 are operated by major oil companies, and the remaining 163 are independently operated.

Steven D. Cox appered and presented his written statement. A copy is attached.

Due to the lack of time for all who wish to appear on these bills to present testimony, arrangements were made for a special meeting of the committee at 12:00 noon today.

Senate Bill No. 326 - Relinquishment of illegitimate children. The author of the bill, Senator Meyers, explained the bill. She said this bill involved only relinquishment. Committee discussion with her followed.

Jacquelyn Hampton, of the Kansas Children's Service League, testified in support of the bill. She related problems the league has on adoption procedures when the father cannot be located.

Ed Podmore testified in support of the bill. A copy of his statement is attached. He stated the bill would give clear guidelines to the court in considering termination of parental rights for children relinquished for adoption.

Charles Hamm testified that the SRS department supports the bill.

A spokesman for the National Association of Social workers stated the association supports the bill.

The meeting adjourned.

These minutes were read and approved by the committee on 4-25-79.

2-21-79

GUESTS

SENATE JUDICIARY COMMITTEE

NAME	ADDRESS	ORGANIZATION
JAMES D. HOUK	TULSA, OKLA.	CHAMPLIN PETRO. Co.
JAMES SAILER	FT. WORTH, Tx	Champlin Petroleum Co.
MARVIN TAYLOR	Wichita Ks.	Derby Refining Co
Bob Keeshan	Topeka	CIRM
Mary Hudson	Kansas City	Hudson Oil Co
[illegible]	Des Moines, Ia.	Poster Refining Co.
Amos Kramer	Wichita	KPC
Jim Eland	Lawrence	Continental Oil Co
Steven Cox	KC, Ks	Pacer Oil Co.
R.S. SNIDER	WICHITA	VICKERS PETROLEUM
Charles Nicolay	Topeka	KOMA
Ellen Richardson	Box 5314 Topeka	Kansas Children's Service League
Jacquelyn Hampton	1125 N. 5th Kansas City	Kansas Children's Service League / Black Adoption Program
[illegible]	[illegible] Ottawa	Mid Cont Oil & Gas
Walter [illegible]	Topeka	East Ks Oil & Gas Assn
George [illegible]	[illegible]	Mobil
Bill Rinehart	Tulsa, OK	Gulf Oil
Helen Platis	Topeka	
Connie Toner	Topeka	
Steve Folger	Holton	
Beck Williams	Holton	
Sheryl Bishop	Holton	
Tracy Hauck	Holton	
Theresa Ehrhart	Holton	

GUESTS

SENATE JUDICIARY COMMITTEE

NAME	ADDRESS	ORGANIZATION
Mary E. Ballard	Holton	
Lisa Christensen	Holton	
Terri Beightel	Holton	
Julie Bleier	Holton	
Bud Grant	Topeka	KACI
Richard Norris	K.C.	Standard Oil (Ind.)
Ron Betz	Bartlesville, OK	Phillips Pet.
Roy L. First	Topeka, Ks	Ks Petro Council
Dave Brasher	Des Moines, Iowa	National Federation of Independent Business
Jesse W. Prisock	Wichita	Kansas Assoc. of Broadcasters
Phil Osborne	Blue Rapids	Interested citizen
Tom H. Platz	9980 S.W. K-4 Highway	Highway Oil, Inc.
Chuck Engel	Topeka	KMCDA
Marvin C. Umholtz	Lawrence	KCUL

2-21-79

Testimony of

Senator Paul Feleciano, Jr.

before the

Senate Judiciary Committee

Wednesday, February 21, 1979

MR. CHAIRMAN, MEMBERS OF THE COMMITTEE:

SENATE BILL 314 PROVIDES FOR MOTOR VEHICLE FUELS TO BE SOLD BY INDEPENDENT DEALERS AND PROHIBITS FUEL MANUFACTURERS FROM PARTICIPATING IN DIRECT RETAIL ACTIVITY. THE BILL IS MODELED AFTER A 1974 MARYLAND STATUTE UPHELD 7 TO 1 BY THE UNITED STATES SUPREME COURT LAST YEAR.

FOUR MARKETING LEVELS - - PRODUCTION, REFINEMENT, DISTRIBUTION AND RETAIL - - CAN BE IDENTIFIED IN THE OIL INDUSTRY. THE RETAIL LEVEL IS THE ONLY ONE WITH MEANINGFUL FREE MARKET ACTIVITY. THE NON-COMPETITIVE ASPECTS OF JOINT EXPLORATION, JOINT PIPELINE OWNERSHIP AND CONTROL, INTERLOCKING DIRECTORATES, AND REGIONAL EXCHANGE OF CRUDE OIL SUPPLIES ARE WELL DOCUMENTED. (SEE 30 VANDERBILT LAW REVIEW 1115).

DURING THE 1973 OIL EMBARGO THE GOVERNOR OF MARYLAND RESPONDED TO COMPLAINTS OF INEQUITABLE DISTRIBUTION OF GASOLINE SUPPLIES AMONG RETAILERS BY ORDERING A STATE COMPTROLLER MARKET SURVEY. HE

FOUND MARYLAND STATIONS OPERATED BY PRODUCERS RECEIVED PREFERENTIAL TREATMENT. THE MARYLAND ACT WAS THE RESULT OF THAT STUDY.

SINCE THE 1973 EMBARGO, THE INDUSTRY HAS BEEN INCREASING ITS STRANGLEHOLD IN THE RETAIL MARKET. STUDIES BY THE OIL INDUSTRY ITSELF (AMERICAN PETROLEUM INSTITUTE) AND THE DEPARTMENT OF ENERGY INDICATE WHILE TOTAL RETAIL OUTLETS DECLINED 12% BETWEEN 1972 AND 1977, AND INDEPENDENTS DECLINED 11% BETWEEN 1974 and 1976, REFINER OWNED OUTLETS INCREASED 70%.

KANSAS INDEPENDENT SERVICE STATION OPERATORS WERE INJURED BY THESE PRACTICES DURING THE OIL EMBARGO, AND ARE THREATENED WITH ELIMINATION BY THESE MARKET TRENDS.

THE MAJOR OPPOSITION TO THIS BILL COMES FROM THE GIANT PRODUCERS THEMSELVES, MAINLY THROUGH THE AMERICAN PETROLEUM INSTITUTE (API), ONCE DESCRIBED BY CLARENCE DARROW AS "THE SWITCHBOARD OF THE CONTROLLING (OIL) COMPANIES." THE API STATEMENTS ON POSSIBLE IMPACTS OF DIVESTITURE AMOUNT TO MERE SABRE RATTLING OF "SUPPLY UNCERTAINTIES", INCREASED EXPENSES AND INVESTMENTS, AND POSSIBLE LOSS OF "MARKETING SUPPORT" SUCH AS ADVERTISING, PROMOTIONS, DEALER TRAINING AND HIGH INTEREST CREDIT CARD SYSTEMS. THIS LEGISLATURE SHOULD TAKE THESE SUGGESTIONS FOR WHAT THEY ARE, THE THREATS OF A

SPOILED MONSTER WHO WANTS TO HAVE EVERYTHING ITS WAY, LEST IT TAKE ITS FOOTBALL AND GO HOME. SO LONG AS KANSAS OIL CONSUMPTION PRODUCES NEARLY $1 BILLION IN REVENUE, PRODUCERS WILL NOT TURN AWAY OUR MONEY, AND WILL CONTINUE TO SEND OIL TO KANSAS.

THIS BILL WILL ASSURE THAT WHEN THE CRUNCH COMES AGAIN THE MAJOR OIL COMPANIES WILL NOT FAVOR THEIR OWN OUTLETS, RIDING ROUGHSHOD OVER AREA INDEPENDENT DEALERS. IT WILL ALSO REMOVE THE MOTIVE AND THE TOOL TO SQUEEZE THE INDEPENDENT DEALER OUT OF THE MARKET PLACE BY ARTIFICAL PRICE CUTTING.

MR. CHAIRMAN, I BELIEVE THE TIME HAS COME FOR THE LEGISLATURE TO MAKE A CHOICE. WE CAN CAVE IN TO THESE PETROLEUM GIANTS OR WE CAN SHOW A DECENT REGARD AND CONCERN FOR THE ECONOMIC SURVIVAL OF OUR KANSAS SMALL BUSINESSMEN.

2-21-79

BACKGROUND INFORMATION

Senate Bill 314

I Wholesale Distribution

A. The refiners

1. Large integrated (major) refiners - 15

   a. Amoco, Atlantic Richfield, Chevron, Cities Service, Continental, Exxon, Getty-Skelly, Gulf, Marathon, Mobil, Phillips, Shell, Sun, Texaco and Union

2. Large independent refiners - 7

   a. Amerada Hess, American Petrofina, Ashland, Sohio, Coastal States, Kerr McGee, and Tosco

3. Small Refiners - 120

   a. less than 175,000 barrels/day and less than 30% ownership or control of the crude oil

B. From Refinery to Retailers

1. Petroleum terminals

   a. majority refiner/supplier owned

   b. distribute bulk plants, larger customer accounts and service stations

2. Bulk plants

   a. smaller and declining in number

   b. independent bulk plant operators are jobbers

   c. other middlemen: consignee or commission agents

II National Trends in Motor Gasoline Marketing

A. Major and nonmajor refiner sales (January 1972-December 1976)*

1.	Total	increased by 10.8 billion gallons or 11%
2.	Retail (direct)	increased by 5.4 billion gallons or 69%
3.	Wholesaler-resellers	increased by 12.8 billion gallons or 36%
4.	Independent dealers	declined by 5.5 billion gallons or 11%

* U.S. Department of Energy Study: An Analysis of the Relative Competitive Position of Marketers of Motor Gasoline

B. Retail Outlets

1. Total numbers declining
   a. 1972-1977 a 12.8% decline (226,459 to 176,400)
2. Independents declining
   a. 1974-1976 a 11.0% decline (169,500 to 154,700)
3. Refiner owners increasing
   a. 5 refiners added 2,140 units at a 70% increase
4. Refiner retail outlet sales increasing (1972-1976)

Large Independent Refiners	53%
Large Integrated Refiners	62%
Small Refiners	86%

C. Kansas 1978 Statistics

1. Gasoline Service Station Sales $918,325,000
2. Retail Outlets 3,209
3. Market Share

Amoco	11.26%
Vickers	7.74
Phillips	6.85
Derby	6.23
Coop Associations	6.06
Getty	5.77
Apco	4.40
Mobil	4.23
Texaco	3.46
Champlin	2.70
Total	58.70%

4. Self Service Comprises only 33% of sales
5. Gas Consumption (Rank 28th) 1,384 billion gallons

D. National 1978 Statistics

1. Gasoline Service Station Sales

a.	Franchisee-owned	$45.12 billion
b.	Company-owned	11.53
c.	Total	$56.65 billion
d.	Average sales/store	$337,000

2.

Franchisee stations	136,800
Company stations	34,200
Total	171,000

3. Market Share (Top 8)

Shell	7.53%
Amoco	7.30
Exxon	7.14
Texaco	7.11
Gulf	5.91
Mobil	5.59
Chevron	4.75
Atlantic Richfield	3.85
Total	49.18%

BRANDED RETAIL OUTLETS IN KANSAS, 1977

Company	Outlets
American Petrofina Inc.[1]	212
Amoco Oil Co.[2]	406
Clark Oil and Refining Corp.[3]	15
Consumers Oil Stations, Inc.	2
Continental Oil Co.	240
Derby Refining Co.	153
Diamond Shamrock Corp.	8
Farmland Industries Inc.	200
Fisca Oil Co., Inc.	2
Getty Refining and Marketing Co.	537
Hi-Quality Lo-Cost Service Stations, Inc.	20
Highway Oil Inc.[4]	21
Kerr-McGee Refining Corp.	140
Koch Refining Co.[5] (includes Hudson Oil Co. of Delaware, Inc.)	7
KWIK Shop Inc.	28
Mico Oil Co., Inc.	2
Mobil Oil Corp.[6]	230
Musket Oil Corp.	15
Pester Corp.[8]	2
Phillips Petroleum Co.[9]	371
Rapp's U-Pump It	13
Sunmark Industries	48
Texaco Inc.	241
Tommy Oil Co., Inc.	3
Union Oil Co. of California	1
Vickers Petroleum Corp.	292
	3,209

1. Includes K-T Oil Corp., Dujox Fina Oil Co., Porto Fina Oil Co. and Tambay Fina Oil Co.
2. Includes Omega Oil Co.
3. Includes Owens.
4. Includes Hi-Lo Oil Co. Inc., Workingman's Friend Oil Inc., Fairway. Oil Inc., and Cook Oil Co.
5. Includes Hudson Oil Co. of Delaware Inc. and X-Cell Oil Co.
6. Includes Sello, Rello, Hi-Val and Big-Bi.
7. Includes Love's Country Stores.
8. Includes Pester Derby Oil Co. and Pester Colorado Corp.
9. Includes Pyramid Oil Co., Superior Oil Co., Aero Oil Co., Tallman Oil Co., and Metro 66 Oil Co.

OURCE: 1978 National Petroleum News Factbook, Annual Reports.

ncluded in the lists are only those companies that reported. Champlin, which has a number of tations in Kansas, apparently did not report on its operations.

HOW OIL COMPANIES HANDLE PRODUCT DISTRIBUTION [1]

	Total Branded Retail Outlets	Total Branded Service Stations	Supplied Directly	Supplied Through Jobber and Commission Agents	Lessee/ Dealer Operated	Salary Operated	Commission Operated	100% Full-Service	100% Self-Service	Service & Self-Service
Major Oil Companies										
Amoco Oil Company	23,492	22,050	8,835	13,215	21,958	43	49	5,471	256	2,459
Mobil Oil Corp.	19,624	Mobil maintains records on total branded retail outlets only.								
Texaco Inc.	26,232	26,236	9,348	16,884	26,183	13	19	13,661	2,680	9,891
Semi-Major Oil Companies [2]										
Continental Oil Co.	5,771	5,771	694	5,077	762	282	6			
Diamond Shamrock Oil & Gas Company	1,595	1,595	41	1,554	1,558	5	32			
Getty Refining & Marketing Co.	5,712	5,712	2,511	2,069	3,418	91	1,070	3,762	58	850
Kerr-McGee Corp.	1,633	1,568	445	1,123	1,380	188	0	157	78	1,333
Phillips Petroleum Co.	12,209									
Sunmark Industries	10,829	10,829	7,000	3,829	6,850	150	8	10,000	300	529
Union Oil Co. of California	13,760	8,343	4,134	4,209	8,237	106	-	5,185	423	2,735
Independent Oil Companies										
American Petrofina Inc.	4,496	3,597	0	3,597	0	0	0	3,021	36	560
Clark Oil & Ref. Corp.	1,832	1,832	1,832	0	-	-	-	1,577	219	36
Consumers Oil Stations Inc.	36	36	36	0	0	36	0	2	9	25
Derby Refining Co.	601	601	188	413	71	117	413	260	85	256
Farmland Industries Inc.	927	850	0	850	0	765	85	550	100	200
Flacs Oil Co. Inc.	109	109	109	0	0	109	0	90	4	15
Hi-Quality Lo-Cost Serv. Stations Inc.	20	20	20	0	0	20	0	0	0	15
Highway Oil Inc.	223	223	223	0	0	0	223	223	0	0
Koch Refining Co.	265	265	265	0	0	265	0	62	165	38
Mico Oil Co. Inc.	30	30	30	0	0	30	0	29	1	0
Husket Corp.	58	58	58	0	0	58	0	-	-	2
Pester Corp.	199	199	199	0	0	199	0	-	-	-
Tommy Oil Co. Inc.	51	51	0	51	0	51	0	0	0	51
Vickers Petroleum Corp.	754	732	409	323	304	420	8	254	150	378

[1] This list of oil companies includes only those oil companies operating in Kansas, however, the figures are for all their branded outlets. As mentioned in the text of the memorandum, state-by-state data on how oil companies handle product distribution is not available.

[2] Included in the lists are only those companies that reported. Champlin, which has a number of stations in Kansas, apparently did not report on its operations.

SOURCE: 1978 National Petroleum News Factbook, Annual Reports.

POSSIBLE IMPACTS OF DIVESTITURE

(According to American Petroleum Institute)

1. "Supply uncertainties" for dealers
   a. new negotiated contracts with supplies not being guaranteed
   b. new suppliers may have to be approached
   c. refiners may have to seek higher profits
2. Accelerated service station closings
   a. trend is towards fewer, more profitable stations
   b. marginal and high cost stations would close
   c. withdrawals, mergers or sales elsewhere may force closings
3. Increased investments
   a. dealers may have to own stations and compete with other buyers
   b. suppliers may provide fewer equipment needs
4. Increased expenses
   a. individual companies or dealers having to make real estate investments would result in higher rentals.
   b. suppliers may reduce station maintenance and equipment repair services
   c. reduction of short term credit
   d. discontinuation of credit card programs
5. Reduction in lessee operations
   a. increase in high-volume, direct-operated stations
   b. separated companies may be bought up by large operators or conglomerates
6. Loss of marketing support
   a. no credit card support meaning "more expensive credit arrangements"
   b. no dealer training, ad support or promotions

The U.S. Supreme Court in Exxon Corp. v. Governor of Maryland upheld the validity of a Maryland statute forcing divestiture by oil producers or refiners of retail stations. The Supreme Court considered in the appeal three major contentions by Exxon as to the validity of the statute and rejected all three. Exxon argued basically that the statute violated the Due Process Clause, the Commerce Clause and was in conflict with the Robinson-Patman Act.

Due Process

Exxon - Maryland statute invalid exercise of state's police power

Supreme Court - Statute bore a "reasonable relation to the state's legitimate purpose in controlling the gasoline retail market."

Commerce Clause

Exxon - Maryland statute violates by

(1) discriminating against interstate commerce

(2) unduly burdening interstate commerce

(3) being non-amenable to state regulation due to the integrated nature of the oil industry

Supreme Court - (1) No discrimination since Maryland's entire gas supply flowed in interstate commerce. The act didn't distinguish between in-state and out-of-state retail companies

(2) The Commerce Clause protected the overall market and not particular companies that might bear the burden.

(3) Nation-wide nature of gasoline marketing does not pre-empt the entire field from state regulation. State divestiture did not present a question of differing regulations.

Federal Pre-Emption

Exxon - Congress intended to pre-empt state legislation with the (§ 2 (b)) of the Robinson-Patman Act

Supreme Court - State act and Robinson-Patman are similar in some ways however state is <u>not</u> pre-empted by federal law

Equal Protection

Exxon - Maryland was singling out oil companies in this act

Maryland Court -Act was a legitimate state interest: preserving competition

Supreme Court - Not pursued.

2-21-79

VANDERBILT LAW REVIEW

VOLUME 30 NOVEMBER 1977 NUMBER 6

ARTICLES

VERTICAL DIVESTITURE OF THE PETROLEUM MAJORS: AN AFFIRMATIVE CASE ..... *Walter Adams* 1115

THE TOXIC SUBSTANCES CONTROL ACT: A REGULATORY MORASS ..... *Kevin Gaynor* 1149

REMEDIES UNDER THE TENNESSEE COMMERCIAL CODE ..... *John A. Walker, Jr.* 1197

NOTE

CONSCIOUS PARALLELISM AND THE SHERMAN ACT: AN ANALYSIS AND A PROPOSAL ..... *D. J. Simonetti* 1227

RECENT CASES

Administrative Law—Ripeness—Agency Head's Informal Opinion Letters Held Unripe for Review When No Substantial Hardship Placed on Parties [*New York Stock Exchange v. Bloom*, 562 F.2d 736 (D.C. Cir. 1977)] 1249

Civil Procedure—Res Judicata—Challenge of Racial Discrimination Under 42 U.S.C. § 1981 Barred By Prior Submission of Civil Rights Question to State Court [*Mitchell v. National Broadcasting Co.*, 553 F.2d 265 (2d Cir. 1977)] 1260

Environmental Law—Standing to Sue—Alleged Violation of Private Party's Informational Interest in Environmental Impact Statement Is Sufficient to Establish Standing to Enforce National Environmental Policy Act [*Atchison, Topeka & Santa Fe Railway v. Callaway*, 431 F. Supp. 722 (D.D.C. 1977)] 1271

BOOK REVIEW

NADER & GREEN: Verdicts on Lawyers ..... *Ted Finman* 1281

Annual Index

VANDERBILT LAW REVIEW

VOLUME 30 NOVEMBER 1977 NUMBER 6

Vertical Divestiture of the Petroleum Majors: An Affirmative Case

*Walter Adams**

In October of 1976, the Vanderbilt Law Review *published an article on vertical divestiture of the petroleum industry by Mr. Stark Ritchie, general counsel for the American Petroleum Institute. In his article, Mr. Ritchie examined the economic justifications for vertical integration in the oil industry, suggested several consequences of divestiture, and concluded that the remedy would be an inappropriate and inefficient method of increasing competition in the industry. In response to that article, Professor Adams examines the concentration of economic power in the petroleum industry, the relationship of vertical integration to the exercise of horizontal control, and the merits of the efficiency rationale for vertical integration. He concludes that functional vertical divestiture would be both technically and financially feasible and in the public interest.*

TABLE OF CONTENTS

Page

I. INTRODUCTION 1115
II. THE CONCENTRATED POWER OF BIG OIL 1118
III. THE REINFORCEMENT OF SHARED MONOPOLY POWER THROUGH VERTICAL INTEGRATION 1133
IV. VERTICAL INTEGRATION AND EFFICIENCY 1139
V. THE FEASIBILITY OF VERTICAL DIVESTITURE 1144
VI. CONCLUSION 1147

I. INTRODUCTION

On September 30, 1940, the Department of Justice filed a massive antitrust case against twenty-two major oil companies, 379 of

* Distinguished University Professor, Professor of Economics, and Past President, Michigan State University; member of the Attorney General's National Committee to Study the Antitrust Laws (1953-1955). B.A., Brooklyn College, 1942; M.A., 1946, Ph.D., 1947, Yale University.

their subsidiaries and affiliat[illegible]nd the American Petroleum Institute (which Clarence Darrow had described in 1934 as "the switch board for the controlling companies").[1] The Department articulated the rationale for filing this comprehensive structural case, which came to be known as the *Mother Hubbard* case, as follows:

> This proceeding is being instituted under the Department's policy of taking up in a single investigation or proceeding all of the restraints which affect the distribution of a product from the raw material to the consumer. Only in this way can economic results be achieved. Piecemeal prosecutions against segments of an industry are both costly and inconclusive. They do not raise the fundamental issues which the Court should decide, and therefore do not clarify the law. They allow restraints of trade to flourish in one segment of the industry while they are being prosecuted in another.
>
> In the past 10 years, the Department has been flooded with complaints from independents and consumers against various practices in the oil industry. These complaints have resulted in a series of piecemeal prosecutions in all of which the Government has been successful. Yet in spite of the success of these prosecutions, the complaints continue, prices are still inflexible, independent enterprise is still under a handicap, because the cases applied only to segments rather than to the entire structure of the industry.
>
> For this reason the present action is brought. It will eventually present to the Supreme Court of the United States for final decision all of the issues with respect to the reasonableness of the present vast combinations in the production, transportation, refining, and distribution of petroleum products.[2]

The complaint as originally drafted asked that the twenty-two principal defendants be ordered to divest their transportation and marketing facilities. With the outbreak of war in Europe and the United States' imminent involvement in the conflict, however, the Attorney General agreed to delete the request for structural relief from the complaint.[3] Like so many other cases of great pitch and moment, the *Mother Hubbard* case eventually was [illegible]ed by a pusilanimous consent decree.[4]

On July 18, 1973, the Federal Trade Commission issued a complaint against the eight largest domestic oil companies.[5] The complaint in *In re Exxon Corp.* charged the companies with maintaining and reinforcing "a noncompetitive market structure" in the refining industry on the East and Gulf coasts through their control of crude oil and crude transportation. In language reminiscent of the *Mother Hubbard* case, the Commission stated the rationale for its action as follows:

> The history of the Federal Trade Commission's activity in the petroleum industry has been characterized by a case-by-case attack on specific anticompetitive marketing practices. This approach has, in general, been of limited success in controlling wasteful marketing practices, dealer coercion, and the lack of competition in the petroleum industry. Despite the staff's success in bringing and winning cases before the Commission and in the courts, as well as obtaining compliance orders, the petroleum industry over the last 50 years has managed to circumvent the orders in many cases by subtle changes in policy or practices. . . .
>
> The reason for the limited success of the early petroleum cases is not to be found in the cases or remedies themselves. The staff did a thorough job in researching, developing and prosecuting the individual cases. The remedies applied in each case were directed at the particular abuse. But the practice-by-practice approach to antitrust attack, which sought to correct specific anticompetitive conduct at the marketing level, did not adequately address the industry's vertically integrated structure or its multi-level behavior. The major oil companies operate on four levels—crude production, refining, transportation, and marketing. To fashion a remedy for one level without considering the performance of a company, or the industry, at the other levels, ignores the market power associated with vertical integration and [illegible] competition.[6]

As in *Mother Hubbard*, the antitrust authorities recognized that an industry's noncompetitive structure militates toward noncompetitive behavior and results in noncompetitive performance. They recognized that, if the goals of the antitrust laws are to be attained, there is no alternative to structural reorganization of the horizontally and vertically integrated oil oligopoly.

---

1. A. SAMPSON, THE SEVEN SISTERS 202 (1975).

2. *Consent Decree Program of the Department of Justice: Hearings Before the Subcomm. on Antitrust of the House Comm. on the Judiciary*, 85th Cong., 1st Sess. 123-24 (1957), *quoted in* SENATE COMM. ON THE JUDICIARY, PETROLEUM INDUSTRY COMPETITION ACT OF 1976, S. REP. No. 1005, 94th Cong., 2d Sess. 105 (1976) [hereinafter cited as PETROLEUM INDUSTRY COMPETITION ACT REPORT]. This report makes a cogently reasoned case, replete with documentary references, in favor of vertical divestiture.

3. Prior to filing the case, Attorney General Robert H. Jackson submitted the complaint to the Council of National Defense. The Council in turn referred it to its Oil Industry Advisory Commission, nine of whose eleven members were connected with either Jersey Standard (Exxon) or Shell. Both of these companies, of course, were parties to the case and it came as no surprise that the advisory commission found that divestiture of transportation and marketing would adversely affect the defense effort. Any effort at using the antitrust laws to restructure the industry would, in their words, "becloud relationships between the Government and Industry." Attorney General Jackson acquiesced in the Commission's report and deleted the request for structural relief from the complaint. PETROLEUM INDUSTRY COMPETITION ACT REPORT, *supra* note 2, at 105.

4. For the deplorable record of antitrust versus the petroleum industry and some of the reasons for it, see *Market Performance and Competition in the Petroleum Industry: Hearings Before the Senate Comm. on Interior and Insular Affairs, Part 1*, 93d Cong., 1st Sess. 370-98 (1973) (testimony of Mark J. Green). *See also* PETROLEUM INDUSTRY COMPETITION ACT REPORT, *supra* note 2, at 95-124.

5. *In re* Exxon Corp., 83 F.T.C. 233 (1973).

6. STAFF OF SENATE PERMANENT SUBCOMM. ON INVESTIGATIONS OF THE SENATE COMM. ON GOVERNMENT OPERATIONS, 93D CONG., 1ST SESS., INVESTIGATION OF THE PETROLEUM INDUSTRY 4-5 (Comm. Print 1973) [hereinafter cited as INVESTIGATION OF THE PETROLEUM INDUSTRY].

More important than this latest antitrust action against the petroleum industry, however, is the growing awareness in Congress—precipitated in part by the Arab oil embargo of October 1973 and by the subsequent rise in petroleum prices and oil company profits—that the oil industry for all intents and purposes is operating a worldwide cartel that is not subject to effective regulation by the government, to the discipline of a competitive marketplace, or to systematic compulsion to promote the public interest. Policy makers grow increasingly aware that structural reform of the industry is imperative and that such reform probably will have to be achieved by legislation rather than by litigation. Accordingly, several divestiture bills were introduced in the Ninety-fourth Congress, some providing for functional vertical divestiture within the petroleum industry, others for horizontal divestiture to prevent the leading oil companies from dominating alternate sources of energy.[7] One of these bills, S. 2387, was reported out favorably by the Senate Judiciary Committee on June 15, 1976, but no floor action was taken. Nevertheless, S. 2387 was attached as a vertical divestiture amendment to the natural gas deregulation bill, but was defeated by the narrow margin of only nine votes, forty-five to fifty-four.[8] Divestiture had become one of the central issues in congressional debates during the energy crisis.

This article will examine: first, the concentration of economic power in the oil industry; second, the manner in which vertical integration reinforces the horizontal control exercised by the major oil companies; third, the extent to which prevailing patterns of vertical integration are based on efficiency considerations; and, finally, whether vertical divestiture is a feasible remedy.

II. The Concentrated Power of Big Oil

Spokesmen for the oil industry claim that it includes some 10,000 producers and that the concentration ratios, especially in crude oil, are far lower than in other major industries, notably the automobile, aluminum, computer, and aircraft industries.[9] Commenting on this line of argument, John W. Wilson has observed:

7. *E.g.*, S. 739, S. 745, S. 756, S. 1137, S. 1138, and S. 2387, 94th Cong., 1st Sess. (1975), dealing with vertical divestiture, and S. 489, 94th Cong., 1st Sess. (1975), dealing with horizontal divestiture.

8. J. Blair, The Control of Oil 382 (1976).

9. *See, e.g.*, Ritchie, *Petroleum Dismemberment*, 29 Vand. L. Rev. 1131, 1137-42 (1976). *See also The Petroleum Industry: Hearings Before the Senate Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary, Part 3*, 94th Cong., 1st Sess. 1849-1917, 2102-29, 2217-49 (1975) [hereinafter cited as *Vertical Integration Hearings*].

> Despite its size, conventional concentration ratio measurements indicate that oil is not particularly concentrated in comparison with other major industries . . . . [W]hile the concentration ratios for the top four or top eight crude oil producers have increased substantially in the last twenty years, the industry still seems to compare favorably with other leading manufacturing industries, such as automobiles, copper, computers, and aluminum. Thus, argue the industry's defenders, right-thinking rational men should direct their antitrust interests toward more critical targets like breakfast cereals and beer, and leave oil alone.[10]

At first blush, the oil industry's argument seems persuasive (see Table 1), but, in fact, it is misleading for a number of reasons.

First, concentration has been increasing steadily since the mid-1950's, so that by 1974 the eight largest companies controlled almost as large a share of crude oil production as did the twenty largest in 1955.

Table 1

Concentration in Crude Production

	1955	1965	1974
4 Top	21.2%	27.9%	31.1%
8 Top	35.9%	44.6%	54.0%
20 Top	55.7%	63.0%	76.9%

Source: Energy Action Committee, Divestiture Factbook 15 (1976).

This trend is explained in part by the massive mergers during the period, especially mergers between the very largest companies. In 1965, for example, Union Oil (assets of 916.5 million dollars) acquired Pure Oil (assets of 766.1 million dollars). In 1966, Atlantic Refining (assets of 960.4 million dollars) acquired Richfield (assets of 499.6 million dollars), and in 1968, Sun Oil (assets of 1,[illegible] million dollars) acquired Sunray DX (assets of 749.0 million dollars). In 1969, Atlantic Richfield (assets of 2,450.9 million dollars) acquired Sinclair (assets of 1,851.3 million dollars). As a result, the twenty majors of 1955 have become the sixteen majors of today. Moreover, as Professor Walter Measday points out,

> concentration in reserve ownership is even more important, particularly for the future, than concentration in current production. And the largest companies control most of the proved reserves. The Federal Trade Commission staff found that in 1970 our sixteen major companies controlled 77 percent of the net

10. Wilson, *Market Structure and Interfirm Integration in the Petroleum Industry*, 9 J. Econ. Issues 324 (1975).

proved oil reserves in the United St[illegible] and Canada. The producer has effective control, however, over all of the [illegible]e lifts including the shares for royalty owners and other nonworking interest holders. In terms of gross reserves, the sixteen majors may control more than 90 percent of existing proved reserves.[11]

Second, the major oil companies are not the run-of-the-mill corporate giants dominating *Fortune*'s list of the 500 largest industrial corporations. Rather, they are multinationals whose domains extend from Alaska to Kuwait, from Indonesia to Venezuela. Indeed, the sun never sets on their far-flung empires. Table 2 compares the control over crude production exercised in the United States, the Middle East, the OPEC countries, and the Free World by the seven largest majors, the so-called Seven Sisters.[12] The percentage control exercised by *all* the majors, of course, is even higher than that of the Seven Sisters. That these companies may no longer *own* their erstwhile properties in the OPEC countries is, as shall be demonstrated, of secondary importance. In practice, they still *control* the disposition of the lion's share of the free world's crude oil production.

Third, the major oil companies are intertwined with one another through a seamless web of interlocking control.[13] They do not function as independent or competitive units but as cooperative entities at every strategic point in the industry's integrated structure. They are meshed with one another like strands of spaghetti in a symbiotic relationship almost inevitably precluding any genuinely competitive behavior. John W. Wilson, the former chief of the Federal Power Commission's Division of Economic Studies, has explained the significance of bringing "horizontally and vertically juxtaposed firms into close working relationships with each other" as follows:

> They *must* work together to further their joint interests. Consequently, each becomes familiar with the others and with each other's operations. Men in such close working relationships learn to consider one another's interests. This process of learning to live together is, of course, quite laudable in certain social and political contexts. The success of our Nation's international relations, for example, depends greatly upon this process. But it is, most assuredly, not the kind of institutional setting within which a free market economy can be expected to function efficiently. Real economic competition is made of tougher stuff. . . . In order to function both efficiently and in the public interest, free markets *must be competitive*. This means that the parti[illegible]ts must be structurally and behaviorally independent of each other. That precondition, quite apparently does not apply to the petroleum industry.[14]

The claim, therefore, that the petroleum industry fits the structural model of effective competition is pure fiction.

TABLE 2

THE SEVEN SISTERS' SHARES OF WORLD CRUDE OIL PRODUCTION (1972)

Company	Production in U.S. (Thou. b/d) (1)	% of total U.S. production (2)	Production in Middle East[2] & Libya (Thou. b/d) (3)	% of total M.E.[2] & Libya production (4)	Production in all OPEC (Thou. b/d) (5)	% of total OPEC production (6)	Production[1] world-wide (excluding E. Europe & China) (Thou. b/d) (7)	% of world production (excluding E. Europe & China) (8)
Exxon	1,114	9.9	2,527	12.9	4,050	15.2	6,145	14.7
Texaco	916	8.1	2,155	11.0	2,674	10.0	4,021	9.6
Socal	526	4.7	2,155	11.0	2,614	9.8	[illegible]	7.9
Gulf	651	5.8	1,887	9.7	2,409	9.0	3,404	8.1
Mobil	457	4.1	1,178	6.0	1,477	5.5	2,399	5.7
BP	—	—	3,903	20.0	4,506	16.9	4,659	11.1
Shell	726	6.5	1,372	7.0	2,877	10.8	5,416	12.9
Total	4,392	39.1	14,165	77.6	20,607	77.1	29,367	70.0

1. Taken from company annual reports.
2. Excludes Bahrain.

Source: Multinational Corporations and United States Foreign Policy: Hearings Before the Senate Subcomm. on Multinational Corporations of the Senate Comm. on Foreign Relations, Part 4, 93d Cong., 2d Sess. 68 (1974).

Joint ventures are one manifestation of this symbiotic relationship. A joint venture establishes a community of interest among the parents and a mechanism for avoiding competition between them. The mechanism provides an opportunity for foreclosing nonpartners from access to supplies and/or from access to markets and serves as a forum in which ostensible competitors can meet to exchange information and coordinate plans with apparent impunity.[15] Most impor-

11. Measday, *The Petroleum Industry*, in THE STRUCTURE OF AMERICAN INDUSTRY 136 (5th ed. W. Adams ed. 1977). For concentration in refining, see BLAIR, *supra* note 8, at 131-36.

12. *See also* BLAIR, *supra* note 8, at 25-76.

13. *Id.* at 136-51; S. RUTTENBERG, THE AMERICAN OIL INDUSTRY: A FAILURE OF ANTI-TRUST POLICY 41-118 (1973).

14. *The Natural Gas Industry: Hearings Before the Senate Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary, Part 1*, 93d Cong., 1st Sess. 499 (1973). The Wilson evidence on joint ventures, interties, and interlocks deserves detailed attention. *Id.* at 478-97.

15. A classic example is the Cal-Tex group of companies through which Texaco and Standard of California jointly have operated many of their foreign assets for the past 40 years.

tant, perhaps, the device, a[illegible]ust in the oil industry, thus far has remained immune from antitrust attack. Table 3 indicates how the major oil companies use joint ventures, now with one partner and then with another, in a seemingly infinite set of permutations and combinations in bidding for federal offshore lease sales. Thus, Amerada Hess submitted no independent and 168 joint bids during the period; Getty, no independent and 281 joint bids; Phillips, no independent and 169 joint bids; and Union, no independent and 245 joint bids.

TABLE 3

JOINT BIDDING IN FEDERAL OFFSHORE LEASE SALES (1970-72)

Company	Number of independent bids	Bidding partners	Number of joint bids with each
Amerada-Hess	0	Signal	50
		Louisiana Land	51
		Marathon	51
		Texas Eastern	16
Amoco	6	Texas Eastern	117
		Union	96
		CNG	79
		Transco	15
		Shell	14
Atlantic-Richfield	12	Cities	106
		Getty	73
		Continental	114
Chevron	79	Mobil	25
		Murphy	17
		General American	17
		Pennzoil	12
		Pelto	13
		Superior	9
		Gulf	7
		Burmah	4
		Mesa	4
Cities Service	7	Atlantic	106
		Getty	100
		Continental	163
		Tenneco	3
Continental	27	Atlantic	114
		Cities	163
		Getty	102
		Tenneco	5
Exxon	80		
Getty	0	Atlantic	73
		Cities	100
		Continental	102
		Placid	4
		Superior	2
Gulf	17	Mobil	17
		Pennzoil	8
		Standard Oil of California (Chevron)	7
Marathon	24	Signal	65
		Louisiana Land	69
		Amerada	51
		Texas Eastern	29
Mobil	8	Pennzoil	30
		Standard Oil of California (Chevron)	25
		Mesa	16
		Burmah	[illegible]
		Gulf	17
		Ashland	2
Phillips	0	Skelly (Getty)	69
		Allied Chemicals	66
		American Petrofina	34
Shell	59	Transco	47
		CNG	15
		Standard Oil of Indiana (Amoco)	14
		Florida Gas	17
Sun	115	Pennzoil	2
Texaco	15	Tenneco	32
Union	0	Amoco	96
		Texas Eastern	96
		Texas Gas	48
		Florida Gas	5

Source: The Natural Gas Industry: Hearings Before the Senate Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary, Part 1, 93d Cong., 1st Sess. 481 (1973).

Caltex's profits accounted for 59.5% of Texaco's total profits [in 1975], up sharply from 37.3% and 26.5% in the two previous years. For Socal, the reliance on Caltex also increased, but less sharply, rising to 63.9%, from 59.3% and 40.5% of Socal's total profits in the two previous years.

PETROLEUM INTELLIGENCE WEEKLY, March 22, 1976, at 5. A reasonable person might well question whether companies whose fortunes are so closely tied to one another are competitors, as the industry contends, or partners.

According to Professor Walter Mead, this amounts to bid rigging:

> In any given sale, it is obvious that when four firms . . . each able to bid independently, combine to submit a single bid, three interested, potential bidders have been eliminated; i.e., the combination has restrained trade. This situation does not differ materially from one of explicit collusion in which four firms meet in advance of a given sale and decide who among them should bid (which three should refrain from bidding) for specific leases and, instead of

competing among themselves, attempt to rotate the winning bids. The principal difference is that explicit collusion is illegal.[16]

Indeed, explicit collusion has been illegal per se since bid rigging was condemned in 1898 by *United States v. Addyston Pipe & Steel Co.*[17]

The major oil companies also use joint ventures in their control of interstate pipelines (see Table 4). Outside of the United States, the pattern is similar. In 1952, according to one report, "every important pipeline in existence or even proposed [was] controlled by the seven principal international oil companies, individually or jointly."[18] The significance of this joint control over pipelines as a vertical integration lever will be discussed below.

TABLE 4

JOINT VENTURES IN THE OIL PIPELINE INDUSTRY

Pipeline company and co-owners	Percent held by each
Badger Pipeline Co. (assets = $12,400,000):	
Atlantic-Richfield	34
Cities Service	32
Texaco	22
Union Oil	12
Dixie Pipeline Co. (assets = $46,400,000):	
Amoco	12.1
Atlantic-Richfield	7.4
Cities Service	5.0
Continental	4.1
Exxon	11.1
Mobil	5.0
Phillips	14.5
Shell	5.5
Texaco	5.0
Gulf	18.2
Transco	3.6
Allied Chemical	8.6
Laurel Pipeline Co. (assets = $35,900,000):	
Gulf	49.1
Texaco	17
Clark	11
Marathon	10
Cities Service	8
Shell	7
Platte Pipeline Co. (assets = $33,000,000):	
Continental	20
Marathon	25
Union Oil	15
Atlantic-Richfield	25
Gulf	15
West Shore Pipeline Co. (assets = $17,600,000):	
Shell	20
Amoco	16.5
Mobil	14
Texaco	9
Marathon	9
Clark	8
Cities Service	8
Continental	6.5
Union Oil	5.5

16. Mead, *The Competitive Significance of Joint Ventures*, 12 ANTITRUST BULL. 839 (1967).
17. 85 F. 271 (6th Cir. 1898).
18. FTC REPORT ON THE INTERNATIONAL PETROLEUM CARTEL 27-28 (Comm. Print 1952).

Pipeline company and co-owners	Percent held by each
Texaco	33.9
Sohio	17.0
Colonial Pipeline Co. (assets = $480,200,000):	
Amoco	14.3
Atlantic-Richfield	1.6
Cities Service	14.0
Continental	7.5
Phillips	7.1
Texaco	14.3
Gulf	16.8
Sohio	9.0
Mobil	11.5
Union Oil	4.0
Plantation Pipeline Co. (assets = $176,100,000):	
Exxon	48.8
Shell	24.0
Refiners Oil Corp	27.1
Four Corners Pipeline Co. (assets = $20,900,000):	
Shell	25
Chevron	25
Gulf	20
Continental	10
Atlantic-Richfield	10
Superior	10
Olympic Pipeline Co. (assets = $30,700,000):	
Shell	43.5
Mobil	29.5
Texaco	27.0
Wolverine Pipeline Co. (assets = $21,800,000):	
Union Oil	26
Mobil	21
Exxon	3.5
Wyco Pipeline Co. (assets = $14,100,000):	
Amoco	40
Texaco	40
Mobil	20
Yellowstone Pipeline Co. (assets = $16,000,000):	
Continental	40
Exxon	40
Husky	6
Union Oil	14
West Texas Gulf Pipeline Co. (assets = $19,800,000):	
Gulf	57.7
Cities Service	11.4
Sun	12.6
Union Oil	9.0
Sohio	9.2
Chicap Pipeline Co. (assets = $25,600,000):	
Union Oil	43.4
Clark	33.2
Amoco	23.4
Cook Inlet Pipeline Co.:	
Atlantic-Richfield	20
Marathon	30
Union Oil	30
Mobil	20
Texas-New Mexico Pipeline Co. (assets = $30,000,000):	
Texaco	45
Atlantic-Richfield	35
Cities Service	10
Getty	10

Source: The Natural Gas Industry: Hearings Before the Senate Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary, Part 1, 93d Cong., 1st Sess. 485 (1973).

Table 5 is a selected list of joint ventures by the major oil companies outside of the United States. A more comprehensive listing of these ventures and an analysis of their anticompetitive impact is found in the Federal Trade Commission's landmark *Report on the International Petroleum Cartel.*[19]

19. *Id.* at 37-193.

TABLE 5

SELECTED INTERNATIONAL JOINT VENTURES OF PETROLEUM COMPANIES

Petroleum Company (1971 crude production)	Co-owners	Percent Held by Each
Arabian American Oil Co. (1.45 bil. bbls.)	Texaco	30.00
	Exxon	30.00
	Chevron	30.00
	Mobil	10.00
Iranian Oil Participants, Inc. (1.3 bil. bbls.)	Mobil	7.00
	Exxon	7.00
	Chevron	7.00
	Texaco	7.00
	Gulf	7.00
	B. P.	40.00
	Shell	14.00
	Atlantic	1.67
	Signal	.83
	Getty	.83
Iraq Petroleum Co.	B. P.	23.750
	Shell	23.750
	Exxon	11.875
	Mobil	11.875
Kuwait Oil Co., Ltd. (1.27 bil. bbls.)	Gulf	50.00
	B. P.	50.00

Source: Horizontal Integration of the Energy Industry: Hearings Before the Subcomm. on Energy of the Joint Economic Comm., 94th Cong., 1st Sess. 112 (1975).

In all, according to one estimate, joint ventures among the major oil companies provide approximately 12,000 occasions each year for ostensible competitors, the joint venture parents, to meet and discuss their common problems and means for resolving them.[20] The devices are the cement for binding together a loose-knit cartel into a cozy system of mutual interdependence.

Fourth, as Table 6 demonstrates, the major oil companies are further bound together by a network of indirect interlocks. With the exception of Gulf and Socal, as John Blair has observed,

> all of the eight largest oil companies were interlocked in 1972 through large commercial banks with at least one member of the top group. Exxon had four such interlocks—with Mobil, Standard (Ind.), Texaco, and ARCO. Mobil had three (with Exxon, Shell, and Texaco), as did Standard of Indiana (with Exxon, Texaco, and ARCO), as well as Texaco (with Exxon, Mobil, and Standard of Indiana). ARCO was interlocked with Exxon, and Standard (Ind.), and Shell with Mobil.[21]

20. S. RUTTENBERG, *supra* note 13, at 61.

At the very least, Blair concluded, "meeting together presents directors of competing companies with potential conflicts of interest."[22]

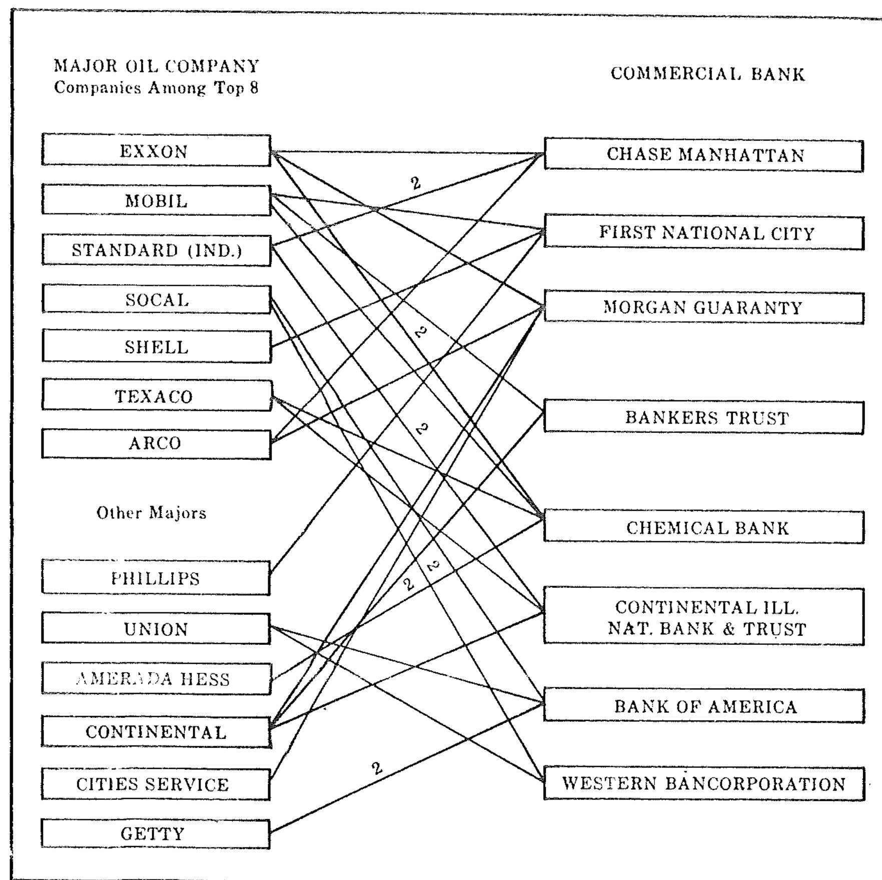
Fifth, the extensive use of exchange agreements among the major oil companies not only has cemented their horizontal fraternity, but has given them a powerful weapon against their vertically nonintegrated competitors. For years the United States has gone without a meaningful crude oil market. Most crude oil is bought and sold under exchange agreements by which the buyer of *x* barrels of crude oil for his refinery at a particular location agrees to deliver an equivalent amount to the seller at another location. Walter Measday has pointed out that such exchange agreements "replace a competitive market with a network of bilateral or multilateral barter transactions from which nonintegrated firms can be easily excluded as first purchasers of crude and which, by their very nature, must be less efficient allocators of resources than open markets would be."[23]

Sixth, oil companies, discontent with their control over only the oil and natural gas industries, have expanded, largely by merger and acquisition, into other energy industries. They have acquired coal, uranium, geothermal, and tar sands reserves to protect their oil and gas empires from interfuel competition (see Table 7). In 1965, one oil company (Gulf) engaged in coal operations and produced less than two percent of the industry's output. Ten years later, eight oil companies produced more than twenty percent of the industry's output, and eleven of the sixteen majors controlled more than forty percent or more of all privately held coal reserves. Companies like Phillips, Mobil, Shell, Atlantic Richfield (ARCO), and Sun Oil are all in the multibillion-ton coal-reserve class without ever having mined a single ton of coal. The biggest risk they face in becoming major producers, as Senator Kennedy has pointed out, "is that coal may become technologically obsolete before they could exhaust their reserves."[24]

21. BLAIR, *supra* note 8, at 144-46.
22. *Id.* at 147.
23. Measday, Feasibility of Petroleum Industry Divestiture, at 8 (paper presented to Stanford University Institute for Energy Studies, Sept. 1976) (on file at the *Vanderbilt Law Review*).
24. Letter from Senator Kennedy to the Senate Judiciary Committee (Aug. 27, 1977) (on file at the *Vanderbilt Law Review*) (asking for support of his amendment to the Coal

TA

INDIRECT INTERLOCKING DIRE...RATES AMONG MAJOR OIL COMPANIES THROUGH COMMERCIAL BANKS (1972)



Source: J. BLAIR, THE CONTROL OF OIL 145 (1976).

The same takeover pattern occurred in the uranium industry. In 1967, two oil companies engaged in uranoso-uranic oxide (U_3O_8) milling operations with less than twenty-eight percent of the industry's output. In 1972 Exxon and Continental Oil entered the industry, giving oil companies thirty-eight percent of the milling capacity. By 1977 Atlantic Richfield (ARCO) had acquired Anaconda, the third largest uranium producer, and Standard of Ohio also had

Conversion Bill (S. 977), which would bar future acquisition of competing coal and uranium resources by major oil companies).

entered the field. As a result, oil companies now trol from fifty to fifty-five percent of the uranium industry's rese... .[25]

TABLE 7

ENERGY RESERVES OF TOP THIRTY OIL COMPANIES IN TRILLIONS OF BTU'S

Company	1975 Net Domestic Crude OIL/NGL	1975 Net Domestic NATURAL GAS	1975 COAL	1975 URANIUM
1. Exxon	23,374.0	23,198.7	199,332.0	7,525.0
2. Texaco	16,344.0	15,872.0	47,460.0	—
3. Shell	10,782.2	7,101.4	23,730.0	—
4. Standard of Indiana	13,003.6	10,936.3	—	—
5. Gulf	7,424.0	6,736.9	61,698.0	34,400.0
6. Standard of California	10,248.6	7,341.1	—	1,290.0
7. Atlantic-Richfield	13,166.0	12,820.5	52,206.0	—
8. Mobil	5,800.0	7,782.4	59,325.0	—
9. Getty	9,488.8	3,449.9	—	8,600.0
10. Sun	5,115.6	4,198.4	53,890.8	—
11. Union	3,543.8	7,354.4	—	—
12. Phillips	4,036.8	5,462.0	47,460.0	5,375.0
13. Continental	3,010.2	3,212.3	316,795.5	10,750.0
14. Cities Service	4,332.6	4,710.4	—	—
15. Marathon	4,634.2	2,345.0	—	—
16. Amerada Hess	3,132.0	1,536.0	—	—
17. Tenneco	1,258.6	3,843.1	40,341.0	—
18. Louisiana Land & Exploration	1,084.6	1,353.7	—	—
19. Pennzoil	852.6	1,923.1	—	—
20. Superior	1,160.0	3,481.6	—	—
21. Union Pacific	684.4	[illegible]	237,300.0	[illegible]
22. Santa Fe	765.6	81.2	8,780.1	—
23. R. J. Reynolds	N/A	N/A	—	—
24. International Paper	580.0	362.5	—	—
25. Kerr-McGee	342.2	840.7	66,444.0	62,350.0
26. Standard of Ohio	26,332.0	6,425.6	18,984.0	2,150.0
27. General American	585.8	630.8	—	—
28. Ashland	365.4	1,010.7	21,357.0	—
29. American Petrofina	324.8	192.5	—	—
30. Diamond Shamrock	713.4	1,126.4	—	—

Source: "Horizontal" Oil Company Divestiture and Separation Proposals, Exhibit IV-D. (Report to the American Petroleum Institute, Oct. 15, 1976).

The impact of these incursions by the major oil companies into the domain of substitute fuels is not difficult to conjecture. After all, no man can be expected to compete with himself, nor can any man be expected to serve two masters and be equally loyal to each. As Walter Measday has observed:

> Would Continental Oil encourage price and market competition between [its subsidiary] Consolidation Coal and its traditional oil operations? Would Union Oil push geothermal development in an area where it might cut into the market for Union's fuel oil? The question extends to the exploitation of successful R & D. According to Senator Bartlett (R., Oklahoma), 49 of 52 patents relating to coal gasification or liquefaction issued from 1964 to 1974 went to oil companies. Let us make the highly unlikely assumption that an oil company with extensive foreign investments were to achieve a technological break-

25. *Id.* A recent compilation by the Federal Energy Administration of nonpetroleum holdings by oil companies revealed the following:

through which could make the United States self-sufficient in energy. Would Exxon enjoy telling Sheik Yamani or would Occidental inform Col. Qadaffi that no more Saudi Arabian or Libyan oil would be lifted for the U.S. market? Or would there be some temptation to delay exploitation of the technology until "it's really needed"?[26]

NUMBER OF NONPETROLEUM HOLDINGS OF OIL COMPANIES

Oil Company	Number of Non-Petroleum Holdings
Atlantic-Richfield	27
Cities-Service	30
Continental	22
Exxon	12
Gulf	50
Getty	31
Mobil	119
Shell	9
Standard of Calif.	25
Standard of Indiana	72
Standard of Ohio	12
Sun	28
Texaco	11
Phillips	48
Union of Calif.	11

Source: FEA, THE PETROLEUM INDUSTRY, A REPORT ON CORPORATE AND INDUSTRY STRUCTURE (1975).

26. Measday, *supra* note 23, at 13. These questions are not entirely rhetorical. The oil giants have a track record in the suppression of competing fuels. Jersey Standard's (Exxon) handling of the hydrogenation patents, acquired pursuant to a cartel agreement with I.G. Farben of Germany, is a case in point:

To Standard, these agreements promised, first, ownership and control, outside Germany, of IG's hydrogenation processes and any future IG processes for making synthetically products having similar uses to those of the customary petroleum refinery products, from whatever raw material they might be derived; and, second, a junior partnership

Such considerations lend force to current congressional attempts to protect interfuel competition by prohibiting the oil companies from further expansion into rival branches of the energy industry.[27]

Finally, the government historically has done for the oil companies what they could not do for themselves without clear violations of the antitrust laws. Under the guise of conservation and national defense, the Bureau of Mines has set national output quotas, the states have authorized prorationing schemes, and Congress has approved the Interstate Oil Compact and has legislated tariff protection and import quotas. In addition, the federal government has subsidized the multinational giants with special tax offsets and both the domestic and the multinational producers with magnanimous depletion allowances. In war and peace and in times of crisis, real or imagined, the government has favored the industry with antitrust exemptions. The State Department, according to one analyst, has

with IG, outside Germany, in the manufacture of new chemical products derived from petroleum or natural gas. . . .

Standard's use of its exclusive rights to IG's processes in the oil industry shows clearly that its main object in acquiring them was to strengthen its control over the oil industry. For the purpose, the IG agreements performed a dual function—defensive and offensive. Acquisition of the hydrogenation rights eliminated the most serious threat ". . . which has ever faced the company since the dissolution," according to Frank Howard, the Standard official who played a leading role in the negotiations with IG. Once these rights were safely acquired, Standard and Shell showed little disposition to use them, or to encourage others to use them, in actual productive operations. Their acquisition forestalled the threat to the oil industry of liquid fuels and lubricants from coal. . . .

Standard and Shell did little to encourage widespread synthetic production of liquid fuels and lubricants from coal. They had acquired these processes primarily to protect their own vast interests in petroleum. Standard summarized its policy as follows:

I.H.P. [International Hydrogenation Patents Company] should keep in close touch with developments in all countries where it has patents, and should be fully informed with regard to the interest being shown in hydrogenation and the prospect of its introduction. . . . *It should not, however, attempt to stir up interest in countries where none exists.* If the Management decides that in any country the interest in hydrogenation is serious, or that developments in such country are likely to affect I.H.P.'s position adversely, then I.H.P. should discuss the matter actively with the interested parties, and attempt to persuade them that its process should be used. . . .

If coal, tar, etc., hydrogenation be feasible from an economic standpoint, or if it is to be promoted for nationalistic reasons or because of some peculiar local conditions, it is better for us as oil companies to have an interest in the development, obtain therefrom such benefits as we can, and assure the distribution of the products in question through our existing marketing facilities.

G. STOCKING & M. WATKINS, CARTELS IN ACTION 491-93 (1946) (footnotes omitted).

27. *See, e.g., Interfuel Competition: Hearings Before the Senate Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary*, 94th Cong., 1st Sess. (1975); *Horizontal Integration of the Energy Industry: Hearings Before the Subcomm. on Energy of the Joint Economic Comm.*, 94th Cong., 1st Sess. (1975) [hereinafter cited as *Horizontal Integration Hearings*].

been the industry's law firm, the Interior Department its Washington office.[28] No wonder that the industry is sometimes depicted as

28. *See* R. ENGLER, THE BROTHERHOOD OF OIL: ENERGY POLICY AND THE PUBLIC INTEREST (1977); R. ENGLER, THE POLITICS OF OIL: A STUDY OF PRIVATE POWER AND DEMOCRATIC DIRECTIONS (1961). The erstwhile description of the political influence of oil—according to which "the Standard has done everything with the Pennsylvania legislature except to refine it"—may no longer be apt, but the omnipresence of oil in the corridors of political power is unshaken. Respectable men with bulging briefcases still penetrate the portals of government. As Sampson reports, the oil companies contributed

> generously to the Republican Party, and President Nixon's fundraisers, Maurice Stans and Herbert Kalmbach, leaned heavily on them to help finance the notorious 1972 campaign. Four of the sisters contributed substantially, mostly through individuals. Officials of Exxon gave $217,747 led by the chairman, Ken Jamieson ($2,500), the president Jim Garvin ($3,200) and the head of their Greek affiliate, Thomas Pappas ("the Greek bearing gifts") ($101,672): while the Rockefeller family gave $268,000. Socal gave $163,000, led by their chairman, Otto Miller ($50,000) and including $12,000 from John McCone. Mobil gave only $4,300, and Texaco (whether through caution or meanness) apparently gave nothing. By far the biggest contributor was Gulf whose offerings included a million dollars given clandestinely by Richard Mellon Scaife, a major Gulf shareholder with his own political ambitions; and at least $100,000 which was produced through the Bahamas subsidiary of Gulf by the chief lobbyist of the company, Claude Wild. The eventual discovery of these illegal gifts, and of others, was to bring back all the old public suspicions of the corruptions of oil money.
>
> The global scope of the oil money, however, was not to emerge until 1975, when the Securities and Exchange Commission began investigating political contributions. In April 1975 Gulf were eventually compelled to admit, in their 1975 proxy statement, that between 1960 and 1973 "approximately $10.3 million of corporate funds were used in the United States and abroad for such purposes, some of which may be considered unlawful". Soon a succession of countries—Venezuela, Bolivia, Peru, Ecuador—demanded to know whether their politicians had been bribed, and Peru even expropriated Gulf's properties. Eventually the chairman of Gulf, Robert Dorsey, had to confess to having paid bribes of $4 million from 1966 onwards to the ruling party in South Korea; and to having given another $350,000, together with a helicopter, to the late General Barrientos in Bolivia. The limelight then shifted to Exxon, whose chairman, Ken Jamieson, had to admit in May 1975 that his company had made political contributions in Canada and Italy; and a new uproar ensued.

SAMPSON, *supra* note 1, at 206-07. One indication that such efforts are not in vain is the generous tax treatment Congress has accorded the oil industry over the years:

U.S. TAXES PAID BY THE AMERICAN SISTERS*

	1972		1962-1971	
Company	*Net income before taxes* ($ billions)	*% paid in U.S. taxes*	*Net income before taxes* ($ billions)	*% paid in U.S. taxes*
Exxon	3.700	6.5	19.653	7.3
Texaco	1.376	1.7	8.702	2.6
Mobil	1.344	1.3	6.388	6.1
Gulf	1.009	1.2	7.856	4.7
Socal	0.941	2.05	5.186	2.7

a government-sanctioned, government-protected, government-subsidized cartel operating a finely tuned scheme to restrict output and maintain prices on a worldwide scale.[29]

In summary, introduction of the "moderate" concentration ratios recorded in Table 1 as proof that the oil industry is competitive in structure is disingenuous indeed. These ratios, as has been demonstrated, seriously understate the pervasive horizontal control exercised by the petroleum giants and, when simplistically accepted at face value, conceal the worldwide dominance of these giants over energy reserves.

III. THE REINFORCEMENT OF SHARED MONOPOLY POWER THROUGH VERTICAL INTEGRATION

Vertical integration by corporate giants is the capstone of control in the petroleum industry. As the mechanism for harnessing and transmitting market power through the successive stages of production, refining, and marketing, vertical integration constitutes the primary barrier to new competition. Specialized firms at any one stage of the industry must live at the sufferance of the integrated majors—vulnerable to the constant threat of price squeezes, the denial of supply, and the foreclosure from markets. The very fact of vertical integration, therefore, militates against workable competition in the petroleum industry and relegates competition to the interstices and fringes of the marketplace.

For example, the combined effect of vertical integration and the depletion allowance encouraged the integrated companies to report their profits at the crude oil stage rather than at the refining or marketing stage. The majors accomplishsd this objective by posting a high price on crude oil, which they then sold to their own refineries as well as to independents. For the vertically integrated companies, the high price for crude was simply a bookkeeping transaction. Its effect was to increase profits on crude, to reduce tax payments, and, in spite of lower profits at the refining stage, to increase total profits for the integrated concern. For the independent refiner, by contrast, the increase in crude prices meant a decrease in both refining profits

*Source: *Multinational Corporations and United States Foreign Policy: Hearings Before the Senate Subcomm. on Multinational Corporations of the Senate Comm. on Foreign Relations, Part 4*, 93d Cong., 2d Sess. 104 (1974), *quoted in* SAMPSON, *supra* note 1, at 205.

29. *See, e.g.*, *Horizontal Integration Hearings*, *supra* note 27, at 108; INVESTIGATION OF THE PETROLEUM INDUSTRY, *supra* note 6, at 27.

and total profits; nonintegrat he could not recoup the narrowed margins in refining at some other stage of operations.[30]

To illustrate, assuming a 27.5 percent depletion allowance, an integrated concern that could supply seventy-seven percent of its refinery needs with its own crude oil production stood to gain from an increase in crude prices even if the increase was not passed on at the refining stage. If the integrated company had a self-sufficiency ratio in excess of 38.5 percent, it stood to gain even if it passed on only half of the crude oil price increase.[31] In other words, an integrated company could decide to operate its refineries at zero or subnormal profits and thus discipline, squeeze, or bankrupt the nonintegrated refiners who are both its customers for crude and its competitors in the sale of refined products. (Incidentally, fifteen of the top seventeen refiners in the United States have a crude oil self-sufficiency ratio in excess of 38.5 percent.[32])

As the Federal Trade Commission concluded in its recent petroleum report, "The vertical integration system contained all the elements essential to a squeeze on refining profits and could be overcome only if the potential refining entrant could enter the industry on a vertically integrated basis."[33] By thus raising the cost of entry at the refining stage, vertical integration in and of itself becomes a formidable entry barrier that few newcomers can afford to hurdle. The system is also a barrier to established, independent refiners, many of whom eventually give up the battle for survival and sell out to their integrated rivals. (Incidentally, acquisitions of independent refiners accounted for 40.7 percent of the increase in refining capacity among the top twenty oil companies between 1959 and 1969.[34])

The control of pipelines by the vertically integrated majors poses a similar problem. A pipeline rate set well above the competitive cost of transporting crude oil, for example, imposes no burden on the majors who own the pipeline. For them, the high price is simply a bookkeeping transaction involving a transfer of funds from the refinery operation to the pipeline operation. To the nonintegrated refiner, however, an excessive pipeline charge is a real cost increase that he cannot recoup elsewhere and that places him at a

30. Investigation of the Petroleum Industry, *supra* note 6, at 12-31.

31. M. De Chazeau & A. Kahn, Integration and Competition in the Petroleum Industry 221-22 (1959). *See also* Kahn, *The Depletion Allowance in the Context of Cartelization*, 54 Am. Econ. Rev. 286-314 (1964).

32. Investigation of the Petroleum Industry, *supra* note 6, at 20.

33. *Id.* at 26.

34. *Market Performance and Competition in the Petroleum Industry: Hearings Before the Senate Comm. on Interior and Insular Affairs, Part 1*, 93d Cong., 1st Sess. 1664 (1973).

competitive disadvantage vis-à-vis his integrate ompetitors.

The implications of the integrated majors' control over pipelines has been explained by Beverly Moore as follows:

> Almost every one of the major pipeline systems constructed since World War II is jointly owned by the few companies which dominate the marketing areas which the pipelines serve. From the standpoint of the owners, the arrangement is perfectly natural.
>
> If a few companies wish to exploit a market by constructing a joint venture pipeline to it, they will have little interest in inviting all their actual and potential competitors to come along with them. Likewise, the owners will have an incentive to lay the line so that it or its feeder spurs will pass in close proximity to their own refineries and marketing terminals, but not to those of their nonowner competitors. The owners will have an incentive to provide input and output facilities, storage tanks, and synchronization geared to their own operations, but again not to those of their nonowner competitors.
>
> The result is that, while joint venture pipelines are theoretically common carriers, equally accessible to all, access can be substantially more expensive for nonowners than for owners.
>
> This initial disadvantage is widened by the fact that the nonowner must pay the full rate or tariff while the owner actually pays only the pipeline cost, recouping the difference through the pipeline company's dividend payments to him. The rate-cost differential which measures this further degree of discrimination is commonly as high as 20 to 30 percent.[35]

The integrated majors also can use their control of pipelines as an entry barrier if they choose to exclude or limit flows of crude oil to the independents. According to the Federal Trade Commission's 1973 report:

> This can be done by (1) requiring shipments of minimum size, (2) granting independents irregular shipping dates, (3) limiting available storage at the pipeline terminal, (4) imposing unreasonable product standards upon inde-

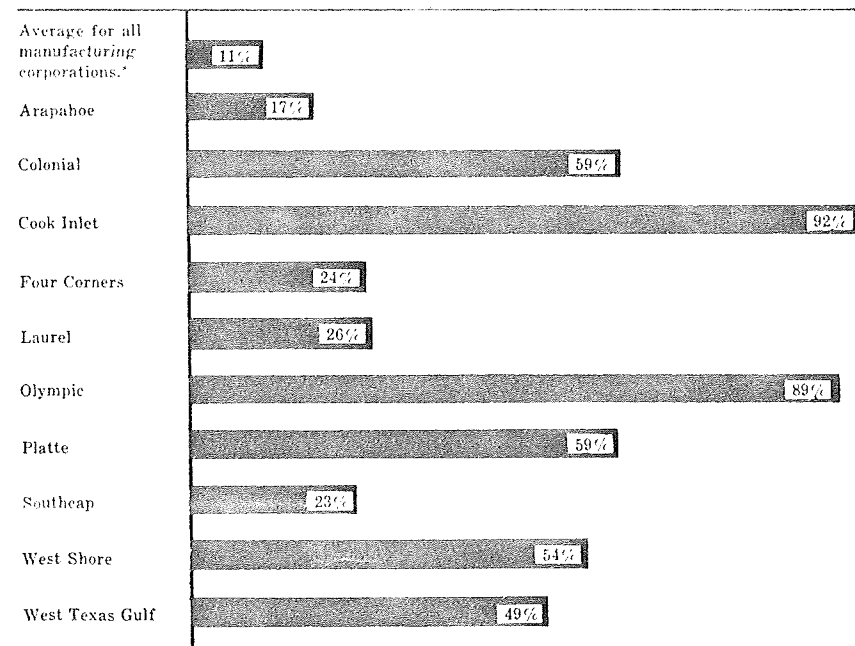
35. *Anticompetitive Impact of Oil Company Ownership of Petroleum Products Pipelines: Hearings Before the House Subcomm. on Special Small Business Problems of the House Select Comm. on Small Business*, 92d Cong., 2d Sess. 129 (1972). The argument that pipelines are common carriers regulated by a government agency is hardly convincing when one examines the following profits data:

pendent customers of pipelines, an employing other harassing or delaying tactics.[36]

The companies controlling the pipelines control, to a large extent, the oil moving through those lines and determine the allocation of that oil among nonintegrated refiners. In addition, as Interstate Commerce Commission statistics for 1973 indicate, ninety-two percent of the crude going into reporting lines was owned individually or jointly by the sixteen majors.[37] Thus, through control of crude oil supplies or through ownership of pipelines, vertical integration gives the majors dominating the petroleum industry the power to mollify, discipline, coerce, and exclude their nonintegrated rivals. It empowers them to determine the conditions for entry and the rules for survival in the petroleum industry.

The consequences of vertical integration by the major oil companies are particularly striking in the international sphere. The

PIPELINES: AVERAGE ANNUAL RETURN ON PAID-IN INVESTMENT, 1968-72



*FTC, QUARTERLY FINANCIAL REPORT FOR MANUFACTURING CORPORATIONS (1968-72).

Source: ICC, TRANSPORT STATISTICS IN THE UNITED STATES, PIPELINES, PART 6, (1968-72).

36. INVESTIGATION OF THE PETROLEUM INDUSTRY, *supra* note 6, at 26.
37. ICC, TRANSPORT STATISTICS IN THE UNITED STATES, PIPELINES, PART 6, at 8-11 (1973).

ability of OPEC to limit output and to maintain aise its revenue levels rests upon its ability to proration production cutbacks satisfactorily among its member countries. OPEC, in other words, needs an agency to perform for it the same function as the Texas Railroad Commission traditionally performed for the domestic industry. To the extent that OPEC can rely upon the integrated oil companies to serve as its prorationing and marketing agent or, in other words, to the extent that it can rely upon these companies to exercise coalescing rather than countervailing power, it can assure the viability of its worldwide control over oil prices. That the companies more or less willingly have lent themselves to the attainment of that objective was made clear by the Church Committee:

> First, access to crude oil is the necessary precondition for an oil company to stay in business. In a supply-limited situation a refiner without secure access to crude is faced with the high probability of being unable to operate. Second, the price at which OPEC sells oil to companies other than the traditional concessionaries has, up to this time at least, been somewhat higher than the cost of similar oil to the established majors. One reason for this differential has been that the established companies have continued to lift some part of the oil produced within their concessions at tax paid cost, i.e., the cost of production, plus royaltie plus taxes rather than at the higher buyback price. Finally, certain tax advantages which reduce the real cost of oil accrue to a company from its ownership of equity oil in a foreign producer country. Thus, for example, a company which lifts part of its foreign oil at tax paid cost may presently credit the income tax portion of that cost against its U.S. tax liability on other foreign income.
>
> Multinational oil corporations are currently engaged in a series of negotiations designed to ensure their exclusive right to "buyback" oil—oil which has become the property of the producer countries by virtue of the various participation "agreements", and which those countries now wish to sell back to the previous company concession holders. The four Aramco shareholders—Exxon, Texaco, Socal and Mobil—by joint negotiations seek to establish a special relationship with Saudi Arabia which would give them preferential access to the Saudi crude oil supply at a discount off the going market price, even should that country acquire 100 percent of Aramco.
>
> The multinational oil companies, on the other hand, provide the OPEC with important advantages. As vertically-integrated corporations, the major oil companies guarantee OPEC members an assured outlet for their production in world markets. The primary concern of the established major oil companies is to maintain their world market shares and their favored position of receiving oil from OPEC nations at costs slightly lower than other companies. To maintain this favored status, the international companies help proration production cutbacks among the OPEC members. Their ability to do this derives from the existence of their diversified production base in OPEC countries.[38]

The importance to the OPEC countries of maintaining common

38. SENATE COMM. ON FOREIGN RELATIONS, 93D CONG., 2D SESS., REPORT ON MULTINATIONAL OIL CORPORATIONS AND U.S. FOREIGN POLICY 10 (1975) [hereinafter cited as MULTINATIONAL OIL CORPORATIONS].

interests with the integrated majors was not lost on the prime movers in the cartel. Said Sheik Zaki Yamani, Saudi Arabia's Minister of Petroleum:

> . . . Nationalization of the upstream (production) operations would inevitably deprive the majors of any further interest in maintaining crude-oil price levels. They would then become mere offtakers buying the crude oil from the producing countries and moving it to their markets in Europe, Japan and the rest of the world. In other words, their present integrated profit structure, whereby the bulk of their profits are concentrated in the producing end, would be totally transformed. With the elimination of their present profit margin of, say, 40 cents a barrel from production operations, the majors would have to make this up by shifting their profit focus downstream to their refining and product-marketing operations. Consequently, their interest would be identical with that of the consumers—namely, to buy crude oil at the cheapest possible price.[39]

In other words, by avoiding nationalization of the integrated majors' crude oil properties and instead entering into participation agreements with them, the companies would be given an incentive to identify with OPEC interests rather than with the interests of consuming countries. In the words of Sir Eric Drake, the companies would not only be the tax collectors for the producers;[40] they now would be much closer partners, serving also as OPEC's prorationing and marketing mechanism. In effect, as Professor M.M. Adelman has stated, they would be the "agents of a foreign power."[41]

The Church Committee summed up the symbiotic relationship between OPEC and the integrated majors in the following fashion:

> Thus the current changeover from the concession system to exclusive long term, large-volume supply contracts does not alter the interest that the international oil companies have in helping OPEC carry out its production and pricing policies. So long as the individual OPEC countries have assured outlets for their oil through exclusive joint arrangements with the major oil companies, the divisions within OPEC are unlikely to manifest themselves in lower oil prices, even in the face of a worldwide surplus of crude oil productive capacity estimated at over eight million barrels per day. There are, thus, parallel interests between OPEC and the major oil companies in which the companies ensure their access to the crude but at the price imposed by OPEC regardless of a theoretical crude oil surplus.[42]

39. *Id.* at 11.

40. SAMPSON, *supra* note 1, at 236.

41. *Id.* As Adelman put it to the Senate Committee on Foreign Relations, "The cartel governments use the multinational companies to maintain prices, limit production, and divide markets. This connection, I submit, is the most strategic element in the world oil market." *Multinational Corporations and United States Foreign Policy: Hearings Before the Senate Subcomm. on Multinational Corporations of the Senate Comm. on Foreign Relations, Part 2*, 94th Cong., 1st Sess. 3 (1975).

42. MULTINATIONAL OIL CORPORATIONS, *supra* note 38, at 11.

In short, the very logic of vertical integration has per[illegible]ed the Seven Sisters and the lesser international majors to enjoy a tenuous co-habitation arrangement, if not an indissoluble marriage with the OPEC producers.

The implications for consumer interests have been clearly spelled out by Walter Measday:

> So long as they can control the marketing of OPEC oil, the integrated majors have little reason to oppose OPEC price increases. They can pass such increases through into the prices of their own products secure in the knowledge that competitors, who are also their customers, are not getting oil any cheaper. They may, indeed, enjoy positive benefits from OPEC price increases through the enhanced values of the reserves which they still possess.
>
> The Prudhoe Bay field alone provides an example here. Each one dollar increase in the value of a reserve barrel raises the North Slope assets of Exxon, Atlantic Richfield and Sohio/BP by a minimum of $10 billion and probably much more—the improvement in asset values is none the less real because it is off-balance sheet. A good case can be made that had it not been for the Arabs, the North Slope would have been a financial disaster, given the escalation in pipeline construction costs. As it is, a recent estimate forecasts profits in the range of $2.00 a barrel for production delivered from this area. Similarly, North Sea oil has been made profitable only through OPEC actions. There is, in short, no great divergence—now that OPEC ownership of [illegible] has been accepted—between the interests of the international majors and the interests of OPEC member nations.[43]

All that has happened since 1973 is the replacement of Seven Sisters private cartel by a cartel of OPEC governments working hand-in-glove with a consortium of vertically integrated international oil giants.

IV. VERTICAL INTEGRATION AND EFFICIENCY

In appearances before Congress and in releases to the media, industry spokesmen are fond of picturing the vertical integration of major oil companies as a finely tuned machine assuring a smooth and continuous flow of materials from the crude fields to service stations. Tampering with that machine, they claim, would make coordination and planning of supply more difficult, would result in wasteful duplication, would increase overhead costs, and generally would entail sizable losses of efficiency. Vertical divestiture, they say, would saddle consumers with higher costs for heating fuel and gasoline.[44]

Little hard-core evidence supports these claims. Indeed, the evidence *produced by the integrated majors themselves* points in

43. Measday, supra note 23, at 11.

44. *See, e.g., Vertical Integration Hearings, Part 1, supra* note 9, at 131 (testimony of Frank Ikard).

the opposite direction. First, there is no such thing as a continuous flow from a major's crude field to its own refinery and through its own marketing organization into its own branded gas pumps. As was noted above, the major companies systematically exchange crude as well as refined products through a system of simultaneous purchases and sales agreements. An indeterminate and probably modest proportion of a major's oil moves in a continuous flow through its own vertical system. Exxon admitted as much in testimony before the Senate Antitrust and Monopoly Subcommittee in 1975:

> It is not possible to trace Exxon-owned feedstocks to each refinery. Exxon's crude production is often commingled with purchased crude, part of the commingled stream sold to others, and some Exxon crude is sold outright. For example, during 1974, Exxon's net crude plus condensate production was 701 [million barrels per day]. We purchased 868 [million barrels per day] from others (including royalty oil), and we sold 780 [million barrels per day] to others.[45]

In other words, Exxon operates a crude oil business, supplied in part from its own wells and in part by outside firms, and distributed in part to Exxon's refineries and in part to other refiners.

Second, the majors repeatedly argue, when the argument suits their purpose, that the functional components of their vertical organization operate quite independently from one another. Thus, Exxon told the South Carolina Tax Commission:

> Each of these functions is managed and accounted for on a functional operating basis. Each is a segment of [Exxon's] total corporate enterprise, but each has its own accounting, budgeting and forecasting, its own management and staff, its own profit center, its own investment center, its own physical facilities, etc. The profit or loss of each function is separately and accurately computed.[46]

Similarly, before the Wisconsin Tax Appeals Commission, Exxon argued:

> [N]one of [Exxon's] functional departments are integral parts of a unitary business composed of all functions combined; rather it [Exxon] will show that each function is independent and not unitary to, or an integral part of, any other function.[47]

45. *The Industrial Reorganization Act: Hearings on the Energy Industry Before the Senate Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary, Part 9*, 94th Cong., 1st Sess. 529 (1975). Professor Adelman underscored this point in his assessment of the logic of vertical integration in petroleum:

> The industry's job, of arranging an immense flow of sticky combustible liquids, is made no easier or harder by common ownership of the segments. A company that on paper is balanced and produces "enough" crude for its own use actually has to dispose of much of most of it to others. Oil is where you find it, scattered in thousands of fields all over the country or the world. It often doesn't pay to bring it home.

PETROLEUM INDUSTRY COMPETITION ACT REPORT, *supra* note 2, at 125.

46. *Vertical Integration Hearings, Part 2*, *supra* note 9, at 1174.

Apparently oblivious of the industry's claim that divestiture would result in the wasteful multiplication of company headquarters, one of Exxon's senior vice presidents explained the organization of his company's production, refining, and marketing departments to the Wisconsin Commission as follows:

> [E]ach of the operating departments had its own separate management responsible for the proper conduct of that operation. Each of these management managers had a technical staff to provide all the supporting technical service that he needed to operate his particular operation. He also had the administrative staff when necessary to assist him. Each of these departments had its own separate and distinct field organization which conducted the operations in the field.
>
> . . . .
>
> . . . [W]hen all these elements are taken together the entire organization of each of these separate functional segments is designed to permit them to operate independently and separate from each other segment . . . [T]hey were on a self-sufficient basis, except . . . the availability of some of the Coordination and Service Departments which was provided at the corporate level. These departments were free to consult with those staff departments, if they felt it was necessary.[48]

Equally revealing is the testimony of Dr. Ezra Solomon, a former member of the President's Council of Economic Advisors, appearing on behalf of Exxon before the Wisconsin Commission. Dr. Solomon gave the following answers in response to questioning by Exxon's counsel:

> Q. Do you have an opinion . . . as to whether Humble [i.e., Exxon] was a unitary company?
> A. No, by my definition. If it is integrated, it is by definition not unitary.
> Q. And on the same basis do you have an opinion as to whether the functional operations of the Humble Exploration and Production Department, the Refining Department and the Marketing Department were carried on as separate businesses?
> A. Yes, there are three separate unitary businesses, and if I remember right, there were even more, but these are the major important stages that a vertically integrated company combines.
> Q. Each stage, E and P, Refining and Marketing, you would say were separate businesses?
> A. Yes.
> Q. On the same basis do you have an opinion as to whether or not the Wisconsin Marketing operations were an integral part of the Humble E and P function?
> A. No, they are not.
> Q. Did you find any economic dependence between the Wisconsin operation and the E and P Department?

47. *Id.* at 1229-30.

48. *Id.* at 1285, 1293.

A. No, none whatever. It appears that Humble's E and P Department was a functioning unit even before there were any Wisconsin operations.

. . . .

[Dr. Solomon] A. Could Humble's E and P Department sever its relationship with the Wisconsin operation without affecting the Wisconsin operation?

[Mr. Ragatz] Q. Right.

A. Yes, I imagine it could.

Q. And could the Wisconsin Marketing operations have been severed without damage to the E and P function?

A. Yes, the Wisconsin Marketing end of it didn't exist for a while, and after it existed, it could have been severed without affecting the E and P viability.

Q. Now, on the same basis as I previously asked, do you have an opinion as to whether the Wisconsin Marketing operations were during the years in issue an integral part of the Humble Refining Department?

A. They were not.

Q. Was there any economic dependence in that relationship?

A. Not that one could see from the record at all. The Refining Department was a unitary business that could have functioned with or without the Wisconsin Marketing.

Q. And so there was no—or the Department could have been feasibly economically severed without damaging the Wisconsin Marketing operations?

A. You could have a Wisconsin Marketing operation without having a Refining Department.

Q. Then in other words, there was an ample supply of products without obtaining them from Humble Refining?

A. That's correct.

Q. Could the Wisconsin Marketing operations have been feasibly economically severed without damaging Humble's Refining Department operations?

A. Yes.

Q. So there was an ample demand for Humble's Refining product without the Wisconsin market?

A. Yes.

Q. And going back to the E and P Department for a minute, I take it that in the market there would be an ample demand for crude oil without the Humble Refining Department being in the picture so that Humble's E and P Department could have disposed of its crude oil produced?

A. Yes. Many companies exist as crude oil producers.

Q. And as to the Refining Department, there was an ample supply of crude oil in the market so that the Refining Department was not economically dependent upon Humble's E and P Department?

A. Not in the sense that I am using the word here.

Q. And the two departments could have been economically severed on a feasible basis?

A. The very fact that refineries exist as independent refineries and producers exist as independent producers and on a fairly large scale suggests that this can be done.[49]

Later, after counsel for the State of Wisconsin had finished his cross-examination, Exxon's counsel resumed his questioning of Dr. Solomon:

49. *Id.* at 1739-42.

Q. Professor Solomon, on cross-examination you were asked questions that seemed to be driving at a dependent relationship between separate functions of an integrated oil company. Would you comment on the concept of dependence in terms of demand and supply in the market itself as to whether or not everybody in business has some dependency on market conditions and distinguish that from an economic dependency in terms of the concept of unitary?

A. Well, in the case of a unitary business, the degree of dependence between the subcomponents that comprise that unit are very strong. They are essential, they are necessary. You could not feasibly run it in today's economy, or whatever economy we are talking about, without all of those components.

In the case of a vertically-integrated company, the presence of business or unitary businesses within the vertical combination, the dependence is not as strong at all. It is quite a bit weaker. There is, obviously, some advantage for each unitary business belonging in a family of businesses. Size alone does provide some help. That degree of dependence is sort of trivial compared to the interdependence within each unit itself.

Q. In the market could you say that the dependence for a refinery would be that there be a supply of crude in the general market itself and that there not be a dependence between ownership of a producing function and a refining function?

A. Well, the common ownership of the two functions is not all that important in terms of the demand and supply of the flow of product, either crude or the products that come out of them. There is a well-established market for crude petroleum. It has a daily quotation. A refinery can buy there, a crude producer can sell there. Likewise, at the refined end there is a clear cut market for petroleum products in which a lot of people engage and in which there are daily quotations so that the degree of dependence is not that great at all.

Q. In other words the refinery can get crude from market sources that have no ownership relationship to the refinery and, in turn, can sell its product to the market sources that have no ownership relationship to the refinery?

A. Quite. The total demand and supply for crude is balanced. It really doesn't matter where you get it. It's the same kind of thing and you get it at the same price anyway.[50]

"Truth," it seems, depends upon the forum in which the majors happen to be testifying. In one case, vertical integration is indispensable for efficiency and cost minimization; in another, it does not seem to make much difference.

Professor M.M. Adelman, who, incidentally, does not support vertical divestiture, has made perhaps the most forthright judgment of the industry's efficiency argument:

> The industry's contention, that vertical integration helps efficiency, is unfounded. Common ownership of these activities, by one company, neither saves money nor costs any. (There are bound to be some exceptions to the rule; relatively, they are unimportant.) Most companies became integrated long ago for reasons that are now history. They have stayed integrated because there is no reason to change.[51]

50. *Id.* at 1750-52.

51. Washington Post, April 30, 1976, § D, at 9, col. 7, *quoted in* Petroleum Industry Competition Act Report, *supra* note 2, at 139.

In addition, interposing g[illegible]ne markets between successive stages of the oil industry would not impair efficient operations. Given past experience, however, such markets certainly would enhance competition by lowering the entry barriers to newcomers at all levels of the industry.

V. The Feasibility of Divestiture

After extensive hearings on S. 2387, the Senate Subcommittee on Antitrust and Monopoly concluded that divestiture of the vertically integrated petroleum majors is not only desirable, but feasible.[52] Divestiture is technically feasible because, as has been noted already, the majors operate their departments as functionally separate units. Several companies, including Gulf, Sun, and Continental, already have restructured their organizations to place production activities within wholly owned subsidiaries that are separate from other functional subsidiaries. Other companies have a similar functional separation in their organizations, although they operate through separate divisions rather than through distinct subsidiaries. In other words, they already have accomplished *technical* divestiture as a result of internal management decisions. As counsel for Exxon told the Wisconsin Tax Appeal Commission:

> The evidence will show that Humble [Exxon] was organized on a functionally independent basis, and that its separate functions were operated as separate businesses in competition with other oil companies having similar functions and other companies which only operated in the business activity of a particular function.
>
> We intend to develop through the evidence the functional independence of the various departments.[53]

As for the *financial* feasibility of divestiture, courts are fully equipped to handle the remedy's problems—problems no less routine than those arising from bankruptcies and voluntary spinoffs in cases of corporate reorganizations. As one expert in the field told the Subcommittee,

> All of the activity which I have described in general terms should provide us with a measure of comfort, in that we are not without the requisite legal, accounting and financial expertise to accomplish complex corporate transactions of substantial magnitude without making economic tidal waves and without transcending the constitutional limitations of due process and on deprivation of property rights. These have been accomplished in the main, without denigrating the rights of shareholders, debtholders, or other creditors and

52. Petroleum Industry Competition Act Report, *supra* note 2, at 147-50.
53. *Vertical Integration Hearings, Part 2*, *supra* note 9, at 1219-20.

> where the rights of shareholders, debtholders or creditors have been affected, our judicial system has adequately dealt with these situations.[54]

Experience with the Public Utility Holding Company Act of 1935 indicates that massive divestiture can take place without crippling the reorganized industry, damaging the efficiency of its operations, or riding roughshod over the interests of stockholders or creditors.[55]

Rearranging stockholder equities would be the simplest problem. If past practice is followed, the petroleum majors would be reorganized into functional subsidiaries whose stock would either be sold off or, more likely, distributed to existing stockholders with the proviso, of course, that the interests controlling the company before divestiture would not control more than one of the functionally separate successor companies. Management of the corporate debt, issued with the backing of the full faith and credit of a corporate entity that is to be altered substantially by divestiture, would pose a stickier problem. Debt under covenants of this type clearly might have to be refinanced. If securities issued in the past at a relatively low rate of interest must be refinanced at a time when interest [illegible] are higher, the major concern would be the effect on the embedded cost of a company's debt. As Walter Measday points out, however, such problems are not insoluble:

> An example of one such solution is the recent divestiture of Northwest Pipeline by El Paso, which affected 26 series of El Paso's long-term debt. By court order, each of these series was replaced by an El Paso issue and a Northwest issue bearing the same maturities as the original series but with a 1/8 percent higher interest rate "to sweeten the deal." The ratio between the two companies' debt is the proportion between the taxable basis of properties retained by El Paso and those transferred to Northwest. In other words, an investor in El Paso 5's issued in 1962 and maturing in 1982 now holds El Paso 5-1/8's and Northwest 5-1/8's, still maturing in 1982. The increase in interest rate is minor compared to the inflation in rates since 1962, while the value of the securities to investors has been enhanced.[56]

Such problems, although obviously not devoid of complexity, clearly are soluble without prejudice to investor interests.

Moreover, companies threatened with divestiture would not likely find the raising of needed funds in the capital market an impossible task. For example, Georgia Pacific, which was the subject of an FTC divestiture action, was able to raise nearly 500 million dollars in debt on favorable terms in the short period between

54. *Id.*, *Part 3*, at 2049.
55. *Study of Monopoly Power, Hearings Before the Subcomm. on Study of Monopoly Power, House Comm. on the Judiciary*, 81st Cong., 1st Sess. 1339-53, 1460-69 (1949).
56. Measday, *supra* note 23, at 21-22.

the announcement of the [illegible]s complaint and the spinoff of Louisiana-Pacific pursuant to a voluntary consent settlement.[57] Similarly, in the six years between the filing of the FTC's complaint against Kennecott, in which the government sought divestiture of Peabody Coal, the company raised at least 700 million dollars on terms at least as favorable as those available to most other large corporations. Indeed, six months *after* the Supreme Court denied certiorari in the case, Kennecott obtained a revolving credit of 250 million dollars—at the prime rate for two years and thereafter at one-fourth above the prime rate until the last two years of the loan, during which an interest charge one-half above the prime rate was to be in effect.[58] The investment community apparently views the "uncertainties" of divestiture with considerably more equanimity than many other risks to which its business clients may be subject.[59]

A vertical divestiture action against the petroleum majors should be an even less than average cause for concern. Contrary to the industry's dire forebodings about "disintegration" and "dismemberment"—implying that the majors would be broken down to the size of the neighborhood gasoline station—the successor companies still would be corporate entities of impressive size and power. In the words of the Senate Subcommittee:

> Exxon was the largest U.S. manufacturing company, in terms of 1974 assets, on the Fortune "500" list. Divested, Exxon's manufacturing—refining, chemicals, etc.—and marketing assets would have totaled about $15.8 billion, surpassed only by General Motors—$20.5 billion. Exxon's producing operations—$10.5 billion in assets—would have been in sixth place—behind General Motors, Exxon manufacturing and marketing, Ford, IBM, and, by a narrow margin, I.T.&T. Exxon Pipe Line Co., with assets of $709 million, would have been nearly within the top 200 companies.
>
> Marathon Oil, smallest of the majors in assets, ranked No. 77 on this basis among U.S. companies in 1974. The surviving producing operation—$883 million in assets—would still have been among the top 200 companies, as would refining and marketing—$751 million. Even Marathon Pipe Line Co.'s assets—$102 million—were within the range spanned by the 500 largest companies.[60]

If the successor companies resulting from divestiture of the petroleum giants were to find survival difficult or if they were to find raising capital impossible in spite of sound management, the 99.8 percent of United States manufacturing firms that are smaller than those successors must abandon hope.

57. Petroleum Industry Competition Act Report, *supra* note 2, at 134-35.
58. *Id.* at 133-34.
59. Measday, *supra* note 23, at 22.
60. Petroleum Industry Competition Act Report, *supra* note 2, at 132-33.

VI. Conclusion

In its report on S. 2387, the Senate Judiciary Committee recommended that the eighteen vertically integrated petroleum giants be reorganized into separate producing and refining-marketing companies and that all pipelines be reconstituted as independent common carriers having no interest in the crude oil and products being transported through them.[61] The Committee assured the Senate that the proposed divestiture could be accomplished:

> Without the loss of managerial and operating efficiencies;
> Without inhibiting needed capital investments;
> Without injuring investors in the companies;
> Without inhibiting the timely growth of energy supplies.[62]

The Committee expressed the confidence that implementation of its divestiture proposal would:

> Allow the development of free markets in crude and products;
> Bring about increased efficiencies in the industry;
> Deliver products and services at the best prices to consumers;
> Protect the independent refiners and marketers from extinction without requiring Government intervention;
> Remove the Government from various phases of the industry's operation;
> Put pressure on the operation of the OPEC cartel;
> Forestall the nationalization of the oil industry.[63]

In the light of available evidence, these contentions seem eminently reasonable, especially because the policy alternatives to divestiture—the status quo, governmental regulation, or nationalization—clearly are deficient in protecting the public interest.

61. *Id.* at 5.
62. *Id.* at 6.
63. *Id.*

2-21-79

My name is Tom Platis. I am General Counsel for Highway Oil, Inc. I am also General Counsel for Hi-Lo Oil Co., Inc., Workingman's Friend Oil, Inc., Fairway Oil, Inc., and Cook Oil Co., Inc.

Highway Oil, Inc. was started in 1959 as a new marketing concept in the retail sale of gasoline by Mr. A. B. Hudson. Prior to the formation of Highway Oil, Mr. Hudson was involved with his family who owned and operated service stations since 1932.

Highway Oil, Inc. and its affiliates retails motor gasoline through 220 stations in 28 states. In addition to gasoline, it retails motor oil and transmission fluid, but is not involved in any service work or tires, batteries and accessories programs. It accepts no credit cards, making 100% of its sales to the ultimate consumer on a cash basis. We obtain supplies from the best available source. We do not advertise, and we avoid expensive locations. The sale of motor gasoline is through two twin-dispensing pumps during the hours of 6:00 a.m. and 9:45 p.m., seven days a week and uniquely operates with only one driveway attendant per shift. Generally, we would be classified as full service inasmuch as we deliver the product to the vehicle, wash the windshield and make proper change. However, in recent months, we have installed a new set of pumps which offers the public self-service. Gasoline supplies are purchased on a spot basis from pipeline terminals or water terminals most convenient to the particular stations which are in need of product. Delivery to the stations from the terminals is accomplished by common carrier transport truck. In a few instances product is purchased from jobbers or distributors who deliver in their own private truck. Historically, this

type of purchase and delivery is the manner in which nonbranded, independent marketers have obtained their supplies. It has been the most convenient method since the inception of service stations and provides purchase leverage in favor of the nonbranded independent marketer since he is not committed to any contract from any particular supply. If for example gasoline is available for any one station at a cheaper price, it is a small matter to inform the common carrier to discontinue loading from one supplier in favor of the cheaper priced product.

MARKETING

Highway Oil enjoys the largest per unit gallonage average in the retail sale of motor gasoline which, in one year, was in excess of 120,000 gallons per month per station. Our marketing philosophy is responsible for that high figure which centers around those concepts of no credit cards, a limited size outlet, an overall low overhead cost and the philosophy of selling our product on the street at the same price or lower as the lowest competitor.

SUPERVISION

The Company is headquartered in Topeka, Kansas, and the home office is responsible for the overall administration and supervision of all retail outlets all of which are wholly-owned and operated by the Company. We have 23 District Supervisors who are responsible for approximately 10 stations each. Our station personnel are salaried with commission incentive and all employees are totally answerable to Highway Oil for compliance with all policies and procedures. Highway Oil is respected in the industry for having the tightest

inventory and cash control with losses minimized to the point that insurance coverage is not beneficial.

However, there has been a change in the marketing of gasoline at the consumer level since the shortage of gasoline supplies in 1973. The shortage brought home the fact that suppliers were given preferential treatment to their own service station outlets. During the time of the shortage in 1973, Highway Oil had to padlock over 40 service stations because the gasoline we had been buying from our suppliers was diverted to their own service stations. This shortage in 1973 was a direct threat to the small businessman who was operating his own service station. The direct effect on Highway Oil was that we can no longer boast that the average gallonage per unit is 120,000 gallons per month. It is easy to see when there is a shortage of product why the manufacturers of gasoline can manipulate the market and freeze out independent, small businessmen. A more difficult situation to explain is what happens where there is amply supply of the product. Having had a taste of what a major oil company can do when there is no supply, the oil companies took little time in developing steps to freeze out the independent, small businessman at the retail level.

I wanted to come to this Committee with hard, cold facts on what the manufacturers of gasoline are trying to do. However, circumstantial evidence indicates that the manufacturers are driving out the independent, small businessman through a program of subsidizing their pump prices. A study by the Department of Energy, Office of Competition, supports this view. Subsidization of vertically integrated refiner/marketer operations is

in evidence when the tank wagon prices to jobbers is near or the same as rack prices at the terminals. Integrated firms must treat their cost increase on an integrated firm basis rather than allocating costs to the level at which they are incurred. This results in the increased costs of refiner-owned retail outlet operations being reflected in the wholesale price charged by the refiner to competing independent marketers. Under the Federal Regulations, "a refiner which sells more than 5% of its gasoline through directly operated retail outlets must treat its cost increases on an integrated firm basis. That is, the product and nonproduct cost increases at all levels, production, transportation, refining and marketing are aggregated on a weight-average basis. The resulting average figure is then uniformly added to the base period price at each marketing level for each class of customer. Therefore, retailing cost increases are reflected in the wholesale price charged to independent marketers which must compete with the refiner-owned retail outlets." This subsidization not only has the effect of giving refiner-operated stations an inherent price advantage over their independent competitors, but actually exacts subsidization payments from those independent marketing customers as a result of wholesale prices which reflect retail costs.

This subsidy has another effect which compounds and grows like cancer in that it encourages downstream vertical integration by a refiner. The refiner can integrate forward by building or expanding retail outlets and pass the interest, depreciation and operating costs of that expansion on to its wholesale customers as a result of the cost increase passthrough

formula promulgated by the Regulations. Because of the unique character of the Regulations imposed on the refiner, the refiner-marketer has a positive incentive to purchase high-priced gasoline on the open market in order to raise its average weighted price. In this fashion, it can sell gasoline at or below the market price and still increase its total income by significantly increasing the maximum allowable price for its lower priced equity gasoline. The DOE's conclusion as to how refiners/marketers use the regulations to their advantage is as follows, and I quote:

> "This has two effects: First, it drives the independent marketer, both branded and unbranded, out of business to the extent it cannot obtain product at a wholesale price sufficiently below that of the new product purchased by the refiner to enable them to make a profit; and second, it forecloses supplies of gasoline from cost efficient independent marketers."

Again, this theory is not one of my own but was one formulated and supported by the Office of Competition, Department of Energy. I also cite Vanderbilt Law Review, November, 1977, page 1133, in which it is the conclusion of that author that vertical integration through the successive stages of production, refining and marketing constitutes the primary barrier to new competition.

And now, I want to submit to you some hard, cold facts which in our opinion show the lack of competition in the area of retail gasoline marketing as it pertains to Kansas. In 1972, we operated 12 service station sites during the full year. I have compared the gallonage that we have pumped through these service station sites with the 1977-78 year. These same service stations were operated during the full year 1977-1978. In 1977,

on an average, we pumped 90,800 gallons less than in 1972. In 1978, as a comparison with these same 12 stations, we pumped 246,316 gallons per month less. The drop in the gallonage by our stations is during a period when the American public was consuming more gasoline and during a period when there were less retail service station outlets in operation. This indicates to us that we are losing a competitive edge against the refiner giants and indicates that the giants are trying to freeze out the independent marketers. From these figures, Gentlemen, their plan is working.

In summation, Senators, it all boils down to the fact that small businessmen who are at the marketing level of retail sales of gasoline to the consumer are in a fight for their lives. Now is the time to act to prevent the death of the independent marketers. I believe Senate Bill 314 is a solution to this problem at least as far as the State of Kansas is concerned.

I submit at one time the refiner did not want to get involved in the retail marketing of gasoline because of the many problems it posed and because they could not compete with the independent marketers. However, the shortage in 1973 showed a way in which they could freeze out their competition and take over the whole market. If things continue as they are without appropriate legislation, the public will be at the mercy of the big oil companies and refiners.

We take great pride in saying that it was us, the independent marketers who kept the major oil companies at the present time from consuming the whole

area of oil production and sales. Without this legislation, it will be just a matter of time when there will be no independent marketers and no effective competition.

POSITION PAPER OF

INDEPENDENT REFINERS/MARKETERS

BY JACK A. QUINLAN

FOR THE

JUDICIARY COMMITTEE OF

THE KANSAS SENATE

ON

SENATE BILLS NOS. 314 and 327

REFINING/MARKETING DIVORCEMENT

FEBRUARY 21, 1979

The Committee of Independent Refiners/Marketers is unalterably opposed to Senate Bill Nos. 314 and 327 which would absolutely prohibit gasoline manufacturers and retailers from operating salaried retail gasoline service stations in Kansas.

The Committee of Independent Refiners/Marketers is an organization formed by smaller petroleum refining and marketing companies. In Kansas the Committee of Independent Refiners and Marketers consists of Vickers Petroleum Corporation, Derby Refining Company, Hudson Oil Company, Clark Oil & Refining Company, Koch Refining Company, Champlin Petroleum Company, Sinclair of Colorado, and Pester Refining Company.

The production and marketing of gas, oil and petroleum products is an important and complex subject. It has been said that, "(i)f one were forced to choose a single key industry, it would have to be petroleum." To understand the complex gasoline, oil and petroleum marketing situation, one must understand the definitions involved, the proponents and opponents of retail divorcement legislation, the recent changes in the retail gasoline market and the reasons therefore, Maryland divestiture legislation, the proposed Senate Bills Nos. 314 and 327 and their impact on CIRM, consumers, major oil companies and dealers, as well as the legal and practical ramifications of Senate Bills Nos. 314 and 327. The complexity of this subject is indicated by the fact the federal Congress has allocated 18 months for a study of motor fuel marketing. (15 U.S.C. 2841.)

I. DEFINITIONS

In addition to understanding the definitions in Senate Bills Nos. 314 and 327, the Committee of Independent Refiners/Marketers (CIRM) believes it necessary to understand the following terms:

Divestiture -- The act of forcing any firm integrated into crude oil refining or production to sell its retail marketing operations in Kansas and to refrain from engaging in such operations in the future. Divestiture would prevent ownership or operation of retail service stations.

Divorcement -- The act of permitting a firm integrated into crude oil refining or production to own retail marketing operations in Kansas, but not operate these outlets by employees of the integrated owner. Retail service stations would be operated by a lessee-dealer.

Independent Marketer -- Means either a branded independent marketer or a non-branded independent marketer; not one of 15 major integrated oil marketing firms; crude deficient, dependent on others for production of crude oil. In past years the independent marketers have maximized profits in marketing gasoline, not in crude oil discovery and importation.

Independent Refiner -- A refiner which obtains, directly or indirectly, more than 70% of its refinery input of domestic and imported crude oil from producers which the refiner does not control and markets and distributes a substantial volume of gasoline refined by it through branded independent marketers or non-branded independent marketers; usually with a daily average volume of crude oil runs to stills of less than 175,000 barrels. In past years the independent refiners have maximized profits in refining, not in crude oil discovery and production.

Jobber -- Terminology meaning in this case a retail gasoline wholesaler who operates on a smaller scale and generally sells to lessee-dealer, contract dealers and to farm and commercial accounts. A jobber may also own service stations and operate as a manager.

Lessee Dealer -- These persons lease a building from the owner (usually a refiner) at some negotiated rate. Dealers use a supplier's trademark, credit card, delivery system, advertising and training programs. They invest in their own tow vehicles, tools, equipment and buy their own tires, batteries, accessories (TBA) items for resale. Their profits derive from the sale of gasoline, repair and service work, and TBA sales.

Major Oil Company -- One of 15 biggest oil companies; fully integrated companies with refining capacity in excess of 175,000 barrels per day; usually not crude deficient. In past years the major oil companies have maximized profits in crude oil production and utilized marketing operations to dispose of their crude oil.

II. CHANGES IN GASOLINE MARKETING

Years ago the major oil companies all followed a similar gasoline marketing strategy. Each sold a nationally advertised brand of gasoline. The major oil companies attempted to sell gasoline as a differentiated product in order to command a higher price. Elements of this strategy included: (1) a large number of conveniently located stations, (2) elaborate buildings on small lots, (3) image advertising, (4) offering premiums or trading stamps, (5) combining gasoline sales with car repairs and services, and (6) an expensive credit card operation. Lessee-dealers operated the major oil companies stations.

The independent refiners/marketers represented by CIRM have differed from the major oil companies in that they: (1) use private, "off-brand" or nonbranded names; (2) have smaller buildings; (3) use little advertising; (4) offer self-service or limited service; (5) are usually a cash-only business; (6) are operated by salaried employees, (7) are operated more hours per day and more days per week than branded stations; (8) offer prices to consumers at prices from two cents to six cents per gallon cheaper than prices at stations operated by lessee-dealers from the major oil companies, and (9) both for refining and retail sales purposes, independent refiners and marketers generally produce an insufficient amount of crude oil to meet their needs. (In the industry they are termed crude deficient.) As such they are not fully integrated, and in order to deal without a long lay time that is involved from the pumping of crude oil to getting gasoline to the consumer, they need a stable "base loan" in the retail market.

In the last six years, over 50,000 full service stations have been closed. Recent trends have definitely been to fewer, high volume stations which exist with smaller margins, with more adequate return on investment, and, most importantly, which offer price advances to the American motorist.

In Kansas the number of service stations has declined from 3,609 in 1972 to 2,725 in 1978. Yet the average sales per station, even when adjusted for inflation, has risen in the United States from $117,000 to $163,000. The Federal Energy Commission has found the average retail dealer margins per regular gasoline at full service retail outlets was 8.2 cents per gallon in November of 1975. Average margins decreased in the summer of 1976 to 7.4

cents per gallon and gradually increased to 9.0 cents per gallon in December, 1977. On the other hand, average retail dealer margins at self-service outlets have declined from 5.5 cents per gallon in November, 1975 (the first available date on self-service stations margins) to 4.2 cents per gallon in December of 1977.

The reasons for the changes are many fold. The oil embargo has made Americans price conscious. The Tax Reduction Act of 1975 repealed the depletion allowance for the major oil companies. But other factors also contributed to the closing of full service stations. Special automotive repair centers, such as Midas, Amoco, Sears, etc. performed many services. Chain stores increased their tire-battery-accessory sale. Long term guarantees and warranties on new cars which require service at the manufacturer's designated service center reduced business.

III. MARYLAND LEGISLATION

In 1974, following the Arab oil embargo, the Maryland lessee-dealers convinced the Maryland legislature to pass divorcement legislation. (Md. Ann. Code, Article 56, §157E.) The United States Supreme Court in Exxon Corp. vs. Governor of Maryland, 57 L.Ed.2d 91 upheld the constitutionality of this legislation although it in no way passed judgment on its economic or social wisdom

Two issues were raised by the Maryland dealers--arbitrary cancellation of dealer leases by major oil companies, and discrimination by majors in allocation of products to their dealers. Both issues have been resolved by the federal government. Congress passed the Petroleum Marketing Practices Act (Dealer Day in Court Act), 15 U.S.C. §2801 et seq. This act requires an oil company terminating or not renewing a lessee-dealer franchise to provide adequate notice and limits termination or non-renewal to situations of mutual consent or "good cause". Violation subjects an oil company to actual and exemplary damages, reasonable attorney and expert witness fees, and injunctive relief.

The federal government also passed the Emergency Petroleum Allocation Act of 1973, 15 U.S.C. §751 et seq., which provides the United States Department of Energy with broad powers to control both the price and allocation of crude oil and refined products in times of shortage, emergency or embargo.

In addition to the above acts, any agreement to withhold petroleum products in order to injure, competition would violate Section 3 of the Robinson-Patman Act, Section 2 of the Sherman Anti-Trust Act as well as K.S.A. 50-101 et seq.

Insofar as future state legislation is concerned, the issues used by the Maryland lessee-dealers are moot.

In an effort to now extend divorcement legislation to independent refiners/marketers, wholesalers and Co-Ops, the lessee-dealers are exposing their true objective which is to promote legislation which would be to their financial advantage but disadvantageous to the competitive retail gasoline marketing system, to the American consumer, and with minimal impact on the major oil companies.

A. Impact on CIRM

Divorcement legislation will adversely affect independent refiners/marketers. Independent refiners/marketers have aggressively competed with the traditional marketing strategy of the major oil companies lessee-dealers. The use of salaried outlets has given the independent refiners/marketers the ability to be innovative and imaginative in such areas as station design, limited service, self-service, variable hours, etc. Furthermore, new marketing concepts which couple gasoline sales with the sale of other products and services (convenience stores, car washes, car care centers) are only possible through vertically integrated operations which provide volume purchasing opportunities, inventory control in management, constant oversight and supervision, and maintenance of minimum operating standards. The clear objective of independent refiners/marketers has been to reduce overhead and spread fixed and variable cost of a larger station and larger volume to the distinct advantage of both the consumer and the independent refiners/marketers. None of these advantages are feasibly obtained through a supplier/lessee-dealer relationship. Adoption of divorcement legislation hinders the truly effective competition of the independent refiners/marketers in gasoline retailing.

B. Impact on Consumers

Divorcement legislation would also have an adverse effect on consumers. Higher gasoline prices are a certainty. OPEC price increases, strife in Iran, and other events have steadily increased price pressures. No end is in sight. Yet divorcement legislation would bar a large class of effective competitors and lead to higher prices.

Independent refiners/marketers outlets generally have smaller lots with smaller buildings, no car repair services, limited use of credit cards, little or no brand advertising, self-service and high sales volume. It is

no wonder they can sell their gasoline two to six cents cheaper. Removal of this competition can only increase prices.

John H. Shenefield, Assistant Attorney General, Anti-Trust Division of the United States Department of Justice in an address to the American Bar Association on August 8, 1978, stated:

> ". . .Legislation has been passed at the state level (Maryland) which may well have the effect of limiting competition in the distribution of petroleum products. . . It is also reasonably clear that over the long run consumers will pay higher prices as a result. This might explain why, in upholding the constutionality of this statute, the Supreme Court disavowed any endorsement of its economic wisdom."

C. J. Collier, Chairman, Federal Trade Commission, addressing the annual conference of the Consumer Federation of America on February 10, 1977, said:

> ". . .The gas station operators figure that the way to get rid of their little problem is to get rid of a little competition. Why not? It's just three to six cents, they say. Well, I say I'm not for it."

C. Impact on Major Oil Companies

Furthermore, divorcement legislation will have little effect on major oil companies. Of the many retail service stations operated by major oil companies in Kansas, only twenty-nine (29) are operated by salaried employees.

John Shenefield, previously referred to in testifying before the General Laws Committee of the Virginia House of Delegates on January 18, 1979 stated:

> "Thus, divorcement legislation would needlessly impose significant cost on one of the most competitive sectors of the industry, independent refiners, who had not been shown to engage in anti-competitive conduct, in order to protect independent dealers from unsubstantiated allegations of anti-competitive conduct by larger integrated petroleum companies."

V. RAMIFICATIONS

The ramifications of divorcement type legislation are not encouraging.

A recent survey showed over 25% of the nation's convenience stores sold gasoline in 1975. Most of these were tie-in outlets operated by salaried employees rather than independent dealers, as these specialized operations required properly trained and supervised specialists and quality management,to justify the investment. Will the lessee-dealers next attempt to bar convenience stores from selling gasoline?

Many jobbers who supply gasoline also operate their own service stations. Will jobbers and other wholesalers be prohibited from managing a retail service station if the lessee-dealers will not be able to compete despite the removal of independent refiners/marketers?

Innovation for all surviving companies will be more difficult. Traditionally, refiner/marketing companies established some salary-operated stations for the purpose of testing new marketing techniques and products and provide training for lessee-dealers. Present legislation would remove these stations.

Removal of manufacturers would also prevent the rural CO-OPS from selling gasoline in retail service stations unless operated by an independent dealer.

Removal of independent refiners/marketers and the effective competition that they will provide will leave a vacuum in the marketing of gasoline. Who will fill this gap? Major companies or chains such as Sears, Pennys, and Woolco may move in and prevent the lessee-dealers from achieving the anti-competitive effects they desire. Montgomery Wards, however, would not be one of these future competitors as it is owned, in part, by Mobil Oil Company.

Finally, the divorcement legislation negatively affects present independent refiner/marketing company employee pension and retirement plans. Thus, a host of problems will arise from adoption of divorcement legislation.

If divorcement legislation were extended to other industries, the inequity would be apparent. Prohibiting a company such as Vickers from operating salaried outlets is comparable to prohibiting:

Goodyear from selling tires through Goodyear retail stores;

General Motors from doing repair work on automobiles;

Sherwin-Williams from operating retail paint stores;

Prohibiting factory outlet stores;

Prohibiting farmers from selling crops at retail.

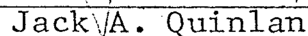
The public policy precedent this legislation would establish it is an extremely poor one.

VI. CONCLUSION

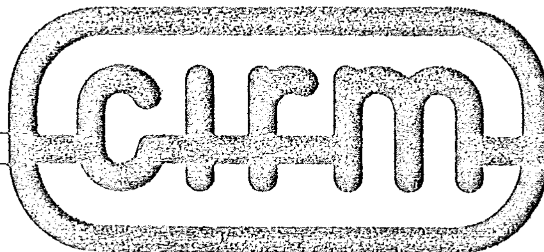
Legislation to prohibit gasoline producers or refiners from operating salaried retail gasoline service stations in Kansas should be opposed. Such legislation is contrary to the interest of Independent Refiners/ Marketers as well as Kansas consumers.

Even from the lessee-dealer's viewpoint, enactment of this legislation will not roll the clock back to the 1960's. Changes in consumer purchasing decisions following the Arab oil embargo of late 1973 are a fact of life. Changes in consumer preferences and purchasing decisions cannot be legislated.

Retail gasoline divorcement legislation would be poor public policy, as against the interest of Kansas consumers, and should be opposed.



Jack A. Quinlan



WHAT LEADERS ARE SAYING ABOUT RETAIL DIVORCEMENT LEGISLATION

Supreme Court Justice John Stevens, writing the majority opinion about the Maryland law:

> "It may be true that the consuming public will be injured by the loss of the high-volume, low-priced stations operated by the independent refiners, but that argument relates to the wisdom of the statute and does not prove that it is an unconstitutional burden on interstate commerce."

C. J. Collier, Chairman of the Federal Trade Commission, addressing the annual conference of the Consumer Federation of America:

> "The gas station operators figure that the way to get rid of their problem is to get rid of a little competition. Why not? It's just 3 to 7 cents (per gallon), they say. Well, I say I'm not for it."

John H. Shenefield, Assistant Attorney General, U.S. Department of Justice, speaking before the American Bar Association:

> "Legislation has been passed at the state level (Maryland) which may well have the effect of limiting competition in the distribution of petroleum products."

> "It is also reasonably clear that over the long run, consumers will pay higher prices as a result. This might explain why, in upholding the constitutionality of this statute, the Supreme Court disavowed any endorsement of this economic widsom."

Committee of Independent Refiner/Marketers
P.O. Box 10006 / Des Moines, Iowa / 50306

Charles J. Irwin, consumer advocate and former Director of the New Jersey Division of Consumer Affairs:

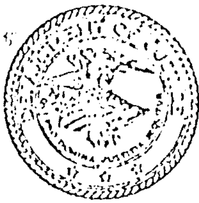
> "There is no question in my mind that (the proposed legislation to divest refiner marketing) is not consumer protection legislation. To represent it to be protective of the consuming public would be an unjustifiable hoax."
>
> "If the objective of the New Jersey legislature is to strike out at the major oil interests out of anger or frustration because of the world energy crisis or because some of the oil companies reported unusually high profits, this bill may provide a vehicle for such emotional ventilation. If your objective is well-reasoned, well-founded consumer protection legislation, this bill offers nothing."

Washington Post editorial, June 19, 1978:

> "The Maryland legislation restricts price competition, as the Court observed. While it may not be unconstitutional, that kind of regulation is bad in principle."

Federal Energy Administration, August 18, 1978;

> "However, information available to the FEA does not indicate that (1) any marketing sector is presently threatened or that (2) government intervention is required at this time to maintain any segment, or that (3) ultimate consumers of motor gasoline have been adversely affected by these developments."



Department of Justice

Testimony of

John H. Shenefield
Assistant Attorney General
Antitrust Division

Before the

General Laws Committee
of the
Virginia House of Delegates
Richmond, Virginia

Concerning

Retail Marketing Divorcement and
Divestiture Legislation

January 18, 1979

I am indeed honored to accept the Committee's invitation to discuss the views of the Department of Justice on the benefits and the potential competitive consequences of proposed legislation affecting the retail marketing of refined petroleum products in Virginia. In general, this proposed legislation, and similar proposals in other states, would take one of two forms. The first of these, known as divestiture, would force any firm integrated into crude oil refining or production to sell its retail marketing operations in Virginia and to refrain from engaging in such operations in the future. The other approach, frequently referred to as "divorcement", would permit such firms to own retail marketing operations in Virginia, but would require that those outlets be operated by franchised independent dealers rather than by employees of the integrated owner. For the purposes of simplicity, I will use the term "divorcement legislation" to describe both of these proposals.

As you can well imagine, competition in the petroleum industry is of particular concern to me in my role as head of the antitrust enforcement activities of the Executive Branch of the Federal Government. The antitrust laws are designated to protect competition, not competitors. Vigorous competition stimulates innovation, efficient allocation of resources and prices based on the cost of production - all to the benefit of consumers.

In considering the merits of divorcement legislation, it is important to bear in mind that consumer interests are not necessarily identical to the interests of individual competitors; indeed, consumer interests are relatively fragile and can be easily sacrificed if the competitive process is distorted or stifled. Certainly, this has been the result of much Federal regulation - for example, regulation of transportation industries where entry restrictions, minimum rate regulation and authorized price fixing have been common. As you know, President Carter signed the Airline Deregulation Act of 1978 into law, an action that almost immediately produced lower fares for consumers and higher profits for the airlines. Significantly, the President's National Commission for the Review of Antitrust Laws and Procedures has voted to recommend substantial and further cutbacks of Federal regulation that interferes with the competitive process to the detriment of consumers.

The Antitrust Division has been a staunch advocate of this trend toward more competition and less regulation at the Federal level. We also believe that the states can help to lead the fight to vindicate competitive principles and consumer interests. That challenge is afforded by the very legislation that is the subject of these hearings.

According to proponents of divorcement legislation, adoption of that legislation could be expected to cure four claimed defects in the competitive structure of the petroleum industry at the retail level: (1) Divorcement would prevent large integrated oil companies from taking advantage of their greater bargaining power in order to terminate some or all of their independent dealers; (2) In the event of another energy emergency similar to the Arab embargo of 1973, divorcement would prevent those large integrated oil companies from attempting to restrict the availability of refined products to certain classes of independent marketers in an attempt to damage the competitive structure of the market; (3) Such legislation would prevent integrated firms from using revenues drawn from high-profit production operations to subsidize reduced operating margins at company-owned and operated service stations; and (4) By limiting the trend towards gas-and-go operations, such legislation would prevent that trend from creating a shortage of needed automobile repair services.

Let me review the best arguments which have been mustered in support of divorcement legislation. After reviewing these arguments, I will discuss the likely effects of such legislation on the competitive structure of the retail market for refined petroleum products.

1. The Claim of Unequal Bargaining Power Between Large Integrated Oil Companies and Their Branded Dealers

Before the 1973 energy crisis, full service gasoline stations were the predominant method of marketing refined petroleum products at the retail level. The rapid increase in gasoline prices since that time, however, appears to have increased the popularity of high-volume low-overhead "gas-and-go" stations. By eliminating many of the services offered by traditional full service stations, these outlets are able to supply consumers with refined products at reduced prices. In response to the increased popularity of this type of station, many oil companies are apparently seeking to alter their marketing practices.

Consequently, integrated firms that had traditionally relied upon branded independent dealers often refused to renew their franchise agreements with some of those dealers and converted their stations to company-operated gas-and-go outlets. Because most franchise agreements did not

protect independent dealers from non-renewal of their franchises in these unforseen circumstances, those dealers were often forced to abandon profitable stations that they had developed at considerable personal effort and expense. While the integrated firms were willing to buy back the products and accessories stocked by the dealers, few were willing to provide those dealers with more than token compensation for the loss of their businesses.

Because this result was perceived as highly inequitable, Congress and a number of State legislatures have recently enacted statutes to protect franchised independents from similar actions in the future. The Federal franchise protection statute is Title I of the Petroleum Marketing Practices Act of 1978. 1/ This Act requires that an oil company terminating or failing to renew a franchise must provide adequate notice to the dealer in question, and limits franchise termination or non-renewal to situations involving mutual consent or "good cause." As defined by that Act, good cause does not include termination or non-renewal simply on the grounds that a gas-and-go outlet would be more profitable than a full-service franchised station. A franchised dealer injured by a termination or non-renewal in violation of this Act may bring suit in Federal court to recover actual and

1/ Pub. Law No. 95-297.

exemplary damages, reasonable attorney and expert witness fees, and, if appropriate, to obtain injunctive relief. Thus, the franchised dealer is protected from unfair termination of or refusal to renew his franchise agreement.

This legislation does not, however, eliminate the underlying economic incentive to replace the full service dealer with a company operated outlet. Consequently, integrated firms seeking to increase the profitability of their marketing operations may have an incentive to pressure their franchised dealers into accepting the "voluntary" terminations permitted by law. Such pressure could be applied in a number of ways, including increasing product prices or service station rents, forcing dealers to load up on tires, batteries and accessories, and failing to deliver adequate supplies in a timely fashion.

While such harrassment poses a significant threat to franchised dealers, it is likely to be recognized by the courts for precisely what it is - an attempt to circumvent the franchise protection laws. Thus, if franchised dealers are made aware of their legal rights, there is no need for more drastic - and probably more anticompetitive - action such as retail divorcement. Moreover, even if a divorcement statute were adopted, the pressures to shift from full-service stations to gas-and-go outlets would remain. Accordingly, integrated companies might seek to pressure dealers committed to full-service marketing into

voluntary terminations in order to replace them with other independent dealers willing to operate their stations as gas-and-go outlets. Divorcement legislation may therefore be both an unnecessary and ineffective remedy to the problem of unequal bargaining power of the larger integrated oil companies. A far better approach would be to inform branded independent dealers of their rights under the franchise protection statute - a task for which state officials, who are more accessible to dealers, are particularly well suited.

2. The Claim that Large Integrated Oil Companies May Discriminate Against Independent Marketers in the Event of A Future Energy Shortage

A second concern frequently advanced by proponents of divorcement legislation is that in the event of a severe shortage of refined products, certain large integrated oil companies may attempt to limit the access of independent marketers to gasoline in order to eliminate those independent firms and reduce competition in that market. While such conduct is certainly a possibility, the Emergency Petroleum Allocation Act of 1973 2/ provides the Department of Energy with broad powers to control both the price and allocation of crude oil and refined products in order to prevent this type of misconduct. Moreover, whether or not an emergency exists, any agreement or understanding to withhold refined products in order to injure competitors at any level of the petroleum industry would violate the Federal antitrust

---

2/ 15 U.S.C. § 751 et seq.

laws. Thus, a state regulation aimed at this conduct would not provide any protection beyond that already available at the Federal level.

3. The Claim of Downstream Subsidization

The third, and perhaps most widespread, concern underlying the recent proposals for divorcement legislation is the belief that integrated firms may use high profits from production operations to finance reduced operating margins at the retail level. This would injure independent dealers unable to compete effectively in the face of the artificially reduced prices allegedly charged by the integrated firms. Four questions must be answered in order to determine whether divorcement legislation is necessary to deal with this problem:

(1) do integrated firms in fact subsidize their retail outlets with profits drawn from upstream operations;

(2) why does this conduct occur;

(3) will divorcement legislation eliminate the incentive or the opportunity for integrated firms to engage in such conduct; and

(4) are there any equally effective methods of preventing that conduct that avoid the potential anticompetitive effects of divorcement legislation.

No empirical study has yet been conducted to determine whether the prices charged by company-operated gas-and-go outlets have been held artificially low by subsidization with profits earned at other levels in the petroleum industry. While precisely such a study is mandated by Title III of the Petroleum Marketing Practices Act and is now being undertaken by the Department of Energy in consultation with the Federal Trade Commission and the Department of Justice, the results of that study will not be available until December of 1979. Thus, at present, the subsidization argument is supported primarily by the belief that the difference between the prices charged by company-operated gas-and-go outlets and independent service stations is too large to be cost justified.

This belief emerges from the fact that company-operated stations sometimes sell gasoline at a pump price near or, in some cases below, the price at which the branded independent dealer purchases from his supplier. Since the typical markup by branded independents is approximately 6 to 8 cents per gallon, they would then suffer about an 8 cent price disadvantage. In a market as sensitive to price as today's gasoline market, such a difference may place the branded independent service station at a significant competitive disadvantage.

However, a number of factors suggest that this price difference may be due to factors other than downstream subsidization. First, much of this difference in price may be cost justified. Unlike branded independent outlets,

most company-operated gas-and-go outlets usually do not accept credit cards, which add approximately one cent per gallon to the price of gasoline. Also gas-and-go outlets do not offer a branded product, thereby avoiding the advertising and other expenses of establishing and maintaining a brand identity. Further, since the company-operated station generally has a higher product volume and provides a lower level of service, overhead expenses are lower. The large sales volume may also reduce delivery costs, since such company-operated stations may be able to accept most or all of the contents of a large tank truck, obviating the need for such trucks to make costly multiple stops. The benefits of these cost savings are passed on by the gas-and-go's to consumers in the form of lower gas prices.

Obviously, it would take a comprehensive study like the one mandated by Title III of the Petroleum Marketing Practices Act to determine whether the combined effect of these and other sources of cost savings are sufficient to account for observed differences between the prices charged by company-owned gas-and-go outlets and their full-service branded independent rivals. It is clear, however, that currently available evidence is just not sufficient to establish whether these price differences are, in fact, cost justified. This is a question that would have to be answered in order to show the existence of downstream subsidization at the retail level of the petroleum industry.

The absence of any convincing evidence of downstream subsidization at the retail level becomes highly significant when one asks why integrated firms would engage in such conduct. At first glance, subsidization of marketing operations would appear to run counter to normal profit-maximizing behavior. If integrated firms do earn high profits on their upstream operations, they have the option of setting prices at their controlled retail outlets at the same level as charged by their independent retail rivals. This strategy would permit integrated firms to retain higher earnings while avoiding the appearance of anticompetitive conduct. It is, therefore, doubtful that those companies would adopt a different pricing scheme unless the benefits of that scheme clearly exceeded the benefits of simply retaining those higher earnings.

One situation where an integrated firm might attempt such conduct would be when it believed that by cutting prices it could eliminate independent competitors and thereafter raise its price high enough to profit from its predatory actions without attracting too many new entrants into the market. Although such predatory conduct could be financed from high profits earned at the production level of the petroleum industry, it could just as easily be funded by profits drawn from a totally unrelated endeavor. Further, although this subsidization theory is plausible, allegations of subsidization of refining operations have

seldom included a claim of predation. This is highly significant since predatory conduct of this nature would constitute a clear violation of the antitrust laws. In such circumstances, application of the antitrust laws would be preferable to divorcement legislation. The possibility of an antitrust suit would provide both an adequate deterrent to such behavior in the future and a potential source of relief and compensation for injured refiners, while avoiding the inevitable anticompetitive effects of divestiture legislation.

4. The Effects of the Trend Towards Gas-And-Go Operations on the Availability of Automobile Repair Services

Another argument frequently advanced in support of divorcement legislation is that it would prevent the trend towards gas-and-go operations from bringing about a shortage of automobile repair facilities. According to this view, such a shortage could develop as large numbers of full-service stations are forced from the market due to their inability to compete with gas-and-go operations in the gasoline market. This argument ignores the fact that competitive market forces apply to the service market as well as to the gasoline market.

In the service market, full service stations compete with the service facilities operated by new car dealerships, tire and accessory companies, and independent businessmen. Like any service or product produced in a competitive

market, the supply of automobile services will vary with price. In the absence of any identified defect in the automobile service market, there is no reason to believe that market will be unable to provide consumers with the services they demand. Further, reliance on market mechanisms will provide such services at the lowest reasonable price without the need for divorcement legislation with its attendant anticompetitive effects in the gasoline retail market.

5. The Potential Costs of Divorcement Legislation

Absent persuasive evidence that divorcement legislation would bring about any real improvement in petroleum marketing, that remedy should not be adopted if there is any likelihood that it would bring about significant undesirable consequences such as increased retail prices. Our analysis of divorcement legislation suggests, however, that it would be highly inequitable and seriously anticompetitive.

For example, divorcement legislation would prohibit the marketing of refined products through company-owned and operated outlets not only by the large integrated firms suspected of engaging in anticompetitive behavior, but also by independent refiners that do not have substantial crude

holdings. This would needlessly disrupt the business patterns of a group of companies that apparently lack the ability to engage in any of the anticompetitive conduct that such legislation was intended to preclude. Legislation proposed in a number of other states, including Wisconsin and New Jersey, would also prevent independent jobbers from operating their own outlets. This would occur despite the fact that there is no evidence that independent jobbers have either the incentive or the ability to engage in anticompetitive conduct.

In addition, since many of these firms rely more heavily on low price retail outlets than the larger integrated oil companies, the burden of this ban on company-owned and operated stations is likely to fall more heavily on these independents than on the integrated majors that the proposal was designed to control. In fact, ultimately such legislation could benefit large integrated petroleum companies by disrupting the activities of one of their most efficient independent rivals. Thus, divorcement legislation would needlessly impose significant costs on one of the most competitive sectors of the industry, independent refiners, who have not been shown to engage in anticompetitive conduct, in order to protect independent dealers from unsubstantiated allegations of anticompetitive conduct by larger integrated petroleum companies.

Indeed, the very breadth of this legislation suggests that its effect would be to restrict rather than promote competition. As I have indicated, the available evidence does not indicate that divorcement legislation is needed to protect independent dealers from the allegedly anticompetitive actions of large integrated oil companies. There is, however, substantial reason to believe that such legislation might be perceived by independent dealers as an effective means of eliminating part of the competitive threat posed by the recent trend towards gas-and-go operations. Experience indicates that the increased popularity of gas-and-go operations has primarily been at the expense of independent service stations and that a large number of gas-and-go operations are directly operated by both independent and integrated refiners. Thus, a ban on the ownership or operation of retail marketing outlets by all refiners would significantly reduce the competitive threat of gas-and-go operations.

Divorcement legislation could insulate independent dealers from the competition offered by gas-and-go outlets refinery operated, thereby benefiting those dealers and, indirectly, the large integrated firms that dispose of most of their products through such dealers. Consumers, however, would be forced to pay for this protection in the form of higher gas prices. Thus, there is every reason to believe

that divorcement legislation will in all probability bring about the high prices for refined products that the legislation was ostensibly designed to prevent.

As I stated at the beginning of my remarks, my purpose in appearing before this Committee is to advance the interest of consumers in having a competitively sound petroleum industry and low prices for refined products. While government regulation often fosters competition, great care must be taken to assure that it does not inhibit competition by placing the interests of individual competitors above the interests of all consumers. To avoid this risk, we at the Federal level are carefully reviewing proposed government regulations to determine whether they pose significant competitive risks and if so to ensure that such risks are necessary to achieve an over-riding purpose and that they are the least anticompetitive alternative capable of achieving that purpose. I urge you to apply this standard to legislative proposals. 3/

3/ See, e.g., FMC v. Aktiebolaget Svenska Amerika Linien, 390 U.S. 238 (1968): U.S. v. Civil Aeronautics Board, 511 F.2d 1315 (D.C. Cir. 1975); Northern Natural Gas Co. v. FPC, 399 F.2d 953 (D.C. Cir. 1968). There will shortly be introduced in this Congress legislation to impose this competitive review standard on all Federal regulatory agencies. See Senate Bill 2625 introduced in the 95th Congress.

I respectfully submit that divorcement legislation does not pass muster under this test. Such legislation would impose severe and unnecessary hardships on independent refiners in a manner that suggests that it may be designed to insulate the full-service independent dealer from the competition offered by high-volume, low-overhead company operated gas-and-go stations. Divorcement legislation would therefore protect branded independent dealers by increasing the price of refined products. This would benefit independent dealers and the large integrated oil companies that usually supply such dealers, but would result in higher prices to consumers.

In addition, proponents of divorcement legislation have yet to establish that its supposed benefits to consumers can not be achieved in a less anticompetitive manner. State and Federal legislation now protects franchised dealers from the unfair effects of the greater bargaining power of large integrated oil companies. The anticompetitive consequences of any future shortage of crude oil or refined products can, and will, be dealt with by Department of Energy regulations and, where appropriate, by enforcement of the Federal antitrust laws. Furthermore, a Federal study is now underway to determine if integrated oil companies are subsidizing their their company operated retail marketing outlets. Finally, we can rely on market mechanisms to provide needed automobile repair services. Thus, there is no demonstrated need to

adopt divorcement legislation at the retail level of the petroleum industry in Virginia.

Since, on the basis of the evidence now available, there is no reason to believe that divorcement legislation offers consumers any tangible benefits in exchange for the increased costs for refined products it would inevitably bring about, I would not recommend adoption of such legislation.

THE ARLINGTON-ALEXANDRIA STAR

JANUARY 17, 1979

'Unprecedented' Lobby On Gas Bill

By Jody Beck
W[illegible]on Star Staff Writer

RICHMOND — Oil refiners and gasoline station owners have been battling for the support of Virginia's legislators in the most heavily lobbied issue before the General Assembly this year.

The two sides — both claiming to be pro-consumer — will meet in formal duel tomorrow at a public hearing on a bill that would prohibit companies that refine oil from also owning gasoline stations.

Only the Equal Rights Amendment has drawn more mail than this issue, according to one delegate.

Delegate Richard L. Saslaw, D-Fairfax, chief patron of the bill, said the intense lobbying is "unprecedented."

Saslaw, who signed up 43 of the other 99 delegates as co-patron when the bill was introduced last year, said, "What's the other side been doing? They've inundated the place . . . If anybody believed the oil companies are down here in Richmond on behalf of the consumer, then those people would be susceptible to buying stock in the Brooklyn Bridge."

Proponents and opponents of the bill, when asked about the lobbying, pointed out that 31 persons have registered to lobby on behalf of refiners. On the other side, approximately 20,000 Virginians make a living working at dealer-operated service stations.

"A lot of service station dealers vote, and their customers vote," said James W. Heizer, executive secretary of the Virginia Gasoline Retailers Association, "that's the one thing they (oil companies) don't have."

Heizer's organization represents individual dealers who operate stations on a franchise agreement with oil refiners.

Maryland and the District have laws to prohibit oil companies from owning and operating gasoline stations. They are patterned after laws in many states, including Virginia, that seek to increase competition in the beer and automobile

See LOBBY, A/A-3

Lobby

From A/A-1

industries by prohibiting manufacturers from competing directly with local dealers.

Maryland's law, which was upheld by the U.S. Supreme Court last spring, requires oil companies to sell their gasoline stations by July 1.

"Our law is a real marshmallow compared to what they've got in Maryland," said Gary L. Benton, a lawyer and lobbyist for the retailers.

The retailers group and Saslaw argue that oil companies are trying to force dealers out of business by charging them higher prices for wholesale gasoline than the oil companies charge retail customers at their own stations, where they subsidize losses.

Once the dealers are gone, a handfull of refiners will be able to control the market and prices will skyrocket, the dealers say.

Oil companies claim the bill would restrict high-volume, low-service gas stations that proliferated after the Arab oil embargo of 1973 sent gasoline prices spiraling.

The bill would force consumers back to full service gas stations and higher gasoline prices, according to opponents.

"All it does is hamstring the competition," said Carl E. Schwobel, of the marketing relations office of Marathon Oil Co. Marathon is one of five "non-major refiners" in the Virginia Committee of Independent Refiner-Marketers.

The group has on retainer a Richmond public relations firm and the Alexandria and Richmond law firm Thomas & Sewell.

William G. Thomas, one of four Thomas & Sewell lawyers registered to lobby for the oil firm, was described by a fellow Alexandrian, Republican Delegate Gary R. Myers, as "one of two — or maybe the — best lobbyist down here. He is very effective."

Included in the lobbying efforts are two statewide consumer groups, neither of which has taken a position on the bill.

Saslaw said oil companies have given out incorrect information about the bill. Lobbyists have told legislators it would require divestiture, he said, although it contains a grandfather clause that would allow oil companies to continue to operate stations they now own.

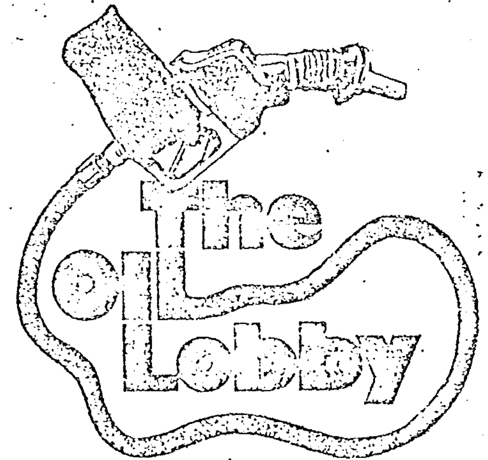
About 10 percent of Virginia's 3,600 gas stations are refiner-owned.

Today, Saslaw is distributing a three-page memo on the bill to all senators and delegates.

"For every one piece of paper I generate, they can generate 200," he lamented.

Reacting to comments about the massive lobbying by oil firms, R.W. Martenis, district manager for Exxon, said he was at the Capitol yesterday to talk to legislators and saw a number of persons from the retailers' group.

"I was by myself and I ran into 10 of them," Martenis said. Four Exxon employees, two from the Baltimore office, are working against the bill, according to Martenis.



This is the first in a series of occasional articles examining the powerful oil lobby in Virginia.

Friday, January 19, 1979 THE WASHINGTON POST

Va. Panel Votes to Curb Refinery-Owned Stations

By Paul G. Edwards
Washington Post Staff Writer

RICHMOND, Jan. 18—A Virginia House of Delegates committee approved a bill today that would prohibit oil refiners from expanding their ownership of service stations despite warnings from the nation's top antitrust official that the proposal probably would increase gasoline prices for consumers.

The controversial measure was approved by the House General Laws Committee, 13 to 6, after intensive lobbying by oil companies that oppose it and individual service station owners who favor it.

Assistant Attorney General John G. Shenefield, head of the Justice Department's anti-trust division, urged the committee to defeat the bill. This bill "will in all probability bring about the high prices for refined products that the legislation was ostensibly designed to prevent," he said.

Shenefield and S. John Byington, who was consumer adviser to former president Gerald R. Ford, said the bill would prevent expansion of high-volume, low-overhead service stations by independent oil refiners and others.

"This bill is aimed at the independent refiner-marketer who is the No. 1 price competitor against the major oil companies," Byington told the committee. "If you pass this bill, you will eliminate the major price competitors in the business."

Lobbyists for the service station dealers argued that the bill is needed to protect station operators from unfair competition from the oil companies that supply them with gasoline. Most of the operators lease their stations from oil companies and they complained of unfair practices by the companies intended to force them out of business.

Their presentation to the committee included an NBC television film from the network's "Weekend" show alleging that Gulf Oil Corp. abused its service station operators in southern California. A Gulf spokesman presented the committee with a written statement denying the charges, which included claims that Gulf pressured

See GAS, B5, Col. 1

GAS, From B1

its dealers to quit the business so it could convert their stations into discount operations.

Shenefield told the committee that state and federal franchise laws provide ample protection to dealers who lease stations from oil companies. He called the allegations of "anticompetitive conduct" against major oil companies "unsubstantiated" and said the bill would "needlessly impose significant costs on one of the most competitive sectors of the industry, independent refiners . . ."

The bill would permit those company-owned stations now in existence to remain in business, but would prohibit the companies from opening new stations.

Some committee members made an unsuccessful effort to extend a current moratorium on new station openings for another year while the assembly studies the issue. This approach was endorsed by the Fairfax County Consumer Protection Commission.

James Heizer, a spokesman for the Independent Gasoline Retailers Association, reminded the committee several times during the hearing that the 3,000 dealers in his organization are "voting Virginians." A lobbyist not involved in the issue said after the hearing, "Heizer and his group did a masterful job. They won it before the hearing began."

Del. Richard Saslaw (D-Fairfax) is chief sponsor of the bill. All three Northern Virginia delegates on the committee voted for the measure. They are Elise B. Heinz (D-Arlington), Ramond E. Vickery Jr. (D-Fairfax) and Warren E. Barry (R-Fairfax).

In other action today, the House Corporations, Insurance and Banking Committee approved a bill sponsored by Sen. Charles J. Colgan (D-Prince William) that would permit cities to combine their existing electric generating systems into larger, more efficient networks linked to other city-owned electric systems. The bill was approved by the Senate last year but was narrowly defeated in the House.

The Richmond News Leader
Thursday, January 18, 1979

H.B. 458 — Tow It Away

Today the House General Laws Committee was expected to consider House Bill 458, which is totally alien to the realm of reason. Yet it carries a passel of sponsoring names and may stand a good chance of success.

The bill is neither clean in body nor pure in heart. Called the "divestiture" or "divorcement" bill, it would forbid the sale of gasoline through service stations (a) owned by companies that refine petroleum and (b) operated by those companies' personnel. Championed primarily by dealers who lease their stations — and modeled after a new Maryland law — the bill would force the closing of about 375 Virginia service stations and would put their employees out of work.

Virginia currently has about 8,700 outlets that retail gasoline, many of which are mom-and-pop operations that sell gasoline as a sideline. Of the 8,700 total, Virginia has about 3,600 Class A stations — *i.e.*, those for which the sale of gasoline is more than 50 per cent of their gross receipts. Of those 3,600, about 375 are owned and operated by companies that refine petroleum; of the remaining 3,200, most are leasee-dealer stations whose operators would like nothing better than to see the 375 refiner-operated stations disappear around the bend.

Thus, H.B. 458 — the brainchild of the leasee-dealers. They are unhappy with the refiner-operated stations, because the latter tend to be gas-and-go, no-frills stations — often self-service — that market gasoline and little else. Operating on economies of scale, and enjoying certain cost advantages, these low-margin high-volume stations frequently undersell leasee-dealer stations. H.B. 458 is designed to put these stations out of business.

As such, it is protectionist, anti-competitive, and the very essence of government intrusion that Virginians abhor. In a single stroke it would eliminate an entire class of gasoline marketers — indeed, the class which has demonstrated innovations and efficiencies that often have kept prices lower than at other stations. The bill would legislate a political preference for restraint of trade, it would construct barriers against new entrants into gasoline retailing, and it would restrict consumer choice in the gasoline marketplace. By reducing competition, the bill would diminish market resistance to higher prices. What's more, passage of this bill might invite similar legislative assaults in other retailing areas, such as against food and drug chains.

Precisely nothing about this bill is commendable. The Assembly has utterly no business adopting it — none. We urge the Assembly to tow it swiftly to the nearest bone yard and to deposit it there, for good.

In Brief

The U.S. Office of Education reports that "this office's activities during the year were primarily continuing their primary functions of education of the people to acquaint them of their needs, problems, and alternate problem solutions, in order that they can make wise decisions in planning and implementing a total program that will best meet the needs of the people, now and in the future." So *that's* what the OE has been doing.

Measure to Limit Refineries' Stations Advances

By Shelley Rolfe
Times-Dispatch Staff Writer

The House General Laws Committee approved legislation yesterday that proposes to throw up a roadblock in the way of expansion of refinery-owned service stations in Virginia.

The committee vote was 13-6 with one abstention and it came after an almost three-hour public hearing at which consumerism was frequently invoked and, at times, esoteric economic questions were raised.

Proponents of the legislation, sponsored by Del. Richard L. Saslaw, D-Fairfax, pictured it as a boon to consumers. Opponents said it would be a bane.

The opponents, many of whom were spokesmen or representatives of large and small oil producers and refiners, also called on John H. Shenefield, the head of the Justice Department's Antitrust Division, to help plead their cause.

Shenefield, who joined the Carter administration after serving with a major Richmond law firm, Hunton & Williams, pictured himself as speaking to the "philosophical perspective of this thing" and described Saslaw's legislation as anti-competitive as well as anticonsumer.

Proponents, who represented many of the state's independent service station operators, also brought in an outside lawyer with a governmental background — Thomas M. Wilson III, a former Maryland assistant attorney general.

Wilson represented Maryland before the U.S. Supreme Court last year when it declared constitutional a law that bars refinery ownership of service stations.

The Maryland law is more sweeping than the measure the General Laws Committee considered yesterday. In Maryland, refineries were required to divest themselves of service stations they owned. The Virginia proposal contains a "grandfather clause" that permits refineries to keep stations they now own and operate.

"The constitutional problem" of the Virginia proposal "has been settled," Wilson said.

Shenefield said that ever since the Supreme Court decision, he had been looking for a forum to express his opposition to laws that prohibit refineries from owning service stations.

However, Virginia Attorney General Marshall Coleman declined an invitation from a committee member, Del. L. Ray Ashworth, D-Sussex, to speak on the constitutionality and other aspects of Saslaw's measure.

Declining the invitation, Coleman wrote Ashworth, "Since there are no clear constitutional and legal questions involved, I feel it would be inappropriate for this office to inject itself in the committee's deliberations."

Yesterday's action by the General Laws Committee was one more skirmish in a battle that begin in the 1977 General Assembly session. It has been marked by heavy lobbying and has pitted refineries against independent service station operators. The operators have argued that refineries were using company-owned stations to drive them from business.

Last year the assembly deferred action on Saslaw's legislation and adopted a one-year moratorium on the expansion of refinery-owned stations.

Ashworth proposed yesterday a study of Virginia's trade and antitrust laws and an extension of the moratorium, a proposal that was embraced by William G. Thomas, counsel for a group of smaller refiners.

Yesterday's hearing was staged before a demonstrative crowd of approximately 300 which packed a General Assembly Building committee room. Many were independent operators who spent the morning calling on their home area legislators and turned up at the hearing in the afternoon wearing work uniforms and buttons that read "Support HB 458 [Saslaw's Measure], Preserve Small Business."

Each side was given an hour to present its case. The proponents' hour included a 10-minute clip from NBC's "Weekend" TV program which charged that Gulf Oil Co. was using company-owned stations to drive California and Arizona independent operators from business. The committee was furnished with a statement by a Gulf executive which said the TV program had been inaccurate and added that its independently owned operators were being eliminated because of a company decision to reduce its West Coast business.

Staff Photos by Bob Brown

CLOCKING EXPRESSIONS — The hand holding the stopwatch belongs to Del. Thomas W. Moss Jr., D-Norfolk, who kept tabs on the time used by each side at yesterday's public hearing on legislation that would prohibit expansion of refinery-owned service stations in Virginia. At the left of the stopwatch are two proponents of the measure — Lee Williams, a Williamsburg service station operator (far left), and James W. Heizer, head of the Virginia Gasoline Retailers Association. At the right are two men who opposed the measure, John H. Shenefield, chief of the Justice Department's Antitrust Division, and William G. Thomas (far right), counsel for a group of smaller refineries.

2-21-77

Department of Energy, Office of Competition

COMPETITIVE ANALYSIS OF THE MOTOR GASOLINE PRICE AND ALLOCATION REGULATIONS

Executive Summary

- The allocation regulations, predicated on a six-year old base period for monthly supplies and frozen supplier/purchaser relationships, have prevented the formation of more cost-effective patterns of supply and distribution, and distorted the spot market. The effect has been to slow the exit of many inefficient marketers, and to reduce the competitive effectiveness of more efficient nonintegrated firms.

- The price regulations have manufactured an arbitrary distribution scheme of profits and losses. Prices do not necessarily reflect costs or market conditions, and inefficient marketers are insulated from the need to improve their efficiency at the same time more efficient distributors may be eliminated from the market.

- The price regulations have frozen allowable unit margins to the May 15, 1973 level. These artificial margins do not encourage efficiency under current market conditions, and, coupled with regulations controlling class of purchaser, may result in refusals to deal with certain classes and excessive distribution costs.

- Subsidization of vertically integrated refiner/marketer operations has also been fostered by the price regulations. Integrated firms must treat their cost increases on an integrated firm basis rather than allocating costs to the level at which they are incurred. This results in the increased costs of refiner-owned retail outlet operations being reflected in the wholesale price charged by the refiner to competing independent marketers. Refiner/marketers are given an inherent price advantage, and independent marketing customers are forced to subsidize integrated firms. Downstream vertical integration by refiners is encouraged.

- By regulating margins rather than profits, the regulations also inhibit investment in needed refinery expansions and improvements. Under the cost pass through formula, interest on borrowed funds and depreciation are the only allowable capital costs. No allowance is made for a return on capital investment. As a result, refiners have an incentive to make

investments in less capital intensive facilities, and (since operating costs can be passed through) have no incentive to avoid operating costs caused by inefficiency. In addition, refiners have been discouraged from making needed improvements such as refinery modifications necessary to manufacture high-octane unleaded gasoline. In this way, social and environmental as well as competitive concerns are being hindered by the gasoline price regulations.

- The regulations have imposed disproportionately large compliance burdens on small, independent firms, impacting negatively on their ability to compete.

COMPETITIVE ANALYSIS OF THE MOTOR GASOLINE PRICE AND ALLOCATION REGULATIONS

INTRODUCTION

The Mandatory Petroleum Price and Allocation Regulations (10 CFR Parts 211 and 212) provide for both allocation and price constraints on the purchase and sale of motor gasoline. These constraints, imposed during a period of critically short supply, were necessary to assure adequacy of supply to firms disadvantaged during the 1973 embargo and its attendant price rise. As studies of the gasoline market have shown, however, that period of supply crisis is long past and market trends now indicate that currently adequate supplies of motor gasoline should remain at that level through 1979.1/ Allocation and price constraints are, however, still in force. These regulatory programs have mutually reinforcing adverse impacts on the normal incentives and rewards of the marketplace which may lead, ultimately, to the decline of the independent marketing sector and severe shortages of supply of certain products, particularly high-octane unleaded gasoline.

The regulations have the effect of arbitrarily providing windfall profits (or losses) to purchaser/resellers regardless of the cost efficiency of their operations by eliminating a competitive bidding market for gasoline. They encourage vertical integration because of their subsidizing effect, and they discourage new, cost efficient capital investment. Therefore, in a dramatically changing market, the growth and adjustment of the refining and marketing sectors in this country have been severely retarded. The problems arising from both allocation and pricing constraints will be dealt with in more detail herein.

ALLOCATIONS

The Department of Energy regulations regarding allocation of gasoline supplies have engendered a number of inequities which have proven detrimental to healthy competition. One detrimental effect pertains to contractual relationships between suppliers and their customers. Specifically, the supplier-purchaser freeze rule has *effectively* stopped the creation of either long-term or short-term contractual relationships. Buyers are foreclosed from numerous sources of supply because the regulations require suppliers to meet the demands of base period customers.

1/ See *Supplement to September 1977 Report; Findings and Views Concerning the Exemption of Motor Gasoline from the Mandatory Petroleum Allocation and Price Regulations*, DOE/ERA, May 1978.

1972 purchaser relationships are essentially given administrative longevity. Therefore, even if a 1972 transaction were a one time only spot purchase, it has been given the effect of an indefinite term contract. The indefiniteness of the market effectively precludes suppliers from entering into new contracts, and this in turn forces marketers with insufficient or high priced supply to seek extra product on the "spot" market.

This problem is exacerbated by regulations governing surplus product and restricting access even to the spot market. Gasoline supplies are first offered to one of the refiner's base period purchasers, who will generally take all gasoline available at or below the prevailing market price, thus removing it from the spot market. Open bidding for surplus is thus almost eliminated. The higher priced product which remains available will not be taken by more efficient marketers, but can only be utilized by those marketers able to take advantage of subsidization effects described below (see p. 5). The elimination of the competitive allocation of supply serves to inflate costs by subsidizing inefficient marketers and forcing efficient operations to expend extra search costs to find gasoline supplies, if possible.

Spot purchases are rendered even more difficult, because the purchaser may have no ability to transport the product which is made available on this basis. Lead times and other considerations make it difficult, if not impossible, to obtain access to pipelines, or secure entrance into a barge cycle. To the extent that the spot purchaser was able to make his purchase and transportation arrangements sufficiently far in advance to secure access to these restricted transport methods, the regulations have succeeded in eliminating this option as a reliable source of competitively priced product. To the extent that a purchaser is able to both secure and transport gasoline by inefficient methods, or over long distances, it will result in increased costs to the detriment of its customers.

The allocation regulations serve to increase costs and restrict supply by encouraging brokerage activity by base period customers of low-cost suppliers. This raises costs since those with excess product allocations are able to resell it at higher costs to spot buyers. Independent brokering also has arisen as an apparent result of suppliers' fears of being frozen into future seller/purchaser relations. This fear may provide one reason for refusals to deal without any other apparent foundation.

The allocation rules provide for monthly supplies to be predicated on a six-year old base period. Those refiners whose base period volume was smaller than their current available supply enjoy frequent surpluses of product while those with larger base period obligations often find themselves hard-pressed to meet demands.

Mandatory allocations and inhibition on competitive bidding for surplus, has also arbitrarily slowed the evolution of the market and the exit of inefficient marketers from the scene at the possible expense of the efficient marketers. The trend towards correction of the overabundance of retail stations has been slowed by the regulations.

Those most able to thrive in the current situation are the vertically integrated firms. They have adequate refinery capacity, access to transportation facilities, and are not subject to the vagaries of the spot market. Moreover, the ground rules as now constituted reduce the competitive effectiveness of more efficient but non-integrated competitors.

PRICE REGULATIONS

Arbitrary Windfalls and Penalties

Substitution of regulatory rules for market pricing inherently results in gains by some firms and losses by others that are unrelated to the determinant factors in a competitive market, such as business acumen or economic efficiency. Gasoline price margins, geared to the market of May 15, 1973, are no longer appropriate to the current market despite elaborate, sophisticated, and extremely complicated regulatory amendments governing cost increases and allowable price increases.

The arbitrary distribution of profits and losses under the regulatory scheme is illustrated in the following situation. So long as he remains below his price ceiling, a jobber whose refiner/supplier just happens to run out of banked costs earlier than other refiners in a tight market will be able to charge the full market selling price even though his buying price is artificially depressed by the regulations on his supplier. This is because the price regulations provide that refiners with banked costs can pass through those costs in setting their selling price. A refiner with low costs will consequently have a lower maximum allowable selling price and will probably have no banks, since he will probably be able to pass through all his costs. The jobber acquiring gasoline from that refiner will be buying at a favorable market price. If the jobber's acquisition cost does not fall below his competitors' acquisition costs by a

greater margin then he is selling his product below his maximum allowable price, the jobber will not have to reduce his price in line with his lower costs and therefore reap the windfall of his reduced acquisition price. In the same situation governed by market operation, however, the refiner supplying that jobber would be able to set his selling price at a level fully reflecting his costs and market conditions. The jobber would not then benefit from a windfall.

The natural trend in gasoline marketing in recent years has been toward higher volume operations along with elimination of unnecessary middlemen--which tends to reduce costs and hence consumer prices. In a free market, this process would eliminate less efficient jobbers. Under the current regulations, however, efficiency is not necessarily the factor determining survival. A less efficient jobber in a windfall situation such as that described above may survive at the expense of a more efficient jobber whose refiner/supplier may, under the regulations, increase the jobber's buying price and, therefore, decrease the jobber's profit margin. Less efficient jobbers are thereby insulated from the need to improve their efficiency at the same time that more efficient jobbers are driven out of business.

The regulations also discourage refiners and marketers from experimenting with new m[illegible]ting practices and inhibit marketers from revising their obligations and prices to reflect their changing market systems. The equal application rule penalizes firms that lower prices in order to meet competition in a district by not allowing those firms to "bank" any increased non-product costs not recovered in the lower prices. In addition, under the price regulations a retailer which acquires another retail outlet must assume the margin of the acquired outlet. If the historic margin of the acquired outlet is inadequate to meet increasing costs, the regulations might inflict arbitrary punishment by first forcing the acquired firm out of business and then not allowing the acquiring firm to increase the price at that outlet in line with costs. Economic waste therefore results because failing stations simply go out of business and the existing facilities are not purchased by another firm.

Frozen Margins

For many reasons, the margins in effect on May 15, 1973, may not be appropriate today, even when some adjustment is allowed for product and non-product costs. For example, it may be that more efficient wholesaling of gasoline has reduced the margin necessary

to conduct certain bulk distribution operations, compared to 1973. But under the class of purchaser regulations a refiner would be forced to sell at the historic 1973 bulk discount even if the advantages to him at the present time are not so great as that discount. He may try to adjust or eliminate certain class of purchaser assignments (put bulk buyers in a rack classification perhaps) or else he may refuse to deal at all with the bulk wholesaler and distribute the bulk gasoline himself. Even though the bulk distribution may cost the refiner more than it would cost the wholesaler, the amount would still be less than the historic margin mandated by the class of purchaser regulations. Thus, margin rules which in 1978 are artificial may be encouraging inefficiency.

For example, if the class of purchaser margin differential mandated a 3¢/gal. discount below the rack price for bulk buyers, but modern efficient methods of distribution have reduced the benefits to the supplier of a bulk sale to 1 1/2¢/gal. the supplier may choose to distribute the gasoline at retail, even though it may be less profitable to choose this mode of distribution in a free market than to sell at a discount to the bulk buyer.

Thus, the regulation which freezes all margins at the 1973 level can effect structural changes in distribution by continuing to mandate margins on some marketing functions which are not cost justified, resulting in refusals to deal and excessive distribution costs, caused either by denial of any discount to bulk purchasers or inefficient distribution by the refiner itself.

Subsidization

The regulations establishing the pricing mechanism also have the effect of subsidizing the operations of vertically integrated refiner/marketers in two ways.

A refiner which sells more than 5 percent of its gasoline through directly operated retail outlets must treat its cost increases on an integrated firm basis. That is, the product and non-product cost increases at all levels, production, transportation, refining and marketing, are aggregated on a weight-averaged basis. The resulting average figure is then uniformly added to the base period price at each marketing level, for each class of customer. Therefore, retailing cost increases are reflected in the wholesale price charged to independent marketers, which must compete with the refiner owned retail outlets.

This inability of refiner/marketers to allocate costs to the marketing level at which they are incurred is, in effect, a powerful federal program of incentives for price discrimination and subsidization which not only has the effect of giving refiner operated stations an inherent price advantage over their independent competitors, but actually exacts subsidization payments from those independent marketing customers as a result of wholesale prices which reflect retail costs. This subsidy has another effect, in that it encourages downstream vertical integration by a refiner. The refiner can integrate forward by building or expanding retail outlets, and pass the interest, depreciation and operating costs of that expansion on to its wholesale customers as a result of the cost increase pass-through formula. 2/

Those incentives have a most unique application when the refiner/marketer has exhausted its fund of "banked" cost pass-through allowances, and is also selling gasoline at its maximum allowable price, which price is below the prevailing market price. At this point, the refiner/marketer has a positive incentive to purchase high-priced gasoline on the open market in order to raise its average weighted price. In this fashion it can sell gasoline at or below the market price and still increase its total income by significantly increasing the maximum allowable price for its lower pr[illegible] equity gasoline.

Another way of stating the price formula is:

$$\frac{V_e(M_o e + AC_t^{e}) + V_p\ (M_o P + AC_t P)}{(V_1 + V_2)} = \text{Maximum Allowable Price}$$

M_o = historic margin
AC = Average current cost (including increased product and allowable non-product costs)
p = purchased gasoline
e = equity gasoline
V_e & V_p = Volumes of equity and purchased gasoline, respectively.

2/ A refiner can pass through certain non-product costs as long as he has actually incurred those costs and can justify them. In addition, he can pass through marketing non-product costs (marketing operations costs) as long as those costs do not exceed a maximum level of 3 3/4¢ per gallon (3¢ at the retail level and 3/4¢ at the wholesale) (§ 212.83). A refiner, under the regulations, can integrate forward by building or expanding retail outlets, and pass those costs on to its wholesale customers as a result of the cost increase pass-through formula, if his marketing non-product increased costs are less than the maximum 3 3/4¢ per gallon allowable.

Therefore, if the historic margin is 5¢ and the current average cost of equity gasoline is 50¢ and that of purchased gasoline is 53¢, then, assuming equal volumes, the maximum allowable price would be

$$\frac{1\ (5 + 50) + 1\ (5 + 53)}{2} = 56.5$$

At this price, the refiner/marketer realizes his historic margin of 5¢/gal. on the market priced (purchased) gasoline, while the independent competitor who competes for the same gasoline, has only a 3.5¢/gal. margin. This differential enables the major refiner/marketer to bid for and purchase product priced above the market, and still sell at an overall profit equal to its historic margin. This financial advantage resulting from the regulation is exacerbated by the fact that at the lower price, the refiner/marketer not only has recovered his historic margin, but also his full allowable increased non-product costs, further eroding his already diminished margins. Finally, to the extent that the refiner who originally sold the high-priced gasoline on the open market knows that it has a ready market for unlifted high-priced product, it will have no incentive to price at the prevailing market price in its sales to its base period purchasers.

This has two effects: First, it drives the independent marketer, both branded and unbranded, out of business to the extent it cannot obtain product at a wholesale price sufficiently below that of the new product purchased by the refiner to enable them to make a profit; and second, it forecloses supplies of gasoline from cost efficient independent marketers.

There is a provision in the Regulations (§ 212.83(h)(2)(iv)) which allows refiner/marketers to pass through up to 3¢ less of their total increased costs to independent marketers than is charged to their directly operated retail stations, and still "bank" those costs despite the equal application rule. This does not affect our analysis, however. When a refiner/marketer's maximum lawful selling price constitutes a binding constraint, he will have no incentives to reduce price, since he will be at or below the market price in any event. Were it to be during a period of general oversupply, the free market forces will govern regardless of controls, and the ability to "bank" should provide no greater incentive to reduce price than the desire of the refiner to move its product. Therefore, the ability to "bank" certain reductions in price has no incentive effect to encourage discounts to independents so that they may be more

viable competitors of the supplier, but merely enables the refiner/marketer to recapture foregone profits during periods of tight supply, when the independent may already be in a precarious supply and price position.

Disincentives to Refining Investment

The price controls by regulating refining margins instead of profits will have a tendency over time to reduce the refiners' profits on new investments (if the refiner has run out of banks). This tendency stems from the failure of the price control rules to allow for a return on capital investment. The regulations provide only for a return to capital, by allowing the pass through of interest on borrowed funds and depreciation of invested capital. Refining is a highly capital intensive activity. Over time, capital costs will increase due to inflation and new regulatory requirements (environmental, work safety, etc.). Higher capital costs and no allowance for a return on these increased costs will decrease the return on a new investment.

Inflation in investment costs can be expected to have two effects. First, it will deter both the expansion of existing refineries and the building of new grass-root facilities. Even a refiner with banked costs would find the price controls to be a disincentive to new investments because of the possibility that those banks would be used up before the new expansion comes on stream. (The same disincentive to new investment can operate to prevent a marketer from replacing labor intensive operations with, for example, computerized centrally controlled gasoline pumps.)

The price controls cause a second distortion in investment and operating patterns because the regulations allow for pass-throughs of non-capital cost increases. For investments which do take place in the chilled environment, there will be a strong incentive for the investment to result in a less capital intensive facility than warranted by other economic considerations. By overemphasizing non-capital factors in the investment, the refiner assures itself a pass-through it could otherwise not achieve. Unfortunately, society suffers because the product could have been produced more efficiently (at a lower total cost) by a different distribution of factors of production.

Moreover, a refiner without banks has no incentive to keep operating cost down because waste can be passed through in the same manner as any other operating expense. Normally, competition forces firms to produce products as efficiently as possible because the alternative is lower profits and a risk to a firm's

business existence. When a firm is forced to charge less for its product than it would command in the open market but is allowed to pass through increased costs, it has no incentive to restrain unwarranted operating cost increases. The resources wasted in this process could be put to better use in other sectors of the economy. This disincentive to refinery investments works in tandem with the incentive to market directly which has been described above to encourage integrated refiner marketers to shift investment activity from refining to marketing, even though such an allocation may be neither efficient nor socially desirable.

A specific example of the disincentive to refinery investment is the reluctance of refiners (especially on the West Coast) to retrofit their refineries in order to process Alaskan or sour crude. While refiners might be persuaded by pure economic calculus to make investments necessary to process potentially cheaper crude oils, they are discouraged from doing so by state laws but also by the Federal regulations which provide for pass throughs of higher acquisition costs but not for capital costs to the same extent. Since the only pass throughs for capital investment are depreciation and interest on borrowed capital, a capital investment which lowers crude acquisition costs may lower the gasoline price to such an extent that the investment is not warranted. The domestic refining system is thus not being encouraged to fully adapt to the changing availability of crude oil types.

This problem is also illustrated by a phenomenon (called "tilt") by which a refiner purchases a more expensive, but higher quality, barrel of crude oil to increase gasoline production. While under certain economic conditions this may be the appropriate acquisition decision, the price control regulations may in fact deter such an acquisition. The regulations permit a pass through of the increased acquisition cost to a controlled product in proportion to that product's percent of the total refinery output. Thus, if a barrel of light crude is purchased at a cost of $1.00 more than the cost per barrel of the normal crude supply, only .50/bbl of the increased cost could be passed through in gasoline prices if gasoline makes up only 50 percent of the product slate. If the $1.00 extra acquisition cost was justified only on the basis of gasoline production, the purchase may not be made. Such decisions not to change crude types where otherwise warranted will lead to inefficient acquisition patterns by refineries.

One further distortion caused by the price controls has both environmental and competitive ramifications. The inability of refiners to pass through increased capital costs has served as a disincentive to making the extremely large investments in refinery modifications necessary to manufacture high-octane unleaded gasoline. Since only two major companies, Amoco and Shell, have been able to market high-octane unleaded gasoline on a commercial basis (due in part to investments in refinery modifications begun before the inception of the regulations), the supply is extremely short. As demand for premium unleaded increases, consumers may switch from regular unleaded to higher-octane leaded gasoline to improve performance. The environmental consequences of such fuel switching have been discussed in the environmental assessment published by FEA on August 12, 1977. Competitive concerns are also hindered, since the incentive to make needed refinery improvements is removed by not allowing an adequate return on such investments for all refiners equally. To the extent that increased demand for high-octane unleaded is met despite the cost disincentive, it will in all likelihood be only the major oil companies, given their greater ability to absorb such costs, that will be able to meet the demand.

BURDEN OF COMPLIANCE

A final factor impacting negatively on competition is the burden imposed on firms in complying with both the allocation and price regulations. Regulations as complex as these impose significant burdens on all sizes of firms, but such costs increase disproportionately to small, independent firms. A major oil company, with a large legal staff and a sophisticated computerized records management system, can interpret and comply with complex Federal regulations with relatively minor disruption of ongoing business activities. A small, owner-run dealership cannot cope with regulatory demands without suffering substantial interference with its daily operations. The cost of compliance can, in the extreme case, make such a company's operation so unprofitable as to force it out of business.

Additionally, DOE regulations require government intervention into ordinary business activities. The allocation regulations make it necessary for firms to seek DOE approval of new supply arrangements and base period volumes. This requirement imposes substantial and unnecessary delay and uncertainty onto business operations. Regulatory needs must in all cases be balanced against the costs of compliance, and unnecessary regulations must be removed as soon as possible to remove those burdens which can decrease a company's ability to successfully compete.

CONCLUSION

The supply "crisis" of 1972-1974 has passed, and most petroleum products have been decontrolled, yet price and allocation regulations remain in effect for gasoline. This memorandum has discussed some economic and competitive reasons for exempting gasoline from the price and allocation regulations. The analysis has assumed that those regulations are constraining suppliers of gasoline at one or more levels of distribution. In a situation where almost all refiners have banked costs and all resellers are pricing below their allowed maximums and large quantities are not being lifted by allocated buyers (thus, creating at least some spot market) the market will be guiding distribution patterns and prices. Although regulation can create certain costs and inefficiencies even in this situation, the effects will not be as serious. However, when demand slightly exceeds supply at the regulated price, the regulations significantly distort economic incentives. In situations of even moderately tight supply, the regulations reward inefficiency, retard modernization, and cripple competition.

The memorandum has not attempted, however, to address the competitive problems that would exist in the gasoline market after controls are lifted. It should not be assumed that decontrol of gasoline will result in a market structure without anticompetitive constraints.

The supply and demand situation as it has existed for the past few years must of course be distinguished from a genuine crisis, where the value of price and allocation regulations in preserving the most competitive segments of the industry has been proven. In less drastic situations, however, the most prominent considerations should be efficiency and competition. The marketing levels of this extremely complicated industry operate on extremely thin profit margins: tenths of a cent per gallon often make the difference between a reasonable return and red ink. The inherent imprecision of regulation that may be necessary during a crisis becomes far less justifiable in other times.

TESTIMONY BY JACK PESTER, BOARD CHAIRMAN
PESTER OIL COMPANY

Good Morning Members of the Committee, I am Jack Pester, Board Chairman of Pester Oil Company. I am here today representing several smaller oil companies, known as the Kansas Committee of Independent Refiner/Marketers. As the name implies, we are independent companies who both refine oil and who market it directly to the consumer through our company-operated service stations. We are in direct competition with the major oil companies--and we are also in direct competition with each other. As a matter of fact, about the only thing the members of this Committee have ever agreed on is our opposition to Senate Bills 314 and 327, which is the subject of this hearing today.

In order to appreciate the devasting--at least to us--impact of the passage of this Bill, I believe it is necessary to know some facts and figures about filling up your gas tank in Kansas.

In this State, there are approximately 3,000 service stations in business. These are all of the stations--major, independent, dealer, jobber and refiner-operated. Out of all of these stations there are only 193 which are refiner-operated. It is at these stations that these Bills take aim.

Of these 193 refiner-operated stations, only about 30 are run by the major oil companies; the remaining 160 or so are run by us--the independents. Thus, this Bill affects only 6% of all the service stations in this State--and yet,--speaking for the independents,--that 6% represents the most competitive and consumer-oriented sector of the market. We stay open longer; we are located conveniently--not just at major intersections or on inter-

state highways--but on county and state roads in the country and in poorer areas of the City. And we sell gas cheaper--anywhere from four to ten cents cheaper than the remainder of those 3,000 service stations.

Our little group alone has a capital investment in this State of nearly Thirty-three Million Dollars. We employ 740 men and women and pay them almost two and a half million dollars a year. We collect for this State millions of dollars in gasoline taxes and we pay property taxes of nearly $300,000 a year.

And yet, it is us that Bills 314 and 327 kick out of the marketplace. Now it is one thing to be run out of business because we can't compete--to lose a station because the customer prefers a competitor. But to be legislated out of existence because we are too competitive is quite another thing. Applied to another field of endeavor, that's the kind of reasoning that says Gayle Sayers should have been barred from playing football.

As a matter of fact, when you apply the logic of this Bill to other facets of the American marketplace, it's more than a little bit frightening. For instance:

What about the cleaners and laundry owners? Will they ask you to legislate self-service laundromats out of the marketplace next?

And what about the big daries? They are the ones who put your milk on the front steps. They "refine" their "product" and can sell it directly to you. Perhaps legislation is needed by Safeway and A & P to require that you buy your milk only from

them--the middle man.

And the vegetable farmer. Maybe he shouldn't be able to sell his produce at the Market or from the back of his pickup truck. Maybe he should be forced to get his produce to you only through the grocery store.

And all of these developments would be brought about not by the consumer--the final judge in any free economy--but by law. Not by choice, but by legislative mandate.

And even if the theoretical basis of these bills were not so faulty, there are two other compelling reasons to take this legislation under advisement--to wait and see.

The Maryland bill,--and Senate Bills 314 and 327 are a replica--does not go into effect until July of this year. What its impact will be upon the refiners, the number of stations remaining open and upon the price of gasoline to the consumer, still remains to be seen. Do circumstances exist which require the pushing of the panic button to launch "canned" legislation which has never been tried and tested? We think not. And neither does the United State Government.

Under Title III of the Dealer Day In Court Act, a special commission from the Department of Energy, the Federal Trade Commission and the Justice Department are studying the effects on competition and the consumer that this type of legislation will have. Doesn't it make sense to await the outcome of this study, which will be available in January, 1980? We think so.

And, very honestly, we think you will agree with us. These

are uncertain times for the oil industry--in fact, for our nation, and for all citizens. Nobody knows for sure what effects the loss of Iranian oil will have on domestic suppliers--but a great many well informed people are asking serious questions. We do know that our customers--your constituents--need all the gasoline they can get...at the best prices. We fulfill those needs every day, and we're working hard to keep pace with future demands. We do our jobs well--and that should be reason enough to let us continue at it. The troubled times we live in are just one more good reason for you not to bow to the pressures of special interests, and to instead encourage the interests of all parties in a spirit of competition and free enterprise.

Thank you.

TESTIMONY BY STEVEN D. COX, PRESIDENT,
PACER OIL - VICKERS PETROLEUM
SUBSIDIARY, KANSAS CITY

My name is Steven D. Cox and I am the president of Pacer Oil Company, a Vickers Petroleum subsidiary which is headquartered in Kansas City. I have worked for Vickers and its subsidiaries since 1959, when I started as a driveway attendant while still attending East High School in my hometown of Wichita.

Vickers helped put me through Wichita State University. This company had a job for me when I was receiving my education, and it had a job for me while I was stationed in Vietnam for two years. I have progressed all the way through the ranks in Vickers, like the majority of the company's executives including our corporate president. I'm very proud of that fact.

I am here today, however, because I am also very, very concerned that Vickers is the kind of company you would see legislatured out of business--were you to pass the divorcement Bill into law.

I can't talk about politics with you. And it's really not my place to talk about business or economics, as related to this Bill. But I can talk about jobs. And I will say that each and every job at Vickers would be wiped out if you decide to break up Vickers and the other small, independent refiner marketers. I alone am responsible for 300 people and over 30 stations while Vickers employs some 500 people in Kansas alone, including our home offices in Wichita. I just hate to think that we've worked hard all these years for that.

Vickers as a whole has worked hard too. This company has been an important part of business life in Kansas, and a key factor in our state's progress, for 61 years now. Doesn't that mean something to us all? Have we reached a time in our bitterness and cynicism towards business in general that we're willing to destroy some companies in particular?

I've spent quite a bit of time lately, examining the many considerations that have gone into this bill. Trying to understand the motivation. If your jobs were on the line, I think you'd probably do the same. I've heard people saying that this bill would kind of free us from bondage to a refiner type of company, and let us go into some promised land where we can all start our own business. We could buy up stations, operate them and be our our bosses.

Well, I don't want that. Vickers is my company, just as much as it's anyone else's. I know I'm speaking for a lot of people when I say that I couldn't get any more satisfaction from any job than I get from my job with Vickers. I ask you today to let me keep that job. Let me return to my people and tell them they can stop worrying about their jobs. Let us continue working ...for Vickers, for our customers, for Kansas and for ourselves.

2-21-79

Testimony

Hearing - February 21, 1979

Catholic Social Service wishes to testify in support of Senate Bill 326 introduced by Senator Jan Meyers. It gives clear guidelines to the court in considering termination of parental rights for children relinquished for adoption. The suggested guideline assessing whether the putative father gave support to the birth mother six months prior to birth, is strongly supported by our agency. That guideline will deal with the putative father who has done nothing to support the birth mother during the pregnancy but appears later to request the child. Catholic Social Service wishes to be on record in support of this bill.

Testimony given by Ed Podmore, Administrator, Catholic Social Service of the Archdiocese of Kansas City in Kansas.