MINUTES OF THE SENATE COMMITTEE ON JUDICIARY

Held in Room 519 S, at the Statehouse at 12:00 ~~a.m.~~/p. m., on February 21, 1979.

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

The next meeting of the Committee will be held at 10:00 a. m./~~p.m.~~, on February 22, 1979.

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

Elwaine Pomeroy
Chairman

The conferees appearing before the Committee were:

Jesse W. Prisock - Kansas Association of Broadcasters
Mary Hudson - Hudson Oil Company
Amos Kramer - Kansas Petroleum Council
Eric L. Richards - University of Kansas
Charles E. Krider - University of Kansas

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

Senate Bill No. 281 - Labor and employment, exceptions to overtime compensation requirements. Jesse Prisock testified in support of the bill. He explained this bill is necessary in order to bring the Kansas statute back into conformity with the Federal law. When the Kansas law was changed several years ago, this exemption was inadvertently stricken, but it is needed. He stated the personnel involved get paid much more than the minimum wage, and it is only the overtime provisions that are important.

Senate Bill No. 314 and Senate Bill No. 327 - Producers and refiners of petroleum products prohibited from operating retail gasoline stations. Mary Hudson testified in opposition to the bill. A copy of her statement is attached. She stated she and others will face virtual destruction if these senate bills become law.

Amos Kramer testified in opposition to the bill. A copy of his statement is attached. He asked the committee to preserve the free and open market system which has served the consuming public well and will continue to give the best service at the lowest cost.

Professors Charles E. Krider and Eric L. Richards discussed a survey and study they made; a copy of their Analysis of

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 and SB 327 continued -

Petroleum Industry Divestiture Legislation is attached. Professor Krider testified the bill would limit competition in the market of gasoline; the price will be more expensive for consumers; and dealer operated stations do have problems and the number of them is declining. Professor Richards testified that competition is best protected by protecting competitors; and he can find no economic benefits for the consumer in the bill.

Senator Gaines moved that the minutes of February 5 and 6 be approved; Senator Hess seconded the motion, and the motion carried.

The meeting adjourned.

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

TESTIMONY BY MARY HUDSON, PRESIDENT
HUDSON OIL COMPANY

2-21-79
P.M.

My name is Mary Hudson. I am President of the Hudson Oil Company. I am grateful for the opportunity to appear before this committee today. I come before you today as an independent business executive, representing my company and, in a sense, other companies similar to mine, all of which face virtual destruction if these Senate bills become law. I appeal to you to hear me out on the facts I wish to present to you regarding this retail gasoline divestiture legislation that has been proposed. I firmly believe that if you interpret fairly what I have to say, you will cast aside this ridiculous bill without hesitation.

I believe that I am qualified to address this bill from a number of important points of view. First, my experience in this business dates back to when I was a very young girl. I was pumping gasoline before some of you here were born. Secondly, as I have said, my company, and other companies like mine, would, to put it bluntly, be destroyed were this bill to become law. Finally (and perhaps this is the woman in me talking) I happen to consider myself a pretty competent business person who knows her customers and knows what they want. And I can tell you, any law that stops Hudson Oil from competing efficiently in a free marketplace is a law that will cause my customers and many thousands of other consumers to suffer greatly. And all for no good reason. Let me tell you why. This bill you are being asked to consider now is, in fact, a version of one introduced in Maryland in 1974. It was introduced in the emotional aftermath of the energy crisis and was passed only through the strangest of legal quirks. Even the United States Supreme

Court questioned its economic wisdom.

So now these big companies that run their own refineries as well as operated their own stations are told to choose one or the other--they couldn't have both. However, this applied not just to the big companies with their vast networks of dealers. It also applied to a small company like mine, which doesn't even have dealers in Maryland.

So, small companies are punished for something they didn't do; and maybe for something that never happened at all. And now, Kansas proposes to repeat the inequities of Maryland. Do you know what that means? Well, let me tell you. For Mary Hudson, it means there are a lot of people who will suffer. They will lose their jobs. And many, many more will suffer because they will have to pay a lot more for their gasoline. And, no sooner was the Maryland law adopted than the Federal Government stepped in and, finding a need to safeguard the rights of private station dealers, passed legislation which absolutely assures these rights. Members of the committee: The Federal Petroleum Marketing Practices Act, commonly called "The Dealer Day in Court Bill," does all the things this bill before you today does. There is no more that can or should be done. Not in a free economy, at any rate.

There is one thing these bills do that the Federal Government does not. These bills so strongly side with one segment of the business--namely, private station dealers--that they even more strongly cause another segment--namely mine--to suffer. I do not regard that as reasonable legislation in this country, nor do I

believe that you will. I do not see the merit in driving me out of business in order to insulate dealers from competition. And I believe you can see that the consequences of doing so would be most severely felt by the consumer.

The facts are that my stations, together with those of other independent refiner/marketers, just happen to be the most competitive segment of the gasoline retailing marketplace. The lower operating costs we realize through the efficiency of our structure and through the direct controls we are able to place on our stations are passed along to the consumer. Now we didn't learn how to do this just overnight. It took years and years of experience. And all the experts in this business and market statistics on our business today will tell you that consumers have expressed a strong desire to patronize stations like ours. Not just because of our locations; the convenience we give them by operating longer hours than most private, full-service dealers; and even by adding convenience store operations to our stations.

In short, it is the people like me who have consistently provided the greatest degree of competition in this business. We've also been the biggest innovators. We've had to be because we have the giants on one side of us and the private franchise dealers to the other. Either one of them would like to take away our business if they could. But, up until now, they had to do it by being better at their jobs than we are at ours.

Now they won't need to be better. Not if you give them this law. And the real irony is that it isn't going to really

have much impact on the giants. Direct retailing of gasoline never has been that important to the major oil companies. What do they care about the law, when they've always been more profitable supplying others through their refineries anyway? It's Mary Hudson who these bills are going to destroy, because she has to have a guaranteed source for retailing her product to the customer. And I don't see how she's going to have one if you pass this bill. I also fail to see how the consumer is going to be helped by this law if you mandate another middleman into the business--between my refinery and someone else's stations.

Maybe you're saying by now that you've heard all this before. After all, it's really very simple. I suppose I could go into a lot of the details of my business and start reciting all the economic and technical data to you. But, the truth is, I don't think that's really the point here--because it is so simple. What matters in my business is what matters in yours. Hard work. Effort. Knowing your customer and having a sensitivity to what your customer wants of you. I learned that nearly fifty years ago when I was left a widow before most girls are even married. And I had a small child to support. With $200 that I borrowed from my father, I bought a station that had gone under. And it had gone under, I might add, because it wasn't run right--not because of some new law.

Those things teach you about survival in a hurry. What is interesting is that my story isn't all that unusual in my segment of the business--that's more or less the way we all started. But

now it seems someone wants to put an end to it all. It's tragic, because you have before you bills that, in the final analysis, no one can predict the full consequence of. I've simply given you my opinion of probably 25 or 30 other companies like mine. I didn't give it to you lightly.

I only hope you will take what I have said as seriously as I do; and I ask that you allow it to guide your actions. If you do, I will be grateful, knowing that a frightening sword has been lifted from my head and from the heads of my customers. And knowing, too, that you will stop this costly piece of legislation before it is allowed to ruin me, to harm the consumers of our state, and to become a horrible embarrassment to yourselves.

I thank you for your time and your attention. Thank you.

2-21-79
PM

STATEMENT IN OPPOSITION TO
SB #314 & SB #327

HOUSE JUDICIARY COMMITTEE
by
AMOS KRAMER, EXECUTIVE DIRECTOR
KANSAS PETROLEUM COUNCIL, TOPEKA, KANSAS
February 21, 1979

Mr. Chairman, Members of the Committee. My name is Amos Kramer, Executive Director of the Kansas Petroleum Council located in Topeka. KPC is a trade organization which represents petroleum companies doing business in Kansas. Membership is drawn from the Major, and to some extent, the Independent ranks of the industry. The group is concerned with all segments of the industry but registers the strongest interest for the refining, transportation and marketing divisions. Because of this concern it is only natural for KPC to be represented at this hearing to speak in opposition to SB #314 and SB #327.

We concur, that if this proposed legislation is adopted, the Independent Refiner/Marketer group would be the segment most affected. KPC supports them to the fullest in their opposition.

It is interesting to note that this legislation would have minimal economic impact on the major companies. A recent survey revealed that seven companies of the Major classification here in Kansas have approximately 1,836 stations. Of this total only 29 are salary operated by the companies and would therefore be subject to divorcement. The remaining 1,807 stations are leased to jobbers or dealers.

KPC is opposed to the passage of SB #314 and SB #327 because the legislation - - -

1. Is self-serving and Anti-competitive, therefore Anti-consumer.
2. It attempts to establish state-wide pricing which has little relation to the real world of marketing and the costs involved.
3. Calls for uniform allocation of product which is already covered by the Federal Energy Act.

4. Prevents companies from test marketing innovative practices and new products in their own outlets under controlled conditions.

5. Would continue to permit chain retailers and other mass marketers to operate their stations - but would not permit refiners, large or small to operate theirs.

Of the reasons stated, perhaps the first, its anti-competitive nature has the greatest adverse economic impact on the motorists of this state. There is no doubt that the refiner operated stations represent a competitive element in the marketplace through appearance, price, location, convenience, hours of operation, etc. But that's what competition is all about, and the consumer benefits since he has been provided with a choice. Take away the competitive element and the consumer's choice is reduced accordingly.

KPC contends that this legislation is unnecessary because it is discriminatory and promotes expanded mediocrity in the market by placing restrictions on who may operate service stations in Kansas. What is needed is more qualified competitors for the benefit of the public.

As a final point, although not a part of this legislation it is a closely related subject. The 95th Congress enacted on June 19, 1978 a statute to protect dealers from any unfair practices by any company.

If you will study Title I Franchise Protections of the Petroleum Marketing Practices Act of 1978 we believe you will agree with John H. Shenefield, Asst. Attorney General, Anti-trust Division of the Justice Department that dealers are protected by law from unfair termination or refusal to renew franchise agreements.

In closing we urge you to report these bill unfavorably for passage. Preserve the free and open market system which has served the consuming public well and will continue to give the best service at the lowest cost.

AN ANALYSIS OF
PETROLEUM INDUSTRY
DIVESTITURE LEGISLATION

January 10, 1979

Charles E. Krider
Associate Professor of Business
Administration
University of Kansas

Eric L. Richards
Assistant Professor of Business
Administration
University of Kansas

TABLE OF CONTENTS

	Page
Introduction	1
Background for Divestiture	4
Rationales For Divestiture	11
Unfair Replacement of Dealers	11
Limit Monopoly Power	14
Protect Independent Dealers	19
Impact on Lessee/Dealers	22
Costs of Divestiture	23
Legal Aspects on Divestiture	25
Due Process	26
Interstate Commerce	28
Preemption	29
Antitrust Law	31
Protection of Dealers	34
Conclusion	36
Footnotes	38

SUMMARY

Both the structure and long-term profit picture indicate that the marketing level of the petroleum industry is workably competitive. Any economic justification for divestiture would therefore have to rest on the premise that vertical integration is inherently bad. But as the U.S. Supreme Court itself has emphasized, such a premise would be false. The efficiencies inherent in vertical integration and the transition costs that would accompany divestiture both mitigate against imposition of such a radical plan.

In light of these economic realities, divestiture would have to be supported by compelling social reasons before it could be considered even slightly beneficial to society. As this analysis will indicate, such a justification does not exist. The protection that the dealers desire from the alleged predation of the majors can already be provided by the existing legislative framework.

Certainly if it is desired to have smaller oil companies as an end in itself, divestiture might appear worthwhile. (Although divestiture might well increase concentration ratios in the long run.) Divestiture proponents must be cautioned that the price of such an end will be high to consumers. Recent projections already indicate minimum pump price increases of six to eight cents a gallon in the wake of the most recent OPEC action. Divestiture would surely raise these prices even higher.

When less costly remedies are already available to the dealers, it would be unwise to drastically alter the industry structure by barring a large class of potentially efficient competitors. It makes no sense to expend vast amounts of resources to achieve, at best, as much harm as good.

INTRODUCTION

In the wake of the Supreme Court's recent decision upholding the Maryland statute mandating separation of the marketing function from petroleum refineries,[1] a number of state legislatures will be contemplating similar proposals. It must be emphasized that the Court in the Maryland case made no judgment as to the wisdom or economic impact of the divestiture plan. The holding was limited to the due process, commerce clause, and federal preemption aspects of the law. The purpose of this study is to analyze the legal and economic implications of state-imposed divestiture plans.[2] The analysis will conclude that such legislation is undesirable from both a legal and economic standpoint. This conclusion is based upon the opinion that such legislation will ultimately have an adverse impact on competition resulting in injury to the consumer's welfare. Further, the benefits that such a plan may intend to achieve are already adequately protected by existing state and federal legislation.

Our concern, we want to make clear, is only the best interests of consumers who purchase gasoline and other petroleum products. That interest is promoted by insuring that goods and services are provided at the lowest prices. Any legislation which proposes to increase prices above market levels cannot be in the public's interest unless the State is truly promoting an increase in a genuine community-wide benefit, such as the health, safety, or general welfare. A basic premise of this study is that competitive markets guarantee the greatest protection for the public welfare[3] and that State regulation should accordingly be limited

to those areas where competitive markets do not exist or are incapable of providing for the good of the entire community.

Many of the divestiture proposals, however, seem to be tainted by a much more pervasive belief. Uniting two traditional American attitudes toward big business they suggest that large industrial accumulations are inherently undesirable and that bigness itself results in economic inefficiency. As a result, they urge the retention of numerous small firms under the mistaken belief that a healthy, competitive economy is thereby secured.[4]

Economic realities mitigate against the validity of such a viewpoint. Rather than protecting competitors as an end itself, competition, and ultimately the consumer welfare, is guaranteed by insuring that certain conduct is followed by individual business firms; and this conduct is itself determined by the industry structure. One must look at the market concentration and the existence of artificial barriers to entry in order to evaluate the likelihood of anticompetitive behavior. This means that in a competitve market some competitors will fall by the wayside. But in the long run, they and society in general will benefit. Comparing the market system to the Darwinian theory of natural selection and physical evolution, it has been posited that

> The environment to which the business firm must adapt is defined, ultimately, by social wants and the social costs of meeting them. The firm that adapts to the environment better than its rivals tends to expand. The less successful firm tends to contract -- perhaps, eventually to become extinct.[5]

The question to be answered, then, is whether the divestiture legislation is truly furthering the public interest or is merely an

example of a special interest seeking to remove itself from the rigors of competition.[6] In any event, divestiture will only result in lower prices to the consumers if it can be demonstrated that the costs of vertical integration in the oil industry exceed any benefits it provides.

This study will indicate that the costs do not outweigh the benefits of divestiture. The oil industry is presently workably competitive, particularly at the marketing level, and the recent changes in retailing strategies are the result of the natural competitive forces. Consequently, divestiture would serve only to shield one segment of the industry - the independent lessee/dealers - from the impact of competition to the detriment of the general public. Increased prices and a delay in the dismantling of an out-dated and inefficient marketing system for gasoline would be the likely result. The only beneficiaries would be the current independent dealers.

Moreover, the deficiencies that do exist in the petroleum industry may be resolved by less inflationary alternatives that already exist in the state and federal regulatory framework. The public benefits when businesses meet the rigors of competition, not when they circumvent them.

Two major propositions will be advanced regarding divestiture:

1) competition will be reduced by the exclusion of refiners from the marketing of gasoline, and
2) consumer prices will rise and there will be excess resources devoted to the marketing of gasoline.

The overall economic impact of such legislation will be a misallocation of resources with an attendant reduction in the efficiency of the economy.

Nontheless, any non-economic justification for divestiture should also be considered. The next part of this study will explore the background of vertical integration in the petroleum industry and examine the validity of calls for dismantling such integration.

BACKGROUND FOR DIVESTITURE

Vertical integration is not unique to the oil industry. In many respects oil is extremely similar to the make-up of the steel industry. However, the controversy and intensity surrounding the issue in oil seems to be much more hostile. This should not be surprising. Not only are petroleum sales extremely high, but oil probably affects the functioning of every industry and most aspects of our daily lives. It has been said that, "(i)f one were forced to choose a single key industry, it would have to be petroleum."[7] Further, many of the proponents of divestiture are extremely well-organized and vocal - and fighting to preserve their present means of employment. The general public's incentive to improve the efficiencies in the retailing of gasoline are also well-founded. Based on 1976 sales, a decrease of only one cent a gallon at the pump would result in a savings of over one billion dollars a year to consumers.

Many of the divestiture proposals are a direct outgrowth of the severe gasoline shortages faced by this country in 1973. Numerous persons felt that these shortages were a direct result of either a deliberate design or a gross oversight by the large vertically integrated oil companies. Whatever the cause, they are now seeking to insure that the shortages do not recur. Independent dealer organizations have argued that the shortage was a direct attempt by the major companies to starve them of needed supplies

in order to eliminate the lessee/dealers and independent discounters as viable competitors to the majors' company operated stations.[8]

Initially, the major oil companies all followed a similar marketing strategy in gasoline. The essence of the strategy entailed the use of independent lessee/dealers - each of whom sold a single nationally advertised brand of gasoline.[9] An effort was made to sell a product that is essentially a commodity (as is wheat) 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 large lots, 3) image advertising ("You expect more from Standard and you get it", Shell's Platformate, and TCP), 4) offering premiums or trading stamps, 5) combining gasoline sales with car repairs and services, 6) an expensive credit card operation, and 7) avoidance of price competition. The customer's attention was to be distracted from prices and directed to other aspects of purchasing gasoline.

Increased attention has now been focused upon the industry because of recent efforts by the majors to abandon their old high saturation, low profit strategy for the more promising high volume, low cost method successfully employed by their independent competitors. The discounters were exemplified by the high volume, self-service station which could undersell the majors' lessee/dealers by two to six cents a gallon. Their stations typically have: 1) small lots with very small buildings - possibly part of a shopping center, 2) no car repair services, 3) limited use of credit cards, 4) little or no brand advertising, 5) self-service, and 6) high sales volume. Prices are lower primarily because operating costs

are lower than for the full service, independent dealers.

As this description of alternate marketing strategies suggests, there exist two types of competition in the retailing of gasoline. The first entails competition among dealers who offer the same mix of services while the second is competition among dealers who vary the mix of prices and services. The latter is by far the most important because of the increased number of choices available to the consumer. Even if divestiture would increase the number of lessee/dealers, competition would still be reduced because consumers would be denied some price/service options.

Responding to the competitive pressures exerted by the discounters, the vertically integrated refiners have begun streamlining their operations - closing their more marginal outlets and selling gasoline through company-operated, unbranded outlets. These changes are perceived as a direct threat by the lessee/dealers who have a vested interest in the full service strategy. Not only will they be unable to compete with the company-operated, self-service stations, but they will also lose the sibsidies they formerly received from the majors which supported their operations. Reacting to this threat to their existence, the dealers have charged that, among other things,

> the existence of employee-operated stations effectively precludes application of antitrust laws regulating sales from distributors to dealers, increases the unwillingness of large oil companies to supply gasoline to retail competitors, and focuses the power of vertically integrated companies against the small, independent private-brand marketers. 10

Accordingly the independent dealers have been encouraging divestiture of marketing from refining, dismantling the vertically integrated

structure. Such a course would prevent the refiners from directly operating their outlets, thereby protecting the economic interests of the dealers by eliminating potential competitors. All of the proposals aimed at divestiture incorporate a single underlying theme - vertical integration is detrimental to the marketplace. This premise, however, appears to be unfounded.

Vertical integration has been condemned as the "capstone of control in the petroleum industry." Non-integrated companies and independent dealers are visualized as standing naked, "vulnerable to the constant threat of price squeezes, the denial of supply, and the foreclosure of markets."[11]

Various explanations are available for the motivation behind both the vertically integrated structure of oil and the low profit, saturation policy originally employed by the major companies. One allegation is that the majors formerly chose to concentrate profits at the crude production level and used their marketing outlets primarily as a conduit for pumping out vast quantities of gasoline. Vertical integration may have encouraged the companies to subsidize downstream levels in order to increase profits at the production stage.[12] This strategy was made possible by various corporate tax programs, such as the oil depletion allowance and foreign tax credits. Further, the majors saw themselves as the dominant force at the crude stage where they could produce their own requirements at minimal costs. The strategy called for the establishment of high crude prices and the production of as much crude as possible in order to make maximum utilization of the tax preferences. Controlled

refining was imperative to insure that adequate refining capacity was available and to prevent the downward pressure on crude prices that independent refiners would exert. Integration downstream into marketing would prevent the independent retailers from squeezing refiners and thereby weakening the price structure.[13]

This saturation policy, requiring downstream subsidization of marketing, has been regarded as a driving force behind vertical integration. Product differentiation has also been posited as a companion motivation for high outlet density and, ultimately, vertical integration. Price competition was perceived as a high risk strategy. Price cuts were seen as self-defeating. A cut in price would be met by all competitors while an increase would not be possible without an industry-wide advance. Since consumers could not generally be expected to buy more gasoline as prices fell, the only result of a price decrease was a loss of profit by all. Product differentiation strategies demand a product recognition by consumers which is brought about by image advertising. Since gasoline cannot be reasonably marketed in separately identifiable packages, the brand name must be attached to the dispensing apparatus. Vertical integration is the least costlv and most effective method a refiner can use to ensure that consumers will identify the physical product with the advertising image.[14]

Passage of the Tax Reduction Act of 1975 changed the situation for the integrated companies. Percentage depletion was repealed for the majors and reduced for the smaller companies. The foreign tax credit was reduced and changes were made which would prevent offsetting intangible drilling

expenses incurred abroad against domestic income. But an even greater blow was struck by the OPEC-initiated increases in the cost of foreign crude. These increases wreaked havoc on the majors' traditional strategy which was premised on the availability of unlimited supplies of inexpensive crude. Combined with the more restrictive tax programs, the majors found it increasingly difficult to maintain their original strategy. Finally, as the prices sky-rocketed at the gas pump, consumers became much more price conscious, thereby undermining the effectiveness of non-price product differentiation as a viable marketing strategy. In order to compete with the increasingly successful, private-brand discounters, the majors were forced to revitalize their marketing effort and make that stage profitable in its own right.

Injecting greater efficiency into the retail stage, as the present controversy indicates, did not include abandoning vertical integration. This integration was seen not as a predatory device, but as a means of enhancing intra-firm efficiency. It reduces overall costs by stabilizing operations and "reducing the functional costs of ascertaining the demands and needs of the consumer."[15] More specifically, it: 1) creates economies of management, 2) reduces the variability of profits - acting like a diversified portfolio, and 3) insures the availability of supplies.[16]

Arguments have been proposed that it is only the refiner who needs vertical integration for the protection which would otherwise be available only through greater horizontal size or diversification. The heavy fixed costs dictate that refining be operated at maximum capacity to reduce per unit costs. The assurances of a crude oil supply and stable distribution

are therefore critical. Increased price-consciousness of consumers as a result of the precipitous increases in the price of gasoline motivate the refiners to take direct control of the marketing process. Integration facilitates maintaining a close check on the pulse of consumer desires and responding quickly to changes in those desires. Direct control of the outlets is seen as far superior to vertical control by various contractural devices (i.e., requirement, output, franchise, exclusive dealing, real estate lease, and consignment.) The greater managerial control resulting from direct operations enhances the responsiveness of the operations. The alternative of long-term contracts is undesirable because constraints on collecting and retrieving information leads to inflexibility since no contract can be written which covers all contingencies. While short term contracts may offer greater flexibility, they are more expensive because they must frequently be renegotiated.[17] Further, lessee/dealers have been criticized as not only being unwilling to compete, but also unable to operate a retail outlet efficiently. It has been urged that "a specialized retail operation must be administered by a specialist; to insure proper training and supervision, these new dealers should be company employees."[18] Finally, direct operation is cheaper because a refiner may meet the challenges of a price cutter at the retail level without being forced to grant allowances to all of its outlets.

Accordingly, the integrated companies have begun a new strategy patterned after the more successful tactics employed by the private-brand discounters. The ensuing uproar, as marginally efficient lessee/

dealers are forced from the market by the highly efficient company stations, focuses upon eliminating the refiners from the marketing stage through a program of state-mandated divestiture. The merits of such a course appear to rest upon three possible rationales: 1) divestiture would prevent the unfair replacement of existing dealers by company operated stations; 2) divestiture would limit the monopoly power of the major integrated oil companies; and 3) divestiture would protect the independent dealers from the price competition waged by more efficient marketers. Each of these justifications will be evaluated.

RATIONALES FOR DIVESTITURE

REPLACEMENT OF DEALERS

One concern of independent dealers is that oil companies are in the process of changing their marketing strategies away from using franchised dealers to market gasoline in favor of using company operated stations. Such a strategy would presumably mean a fewer number of stations, but each with a higher volume of sales and increased profits. The security of independent dealers would be threatened because there would be fewer stations and because fewer of the remaining stations would be operated by dealers. There is clear evidence of a decrease in the number of gasoline stations in recent years. The number of stations reached a peak of 226,000 in 1972 and has since dropped to 171,000 in 1978. It is expected to drop as low as 160,000 by 1980.[19] Table 1 shows the number of stations and average sales from 1972 to 1978 in the United States, and Table 2 shows the same information for Kansas. The decrease in the number of stations was accompanied by an increase in

per station sales of 22% from 1973 to 1978. The same trend is observable in Kansas.

TABLE 1

Number of Gasoline Stations and Sales, United States

(1)	(2)	(3)	(4)	(5)
			Average Sales Per Station	
Year	Number of Stations	Total Sales (Billions)	Current Dollars	1967 Dollars
1978	171,000	57.6	336,800	163,495
1977	176,450	52.4	296,900	157,758
1976	186,400	48.0	257,000	144,463
1975	184,480	43.8	232,000	135,831
1974	146,130	41.0	209,900	131,269
1973	215,880	34.4	159,600	135,139
1972	226,459	33.7	148,800	138,290

TABLE 2

Number of Gasoline Stations and Sales, Kansas

(1)	(2)	(3)	(4)	(5)
			Average Sales Per Station	
Year	Number of Stations	Total Sales (Billions)	Current Dollars	1967 Dollars
1978	2725	918,325	337,000	163,592
1977	2811	834,867	297,000	157,810
1976	2977	759,135	255,000	143,333
1972	3609	456,342	126,000	117,100

From an economic perspective, the decrease in stations is desirable and indicates that the oil industry is moving to a more efficient marketing system. As discussed above, the major integrated oil companies such as Texaco, Gulf, and Shell have historically sought to avoid competition based on prices and have instead competed using advertising, coupons, gifts, games, elaborate stations, and convenience of location. A key part of this strategy was to increase sales by having a large number of stations in convenient locations. An appropriate symbol of this strategy was a station on each of the four corners of major intersections.

Although consumers did benefit from a large number of stations by being able to purchase gasoline more conveniently, they also paid for this privilege through higher prices. With low volume per station, fixed costs must be allocated over a small number of gallons, thus increasing the operating cost per gallon. Once the OPEC mandated increases in prices

occurred in the early 1970's , the consumers became more price-conscious and the low volume/high price approach to selling gasoline became less viable. The change to having a fewer number of stations selling more gasoline will lower the cost of distribution and also prices.

The main point of this discussion is to stress that the decrease in stations is the result of economic forces in the marketplace, and is not caused by any conspiracy on the part of oil companies.

However, the movement to a more efficient distribution system for gasoline clearly has costs for dealers who currently see their economic security threatened. But this consideration does not justify the proposed divestiture legislation. First, if the oil companies are cancelling dealers' franchises without justification or due process, there is federal legislation - Petroleum Marketing Practices Act - which protects the dealers' interests. This law was passed in 1978 in response to complaints from dealers concerning unfair treatment by major oil companies. Second, it must be recognized that dealers should not remain in business if their stations are no longer economically justified. For the State to intervene by imposing vertical divestiture to protect noncompetitive dealers will result in higher prices for the consumer and the preservation of an inefficient marketing system for gasoline.

LIMIT MONOPOLY POWER

A second possible reason for divestiture is to limit the monopoly power of petroleum companies. However, the petroleum industry is workably competitive, and divestiture legislation is not required to reduce undesirable monopoly power. But even if the alleged monopoly power of the

major oil companies is the target of this legislation, the wrong weapon is being used. Existing antitrust laws are sufficient to correct market problems caused by monopoly. Further, if any type of divestiture were justified, it would surely be aimed at the source of monopoly power, which in the petroleum industry could only be in the production of crude oil. Indeed, the divestiture of crude production by the major integrated oil firms has been considered at great lengths by Congress in recent years and has been continually rejected.

The marketing of gasoline in particular is competitive. Economists have two major indications of competition - structure and preformance. On both measures the industry is competitive. In 1978 there were 26 firms with branded retail outlets for gasoline in Kansas. The largest firm, Amoco, had a market share of 11.26% in 1977. The largest four firms had 32.08%. This type of industry structure - a large number of firms, no one of which is dominant, strongly suggests that competition will prevail in the marketing of gasoline.[20] Table 3 shows the market share of gasoline sales in Kansas for 1976 and 1977. Note also that of the ten largest retailers, five are relatively small companies, such as Vickers and APCO, which in no way could have monopoly power.

Underlying the economics of competition is the theory that capital will flow from industries yielding low returns to those yielding higher ones. Concentration ratios that indicate a low number of sellers might suggest the probability of higher monopoly prices. However, "(w)hat concentration' gives, 'easy entry' can take away."[21] Vertical integration is condemned as erecting insurmountable barriers to entry since

potential marketers are forced to enter as more costly integrated concerns in order to avoid being deprived of supplies. Such a justification for divestiture must be seen as costly over-kill. It has been argued that the only real instances of artifical barriers that are injurious to consumer welfare are the result of deliberate predation. As such they can be

TABLE 3

Market Share of Gasoline Sales, Kansas

Company	Market Share		Change in % Point
	1977	1976	
Amoco	11.26%	11.44%	-0.18
Vickers	7.74	7.00	+0.74
Philips	6.85	7.14	-0.29
Derby	6.23	5.82	+0.41
Coop Assn.	6.06	5.65	+0.41
Getty	5.77	6.61	-0.84
APCO	4.40	4.16	+0.24
Mobil	4.23	4.55	-0.32
Texaco	3.46	3.66	-0.20
Champlin	2.70	2.84	-0.44

Source: Dan Lundberg, Associates

effectively dealt with under the antitrust laws. Any prophylactic rules for predation in the form of divestiture would injure consumer welfare by

eliminating numerous efficient companies from the retail level.[22] Entry and exit in marketing appears to be easy and occurs regularly.

With free entry the returns in an industry offering monopoly profits will sink to "normal" or competitive rates of return as new capital is attracted. The non-existence of monopoly profits would therefore indicate a workably competitive industry. The competitive nature of the petroleum industry is further confirmed by its performance in recent years- there is no evidence of excessive profits as would be expected for a monopoly or cartel. If there is monopoly power it would show up in higher than average profits. But the evidence is clear that long run profitability is no higher in petroleum than in other industries.

Table 4 compares the return on stockholders'equity of the eight major petroleum companies (who are most likely to have monopoly power) and Moody's 125 industrials. The latter is a cross section of large American companies. Over the 12 year period 1960-1971, the profitability of the largest petroleum companies exceeded the Moody's average only in 1970. For most years the profitability of the petroleum industry was slightly below that of the Moody average.

Table 5 shows the rate of return on stockholders' equity by industry for 1974-78 and for the most recent 12 months. The five year average return in petroleum was 15.1% for international oils, and 16.1% for other oil and gasoline companies. These rates of return are above the all-industry median of 13.9%, and reflects the temporarily higher profits associated with OPEC's price increases in 1973. This period is not characteristic of the industry's long term profitability. For the most recent

12 month period, the return on equity was 13.9% for international oils and 13.1% for other oil and gasoline companies. These are below the all-industry median of 15.4%. The petroleum industry is clearly not earning a rate of return greater than its cost of capital.

TABLE 4

Comparison of Rates of Return on Stockholders' Equity

Year	Moody's 125 Industrials	Eight Largest Petroleum Companies
1971	11.2	11.1
1970	10.2	10.8
1969	12.2	10.8
1968	13.0	12.4
1967	12.4	12.4
1966	14.2	11.6
1965	13.7	12.1
1964	13.3	10.5
1963	12.4	11.5
1962	11.6	10.7
1961	10.5	10.4
1960	10.8	10.2

Both the structure of the marketing level of the petroleum industry and the industry's long-term profit performance strongly support the hypothesis of a competitive industry. Arguments that the integrated majors are able to exert leverage on retailers by extending upstream monopoly power through to the marketing stage are unpersuasive. It may be argued that the fallacy of this claim is that it counts the same monopoly power twice. This suggests that vertical integration is a legitimate method of doing business, bestowing many benefits on consumers. It is only when it

is associated with monopoly power at a particular level of the industry that any criticism might arise. But in those cases, the monopoly power itself should be attacked through antitrust enforcement rather than through the destruction of a method of business which is beneficial to society.

TABLE 5

Rate of Return on Stockholders' Equity in Selected Industries, 1978

Industry	5-Year Average	Latest 12 Months
1. Personal Products	18.5%	19.1%
2. Aerospace & Defense	17.8	21.5
3. Information Processing	17.6	18.2
4. Leisure	17.1	18.4
5. Health Care	16.6	18.2
6. Electronics & Electrical Equipment	16.3	18.3
7a. International Oils	15.1	13.1
b. Other Oil & Gas	16.1	14.5
8. Wholesalers	16.1	15.1
9. Chemicals	15.9	16.0
10. Construction Contractors	15.7	15.4
11. Industrial Equipment	15.1	17.0
12. Forest Products & Packaging	14.9	14.1
13. Utilities-Natural Gas	14.9	14.6
14. Food & Drink	14.6	13.8
15. Finance-Insurance	14.0	20.3
All Industry Medians	13.9	15.4

Source: Forbes, January 8, 1979, p.244.

PROTECT INDEPENDENT DEALERS

A third possible rationale for the proposed divestiture is to protect independent dealers from competition in the marketplace. The State may wish to protect the lessee/dealers because they operate small businesses, many of which may not survive competition from company operated stations.

This argument is valid only to the extent that society values the preservation of small businessmen for non-economic reasons. But as indicated previously, this is a highly questionable line of reasoning.

There have been several major changes in the petroleum industry during the 1970's which have led dealers to seek protection from the State. First, the oil depletion allowance in the Federal tax law has been eliminated. This has provided an incentive for integrated oil companies to emphasize recording profits in the crude oil phase of their operations in order to take advantage of the tax law, which in effect provided a subsidy to the industry. One consequence of this was that the major oil companies did not need to maximize profits in their marketing operations. Second, the dramatic increases in the price of oil by OPEC has raised the price of imported oil above that of domestic oil for the first time. This means that the marginal barrel of oil, which is imported, costs more than the average barrel. Third, price competition in gasoline retailing has become a more significant means of competing. Independent oil companies and other marketers have successfully competed with the majors by following an alternative marketing strategy: high volume, low service outlets with lower prices than the majors.

The first two changes have led integrated oil companies to place a greater emphasis on profits in their marketing operations. A key element of their traditional marketing strategy was to emphasize sales volume in order to(a) emphasize profits in their crude operations to take advantage of the tax law, and (b) have an outlet for additional barrels of oil whose marginal cost was low in comparison to average costs. The marginal cost

was low in comparison to average costs. The marginal barrel of crude oil was profitable because it was imported at a price below market levels in the US. Neither of these reasons for emphasizing sales volume at retail levels in order to increase after-tax profits of crude production exists any longer.

The response of the major oil companies has been to place a higher priority on profits in their marketing operations. This in turn has led to the elimination of low-volume stations where profits either did not exist or were too low to provide an adequate return on the investment. The important point is that the change in marketing strategy is consistent with market forces and is being done to meet competition from other companies selling gasoline. The change reflects the consumer's desire for lower priced gasoline even if it means fewer stations (implying less convenience), smaller stations, fewer services, the elimination of games and premiums, and other cost-saving approaches to gasoline marketing pioneered by the independent oil companies.

The clear implication of this analysis is that independent dealers are being threatened not because of any conspiracy to deprive them of their livelihood, but because the industry is in a transition from an obsolete and inefficient marketing system to one that more closely reflects the degree of convenience and service desired by consumers. Independent dealers have traditionally emphasized full-range services - including minor repairs, tires and batteries - and have charged higher prices than their no-frill competitors. Some independent dealers will of course survive, but they will be reduced in number to a specialized niche.

The changes occurring in the marketing of gasoline are not unique in our economy. The change is analogous to that which has already occurred in the food distribution industry where many small family-owned stores have been replaced by much larger chain stores. The similar change now occurring in gasoline retailing is evidence of competition in the industry and should not be discouraged by public policy.

Accordingly, there is little economic rationale for the State to intervene in the market place to protect independent dealers from increased competition. Any such protection is likely to raise prices for consumers by de-emphasizing price as a means of competition. This is the economic equivalent of a tax imposed on purchasers of gasoline for the benefit of independent dealers.

IMPACT ON LESSEE/DEALERS

Without doubt, the economic interests of lessee/dealers are harmed by the increased emphasis on price competition and the trend toward less services in selling gasoline. Some will lose their stations, others will possibly have lower incomes. From a personal viewpoint, this is unfortunate. But at the same time there are economic benefits for society as a whole. As the oil industry moves toward a more efficient system for marketing gasoline, resources will be allocated to more useful purposes and the efficiency of the economic system will be improved. Some land and buildings now used to sell gasoline will be available for other uses and employees who now sell gasoline will be available for other work. It is important to stress that such displaced employees- including independent dealers - will be providing services and goods which consumers desire more than what they

provided selling gasoline.

There are costs to individuals resulting from this reallocation of resources. But it must be recognized that this kind of adjustment occurrs continuously in our economy. If there is a compelling reason for the State to protect gasoline dealers, then some alternative means should be found, possibly through the tax system. Consumers should not be burdened indefinitely with an inefficient gasoline distribution system solely to help independent dealers.[23]

COSTS OF DIVESTITURE

Any decision regarding divestiture must take into consideration the costs that such a program would impose.[24] Transaction costs would increase as former intrafirm exchanges became interfirm in nature. Not only would there be a loss of certain inherent economies, but innovation and exploration would suffer as producer-refiners lost control of certain marketing outlets. Further, the asset diversification, gained through integration, would be effectively destroyed. This, coupled with uncertainty over the untested successor companies, would increase the costs of attracting new capital. Certain transition costs would also accompany the change. These would include the costs of designing and implementing the plans, plus legal expenses associated with the current outstanding loans of the present integrated companies. In a tight capital market, investors would pick and choose among the most promising ventures, and even then they would probably demand higher rates of return. At the higher capital costs, many formerly attractive projects would not be undertaken.

A recent United States Treasury analysis estimated that the transition

period might run up to ten years. The study cited three major financial effects of divestiture on affected companies during the transition:

> First, it will be difficult for new unsecured long-term debt issues (including the refinancing of maturing issues) to be sold until lenders could ascertain: 1) what corporate entity would be responsible for debt payment, and 2) what the existing assets and liabilities of that corporate entity would be.
>
> Second, even after this period is reached, it still may be difficult for some companies to raise capital since uncertainties will prevail also about the earnings potential of the divested companies. The return to divested oil companies might well be lower since economies of scale which have been advantageous to the integrated oil companies may no longer be available.
>
> Third, it may be possible for these companies to raise some amount of secured long-term debt. However, since the basic security of loans would be the particular asset rather than the credit worthiness of the company, the potential volume of such financing would appear to be limited by the specialized nature of many of the oil companies' assets or possible efforts of creditors to block such financing in order to protect their existing investments.[25]

In short, the analysis concluded that after divestiture it would be more likely that domestic prices would increase and that domestic energy supplies would decline.

Under a complete divestiture it would be unlikely that most lessee/dealers would be able to raise the capital necessary to purchase the stations they operate. They may well be replaced by large retail chains which might have the direct result of replacing the competitive market with a highly concentrated one.[26]

It has been further noted that the end result of vertical divestiture could be the elimination of the independent discounters who have been

the real innovators in gasoline marketing. Separation of retailing from refining might result in the smaller, non-integrated refiners being caught in a squeeze. On the one end, the retailers would bid down the price of supplies, while at the other, the integrated producer-refiners would seek to raise the price of crude. (This could only be avoided by continuing inefficient controls.) As their margins decreased, the non-integrated refiners would exit the market and potential entrants would be discouraged. Elimination of the independent refiners would deprive the discounters of a primary source of supplies. Consumers would not even benefit since after the elimination of the independent refiners, concentration would increase in the refining stage. This would expand the remaining refiners' countervailing power which would restore refining margins and drive up retail prices.[27] To the extent that consumer welfare could possibly be promoted by protection of individual competitors, it would be a mistake to save the inefficient lessee/dealers by risking extinction of the highly competitive independent discounters.

LEGAL ASPECTS OF DIVESTITURE

A determination of the desirability of enacting a divestiture plan must necessarily include an examination of various legal issues. Not only must such a regulation comport with the due process constraints of both the federal and state constitutions, but it must also be consistent with any present or future federal policies. Otherwise the statute would surely be struck down by a state or federal court. Further, if it can be demonstrated that present federal or state regulations already protect the lessee/dealers from predatory conduct, divestiture would be both unwise

and unnecessary.

Divestment is certainly not a novel means of regulation. Various federal and state statutes have been enacted which require some type of divestiture in an industry. It should be noted, however, that while the federal legislature has frequently entertained proposals for the divestiture of the petroleum industry, it has consistently rejected them.

DUE PROCESS

The recent Supreme Court affirmation of marketing divestiture imposed by the State of Maryland should lay to rest any potential fourteenth amendment due process challenges of similar legislation in other states. The Maryland law was passed in response to a Comptroller's study which indicated that in all cases company operated stations fared better than their lessee/dealers and independent discounter rivals in receiving precious supplies of gasoline. The statute required refiners to divest themselves of their company operated stations and to extend any voluntary allowances uniformly to all the stations they supplied.

Immediately it must be recognized that the Supreme Court decision in no way passed judgment on the economic or social wisdom of the law. When determining the validity of economic regulation under the due process clause of the fourteenth amendment, the concept of separation of powers mandates that the judiciary give deference to the opinion of the legislature on the desirability of a given law. This translates into a presumption of validity for legislative acts in the economic sphere which, for all practical purposes, generally guarantees their success when confronted by a due process challenge. As the Court has emphasized on numerous

occasions during the last forty years, to approach the controversy in any other way would allow the Court "to sit as a superlegislature to weigh the wisdom of legislation . . ."[28]

More concisely --

> The day is gone when . . . (the) Court uses the Due Process Clause of the Fourteenth Amendment to strike down state laws, regulatory of business and industrial conditions, because they may be unwise, improvident, or out of harmony with a particular school of thought.[29]

In many instances, however, divestiture will be less secure from successful due process challenges based upon the constitutions of the various states. The constitutions of some of these states afford persons greater protection from restrictive regulations than can be expected from the U.S. Constitution. Rather than be content with the impotent "mere rationality"test, these state courts interpret their constitutions as giving the judiciary greater authority to weigh the substance of each legislative determination. More simply, the traditional presumption of validity is exchanged for a presumption of invalidity. To overcome this burden, the proponents of the legislation must demonstrate to the court that the regulation genuinely fulfills a "substantial, legitimate, and general public interest." Based on the foregoing economic analysis, divestiture legislation would not be expected to pass this more rigorous scrutiny. And, not surprisingly, in one of these states (Florida) a petroleum divestiture statute was struck down as violative of due process.[30]

The Maryland divestiture plan was originally struck down by the Maryland trial court, based on this more expansive due process analysis. However, the Court of Appeals reversed, holding that Article 23 of the

Maryland Declaration of Rights is similar to the due process clause of the fourteenth amendment, and that the less rigorous mere rationality test should be used.

It appears that a similar divestiture proposal could be upheld in Kansas. The Kansas courts' interpretation of Section 18 of the Kansas Bill of Rights sounds much like the United States Supreme Court when they declare that they will not sit as a super legislature and throw out laws that they find unwise, improvident, or inappropriate.[31] And they have emphasized that they will not inquire into the motives of the legislature in passing regulations.[32]

Coupled with the presumption of validity given to the judgment of the Kansas legislature on the wisdom of a particular regulation, the courts also permit the legislature broad authority to pass restrictive legislation.

> The modern view is that the state may control the conduct of individuals by any regulation which upon reasonable grounds can be regarded as adapted to promoting the common welfare, convenience, or prosperity.[33]

A state-imposed divestiture program would be struck down if it was found to be preempted by a federal policy. Further, state legislation will not be upheld if it discriminates against interstate commerce,[34] or impermissibly burdens commerce among the states.[35] However, the Supreme Court has found that the Maryland plan violates none of these rules.

INTERSTATE COMMERCE

Justice Stevens held that the Act created no barriers against interstate independent dealers, did not prohibit the flow of interstate goods,

and did not distinguish between in-state and out- of-state companies in the retail market. Accordingly, the Act was found to be nondiscriminatory. It should be noted, however, that he did imply that if the effect of a divestiture regulation were to cause local goods to comprise a larger share of the total sales in the market, it might have a discriminatory impact.[36] If so, it could be struck down on commerce clause grounds.

The Court also rejected the argument that the Maryland plan impermissibly burdened commerce. Recognizing that at least three refiners would be forced from the Maryland market and that consumers might be deprived of certain special services, the majority emphasized that the commerce clause protects the interstate market and not particular interstate firms. This does not completely rule out an undue burden challenge in other states, however. Of the 3,780 gasoline stations doing business in Maryland, only 199 were company-operated stations belonging to integrated companies. A state with a much higher proportion of affected stations would be more likely to cause a greater burden by imposing divestiture. Also, the Maryland plan only involved divesting company-operated stations. A statute mandating complete separation of refining and retailing interest would very likely be struck down as too burdensome.

PREEMPTION

Finally, the Court refused to find that the statute in Maryland was preempted by the commerce clause itself or by 2(b) of the Robinson-Patman Act. This holding is quite consistent with a current trend which may well be in vogue for some time. The Burger Court appears to have erected a strong presumption against federal preemption of state regula-

tory programs in the absence of an unambiguously expressed congressional intent to preempt. This flexible, state-directed approach reverses the principle of absolute supremacy for national policies vocalized by Chief Justice Warren when he held that, "(t)he relative importance to the State of its own law is not material when there is a conflict with a valid federal law, for the Framers of our Constitution provided that the federal law must prevail."[37]

As a result, it is highly unlikely that any current federal legislation would be found to preempt a state divestiture law. An argument does exist that a divestiture plan implemented by the states may be in contravention of the federal antitrust laws. This would suggest that while most state regulations are exempted from the federal antitrust laws under the Parker doctrine, state antitrust laws that frustrate the federal antitrust policy of fostering competition would not be excluded. Although the strong presumption against federal preemption, reaffirmed in the Maryland case, seems to mitigate against this theory, some uncertainty still remains because the Supreme Court has not directly addressed the issue in recent years. (In fact, in only one instance has the Court specifically examined the interstate reach of state antitrust laws.[38]) Further, the breadth of the State's exemption from antitrust based on the Parker doctrine is still far from clear despite the fact that the Court has entertained that issue in each of the last five years.

There should be no doubt that Congress could preempt the area and invalidate a state divestiture plan if it so desired. The reach of the commerce clause for affirmative federal legislation is almost without

bounds. As long as the subject matter of the legislation has an economic impact on commerce, and the survival of a state's governmental functions are not threatened by the regulation, the federal government may occupy an area to the exclusion of the states. Since the products sold at service stations frequently move across state lines, and are often sold to interstate travelers, the Court could easily find the requisite impact on interstate commerce. And, under the rubric of the antitrust laws or the recently enacted Petroleum Marketing Practices Act, Congress could easily enact preemptive legislation should a number of states pass divestiture statutes that resulted in great price increases or severe disruption in the petroleum industry.

Even if the federal government does not preempt the area, there are both social and economic reasons mitigating against divestiture. Restrictive views of state authority to affect interstate commerce rested in part upon the inequities and confusion that might accompany widespread state regulations that interfered with the daily lives of persons residing in other states - persons with no political control over the body responsible for the legislation. Since the present Court is granting expanded deference to the powers of the individual states, it is therefore left to each state government to exercise the utmost care in insuring that it does not enact unwise legislation which could impose unwarranted costs on the entire nation.

ANTITRUST LAW

Economically, divestiture would be unwise because of the efficiencies inherent in integration and the availability of numerous statutory devices

When less costly remedies are already available to the dealers, it would be unwise to drastically alter the industry structure by barring a large class of potentially, efficient competitors. It makes no sense to expend vast amounts of resources to achieve, at best, as much harm as good.

FOOTNOTES

1. Exxon Corp. v. Governor of Maryland, 46 U.S.L.W. 4662 (June 13, 1978).

2. Proposals for retail divestiture have been of two general types. The first, and most severe, type would prohibit a refiner from possessing any interest in retail outlets. The second type, of which the Maryland plan is an example, only prohibits or restricts refiners from using company-operated outlets.

3. Competitive markets will ultimately result in: 1) efficiency in production and distribution; 2) full employment with price stability; 3) high rates of progress in technology and productivity; and 4) equity in distribution of income.

4. Greening, Increasing Competition in the Oil Industry: Government Standards for Gasoline, 14 Harv.J.Legis. 193; 193-94 (1977); Ikard, Competition in the Petroleum Industry: Separating Fact from Myth, 54 Ore.L.Rev. 583 (1975).

5. BORK, THE ANTITRUST PARADOX 118 (1978).

6. Assistant Attorney General Shenefield recently commended those states which have begun refusing to shield special groups from competition.

7. Measday, The Case for Vertical Divestiture in CAPITALISM AND COMPETITION (Reigeluth and Thompson,eds.) 13 (1976).

8. See generally, ALLVINE & PATTERSON, HIGHWAY ROBBERY (1974); ALLVINE & PATTERSON, COMPETITION, LTD. (1972).

9. Prior to the mid-1930's the majors had utilized company-operated stations. The shift to lessee/dealers was prompted, in part, by low retail return, chain store taxes, and the threat of union organization. Patterson, Structure and Strategy in the Gasoline Industry, in STRATEGY + STRUCTURE = PERFORMANCE (Thorelli,ed.) 203 (1977). See generally, DE CHAZEAU & KAHN, INTEGRATION AND COMPETITION IN THE PETROLEUM INDUSTRY (1959).

10. Comment: Gasoline Marketing Practices and "Meeting Competition" Under the Robinson-Patman Act: Maryland's Response to Direct Retail Marketing By Oil Companies, 37 Md.L.Rev. 323, 324-25 (1977).

11. Adams, Vertical Divestiture of the Petroleum Majors: An Affirmative Case, 30 Vand.L.Rev. 1115, 1133, (1977).

12. See, HIGHWAY ROBBERY, supra note 8; COMPETITION, LTD., supra note 8; Adams, supra note 11, at 1133; Note: Gasoline Marketing Divestiture Statutes: A Preliminary Constitutional and Economic Assessment,28 Vand.L.Rev. 1277, 1284 (1975).

This profit shifting theory is not without its detractors. Studies have indicated that in order to effectively subsidize downstream operations with crude profits, a company would have to be 94% crude self-sufficient. (Another study placed the figure at 81%.) Only one company was seen as being over 90% with the average being 60%. Card, The Case Against Divestiture in CAPITALISM AND COMPETITION, (Reigeluth & Thompson, eds.) 27 (1976); Ikard, supra note 4, at 599.

13. An explanation for much of the original high volume and inelastic supply has rested upon two legal concepts which distinguish crude production in the U.S. from production in other nations. These principles are: the ownership of subsoil mineral rights by the owner of the surface land and the rule of capture. The former led to a proliferation of owners while the latter meant that oil belonged to whoever captured it - even of ot was drained from another's property. Combined, they led to a race to extract as much oil as possible, as fast as possible, to prevent losing it to neighbors. It wasn't until national output quotas and state prorationing schemes were instituted that some semblance of stability was achieved in crude. BLAIR, THE CONTROL OF OIL 125-25 & 154; Adams, supra note 11, at 1131.

14. Greening, supra note 4, at 207. See Patterson, supra note 9, at 203.

15. Note, the Gasoline Marketing Structure and Refusals to Deal with Independent Dealers: A Sherman Act Approach, 16 Ariz.L.Rev. 465, 467 (1974).

16. The Supreme Court has recognized the efficiencies inherent in vertical integration. Continental T.V., Inc.v.GTE Sylvania, Inc., 429 U.S. 1070 (1977).

17. Ritchie, Petroleum Dismemberment, 29 Vand.L.Rev. 1131, 1133 n.9 (1976); Singer, Vertical Integration and Economic Growth, 50 A.B.A.J. 555, 556, (1964).

18. Comment, supra note 12, at 1290.

19. National Petroleum News p. 15 (Mid-June 1978).

20. The higher the concentration ratio, the lesser the likelihood of competition as collusion is more likely. In order to demonstrate concentration in oil divestiture proponents have been forced to utilize eighteen-firm groupings rather than the traditional four or eight firm group. Advocates have, however, criticized relying solely upon concentration ratios. They suggest that concentration is only one of a series of elements that must be considered. They point to joint ventures, exchange agreements, and indirect interlocks through commercial banks as further manifestations of control. Persuasive arguments can be made, however, that joint ventures and

exchange agreements lower prices and increase exploration.

21. DIXON, Antitrust Policy: Some "Legal" and "Economic" Considerations, 14 U.C.L.A.L.Rev. 979, (1967).

22. BORK, supra note 5, at 329. Bork argues that integration means only that an administrative direction rather than a market transaction organizes the cooperation of the refiner and the marketer. Firms decide upon the mode of organization according to their relative costs, thereby promoting efficiency. Id at 277.

23. One possibility is a temporary system of tax benefits to current independent dealers which could be ohased out in a reasonable period of time. A tax based subsidy has the obvious advantage of making explicit the cost of aiding independent dealers and would not impede the efficient allocation of resources on the petroleum industry.

24. These costs would be much greater under a complete divestiture plan. See generally, Ritchie, supra note 17, at 1154-60.

25. Parsky, The United States Treasury Analysis: The Effects of Divestiture in CAPITALISM AND COMPETITION (Reigeluth & Thompson, eds.) 53 (1976).

26. Fear has been expressed that divestiture would leave a void in marketing that might be filled by the OPEC nations, who are anxious to move into downstream operations. Burnap, Comments on James Patterson's Essay in STRATEGY+STRUCTURE=PERFORMANCE (Thorelli, ed.) 18 (1977).

27. HIGHWAY ROBBERY, supra note 8, at 221-22. The likelihood of such an occurrence is reinforced by recent Energy Department proposals for diminishing the special subsidies currently afforded small refineries dependent on costlier fereign crude.

28. Ferguson v. Skrupa, 372 U.S. 726, 731 (1962).

29. Williamson V. Lee Optical Co., 348 U.S. 483, 487-88 (1955).

30. Exxon Corp. v. Conner. case No. 74-1449 (Cir. Ct. 2d Jud. Cir., Leon County, Fla., Jan. 23, 1975).

31. State ex rel. Schneider v. Leggett, 576 P.2d 221 (1978); State v. Young, 552 P.2d 905 (1976).

32. Leek v. Theis, 539 P.2d 304 (1975).

33. State v. Consumers Warehouse Market, 329 P.2d 638,644 (1958).

34. Dean Milk v. City of Madison, Wisc., 340 U.S. 349 (1951).

35. Southern Pacific v. Arizona, 325 U.S. 761 (1945).

36. 46 U.S.L.W. at 4665 n.16.

37. Note, The Preemption Doctrine: Shifting Perspectives on Federalism and the Burger Court, 75 Colum.L.Rev. 623, 638 (1975) citing Free v. Bland, 369 U.S. 663, 666 (1962).

38. Standard Oil of Kentucky V. Tennessee, 217 U.S. 413

39. Northern Pac.Ry. v. United States, 356 U.S. 1,4 (1958).

40. Continental T.V., Inc. v. GTE Sylvania, Inc., 429 U.S. 1070 (1977).

41. Comment, Conscious Parallelism In the Pricing of Gasoline, 32 Rocky Mt.L.Rev. 206, 211 (1960).

42. Theatre Enterprises, Inc. v. Paramount Film Distrib. Corp., 346 U.S. 537, 541 (1954).

43. 874 A.T.R.R. A-7 (Jul. 27, 1978).

44. Standard Oil Co. (Ohio) Dkt. No. 8910; Phillips Petroleum Co., 84 FTC 1666 (1974).

45. 891 A.T.R.R. A-4 (Nov. 30, 1978).

46. 890 A.T.R.R. A-2 (Nov. 16, 1978).

47. 889 A.T.R.R. A-e (Nov. 16, 1978).

48. However the requirement in the Robinson-Patman Act of two separate sales would render it an ineffective weapon against price discrimination.