JOINT LEGISLATIVE STUDY COMMITTEE ON PETROLEUM PRICING AND MARKETING PRACTICES AND PETROLEUM PRODUCER RETAIL DIVORCEMENT

FINAL REPORT

December, 1988

PREPARED BY LEGISLATIVE STAFF

KITTY DECKER, HOUSE RESEARCH
STACEY KLEWER, SENATE RESEARCH

COMMITTEE AUTHORIZATION AND DUTIES

Senate Bill 1419, Chapter 159, Laws '87, established a Joint Legislative Study Committee on Petroleum Pricing and Marketing Practices and Producer Retail Divorcement. The bill set forth the following duties for the committee:

1. To investigate the issues of petroleum pricing and marketing practices and producer retail divorcement, with special emphasis on this state and prices in relation to the national market.

2. To study other state systems where restrictions on petroleum producer retail operations have been enacted.

3. To determine and weigh the impact of petroleum producer retail divorcement and petroleum marketing and pricing practices in Arizona.

4. The committee may keep records confidential and is authorized to enter into agreements with persons supplying material or information which they consider to be confidential.

5. Submit a report of its findings by December 31, 1988.

In addition, the bill named the Chairmen of the Transportation Committees in both houses as Co-Chairmen of the Committee. The President of the Senate and the Speaker of the House each appointed four other members to serve on the Committee.

COMMITTEE MEMBERS

Senator Pete Corpstein, Co-Chairman
Representative Jack B. Jewett, Co-Chairman

Representative Chris Herstam	Senator Bill De Long
Representative Roy Hudson	Senator Pete Rios
Representative Jack Jackson	Senator Jack Taylor
Representative Don Strauch	Senator Carolyn Walker

COMMITTEE BACKGROUND

During the 1988 Legislative session, HB 2406 passed which prohibits a petroleum product distributor from certain practices relating to franchise agreements until August 31, 1989. This bill temporarily dealt with some of the issues assigned to the Committee until they could be further studied.

The Committee met seven times over the past year. These meetings generally lasted all day with testimony from all aspects of the petroleum industry and the public. The meeting dates were: May 31, July 12, July 19, August 29, August 30, September 19, and October 24. During the course of Committee hearing, there were 33 presentations and the Committee received over 40 exhibits.

During the second hearing, the Committee adopted a work study outline which was divided into three main areas:

1. Market Structure and Gasoline Pricing
2. Petroleum Retail Divorcement
3. Petroleum Marketing Practices

This report follows the outline adopted by the Committee. A copy of the outline is contained in the appendix.

SECTION I

MARKET STRUCTURE AND GASOLINE PRICING

Refining and Origin of Supplies:

Arizona does not have any gasoline refineries within its borders and must obtain its gasoline from out-of-state. The refineries that supply Arizona are located in the Los Angeles and Bay areas of California. Arizona also receives gasoline from refineries located in West Texas and New Mexico.

A breakdown of these refineries and their capacity is shown below. Capacity data is in barrels per stream day except Chevron, El Segundo, which is in barrels per calendar day.

Refinery Capacities
(as of January 1, 1988)

West Coast:

Los Angeles Area		Bay Area	
Texaco	78,400	Chevron	365,000
ARCO	225,000	Conoco	10,000
Chevron	405,000	Exxon	130,000
Champlin	70,000	Shell	143,000
Edgington	44,730	Tosco	132,600
Fletcher	30,500	Unocal	125,100
Golden West	42,300		
Huntway	9,000		
Mobil	130,000		
Shell	133,000		
Unocal	111,000		
TOTAL	1,278,930	TOTAL	905,700

West Texas/New Mexico:

El Paso/Odessa		Artesia, N.M.	
Chevron	78,000	Navajo Ref.	40,000
El Paso Ref.	21,000		
Shell	29,500		
TOTAL	128,500		

These refineries not only supply gasoline to their own stations and outlets but also sell to other distributors and jobbers through supply agreements. The refiner sets the wholesale price, which is the Dealer Tankwagon (DTW) price plus all appropriate taxes. DTW prices vary depending on gasoline market conditions, crude oil prices and other factors. They also vary across geographic areas and sometimes there are several prices within a single metropolitan area. These are referred to as "price zones." (See Section III of this report.)

There are intermittent sources of supply to Arizona. These sources include Las Vegas, Salt Lake City and Ciniza. However, these "spot" supplies are rare.

__Transportation and Terminals:__

The Southern Pacific Pipe Line (SPPL) system is the sole pipeline petroleum supplier to Arizona. This system has over 690 miles of pipeline which supply gasoline to the state. SPPL's west line originates at Watson station in Carson, California and Norwalk station in Norwalk, California. The east line originates at El Paso, Texas. Both pipelines terminate in Phoenix with the east line also serving Tucson.

The pipelines in Arizona are capable of carrying approximately 179,000 barrels of refined petroleum products per day. Of that amount, the west line carries 112,000 barrels from Colton to Phoenix but includes service to Imperial, California. The capacity of the east line which serves Tucson is about 67,000 barrels per day. Pipeline capacities vary somewhat with the mix of products transported, however, nearly 70% of the refined product is gasoline.

The amount of product being shipped on the pipeline is constrained by the physical capabilities of the pipeline system (pipe diameter and pumping capacity). Since 1984, west line capacity limitations have consistently constrained the volume of product transported from the Los Angeles area to Phoenix to levels significantly below those desired by the customers of the pipeline. On the east line, there have been no material capacity constraints experienced in recent years.

To remove capacity constraints would require additional capital investment in either pumping capability and/or expanding pipeline size. According to SPPL, the only feasible alternative for expanding capacity on the west line is to install larger diameter pipe. This is proposed as part of SPPL's Phase II expansion.

It is difficult to determine how much the capacity constraints on the west line have affected prices in Arizona. Since petroleum pricing is a complex interrelationship of factors, it is hard to isolate the impact of any one factor on prices. However, as with any commodity, limitations to sources of supply often contribute to the increased prices. The pipeline is utilized 24 hours a day, seven days a week, and the demand for pipeline time to ship product on the west line is greater than the actual time available. Therefore, the time is prorated by the amount of product requested. The consistent proration on the west line has limited the access to Phoenix of products from the Los Angeles area refineries which, according to studies prepared for SPPL by A.D. Little, enjoy a significant manufacturing cost advantage over the West Texas and New Mexico refineries which supply the east line. In addition, proration limits the flexibility of market participants and has prevented SPPL from providing direct access of products to Tucson from the Los Angeles area refineries.

Since SPPL is a "common carrier" they ship product to anyone who can meet the rules and regulations of SPPL's pipeline tariff. In general, this requires:

> A source of supply capable of providing products at the existing pipeline flow rate.
>
> The ability to provide a minimum quantity, which is 10,000 barrels on the west line and 5,000 barrels on the east line.
>
> The ability to provide products of acceptable quality.
>
> The ability to provide a facility at the destination location or have a contractual arrangement with such a facility which is capable of receiving the product at existing main-line flow rates.

The cost of shipments on the pipeline varies by destination location. Charges in Arizona from El Paso to Tucson cost 79.5 cents per barrel or 1.9 cents per gallon. Shipments from El Paso to Phoenix and Los Angeles to Phoenix cost 115.4 cents per barrel or 2.7 cents per gallon. SPPL's normal credit terms require that payment be made 20 days from the date of billing.

The pipeline is the most efficient form of transportation for petroleum products. However, the Arizona Energy Office estimates that approximately 10%-15% of the petroleum used in-state is transported by truck. The border regions of the state receive their supplies by truck from the nearest or most economical sources outside the state. Also, to a limited extent, trucking acts as a backup for pipeline supply. Some of the major trucking companies that are common carriers are: Calzona Trucking, Petco, Dedicated Transport, R.F. White, Tri-Valley Transport and Northern Industries. Shipment by truck within the state averages approximately 7 cents per gallon. Interstate truck transport costs are 10 cents per gallon from Colton, California to Phoenix; 12 cents per gallon from Los Angeles to Phoenix; and 15-16 cents per gallon from Utah to Phoenix.

Arizona Shippers of Record with SPPL

America West Airlines
Arizona Public Service
Astroline Corporation
Atlantic Richfield Company
BP North America Petroleum
B.S. & W. Energy Corporation
Caljet, Inc.
Cardon Oil Company
Chevron U.S.A. Inc.
Circle K Corporation
City of Phoenix
Crysen Trading & Marketing, Inc.
Defense Fuels Region
Exxon Company, U.S.A.
Gasco, Inc.
Giant Industries, Inc.
International Fuels Corporation
Jaco Oil Company
JCo. Energy, Inc.
Kern Oil & Refining Company
Maricopa County
McCall Oil & Chemical Corporation
Mobil Oil Corporation
Navajo Refining Co.
Petrolane Oil & Gas
Pacific Southwest Trading Co.
Phoenix Fuel Company
Salt River Project
Shady Grove Truck Stop
Shell Oil Company
Sohio Oil Company
Southern Pacific Transportation Company
Tesoro Refining, Marketing & Supply Company
Texaco Refining, Marketing & Supply Company
Tosco Corporation
Triad Aviation
Triangle Refineries, Inc.
Unocal
USA Petroleum Corporation
Union Pacific Resources Company
Western States Petroleum, Inc.
Woodland Oil Company

Annual Volume of Products Shipped Through SPPL to Arizona
1987 barrels

Gasoline	34,225,000
Distillate	14,796,000
Military	4,424,000
TOTAL	53,245,000

Once product is shipped to Arizona it is stored in terminals located at Phoenix and Tucson, which provide tankage and truck loading facilities. Most tanks will be filled and emptied in a week to 10-day period. Most of the terminals are owned by major integrated oil companies, independent oil companies, for-hire terminal companies, governments, and utilities.

At Phoenix there are 12 separate terminal facilities: six terminals are owned by major oil companies, two by utility companies, two by local county and city governments, and two by independent terminal operators (includes SPPL).

At Tucson there are six separate terminal facilities: three terminals owned by major oil companies, one utility company, and two by independent terminal operators (includes SPPL).

Terminal Owners in Arizona

Phoenix:

- Arizona Public Service
- Atlantic Richfield Company
- Caljet, Inc.
- Chevron U.S.A. Inc.
- City of Phoenix
- Maricopa County
- Powerline Oil Company
- Shell Oil
- Salt River Project
- Southern Pacific Pipe Lines, Inc.
- Texaco
- Unocal

Tucson:

- Chevron U.S.A. Inc.
- Shell Oil Company
- Southern Pacific Pipe Lines, Inc.
- S. T. Services
- Texaco
- Tucson Gas & Electric

Each terminal owner operates their own facility. SPPL is considered a "for-hire" terminal because it provides and operates the facility for its customers.

Who uses the storage facilities at the terminals depends on each terminal owner. Terminals operated by major oil companies generally utilize their facilities for their proprietary use as well as for third party customers. SPPL's terminals serve a variety of customers, including major oil companies, independents and airlines. The SPPL facilities allows most any shipper or independent oil company to use storage at the terminals. SPPL's standard terminal rate is 21.8 cents per barrel or 0.5 cents per gallon. SPPL does not own any of the petroleum products that they carry or store. Their customers control the sales of gasoline at the terminal.

Terminal capacity in Phoenix has been relatively tight in recent years, but still adequate to handle market demand. Recent capacity expansion should provide sufficient capacity for the next few years. Tucson terminal capacity is more than adequate at this time. The requirements for oxygenated fuels beginning in the fall of 1989 will likely necessitate additional storage capacity at Phoenix for ethanol and possibly MTBE.

Distribution and Marketing:

To understand the mechanics of distribution and marketing of petroleum products, it is important to be aware of the various players. Listed below are definitions for assorted players and marketing terms involved in the distribution of these products.

<u>Branded Marketer</u> - A branded marketer is one that uses the trademark of a refiner in connection with the marketing or distribution of petroleum products. He may be either a dealer or a jobber.

<u>Chain Marketer</u> - A chain marketer is an independent marketer primarily involved in gasoline retailing through a chain of private branded or unbranded motor fuel outlets. This can be through a convenience store which combines the marketing of gasoline and other petroleum products with the marketing of food products and sundry other merchandise (such as Circle K or 7-Eleven). It can also be a private brand marketer selling petroleum products under its own brand. The private brand company may own its own refinery, but usually markets products refined by others and has several sources of supply.

<u>Company-Operated Station</u> - A company-operated station is a gasoline retail outlet that is both owned (or otherwise controlled) and operated by an integrated oil company,

jobber, private brand marketer or chain retailer. Sometimes referred to as a "company store."

<u>Conventional Outlets</u> - A conventional outlet is a retail outlet that, in addition to selling gasoline, provides a range of products and services for motor vehicles in a station with service bays.

<u>Dealer Tankwagon Price (DTW)</u> - The DTW price is the wholesale price a dealer pays to his supplier for gasoline delivered in bulk to his outlet. Typically, this transaction takes place between a dealer and jobber or refiner. Dealer Tankwagon may be higher than the total of the unbranded (rack) price for gasoline plus transportation costs because it will ordinarily include the value of the brand name (including the additive package), the use of the supplier's credit card and the supplier's promise to stand behind its products.

<u>Independent Marketer</u> - An independent marketer is a firm engaged in the marketing or distribution of petroleum products and which is neither a refiner nor controlled by or under common control with a refiner.

<u>Jobber</u> - A jobber is an independent marketer who buys and takes title to gasoline from a refiner or other supplier and then offers the product for resale. Other frequently used names are reseller, wholesaler and distributor. A branded jobber uses his supplier's trademark in connection with his operations; an unbranded jobber uses his own trademark. A jobber may own and operate a bulk plant and transportation equipment. A jobber may handle products of two or more suppliers at different locations and it is not unusual for a jobber to sell through both branded and private-branded stations.

<u>Lessee Dealer</u> - The lessee dealer leases a service station and basic equipment from a supplier. The supplier can be a refiner or a wholesaler. Lessee dealer operated stations typically offer gasoline to motorists at retail. A significant number of lessee dealers operate car wash or convenience store stations. The lessee dealer has responsibility for paying for the inventory of products, providing his own tools and equipment, and doing day-to-day maintenance. The supplier typically provides a three-year lease and a three-year supply contract for products. As part of these arrangements, the supplier provides the station facilities including the building, tanks and pumps, the supplier's brand and credit card system, advertising and sales support, a line of credit, and delivery of products to the dealer's location. The supplier also has the

responsibility for maintaining all major facilities at the location and pays all property taxes.

Rack Price - The rack price is the wholesale price, typically set at a terminal or refinery rack, to non-branded independent marketers. This price is generally considered to be the commodity price of gasoline.

Refiner Marketer - A refiner marketer is an oil company that owns and operates one or more refineries and also market refined petroleum products. They may market through lessee dealers, jobbers or directly through service stations operated by employees.

Jobbers/Distributors:

The Arizona Petroleum Marketers Association (APMA) estimates that 90% of the jobbers and distributors throughout the state are members of their association. APMA has over 110 regular members; of these approximately 70 are associated with a major brand and the rest are unbranded. This organization does not track member sales. Branded jobbers/distributors acquire their product from their contract supplier; unbranded jobbers can purchase product either from a contract supplier or on the open market. Some of these operators are SPPL shippers and most of the APMA members operate their own service stations with a small percentage that have lessee dealers. Also, their membership is concentrated in Maricopa and Pima counties.

Chain Marketers:

There are several chain marketers in Arizona, some of whom are also members of the APMA. Arizona chain marketers include: Circle K; Kaibab (Whiting); Cardon; and Giant Industries. The largest chain marketer in the State of Arizona is Circle K with 485 units. Of these, 29 are "branded units," which means that they are branded with a major oil company and two are joint-venture facilities with a major oil company. Of the six major oil companies, only three brand with Circle K. These branded units have contracts with their branded oil company to supply all of the gasoline to those particular units.The supply contract does not allow Circle K to sell gasoline on an unbranded basis in those units.

Dealers:

The Service Station Dealers of Arizona (SSDA) represents a number of lessee dealers in Arizona. In Arizona, there are approximately 2,000 retail gasoline outlets, of these, about 1,000 are lessee dealers and SSDA estimates that their membership includes around 300 members. Only a handful of these dealers are unbranded, with the vast majority having branded stations and supply contract agreements with major oil companies.

The only company-operated stations are all within the two urban areas of the state and their numbers have been slowly growing over the past few years. As of June 30, 1988 there were 120 major branded company operated service stations; thirteen of these were operated by the company temporarily while awaiting conversion to lessee dealers. These stations account for around 14.4% of all gasoline sold statewide.

In discussing the general marketing structure of gasoline, there are two basic marketing arrangements by which gasoline finds its way to the gasoline-buying public. These are direct supply arrangements and indirect supply arrangements.

Under a direct supply relationship, the refining company supplies its dealers directly. The refining company will use its own truck, or a common carrier truck, and then truck product to its dealers. Some dealers are lessee dealers; they lease their station from the refining company. They have a lease which lets them occupy the station and use it as a service station. In addition, they have a supply contract under which the company provides product to them and permits them to use the company's brand. Dealers can also be open or contract dealers. Those are dealers who own their own station or leasing their station from a third party (other than a refining company). These dealers have supply contracts with refining companies. They can switch refining companies if they so choose. Regardless of what type of dealer they are, in direct supply, the refining company delivers product to the dealer. Also under the direct supply relationship, refining companies supply their own company-operated stations with product.

Dealers are able to determine the street price of gasoline under the direct supply relationship. They receive product from their supplier at the Dealer Tankwagon (DTW) price, and based on their overhead expenses and other factors, set the street price. Company-operated stations, however, have the street price of gasoline set for them by the refining company.

In the indirect supply relationship, the jobber or distributor will acquire product at the gasoline terminal from his supplier. The jobber usually has his own truck, but may use a common carrier truck, to pick up product. The jobber will acquire product at the rack price. These prices are usually divided between an unbranded rack or a branded rack. (Note: Lundberg data refers to the branded rack price as the terminal price and unbranded rack price as the rack price.) Once the jobber has acquired product, he will set his price to the dealer. This dealer can either be a lessee dealer or an open dealer. It is not uncommon for the jobber to have their own stations, in which case they will establish that price on the basis of their own evaluations. Jobbers often have more than one supplier, and in some cases, are themselves shippers of product on the SPPL line.

Direct Supply

Refining Company
(Refining Company determines DTW delivered)

<u>Dealer</u>
Lessee Dealer
"Open" Dealer
(Dealer determines their own street price)

<u>Company Operated Station</u>
(Refining Company determines its own street price)

****
****

Indirect Supply

<u>Refining Company</u>

Refining company determines rack price (unbranded) & terminal price (branded)

<u>Distributor</u>
(Jobber or Chain Marketer)

<u>Dealer</u>

Lessee Dealer
"Open" Dealer
(Dealer determines their own street price)

<u>Jobber-Operated Station</u>

(determines their own street price)

Pricing and Distribution:

A recent study by University of Arizona professors, under the Department of Economics, examined competition and pricing in the Arizona gasoline market. The authors of the report maintained complete control over all the research and data reported. The professors were R. Marc Issac, Ronald L. Oaxaca, and Stanley S. Reynolds. They concluded that virtually all (more than 99%) of the variation of rack prices in the Phoenix and Tucson areas can be accounted for by three factors:

1. Variations in Los Angeles wholesale prices.
2. Variations in the El Paso wholesale prices.
3. Whether or not the Los Angeles to Phoenix product pipeline is prorationed.

The competitive model used in this study overpredicts the actual Phoenix rack price for July 1982 to December 1987. The same model closely predicts the average Tucson rack price. (However, this masks the fact that the actual Tucson price has sustained sub-periods of being either higher or lower than the model predicts.) A more complex spatial competition model also finds Phoenix prices consistently lower than expected. The average predicted price was 78.3 cents vs. the average actual price of 76.0 cents. The model tracks Tucson prices more closely than the first model, however, actual average Tucson prices were slightly lower than expected. The average predicted price was 79.5 cents vs. 78.0 cents as the average actual price. In general, over the 1982-1987 period, the Phoenix-Tucson price differential has stayed within the expected arbitrage bounds. Recently, however, there have been several months in where the differential has exceeded this expected bound.

The study also noted that there are more major suppliers in the Phoenix area than in Tucson. Specifically, the presence of Mobil and ARCO as major participants in the Phoenix area make it a highly competitive marketplace. Consequently, one possibility for higher prices in the Tucson area is that the competitive process is less than ideal because of the smaller number of suppliers.

The study also observed that because the pipeline on the west line has reached full capacity and must now be prorationed, it is critical to expand the pipeline capacity. In addition, if Tucson was connected to the refineries in California via the west line, then the price differential between Phoenix and Tucson should decline. (See appendix for comparison of gasoline prices.)

Gasoline prices in the rural areas of the state are not only affected by the factors mentioned above for the urban areas, but also by a number of other variables. The Arizona Energy Office identified the following: transportation costs; volume differences between urban and rural areas, differences in operation costs; seasonal market variations, supply/demand imbalances and local market conditions.

The major oil companies supply gasoline to the rural parts of Arizona either by direct supply or through jobbers. The following selected cities indicate who supplies gasoline to the rural areas:

	ARCO	CHEVRON	EXXON	MOBIL	TEXACO	UNOCAL
Globe	***	*	**	**	**	**
Bisbee	***	*	**	***	**	***
Sierra Vista	***	*	**	***	**	*
Yuma	***	*	**	*/**	**	*
Flagstaff	***	*	**	*/**	**	*
Prescott	***	*	**	**	*	*
Kingman	***	*	**	**	**	*

*   Direct supply
**   Through distributor (jobber)
***   Does not supply area

<u>Existing Laws That Apply to Pricing:</u>

Petroleum pricing is subject to a number of state and federal antitrust laws. The general objective of these laws is the maintenance of competition. Competition promotes free access to the market place, promotes better market performance, encourages a progressive technology and high productivity, and encourages conservation of scarce and irreplaceable resources.

The following is a brief summary of the antitrust laws:

<u>The Sherman Act</u> - This was enacted in 1890 and is the first federal antitrust law. Section 1 of the Sherman Act prohibits

contracts, combinations and conspiracies in restraint of trade. Section 2 of the Sherman Act prohibits monopolization, and attempts and conspiracies to monopolize. Although its prohibition taken literally is all-encompassing, the courts have construed the Sherman Act to preclude only those contracts or combinations which "unreasonably" restrain competition. Since 1974, violation of the Sherman Act has been a felony, carrying a maximum fine of $100,000 and up to three years imprisonment for individuals.

The Clayton Act - This Act was passed by Congress in 1914 to supplement and improve enforcement under the Sherman Act. It prohibits price discrimination, tying arrangements and exclusive dealing contracts, and certain mergers and acquisitions where the effect may be to substantially lessen competition or tend to create a monopoly. This Act also creates a private action for treble damages, provides for the relationship between public antitrust suits and subsequent private suits, governs procedural matters, and provides for injunctive relief from antitrust violations.

The Robinson-Patman Act - This Act is actually Section 2 of the Clayton Act, as amended in 1936 by the Robinson-Patman Amendments. The act prohibits certain instances of differential pricing (i.e., charging two different buyers different prices for goods of like grade and quality). Differential pricing is called "price discrimination" in this act and the cases that apply it. However, price differentials are allowed for "meeting competition defense."

The Federal Trade Commission Act - This Act is a statute passed in 1914 that created the Federal Trade Commission and condemns unfair methods of competition. Although not defined as an "antitrust law" in the federal statutes, it reaches anticompetitive practices which may fall short of violating either the Sherman Act or the Clayton Act. Under this statute, the Federal Trade Commission may restrain any conduct that is harmful or potentially harmful to competition.

Arizona's Uniform State Antitrust Act - This Act under ARS 44-1401 - 1415, was adopted by the Legislature in 1974 and is, in essence, a "little Sherman Act". It is to be construed by "interpretations given by federal courts to comparable federal antitrust statutes." The Act prohibits contracts, combinations, and conspiracies which restrain trade or commerce in Arizona. It also forbids monopolization, attempts to monopolize and conspiracies to monopolize.

The Attorney General is authorized to enforce the Act by seeking appropriate injunctive relief and civil penalties of up to $150,000 for each violation, plus reasonable costs and attorney fees. The state, a political subdivision, any public agency, or an individual threatened with injury or injured in business or property by a violation of the Act, may bring an action for appropriate injunctive relief, damages sustained, and reasonable costs and attorney fees. The Act also provides for an award of treble damages to individuals if the violation is flagrant.

<u>Bid Rigging Statutes</u> - ARS 34-251 - 258 is referred to as the "bid rigging" statutes. It prohibits restraints of trade in connection with most contracts or subcontracts with a governmental agency. Violations are Class 4 felonies. In addition, a governmental agency may suspend any person from agency bidding for a period of up to three years if the person is convicted of violating the antitrust laws of this or of any other jurisdiction. The statute further establishes improved civil remedies for governmental entities damaged by antitrust violations. A governmental entity can recover either ten percent of the amount of the contract involved or actual damages. Under either measure, the governmental entity is entitled to recover treble the amount of damages actually awarded.

After a review of the current laws that apply to pricing, the SSDA testified that these laws are inadequate since they apply to retail pricing and not to wholesale pricing. Enforcement of the antitrust laws in the state is primarily the responsibility of the Attorney General's office. The Antitrust Division of the U.S. Department of Justice and the Federal Trade Commission are responsible for enforcement of federal laws that promote competition.

In response to the allegations made by the SSDA, the committee received testimony from the Antitrust Division of the State Attorney General's Office and from the Bureau of Competition of the Federal Trade Commission that the laws currently in place are more than sufficient to cover any type of antitrust or unfair competition violations. The State Attorney General's office has pursued cases in the past and is currently involved in a case involving petroleum pricing practices. If anything, the laws are skewed in the favor of the consumer, thus being overprotective. Likewise, the Federal Trade Commission has the position that enough laws currently exist to handle predatory pricing and antitrust violations.

SECTION II

PETROLEUM PRODUCER RETAIL DIVORCEMENT

Divorcement:

Under petroleum producer retail divorcement, refiners, and possibly wholesalers, would be prohibited from operating retail gasoline outlets through employees or contract management. Some retail marketing divorcement bills apply only to retail operations of large, integrated refiners, others apply to all types of refiners. A refiner could retain ownership of its outlets, but would be force to lease the outlets to independent dealers.

Many divorcement proposals also contain a "grandfather" provision, a provision that permits refiners to continue to operate any of their existing retail outlets which are open for business of the date of enactment.

The History of Divorcement Legislation:

Since 1974, legislators in at least 41 states have considered proposals calling for some type of government intervention in the retail gasoline market. However, laws have been enacted in only the District of Columbia and six states: Connecticut, Delaware, Florida, Maryland, Nevada and Virginia. Florida's statute was invalidated by the courts and the legislature then repealed it in 1985.

At the federal level, the Justice Department, the Energy Department and the Federal Trade Commission have testified in opposition to divorcement proposals under both the Carter and Reagan administrations. Although several Congressional committees have held numerous hearings and issued various reports on gasoline marketing and divorcement, neither the Senate or the House of Representatives have considered a divorcement bill on the floor in years.

The State of Maryland was the first state to pass a divorcement law in 1974 (implemented July 1, 1975). It is probably the best known of all existing divorcement laws. It also has the greatest number of refiner-operated stations which were affected. Two Purdue University professors, John Umbeck and John Barron, conducted an analysis of the effects of Maryland's divorcement law. The study was based on detailed price histories for several hundred retail outlets, and covered the time period of January, 1977 through January 1982. The U.S. Department of Energy has described this study as the finest analysis of the effects of Maryland's divorcement law.

After adjusting for all the major differences between retailing operations and for the effects of inflation, Professors Umbeck and Barron found that:

> After three months, 11 % of the affected stations had closed.
>
> The company stations that had been converted by law to franchise dealerships raised their average prices by 2.12 cents a gallon for self-service and by 5.83 cents for full-service.
>
> All franchised competitors located in the area around each of the divorced stations also increased their prices. The average increase was .69 cents for self-service and 2.87 cents for full-service.
>
> After divorcement, a station was open fewer hours per week than when operated as a company station.

The professors concluded that customers of company operated stations in Maryland are now paying approximately $7.3 million more each year than they would have otherwise. Another report by the Maryland Comptroller concluded that prices actually decreased, however, this report was later disputed by the Maryland Department of Fiscal Services.

Last year S. 177 in the State of Georgia would have amended their code by making it unlawful for a gasoline refiner to open a new retail gas station after July 1, 1988 or to continue to operate any retail stations after July 1, 1989. Violation of this would be a misdemeanor. The bill further provided that any dealer injured by a violation of the statute may sue for damages or for an injunction. The Federal Trade Commission (FTC) is on record opposing this bill. Their reasons for opposition were:

> 1. <u>The need for the bill is not supported by the record.</u> According to the testimony of a gasoline dealer group supporting the bill, the gas stations owned and operated by "big oil" are making it increasingly difficult for independent stations to survive. However, no major refiner in Georgia has any significant number of company operated retail gas station. Two small refiners, Marathon and Crown, are the principal operators of refiner-operated retail gasoline outlets in the state. Only about 400 station out of a total of 9,000 stations are refiner-owned.

2. <u>No evidence supports claims of predatory or monopolistic activities by refiners against independent dealers in Georgia or in any other State in the U.S.</u>

Supporters of the bill argued that it was necessary for independent owners to be protected against refiner-operated stations because the refiners are subsidizing their own retail operations by providing gas to their own outlets at internal transfer prices that are both below cost and below the wholesale price charged to lessee dealers. The FTC did not find any evidence that such subsidizations had occurred in Georgia or any other state.

3. <u>Even if monopolistic and predatory behavior were found it is already subject to prosecution under existing state ad federal antitrust laws; new laws are not needed.</u>

Predatory and monopolistic behavior in the petroleum industry is subject to the Sherman Act, the Clayton Act, the Federal Trade Commission. The FTC expressed that these statutes provide a more rational scheme for dealing with anticompetitive practices in the industry than legislation requiring divorcement.

4. <u>S. 177 would lead to higher gasoline prices.</u>

The adverse effects of divorcement led to higher prices in Maryland. The FTC also stated that the effects of higher prices in Florida led to its repeal there.

5. <u>FTC Conclusion: Special interest legislation is not necessary in Georgia gasoline distribution.</u>

The Supreme Court of Georgia has stricken all special interest legislation for the petroleum industry. This court has struck down the Georgia State legislature's attempt to impose a "below-cost" gasoline pricing bill.

<u>Open Supply:</u>

Open supply should not be confused with divorcement. It is a separate issue. Most branded lessee dealers sell branded gasoline under contracts that provide for the dealer to purchase a certain percentage of their gasoline from the lessor/supplier from whom they lease their retail outlet. Open supply proposals would require this contractual provision to permit the lessee dealer to acquire gasoline (including unbranded gasoline or gasoline of a different brand) from other suppliers and sell that gas through the leased outlet. Some divorcement proposals and been coupled with the open supply issue.

Reasons Favoring the Enactment of Divorcement:

Proponents of divorcement are concerned about the decline over the past in the number of independent stations and gas stations operated by lessee dealers. Their concerns have been intensified by industry trends toward higher volume, limited- and self-service gas stations and increasing numbers of so-called "company stations," which are gas stations operated directly by oil companies, already involved in petroleum production and refining, are moving increasingly into direct retail marketing of refined petroleum products in order to gain complete control over all segments of the industry.

Proponents state that the oil companies have engaged in a number of unfair practices in their attempt to gain this control. They argue that, through lease agreements with dealers, refiners control a significant portion of dealers' operating costs (i.e. station rents, wholesale product costs, and branding charges, such as credit card services). They claim that many dealers have been forced out of business. Proponents also argue that the oil companies' integrated methods of operation allow them to "subsidize" low gas prices at their company stores with profits obtained from other levels of operation. And because of such pricing practices, they contend that refiners have forced many of their retail competitors, including their own branded dealers, out of business. According to proponents, banning company-operated gas stations would help ensure that competitors in the retail marketplace will not enjoy unfair advantages over one another.

Reasons for Rejecting Divorcement:

Opponents of divorcement legislation argue that divorcement laws are anti-competitive and hamper efficiency in the marketplace. They say that reductions in the number of service stations are not due to "predatory practices" of oil companies; instead, they can be attributed to changing business and economic conditions. These conditions are the result of a number of factors, such as escalating service station construction and operating costs, rapid crude oil price increases, and changing consumer preferences (including increased price-consciousness because of inflation). According to opponents, divorcement would only serve the special interest of certain marketers, such as dealers, and insulate them from competition. They note that many marketers competing with full-service dealer operations have adopted efficient low-margin, high-volume retailing methods, which are profitable to marketers and also provide price savings and faster service to consumers. Some of these high volume outlets are refiner-operated. Divorcement laws, which exclude certain competitors from the marketplace, will restrict competition and result in higher overall gas prices for consumers.

Consumers of Petroleum Products:

The firm of Temple, Barker and Sloane, Inc., in consultation with Dennis Carlton, professor of business economics at the University of Chicago Graduate School of Business, evaluated the retail gasoline market in light of a proposed federal divorcement and open-supply bill. This study found that the retail gasoline market is both competitive and responsive to consumer demand and that there is no evidence of predatory pricing on the part of refiners designed to drive dealers out of the market. The study further concluded that enactment would harm consumers by reducing supply availability and services, diminishing product quality and increasing prices at the pump.

In addition, a recent draft report by the Office of Competition of the U.S. Department of Energy stated that the gasoline retail market in the U.S. is undergoing one of the most complex and painful periods of readjustment which has ever been faced by any American industry. The report explained that for many competitors, these changes have brought severe dislocations. For the competitive process, these changes have brought welcome fresh air to the stagnating environment created by controls. For consumers, these changes brought substantial innovations and lower prices.

Factual Data:

As of June 30, 1988, the major oil companies operated 120 branded company-operated service stations in Arizona. Thirteen of these stations were being operated temporarily by a company while awaiting conversion to lessee dealers. These stations account for approximately 230.7 million gallons per year. Total gallonage has remained relatively constant over the past five years, with only a one percent increase during that time. The major oil companies use these stations as a valuable source of market information. In addition, they have direct control of the prices, hours and retail work force. Often, these company-operated stations are used to experiment with marketing techniques, physical layouts, experiments with new products and equipment. These stations are beneficial to the consumer by providing competitive prices and convenient hours.

Of approximately 2,000 retail outlets, the major oil companies account for 404 branded stations in Arizona which are leased to dealers. Due to competition and market conditions, the number of lessee dealer-operated stations has decreased slightly. Lessee dealers are a benefit to a company because they improve the responsiveness of the retail outlets to local market conditions and may limit the company's labor and inventory costs. Dealers are entrepreneurially motivated to be highly responsive to local market conditions. Furthermore, oil companies can have access to markets without the investment and the controls needed for inventory, payroll and other incidental costs. This provides a benefit to the consumer by providing a variety of services.

Circle K Corporation, which has its corporate headquarters here in Arizona, is the largest chain marketer in Arizona with 485 stores. Of these, 29 are branded units with a major oil company. In addition, there are two joint venture facilities with a major oil company in the Phoenix area.

The SSDA reported on the lessee and open dealers in Arizona. These dealers have contracts with the following major oil companies:

ARCO:	22	Mobil:	143
Chevron:	145	Texaco:	81
Exxon:	109	Unocal:	118

Market share information for Phoenix Gasoline Retailers is shown below. The data is from the National Petroleum News, May, 1987.

Arco	18.7 %
Chevron	10.3 %
Exxon	13.5 %
Mobil	18.4 %
Texaco	5.1 %
Unocal	7.4 %
Nonmajor	26.6 %

SECTION III

PETROLEUM MARKETING PRACTICES

Market Surveys:

Numerous studies have been conducted on the petroleum industry, petroleum companies, refineries, and company-operated stores in an attempt to determine whether or not these groups, or any level of the industry, are engaged in predatory pricing against the dealer-operated stations. Research in this area has been undertaken at federal, state, and industry levels. The studies indicate that the petroleum industry is not characterized by or engaged in predatory pricing against dealer-operated stations.

Barron, J.M., Loewenstein, M.A., and Umbeck, J.R., "Predatory Pricing: The Case of the Retail Gasoline Market," Contemporary Policy Issues Vol. III, No. 3, Part 2, Spring 1985.

Fenili, Robert N. and Lane, William C., "Thou Shalt Not Cut Prices!: Sales-Below-Cost Laws for Gas Stations," Regulation, September/October 1985.

Final Report to the Washington State Legislature on the Attorney General's Investigation of Retail Gasoline Marketing, August 12, 1987.

Hogarty, T. and Lindstrom, P., "Empirical Examination of Allegations of 'Below-Cost' Retail Selling of Gasoline Refiners," American Petroleum Institute, Research Study #038, October 1986.

Temple, Barker & Sloane, Inc., "Gasoline Marketing in the 1980s: Structure, Practices, and Public Policy," American Petroleum Institute, May 1988.

U.S. Department of Energy, "Deregulated Gasoline Marketing: Consequences for Competition, Competitors, and Consumers," 1984.

Should it be the desire of the Committee to conduct a survey of the metropolitan area markets to determine whether predatory pricing is occurring, perhaps the best method would be to contract with an outside firm to do a survey that would include cost and pricing analyses at various levels, including street prices and transaction prices. The survey should include various oil companies and stations in different metropolitan areas and at different times. The Committee must continue to recognize that certain of this information is proprietary in nature and, therefore, confidentiality will need to be maintained. Additionally, a random telephone survey of street prices could be conducted by staff on a specific date.

Zone Pricing:

"Zone pricing" is a pricing mechanism used by oil companies to establish a Dealer Tankwagon (DTW) selling price in order to assist dealers in meeting competition. The mechanism includes the practice of dividing one's marketing area into distinct, relatively permanent zones of competition and reflects an assessment of such conditions as local geography, traffic patterns, and distance between dealers. The zone boundaries then allow the oil companies to distinguish between lessee dealers who compete with one another because they are in the same zone and those who do not compete with one another because they are in different zones. By adopting zone boundaries, the oil companies are able to assist their lessee dealer to meet competition from other marketers. This is the oil companies' way of ensuring that their lessee dealers do not have to sell at a loss in order to compete.

Zone pricing is used by all the major oil companies in the Phoenix and Tucson metropolitan areas with the exception of Unocal. The intent of zone pricing is not to put dealers out of business, but to act as a temporary aid in keeping dealers competitive within localized markets of competition.

The Franchise Relationship:

To understand the mechanics of the franchise relationship, it is important to be aware of the three definitions of a franchise.

> Lessee Petroleum Franchise. This type of franchise involves a written agreement between a refiner or a distributor and a dealer under which the dealer is granted the right to sell trademarked products, and to use trade names, service marks, or other identifying symbols or names owned by the refiner or distributor. The dealer is granted the right to occupy premises owned, leased, or controlled by the refiner or distributor, for the purpose of engaging in the retail sale of the petroleum products of the refiner or distributor.
>
> Petroleum Franchise (Definition used in the Federal Petroleum Marketing Practices Act). In addition to those relationships which constitute a petroleum franchise under Arizona law, the federal definition includes (1) oral, as well as written, agreements; and (2) contract dealers, where

the refiner or distributor has no interest in the real estate from which the dealer sells the petroleum products.

Regular or Generic Franchise. This type of franchise is ordinarily defined to specifically exclude petroleum franchises and instead to encompass relationships between a franchiser and a franchisee pursuant to which the franchisee is granted the right to engage in nonpetroleum business employing the franchiser's trademarks, trade names, service marks, or other identifying symbols or names owned by the franchiser. This definition usually refers to a relationship that is regulated by the 1979 Federal Trade Commission Franchise Rules and/or various state franchise statutes. The franchise relationship is regulated by several laws:

Petroleum Marketing Practices Act(PMPA). PMPA regulates the petroleum franchise relationship between suppliers and dealers when sales are made under a refiner's trademark.

1. PMPA specifies the grounds for termination and nonrenewal and protects dealers from arbitrary termination or nonrenewal of leases and supply.

2. A supplier cannot refuse to renew a franchise because the dealer fails to agree to changes or additions that are for the purpose of preventing a renewal of the franchise.

3. No petroleum franchise can be terminated for noncompliance with a term of the franchise agreement unless the term is reasonable and of material significance to the franchise relationship.

4. A supplier deciding to sell or replace a station must make a bona fide offer to sell the station to the dealer or offer the dealer a right of first refusal of at least 45 days duration.

5. A supplier's withdrawal from a marketing area cannot be for the purpose of converting dealer stations to company operation.

6. A supplier cannot withdraw from a marketing area unless the new supplier offers existing dealers the same terms and conditions that he has offered to his other dealers.

Trademark Act. Supplier trademarks are protected by the federal Lanham Act and are often registered under state laws as well. The trademark laws prevent the copying of the supplier's trademark or symbol and thereby prevent others from passing off their products as those of the supplier.

Antitrust Laws. The antitrust laws are designed to protect the competitive process at all levels of distribution and apply to all types of business operations. The petroleum industry has no exemption from antitrust laws. Synopses of the Sherman, Clayton, and Robinson-Patman Acts, and the Federal Trade Commission are included in Section I of this report.

Other Laws. In addition to the abovementioned laws regulating the franchise relationship, the state of Arizona in 1974 established Arizona Revised Statutes, Title 44, Article 8, dealing with Petroleum Products Franchises. Although certain provisions of A.R.S. Article 8 are preempted by the federal PMPA, the Arizona statute does provide some broader rights to the dealer than are contained in PMPA.

A.R.S. 44-1552. Disclosure. Requires disclosure of gallonage volume history to any prospective dealer before any franchise agreement is concluded.

A.R.S. 44-1554. Prohibited Practices . It is unlawful for any distributor to:

1. Prohibit directly or indirectly the right of association among dealers for any lawful purpose.

2. Use undue influence to induce a dealer to surrender any right given to the dealer by any provision contained in the franchise.

3. Change or modify any restrictions on nonpetroleum-related business activities of the gasoline dealer during the term of his franchise.

4. Unreasonably reduce, limit, or curtail the supply of gasoline or other petroleum products to any dealer.

5. Place unreasonable restrictions on nonpetroleum-related business activities by the dealer.

A.R.S. 44-1558. Obligation When Agreement Ends. When an agreement ends by mutual consent or otherwise, the supplier is required to make a good faith offer to repurchase, at current wholesale prices, any and all merchantable products purchased by the dealer from the supplier.

In the event of the death of a dealer the distributor shall accept the designee of the dealer as the successor in interest to rights and obligations under a franchise agreement provided that, prior to death, the dealer notified the distributor of such designation and that at the time of death the designee meets the reasonable qualifications required of dealers by the distributor for the operation of service stations.

Federal and state laws regulating the franchise relationship, by virtue of addressing the relationship between company and dealer, also influence the marketing policies adopted by suppliers. In addition, marketing policy decision-making is affected by consumer demand. Temple, Barker and Sloane, Inc. (TBS) report that over the past 15 years the configurations of gasoline stations have changed significantly. Whereas stations of the 1970s were primarily conventional stations emphasizing full-service gasoline and auto repair services, the present scenario involves a variety of configurations including the conventional stations with repair service bays, self-service stations without service bays, and convenience store stations. Factors influencing these evolutions include an increasing consumer preference for self-service gasoline; the impact of increasing crude oil prices and attempts to constrain the associated labor costs; federal and state regulations enabling the development of self-service stations; and technological advances in station configurations.

The decreasing number of service stations with full-service repair bays has been a result of consumer attitude, changes in automotive technology, and the development of automotive repair "specialty shops." TBS also reports that the service station parts market share of gasoline service stations declined from 16.8% in 1970 to 7.8% in 1985.

Ultimately, the desired end of supplying a product and realizing a profit is the same, but the marketing policies of the major suppliers are as individualized and varied in strategy as the companies involved. In order to provide a better understanding of marketing policies, it is best to summarize briefly the policies of the major suppliers in certain areas.

Hours of Operation

ARCO.	Requires 24-hour operation for stations located within one-half mile of state highway system access. Minimum 16-hour requirement for other stations. Seasonal exemptions may be available.
Chevron.	Dealers must comply with operating hours specified in ground lease. Station must be open sufficient hours to service customers and to compete effectively with other stations in the area. Chevron provides dealers with a rebate incentive of up to $365 per month for maintaining 24-hour operations.
Exxon.	Minimum hour requirement in many dealer leases. A 24-hour operation may be established after a survey of demographics, location, and seasonality. In addition, Exxon provides dealers with a rebate of up to $750 per month on gasoline if they remain open 24-hours.
Mobil.	Generally, requires 24-hour operation for new or rebuilt stations. Other stations, 6 a.m. to midnight requirement. Dealers will be granted a rebate up to $750 per month, if the dealer operates 24-hours a day whether or not the lease specifies such a requirement.
Texaco.	Hours based on competition in and potential of individual location.
Unocal.	Hours set forth in lease requirements. Unocal dealers are provided with a rent incentive of a minimum of $400 per month for operating 24-hours a day. The amount of this incentive can be more, based on gasoline sales.

Conversion of Service Bays to Other Modes

ARCO.	Conversion of service bays at locations where ARCO believes Mini-Market would be profitable and <u>only</u> with the agreement of the dealer.
Chevron.	Conversion after determining which mode will maximize gasoline sales volume and <u>only</u> after consultation with dealer.
Exxon.	Currently involved in a nationwide modernization program to remain competitive.

Mobil.	Conversion only to remain competitive. If service bay is eliminated, dealer will be provided with other profit center.
Texaco.	No established policy.
Unocal.	Supports full automotive service mode of operation.

Assignment

ARCO.	Permits assignment provided the company has first right of refusal and assignee meets ARCO requirements.
Chevron.	Does not permit second- or third-party agreements except where state law requires. Assignee must meet new-dealer standards.
Exxon.	Works with any dealer wishing to sell to a third party who meets dealer selection criteria.
Mobil.	Assignee must meet Mobil requirements.
Texaco.	Assignee must meet Texaco qualifications.
Unocal.	No assignment without Unocal consent.

Charges for Entering Franchise

Relationship

ARCO.	Initial franchise fee.
Chevron.	Business value fee on newly constructed or diverted company-operated facilities.
Exxon.	No fee.
Mobil.	No fee for one year trial or three-year franchise.
Texaco.	Business entry fee required if the service station was previously operated by an independent contractor, was Texaco salary operated, or was a closed unit prior to franchise.
Unocal.	Has never granted a "true" franchise but has entered into service station leases and product contracts.

Charges for Agreeing to Assignment

ARCO.	For conventional service stations, the greater of 25% of transfer or $5,000. For Mini-Market, 25% or $20,000.
Chevron.	Dealer lease transfer fee charged in California.
Exxon.	No fee.
Mobil.	No fee except in California.
Texaco.	No charge.
Unocal.	No franchise agreements; therefore, no charge.

Rental

ARCO.	Rate is based on percent of economic value of land and percent of replacement costs of improvements.
Chevron.	Variable rent program based on revenue required to maintain facility and realized return on investment. Allows dealers to reduce gas rent as they sell motor fuel. Additional profit center rent is an estimated flat rental and remains constant.
Exxon.	Negotiated individually, but at a level to provide satisfactory rate of return on value of property. Currently rate is 12% of appraised value of land and improvements, plus taxes, maintenance, and repairs.
Mobil.	Based on fixed percentage of estimated gross profits of gasoline and other profit centers.
Texaco.	Rate is based at a level adequate to provide a reasonable rate of return on investment.
Unocal.	Volume rental and monthly fixed rental based on factors deemed appropriate for service station being used.

Credit Card and Usage Fees

ARCO.	Does not offer a credit card.

Chevron. Fee to dealer is 3% of total dollar amount on credit card invoice. Dealers have established a two-tiered pricing program to attract cash customers and also provide a competitive price for credit card customers.

Exxon. Processing fee of 3%. Discount-for-cash program to encourage dealers to recover processing fee.

Mobil. Competitive service charge for credit card use. Discount-for-cash program.

Texaco. Processing fee of 3%.

Unocal. Credit card offered to lessee dealers without charge.

Station Appearance

All six of the major suppliers set standards for station appearance and cleanliness standards as of lease requirements.

Other Lease Terms of Interest

Chevron. New dealers sign trial franchise amendment to Dealer Lease and Dealer Supply contracts to provide an initial review period.

Mobil. Permits a dealer to designate a qualified survivor to assume operation of the franchise in the event of the dealer's death.

Rationale for Policies

Marketing practice policies are adopted by the suppliers to create a foundation of a business relationship between the refiner and the lessee dealer on which business transactions can be made. In addition, the policies set forth standards of safety, service, and product guarantee to protect both the integrity of the supplier trademark and the dealer. In setting forth such policies, consumer needs are met and the investments of the company and dealer are protected.

Refiners and dealers are both beneficiaries of marketing policies. The refiner receives rental income from the leased

property and assurance that the station will be operated in a manner consistent with quality of product and satisfactory customer service. Additionally, under provisions of several of the franchise assignment policies the refiner is also assured that a new dealer will be of the same quality and caliber as other company dealers.
The lessee dealer enjoys the right to operate service stations that benefit from site selection, modern technology, training and business counseling, and merchandising without an investment in the property. Lessee dealers of major suppliers are also granted nationwide advertising and sales support. Finally, there is a relatively low turnover rate, and a significant cash value in franchise agreements when they are sold or transferred.

A second group of individuals concerned with the franchise relationship and marketing practices is made up of the jobber. Testimony received by the Committee indicated that while policies of jobbers having leased units may vary, like those of suppliers, the jobber:

* Does not set hours of operation

* Advises on the conversion of modes of operation

* Maintains control of assignment of the lease to ensure that any assignment/incoming lessee is credit worthy

* Does not charge for entering into a franchise relationship or assignment of a franchise

* Charges rent on a flat fee per unit amount based on location

* Charges a surcharge on credit cards if the major refiner requires a surcharge

* Establishes lease requirements for station appearance and cleanliness

* Maintains standard lease for terms of interest

Affect of Legislative Regulation on Consumers

Consumers are the ultimate recipient of changes in pricing and marketing practices. A change implemented by a supplier or dealer can result in a cents-per-gallon increase or decrease depending on existing market factors and the policy involved. The Arizona State Legislature must consider this condition when deciding to impose additional regulations on the petroleum industry.

Each of the major suppliers maintains an individual hours-of-operation policy. As noted earlier, ARCO requires that some stations operate on a 24-hour-per-day basis, while Chevron requires that dealers comply with hour requirements contained in the ground lease. Four of the six major oil companies in the Phoenix metropolitan area offer dealers an incentive program for maintaining 24-hour operations. The decision to establish operating hours is determined by the company after a review of the location, needs of the motoring public accessing the location, surrounding businesses, and local competitors. Regulation of hours of operation, including removal of 24-hour operations, will affect the availability of gasoline and other services to the consumer and may decrease competition and result in an increase in the price of products. As has been stated by members of the Committee, the needs of the motoring public do not adhere to a schedule of hours, and certain standard hours of operation may be associated with a particular brand or station.

Like hours of operation, conversion of service bay areas is undertaken after a review of consumer needs, services available, and the station configurations necessary to have a competitive, profitable outlet in the market. Consumer demands, as studied by TBS, have resulted in changes to the automobile repair market. Service station repair bay areas now are in competition with high-volume specialty repair shops and automotive home-mechanic supply shops. During the period of 1970 to 1985, repair shops increased their market share from 22.4% to 27.6%. In place of service repair bays, stations may be converting to a convenience store mode of operation. These conversions represent a substantial investment by the company and are done only in those outlets where consumer patronage dictates a need. Legislated regulation to restrict the conversion of service bays will reduce the number of convenience stops and items available to the consumer and may result in additional vehicle trips for required items.

Franchise agreements represent an agreement between a company and a dealer to enter into a business relationship for the operation of a station. Currently, major suppliers entering into franchise agreements have established policies to review those individuals who are qualified to operate a station. Removal of the basic requirements for assignees will remove the company's ability to guarantee to the consumer that the individual operating the station is of the caliber of other company lessee dealers and may encourage transfer of operation to the "highest bidder."

Gasoline credit cards represent a convenient method of payment for the motoring consumer. Regulation to remove company credit cards will create an unnecessary inconvenience. Although legislated cancellation of credit card programs may result in a slight increase in revenue to the dealer, there is no evidence to support the claim that these savings would be passed on to the consumer as has occurred with voluntary cancellation of credit programs.

Dealer Profitability:

Dealer margin is the difference between the retail price of gasoline and the sum of DTW price, taxes, and credit card processing fees, net of any gallon rebates offered by suppliers. The pool margin for a station is the weighted average margin for all gallons sold. Finally, the gross margin for each grade of gasoline is weighted by the relative sales volume of each gasoline grade, method of payment, and type of service. The TBS study concluded that, nationally, the lessee dealer margin of major refiners is approximately 11.6 cents per gallon of gasoline sold. The dealer margin ranges from a 6.5 cents per gallon average for regular leaded gasoline to 11.4 cents per gallon for mid-grade unleaded to 14.8 cents per gallon for premium unleaded fuel. The Service Station Dealers of Arizona (SSDA) challenged this finding during Committee hearings, stating that the average profit margin for a dealer in Phoenix, Arizona, is between 1 and 2 cents per gallon on regular gasoline, and between 4 and 6 cents per gallon on unleaded fuel. Perhaps one explanation for this difference is that dealer margins vary according to markets and configurations. The State of Washington in the Final Report to the Washington State Legislature on the Attorney General's Investigation of Retail Gasoline Marketing concluded that "considerably different gasoline margins were found because of the mix of service station types." Both the Washington Report and the TBS study also conclude that, in general, conventional stations experience a higher dealer margin than gas-only stations. Information was not available to extend this conclusion to the Arizona market, or to determine margin variation between rural and metropolitan areas.

The profitability of service stations is determined by such factors as location, number of competitors in the local area, type of profit centers in place at the station, marketing strategies employed by the company, and the dealer and personnel operating the stations. The TBS study indicates a dealer turnover rate of approximately 10% to 14% per year. The relatively low turnover rate and cash values associated with transfer agreements seem to indicate that the service station can be a competitive business enterprise. Information that could have been used to determine whether there is indeed a difference between dealer profitability in urban and rural areas was not available to the Committee. However, it can be assumed that the fixed costs of stations for such items as EPA monitoring equipment, storage tanks, signs, and branding requirements for rural stations will be the same as those for an urban station.

Lower volume of gasoline and other profit center sales may result in an increase in fuel prices in order to achieve a fair rate of return. The Arizona Energy Office will be conducting additional studies into the difference in urban/rural fuel markets and pricing.

The report of the Washington Attorney General's office indicates that there is a relationship between margin, profitability, and mode of operation. The study indicates that "stations could not operate at a breakeven point or at a profit if supported solely by gasoline sales." The increase in additional station profit centers such as grocery and beverage items reported in various studies and addressed in Committee also indicates the realization that profitability is tied to mode of operation.

<u>Dealer Grievances:</u>

Although repeatedly requested by the Committee, specific dealer grievances against suppliers have not been received. Maintenance of the dealer-company relationship is a primary responsibility of the supplier and as such, each company has an established procedure to address a dealer grievance in a fair and expeditious manner. In general, the grievance resolution process begins at the district or retail level, involving the district manager or representative. In the event that a dealer does not feel that a satisfactory resolution has been reached at the local level, the matter can be forwarded to the marketing division representative. As a final step, headquarters management may become involved. In addition to a tiered grievance-resolution structure, certain companies have established councils of dealers to encourage communication between dealers and company in an attempt to avoid grievances at any level.

SECTION IV

COMMITTEE RECOMMENDATIONS

The committee took extensive testimony from persons which represented all aspects of the petroleum industry. The testimony covered all issues in petroleum pricing, marketing practices and retail divorcement. As a result of the testimony, the committee has come to the following conclusions and recommendations:

1. The Committee acknowledges that a price differential exists between the two major metropolitan areas of the state. This is due primarily to the origin of supply for each area. Phoenix receives its supply from the Los Angeles area while Tucson receives supply from west Texas. The pipeline from the Los Angeles area is prorated which restricts the ability of suppliers to receive the amount of product desired. Without enough supply, gasoline is forced to be trucked into the state at an increased cost.

   Therefore, some members of the Committee endorsed a letter to the Federal Energy Regulatory Commission (FERC) which supports the expansion of the west line of the pipeline into Tucson and to increase capacity into the Phoenix area. The Committee will continue to support efforts to expand the capacity of the pipeline and to monitor these efforts to determine if it does have a positive affect on gas prices. These efforts will ultimately benefit the consumer in Arizona.

2. The State Attorney General's Office, Antitrust Division, and the Federal Trade Commission, Bureau of Competition, testified that they have no knowledge or evidence of mischief or predatory pricing practices in this State. The Attorney General's Office further stated that current laws are more than adequate to handle any possible case involving predatory pricing or anticompetitive behavior. In addition, while the SSDA recommended that the legislature consider a retail divorcement bill, other members of this organization testified before the committee opposing such legislation as detrimental to their business opportunities. In addition, evidence supports the fact that any legislation in this area will increase prices.

Therefore, the Committee does not recommend any legislation at this time which would address the issue of predatory pricing practices, open supply or petroleum retail divorcement.

3. The marketplace for petroleum products is very competitive in Arizona. This has worked to the advantage of the consumer, especially in the Phoenix metropolitan area. Testimony was received regarding the case for below cost pricing legislation. This type of legislation, while helping some dealers or wholesalers, would increase the price of gasoline in Arizona.

Therefore, after weighing the benefits of a below cost pricing bill, the Committee recommends that no legislation be introduced at this time. However, petroleum pricing should continue to be monitored, and if the marketplace shows changes which would indicate that such legislation is needed, then the legislature should reevaluate the benefits of such a bill at that time.

4. The Committee received testimony that some dealers are opposed to certain practices that may be required in a franchise agreement (i.e. conversions/bay operations, transfer fees, etc.). These practices vary between the major oil companies. Although the Chairmen requested that the SSDA submit a list of specific grievance by company, this list was never submitted and the Committee never had an opportunity to address these specifics. The Committee also notes that current Arizona Revised Statutes and the Petroleum Marketers Practices Act are adequate to protect the dealer in petroleum franchise agreements.

Therefore, the Committee agreed that no recommendation be made at this time with regard to 24 hour operations. However, the Committee does recommend that no legislation be enacted which would further restrict the franchise agreements between the dealers and the oil companies regarding any other practices. Any negotiations would be best handled internally between the two parties. Competition in the marketplace will best determine these issues and will ultimately benefit the consumer with lower gasoline prices.

APPENDICES

APPENDIX A

Work Program for
S.B. 1419 Study Committee

I. Market Structure and Gasoline Pricing.

A. Refining/Origin of Supplies.

1. Which refineries supply product to the Arizona market on a regular basis?

a. Who owns the refineries?

b. What are the capacities of each refinery?

c. To whom do the refineries sell gasoline?

d. Who may purchase product from the refineries?

e. How is the price of product purchased from a refinery determined?

2. What are the intermittent sources of supply to Arizona?

a. To what extent does the Arizona market have access to refined product from areas other than the Los Angeles Basin and El Paso?

b. How extensive are "spot" supplies (not associated with specific refineries and/or pipeline deliveries) and what are their sources?

B. Transportation and Terminals.

1. How is product shipped to Arizona?

a. Southern Pacific Pipe Lines ("SPPL").

(1) From what points do SPPL lines originate and where do they terminate in Arizona?

(2) What are SPPL line capacities?

(a) Are there constraints on line capacity?

(b) If so, can the constraints be removed?

(c) Do capacity constraints affect prices in Phoenix, Tucson, or other parts of Arizona?

(3) Who may ship product in SPPL lines?

(4) What are SPPL's terms for doing business and how much does it cost to ship product in SPPL lines?

(5) Who currently ships product to Arizona through SPPL lines? Historically, who has shipped product to Arizona through SPPL lines?

(6) What amounts of product are shipped through SPPL lines to Arizona?

b. Trucking.

(1) How much gasoline is trucked to Arizona?

(2) Which companies are available as common carriers to truck gasoline to Arizona?

(3) Which refining companies or distributors ship gasoline to Arizona by truck?

(4) What parts of Arizona are supplied by truck?

(5) How much does it cost to truck gasoline?

2. Terminals.

a. How is product stored once it arrives in Arizona and how long is it stored?

b. Who owns terminals in Arizona?

c. Who owns the storage facilities at the terminals?

d. Who operates these storage facilities?

e. Who uses storage at terminals?

f. Who may use storage at terminals?

g. How much does it cost to use the storage facilities?

h. Who may purchase gasoline at terminals?

i. Is there sufficient terminal capacity? Is there excess capacity?

C. Distribution and Marketing.

1. Jobbers/Distributors.

a. What are jobbers? What are distributors?

b. How many are there, and who are they?

(1) Major Brand

(2) Non-major Brand

c. To what classes of customer do they sell?

d. How much gasoline do they sell?

e. From whom do they buy their gasoline?

f. Are they SPPL shippers?

g. How many service stations do they own and lease to dealers?

h. How many service stations do they own and operate themselves?

i. How much gasoline do stations shown in (g) and (h) sell?

j. Where are these stations located?

k. What other services do they provide at these stations?

2. <u>Chain Marketers</u>.

a. What is a chain marketer?

b. How many are there, and who are they?

(1) Major Brand (including joint ventures with refiners)

(2) Non-major Brand

c. Where are their stations located?

d. How much gasoline do they sell?

e. From whom do they buy their gasoline?

f. Are they SPPL shippers?

g. Are they refiners or do they have arrangements with refiners?

3. <u>Dealers</u>.

a. What is a dealer?

b. How many are there and who are they?

(1) Major Brand

(2) Non-major Brand

c. How many own their own stations?

d. How many lease their stations and from whom do they lease?

e. From whom do they buy their gasoline?

f. How much gasoline do they sell?

4. Company-Operated Stations.

a. What is a company-operated station?

b. How many are there and who operates them?

(1) Major Brand

(2) Non-major Brand

c. How much gasoline do they sell?

d. From whom do they obtain their gasoline?

e. Has the number of company-operated stations been growing in Arizona?

D. Pricing and Distribution Questions.

1. Do prices in the L.A. Basin have any relationship to prices in Arizona, and, if so, what is the relationship?

a. To Phoenix?

b. To Tucson?

c. In other parts of Arizona?

2. Do prices in El Paso have any relationship to prices in Arizona?

a. In Phoenix?

b. In Tucson?

c. In other parts of Arizona

3. What have prices in the L.A. Basin been and what has determined the price? Same question for El Paso.

4. What have prices been to jobbers at the Phoenix and Tucson "racks" (branded and unbranded) and what has determined these prices?

5. What have prices been to dealers (Dealer Tank Wagon ("DTW") price) in the Phoenix and Tucson metropolitan areas and what has determined these prices?

6. Who supplies gasoline to the rural areas of Arizona, e.g.,

   a. To Globe

   b. To Bisbee

   c. To Sierra Vista

   d. To Yuma

   e. To Flagstaff

   f. To Prescott

   g. To Kingman

7. How is gasoline supplied to rural parts of Arizona?

8. What prices have been charged to dealers in the rural parts of Arizona:

   a. By refiners?

   b. By jobbers?

9. What prices have been charged to the consumer by dealers -

   a. In Phoenix?

   b. In Tucson?

   c. In the rural towns identified above?

10. What prices have been charged to the consumer by chain marketers -

   a. In Phoenix?

   b. In Tucson?

   c. In the rural towns identified above?

11. What prices have been charged to the consumer by company-operated stations?

    a. In Phoenix?

    b. In Tucson?

    c. In the rural towns identified above?

E. <u>What Existing Laws Apply to Pricing</u>?

   1. Federal law

      a. Sherman Antitrust Act?

      b. Clayton Act?

      c. Robinson Patman Act?

      d. Federal Trade Commission Act?

   2. State laws?

   3. What do these laws prohibit and how do they protect the consumer?

II. <u>Divorcement</u>.

A. What is divorcement?

B. What has been the history of divorcement legislation at the federal level?

   1. When have bills been introduced and what has happened to them?

   2. What positions have federal agencies such as the Justice Department, the Department of Energy, and the Federal Trade Commission taken on divorcement legislation?

C. What has been the history of divorcement legislation at the state level?

   1. In what states, and over what period, have divorcement bills been introduced?

   2. In what states has divorcement legislation passed?

   3. In what states has divorcement legislation been debated or repealed?

D. What are the reasons <u>in favor of enacting</u> divorcement legislation?

1. From the dealer's perspective:

a. What specific reasons do Arizona dealers claim support divorcement legislation?

b. What, specifically, will be achieved for Arizona dealers if divorcement legislation is enacted?

c. What, specifically, will be achieved for Arizona consumers if divorcement legislation is enacted?

2. From the economist's perspective:

a. What studies have been conducted which conclude that divorcement promotes competition and/or is beneficial to the consumer?

b. What are the economic arguments justifying divorcement legislation?

E. What are the reasons <u>for rejecting</u> divorcement legislation?

1. From the refiner's perspective:

a. What specific reasons do refiners which market in Arizona have for opposing divorcement legislation?

b. What effect will divorcement have upon refiner's gasoline marketing operations in Arizona?

c. What will be achieved for Arizona consumers if divorcement legislation is enacted?

2. From the economist's perspective:

a. What studies have been conducted which conclude that divorcement is detrimental to the consumer?

b. What are the economic arguments against divorcement legislation?

F. What do jobbers and chain marketers think about divorcement and why?

G. What do consumers think about divorcement and why?

H. Factual Data:

1. How many company-operated stations are there in Arizona?

a. Who owns and operates them?

b. What volume of gasoline do they sell relative to the total market?

c. What has been the trend over time?

d. What are the reasons for the trend?

e. Why do refining companies choose to operate their own stations?

f. What are the benefits to the consumer of company operation of stations.

g. What are the detriments to the consumer of company operation of stations.

2. How many stations are there in Arizona which are leased by refiners to dealers?

   a. Branded

   b. Unbranded

   c. What volume of gasoline do they sell relative to the total market?

   d. What has been the trend in numbers over time?

   e. What are the reasons for the trend?

   f. Why do refining companies choose to lease stations and sell gasoline through dealers?

   g. What are the benefits to the consumer of dealer operation of stations?

   h. What are the detriments to the consumer of dealer operation of stations?

3. How many stations are there in Arizona which are dealer-owned or leased by a dealer from some third party which are supplied directly by a refiner?

   a. Branded

   b. Unbranded

   c. What volume of gasoline do they sell relative to the total market?

d. What has been the trend in numbers over time?

e. What are the reasons for the trend?

f. Why do refining companies choose to sell gasoline to dealers who own their own stations or lease the station from third parties?

4. How many jobber-operated stations are there?

   a. Branded

   b. Unbranded

   c. What volume of gasoline do they sell relative to the total market?

   d. What has been the trend over time?

   e. What are the reasons for the trend?

5. How many stations are leased by jobbers to dealers?

   a. Branded

   b. Unbranded

   c. What volume of gasoline do they sell relative to the total market?

   d. What has been the trend over time (volume, number of stations, etc.)?

   e. What are the reasons for the trend?

6. How many stations are operated by chain marketers?

   a. Branded

   b. Unbranded

   c. What volume of gasoline do they sell relative to the total market?

   d. What has been the trend over time?

   e. What are the reasons for the trend?

III. <u>Petroleum Marketing Practices</u>.

A. <u>Pricing</u>.

1. <u>Market Surveys</u>.

a. Do existing studies show that refiner company-operated stations are engaged in predatory-pricing against dealer-operated stations?

b. How can the Committee best survey the metropolitan markets to determine whether predatory pricing is occurring?

2. <u>Zone Pricing</u>.

a. What methods do refiners use in order to assist their dealers in meeting the prices of the dealers' competitors?

(1) For example, what is zone-pricing?

(2) Who uses zone-pricing?

(3) Where is zone-pricing used?

(4) When is zone-pricing used?

b. Are refining companies using zone-pricing to put their dealers out of business?

B. <u>The Franchise Relationship</u> (Service Station Leases/ Supply Contracts).

1. In general--what is a "franchise"?

2. What law currently regulates or applies to the franchise relationship and how does it protect the dealer?

a. Federal law

(1) Petroleum Marketing Practices Act?

(2) Trademark Act?

(3) Anti-trust laws?

(4) Other laws?

b. State law

c. Are proposed protections under state law preempted by or made otherwise inoperative by Federal law?

3. What are the policies of suppliers (refiners) on:

   a. Hours of operation?

   b. Conversion of service stations from service bay modes of operation to other modes of operation?

   c. Assignment?

   d. Charges for entering into a franchise relationship?

   e. Charges for agreeing to the assignment of a franchise agreement?

   f. Rental?

   g. Credit card usage and fees?

   h. Station appearance and cleanliness?

   i. Other lease (franchise) terms of interest?

4. What are the reasons for these policies?

5. Do these policies benefit dealers? If so, how?

6. What are the policies of jobbers on the items listed in 3., above?

7. What are the policies of chain-marketers on the items listed in 3., above?

8. How will consumers be affected if the legislature undertakes to regulate:

   a. Hour of operation?

   b. Service station conversions?

   c. Franchise assignment?

   d. Charges for entering into a franchise relationship?

   e. Charges for agreeing to the assignment of a franchise agreement?

   f. Station rentals?

   g. Credit card usage or fees?

9. Dealer Profitability.

   a. What are dealers' margins?

   b. Do margins vary according to mode of operation?

   c. Do margins vary depending upon rural versus metropolitan location?

   d. How profitable are service stations?

   e. Do profits vary according to mode of operation?

   f. Is there a relationship between margin, profitability and mode of operation?

   g. Do profits vary depending upon rural versus metropolitan location?

10. Dealer Grievances.

   a. What are specific dealer grievances against their suppliers?

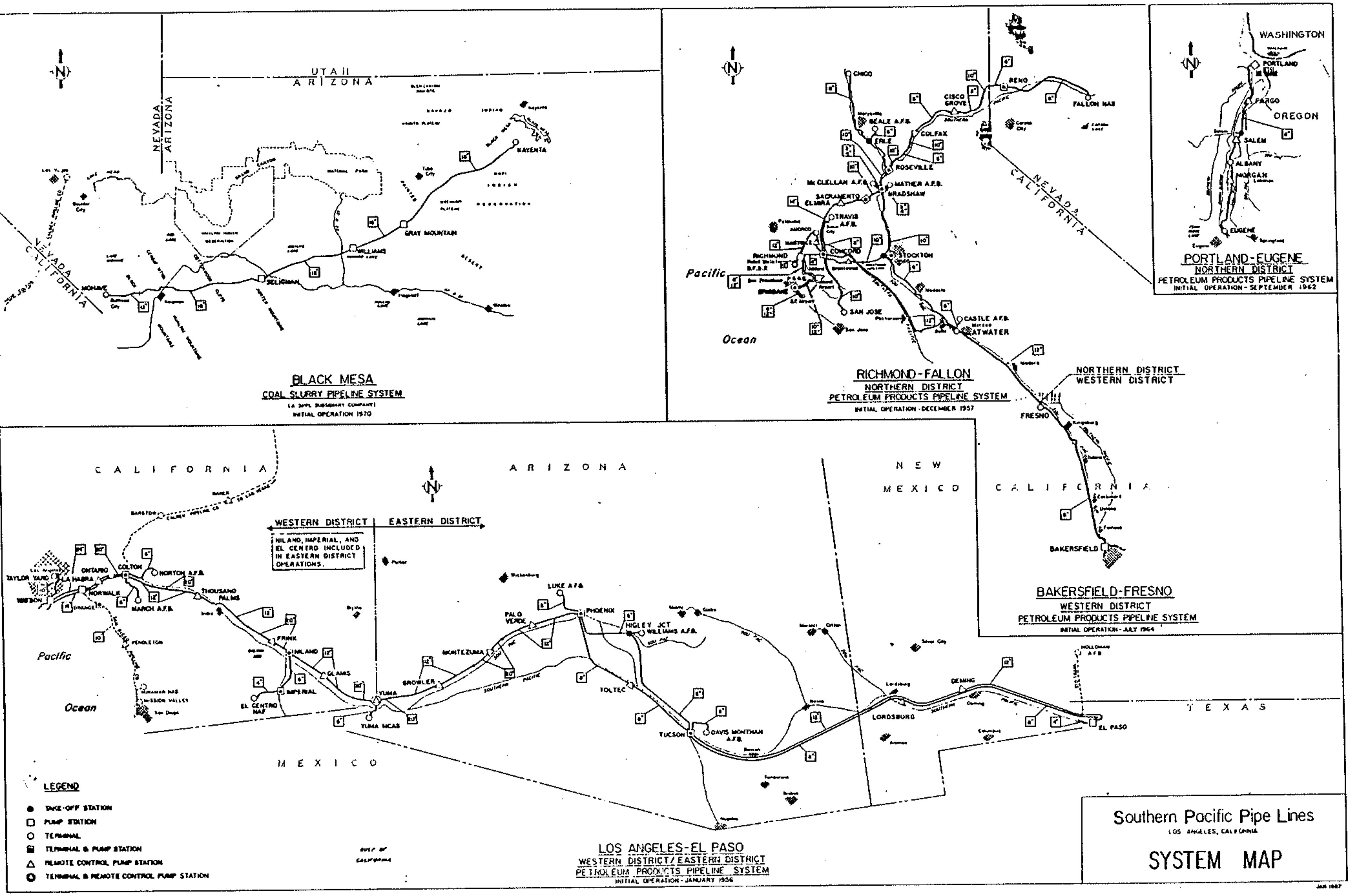
   b. What should the legislature do about these grievances?

   c. Why will the legislation be effective in addressing the grievances?

   d. How will the legislation benefit the consumer?

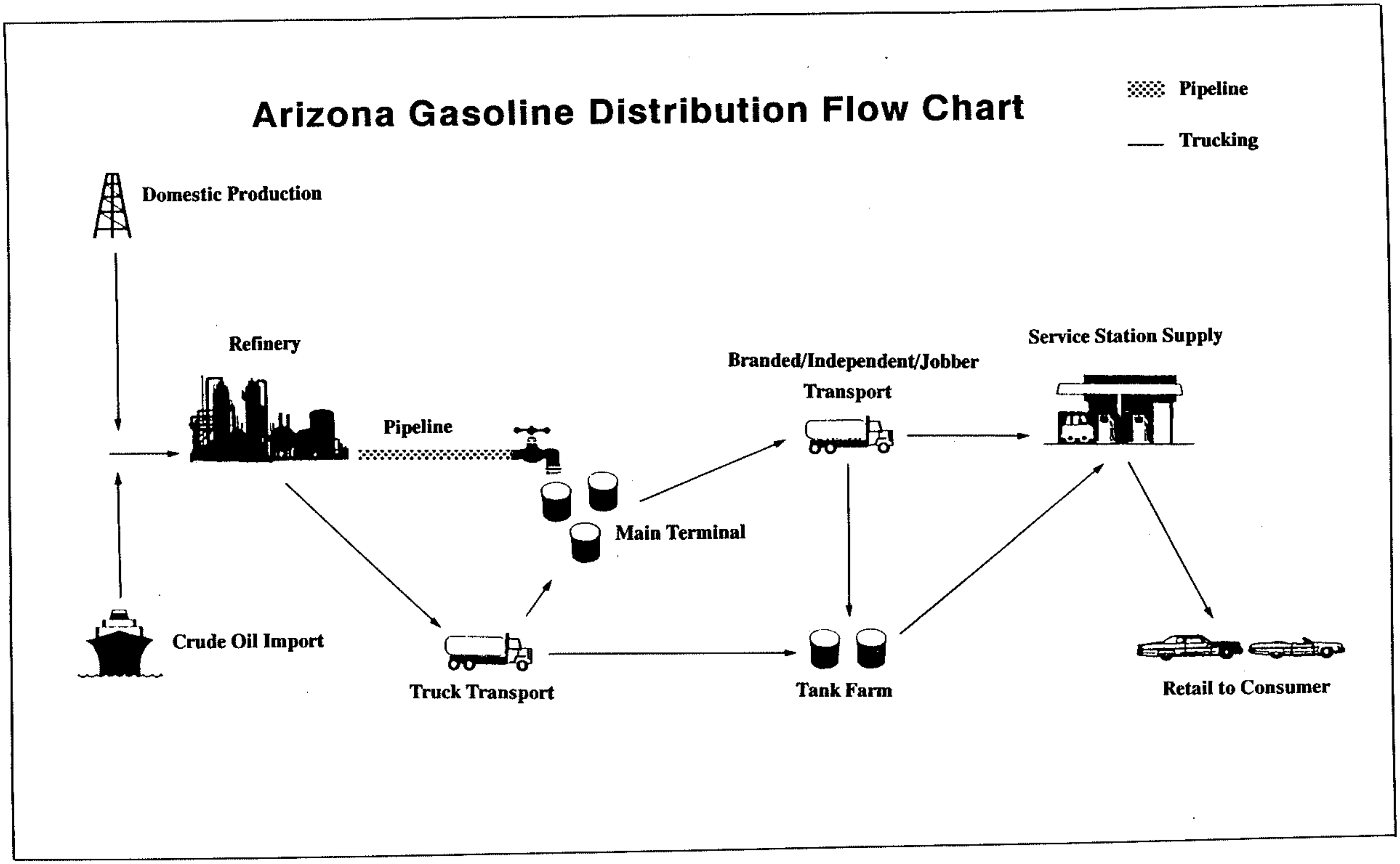
   e. What are refiners' policies and procedures to respond to specific dealer grievances?

APPENDIX B



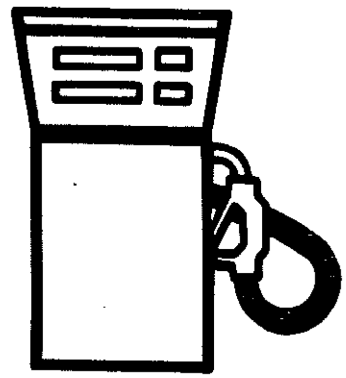
Southern Pacific Pipe Lines
LOS ANGELES, CALIFORNIA
SYSTEM MAP
BLACK MESA
COAL SLURRY PIPELINE SYSTEM
INITIAL OPERATION 1970
RICHMOND-FALLON
NORTHERN DISTRICT
PETROLEUM PRODUCTS PIPELINE SYSTEM
INITIAL OPERATION - DECEMBER 1957
PORTLAND-EUGENE
NORTHERN DISTRICT
PETROLEUM PRODUCTS PIPELINE SYSTEM
INITIAL OPERATION - SEPTEMBER 1962
BAKERSFIELD-FRESNO
WESTERN DISTRICT
PETROLEUM PRODUCTS PIPELINE SYSTEM
INITIAL OPERATION - JULY 1964
LOS ANGELES-EL PASO
WESTERN DISTRICT/EASTERN DISTRICT
PETROLEUM PRODUCTS PIPELINE SYSTEM
INITIAL OPERATION - JANUARY 1956
NORTHERN DISTRICT
WESTERN DISTRICT
WESTERN DISTRICT
EASTERN DISTRICT
NILAND, IMPERIAL, AND EL CENTRO INCLUDED IN EASTERN DISTRICT OPERATIONS.
LEGEND
TAKE-OFF STATION
PUMP STATION
TERMINAL
TERMINAL & PUMP STATION
REMOTE CONTROL PUMP STATION
TERMINAL & REMOTE CONTROL PUMP STATION
WASHINGTON
OREGON
PORTLAND
FARGO
SALEM
ALBANY
MORGAN
EUGENE
NEVADA
CALIFORNIA
UTAH
ARIZONA
NEW MEXICO
TEXAS
MEXICO
Pacific
Ocean
CHICO
BEALE A.F.B.
ERLE
COLFAX
CISCO GROVE
RENO
FALLON NAS
ROSEVILLE
MATHER A.F.B.
McCLELLAN A.F.B.
SACRAMENTO
BRADSHAW
ELMIRA
TRAVIS A.F.B.
RICHMOND
CONCORD
STOCKTON
SAN JOSE
CASTLE A.F.B.
ATWATER
FRESNO
BAKERSFIELD
MOJAVE
SELIGMAN
WILLIAMS
GRAY MOUNTAIN
KAYENTA
TAYLOR YARD
WATSON
LA HABRA
NORWALK
ORANGE
ONTARIO
COLTON
NORTON A.F.B.
MARCH A.F.B.
THOUSAND PALMS
FRINK
NILAND
IMPERIAL
EL CENTRO NAF
GLAMIS
YUMA
YUMA MCAS
GROWLER
MONTEZUMA
PALO VERDE
LUKE A.F.B.
PHOENIX
HIGLEY JCT
WILLIAMS A.F.B.
TOLTEC
TUCSON
DAVIS MONTHAN A.F.B.
LORDSBURG
DEMING
EL PASO
HOLLOMAN A.F.B.

APPENDIX C



Source: Arizona Energy Office

Gasoline Price Factors



- Refinery Economics
- Transportation Modes
  - Pipeline
  - Truck
- Intermediate Storage
  - Pipeline Terminal
  - Jobber Tank Farm
- Class of Trade
  - Company Operated
  - Lessee Dealership
  - Open Dealership
  - Jobber Company Operated
  - Jobber Lessee Dealership
  - Jobber Open Dealership
  - Non-branded Independent Company Operated
  - Non-branded Independent Lessee Dealership
  - Non-branded Independent Open Dealership
- Marketing Incentives
  - Rebate Programs
  - Volume Discounts
  - Temporary Lease Discounts
  - Zone Pricing
- Volume of Product Sold
- Operating Costs
  - Profit
  - Utilities
  - Salaries
  - Insurance
  - Licensing
  - Maintenance
  - Business Expenses
  - Franchise Fee
  - Rent / Mortgage Payment
  - Debt Service
  - Type of Station
    - Self-service
    - Full-service
    - Truck Stop
    - Automobile Service
    - Car Wash
    - Convenience Store
    - Superpumper
- Market Influences
  - Supply / Demand Balance
  - Service Area Competition
  - Seasonality
  - Location

Source: Arizona Energy Office

APPENDIX D

Arizona State Legislature
1700 West Washington
Phoenix, Arizona 85007

July 22, 1988

Ms. Lois D. Cashell
Acting Secretary
FEDERAL ENERGY REGULATORY COMMISSION
825 North Capitol Street, N.E.
Washington, D.C. 20426

Re: Southern Pacific Pipe Lines, Inc.
Docket No. IS85-15-000

Dear Ms. Cashell:

We, the undersigned are, respectively, the Chairmen of the House Transportation Committee, the Senate Transportation Committee of the Arizona State Legislature and members of the Joint Legislative Study Committee on Petroleum Pricing and Marketing Practices (Petroleum Pricing Study Committee). The Committee was established by the Arizona Legislature during the first regular session of the 38th Legislature for the purpose, among other things, of looking into gas prices in Arizona. This letter is written to request you to approve the pending settlement proposal in the above referenced matter.

The Petroleum Pricing Study Committee was established, in part, to look into the question of why gasoline prices in Arizona are, at times, dramatically higher than in other parts of the country. In the course of conducting its investigation, and in related legislative activity during the last session, the Committee members have learned that the bulk of Arizona's gasoline is supplied from the West Coast, principally through Los Angeles Basin refineries, and is shipped to Arizona through a pipeline owned by Southern Pacific Pipe Lines, Inc. (SPPL), which operates the pipeline as a common carrier. We have also learned that the SPPL pipeline is prorated, meaning that it is impossible for all who wish to ship gasoline through it to ship as much as they need to ship. Conditions of proration have continued for several years. Testimony taken by the Petroleum Pricing Study Committee from economists and others indicates that the prorated pipeline has an adverse effect on prices in Phoenix, Tucson and other parts of Arizona and results in difficulty in supplying the actual demands of the Arizona market.

Testimony before the Committee has also shown that SPPL has been unable, thus far, to expand the capacity of the pipeline because there is uncertainty whether the Commission will permit the recovery of the approximately $100 million investment which will be required in order to expand the SPPL pipeline from the West Coast. It is also our understanding that your approval of the pending settlement in the referenced matter will free the way for an expansion of the pipeline.

We believe it to be of great importance to the State of Arizona, and to the motoring public in Arizona, that SPPL be permitted to expand the pipeline and to recover a reasonable rate of return for doing so. The added capacity will relieve conditions of proration, will make it possible to cheaply and efficiently move the supplies necessary to meet our consumption, will enable Arizona to keep pace with its growing demand for gasoline, and will promote increased competition in various Arizona gasoline markets, including Phoenix and Tucson, to the ultimate benefit of Arizona consumers.

We submit that Commission approval of the settlement in the referenced case is in the interest of Arizona and the motoring public in Arizona. We respectfully urge that the Commission approve the settlement.

Very truly yours,

Jack B. Jewett
REPRESENTATIVE JACK B. JEWETT

Pete Corpstein
SENATOR PETE CORPSTEIN

Jack C. Jackson
REPRESENTATIVE JACK C. JACKSON

Ray Hudson
REPRESENTATIVE ROY HUDSON

Don Strauch
REPRESENTATIVE DON STRAUCH

Chris Herstam
REPRESENTATIVE CHRIS HERSTAM

Pete Rios
SENATOR PETER RIOS

cc: Arizona Congressional Delegation

APPENDIX E

ARIZONA

INDEPENDENTS GASOLINE MARKET SHARE

(SOURCE: LUNDBERG SURVEY, INC.)

Year (12 Mos.)	%	Shell
1970	23.94	
1971	24.35	
1972	24.35	
1977	29.87	
1978	28.22	%
1979	29.50	15.11
1980	36.69	10.49
1981	31.42	15.83
1982	30.33	18.31
1983	21.39	14.81
1984	21.29	11.61
1985	19.27	9.47
1986	21.32	8.68
1987	19.38	7.88

Unleaded Regular
Dealer Buying Price ("DBP") Comparison
Los Angeles DBP compared to Phoenix DBP

(Figures within parentheses reflect price difference where DBP is lower in Phoenix than in Los Angeles)

Date	Los Angeles	Phoenix	Difference
08/21/87	60.82	64.50	3.68
09/11/87	60.29	63.18	2.89
09/25/87	60.70	63.46	2.76
10/09/87	60.64	63.14	2.50
10/23/87	60.23	61.30	1.07
11/06/87	59.80	59.46	(.34)
11/20/87	56.84	57.92	1.08
12/04/87	57.61	56.76	(.85)
12/18/87	56.71	55.40	(1.31)
01/08/88	55.72	54.28	(1.44)
01/22/88	54.51	52.45	(2.06)
02/05/88	53.55	51.07	(2.48)
02/19/88	54.29	50.73	(3.56)
03/11/88	53.33	47.47	(5.86)
03/25/88	56.17	50.80	(5.37)
04/08/88	61.48	53.57	(7.91)
04/22/88	64.30	54.77	(9.53)
05/06/88	63.57	54.32	(9.25)
05/20/88	63.60	53.58	(10.02)
06/10/88	64.95	55.09	(9.86)
06/24/88	63.77	54.32	(9.45)
07/08/88	64.66	55.27	(9.39)
07/22/88	64.62	55.83	(8.79)
08/05/88	65.56	54.52	(11.04)

SOURCE: Lundberg

Unleaded Regular
Rack Price Comparison
Los Angeles Rack Price compared to Phoenix Rack Price

(Figures within parentheses reflect price difference where Rack Price is lower in Phoenix than in Los Angeles)

Date	Los Angeles	Phoenix	Difference
08/21/87	60.15	63.70	3.55
09/11/87	58.88	64.35	5.47
09/25/87	59.78	63.00	3.22
10/09/87	59.80	62.50	2.70
10/23/87	59.68	61.60	1.92
11/06/87	58.28	59.50	1.22
11/20/87	51.42	57.60	6.18
12/04/87	55.26	56.65	1.39
12/18/87	52.10	55.65	3.55
01/08/88	48.60	53.30	4.70
01/22/88	47.13	51.95	4.82
02/05/88	48.45	51.45	3.00
02/19/88	50.48	52.20	1.72
03/11/88	50.50	50.25	(.25)
03/25/88	56.67	53.25	(3.42)
04/08/88	63.23	57.90	(5.33)
04/22/88	65.94	56.35	(9.59)
05/06/88	58.41	55.95	(2.46)
05/20/88	59.64	54.95	(4.69)
06/10/88	61.09	58.85	(2.24)
06/24/88	56.23	56.70	.47
07/08/88	62.02	57.45	(4.97)
07/22/88	61.61	57.95	(3.66)
08/05/88	65.05	57.95	(7.10)

SOURCE: Lundberg

Unleaded Regular
Terminal Price Comparison
Los Angeles Terminal Price compared to Phoenix Terminal Price

(Figures within parentheses reflect price difference where Terminal Price is lower in Phoenix than in Los Angeles)

Date	Los Angeles	Phoenix	Difference
08/21/87	61.84	64.03	2.19
09/11/87	60.15	64.39	4.24
09/25/87	60.54	63.84	3.30
10/09/87	60.54	63.34	2.80
10/23/87	60.73	62.16	1.43
11/06/87	60.61	59.86	(.75)
11/20/87	56.74	57.51	.77
12/04/87	57.34	56.39	(.95)
12/18/87	56.86	55.51	(1.35)
01/08/88	54.94	53.25	(1.69)
01/22/88	54.38	52.13	(2.25)
02/05/88	51.60	50.81	(.79)
02/19/88	52.71	51.44	(1.27)
03/11/88	53.25	49.11	(4.14)
03/25/88	56.18	52.05	(4.13)
04/08/88	61.76	55.00	(6.76)
04/22/88	64.08	55.36	(8.72)
05/06/88	63.08	55.00	(8.08)
05/20/88	62.84	54.18	(8.66)
06/10/88	65.28	57.04	(8.24)
06/24/88	62.26	55.62	(6.64)
07/08/88	64.66	55.30	(9.36)
07/22/88	64.98	56.60	(8.38)
08/05/88	65.80	56.55	(9.25)

SOURCE: Lundberg

Unleaded Regular
Dealer Buying Price ("DBP") Comparison
Tucson, Arizona DBP compared to El Paso, Texas DBP

(Figures within parentheses reflect price difference where DBP is lower in Tucson than in El Paso)

Date	Tucson	El Paso	Difference
08/21/87	66.19	72.05	(5.86)
09/11/87	66.07	71.55	(5.48)
09/25/87	65.93	71.55	(5.62)
10/09/87	65.95	71.05	(5.10)
10/23/87	65.61	71.05	(5.44)
11/06/87	64.98	70.55	(5.57)
11/20/87	64.58	70.05	(5.47)
12/04/87	63.51	70.05	(6.54)
12/18/87	62.68	69.55	(6.87)
01/08/88	61.59	67.55	(5.96)
01/22/88	60.83	66.55	(5.72)
02/05/88	59.70	57.60	2.10
02/19/88	59.22	57.60	1.62
03/11/88	58.19	57.60	.59
03/25/88	58.03	56.60	1.43
04/08/88	61.58	57.60	3.98
04/22/88	61.56	59.60	1.96
05/06/88	61.64	58.60	3.04
05/20/88	61.48	63.83	(2.35)
06/10/88	61.73	62.85	(1.12)
06/24/88	61.66	63.98	(2.32)
07/08/88	61.29	64.98	(3.69)
07/22/88	61.08	64.20	(3.12)
08/05/88	60.71	64.70	(3.99)

SOURCE: Lundberg

Unleaded Regular
Rack Price Comparison
Tucson, Arizona Rack Price compared to El Paso, Texas Rack Price

(Figures within parentheses reflect price difference where rack price is lower in Tucson than in El Paso)

Date	Tucson	El Paso	Difference
08/21/87	65.10	69.22	(4.12)
09/11/87	65.10	67.99	(2.89)
09/25/87	64.80	67.74	(2.94)
10/09/87	64.43	67.18	(2.75)
10/23/87	64.27	66.93	(2.66)
11/06/87	62.93	66.01	(3.08)
11/20/87	61.93	64.02	(2.09)
12/04/87	61.27	63.27	(2.00)
12/18/87	60.52	58.60	1.92
01/08/88	58.43	55.47	2.96
01/22/88	56.77	54.30	2.47
02/05/88	55.27	54.30	.97
02/19/88	55.27	54.22	1.05
03/11/88	54.50	53.50	1.00
03/25/88	54.75	53.57	1.18
04/08/88	63.17	54.47	8.70
04/22/88	61.50	55.25	6.25
05/06/88	61.17	55.82	5.35
05/20/88	60.47	56.28	4.19
06/10/88	61.05	57.93	3.12
06/24/88	61.13	58.95	2.18
07/08/88	60.63	59.20	1.43
07/22/88	60.63	60.08	.55
08/05/88	59.97	60.87	(.90)

SOURCE: Lundberg

Unleaded Regular
Terminal Price Comparison
Tucson, Arizona Terminal Price compared to
El Paso, Texas Terminal Price

(Figures within parentheses reflect price difference where terminal price is lower in Tucson than in El Paso)

Date	Tucson	El Paso	Difference
08/21/87	65.74	69.44	(3.70)
09/11/87	65.53	68.76	(3.23)
09/25/87	65.88	68.26	(2.38)
10/09/87	67.00	68.10	(1.10)
10/23/87	65.05	67.74	(2.69)
11/06/87	64.55	67.10	(2.55)
11/20/87	62.83	66.13	(3.30)
12/04/87	62.05	64.64	(2.59)
12/18/87	61.11	61.93	(.82)
01/08/88	59.81	58.74	1.07
01/22/88	58.04	58.34	(.30)
02/05/88	56.26	54.85	1.41
02/19/88	55.91	54.71	1.20
03/11/88	54.46	54.03	.43
03/25/88	55.96	54.14	1.82
04/08/88	61.07	54.54	6.53
04/22/88	61.31	56.22	5.09
05/06/88	61.07	56.33	4.74
05/20/88	60.63	56.53	4.10
06/10/88	61.11	57.92	3.19
06/24/88	61.13	59.38	1.75
07/08/88	61.23	59.51	1.72
07/22/88	60.95	60.84	.11
08/05/88	60.53	61.65	(1.12)

SOURCE: Lundberg