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Arguments for and against Legislative Attacks on Downstream Vertical Integration in the Oil Industry

INTRODUCTION

The American oil industry has long been in the center of a heated debate. Some argue that the size and economic scope of the modern international oil company give rise to a greater possibility of industry concentration and control, which can only be kept in check by proactive government measures.¹ Others argue that the relative size of even the largest international oil company to the market as a whole reveals no sign of significant market concentration.² Still others urge that recent occurrences reveal an already existing market structure that allows the consumer and small businessman to get “raped and pillaged at the discretion of the major[] [oil companies].”³ Although this debate appears to lose some momentum during periods of price stability at the gasoline pump, the sudden oil price spike⁴ that occurred amid the Persian Gulf conflict has again fueled an uproar between competing constituents of the oil industry.⁵

This Note examines the arguments made for and against increased regulation of the activities of vertically integrated oil companies in the operation of retail, or downstream, facilities. Part I provides a brief overview of the events giving rise to the current

¹ See *infra* part IV.A.

² See *infra* part IV.B.

³ J. Richard Shaner, *Divorcement Pressures Growing Once Again; Separation of Petroleum Suppliers and Individual Outlets*, NAT'L PETROLEUM NEWS, June 1991, at 10 (quoting an unidentified Circle K executive).

⁴ See *Gulf War Fear Hikes Oil Price By \$3 A Barrel*, L.A. TIMES, Oct. 25, 1990, at A3.

⁵ These constituents are the independent wholesale marketers of refined oil products (often referred to as “jobbers”) and the integrated oil companies that participate in numerous markets relating to crude oil. The relevant markets include the crude production (supply) market, the transportation market, the refining market, and the wholesale and retail refined products market. For an examination of the positions taken by each constituent, see *infra* part IV.

battle centered on the vertical structure⁶ of the oil industry. Part II discusses the goals of regulatory approaches, such as state divorcement legislation and the proposed federal legislative response.⁷ Although the proposed federal legislation is not divorcement *per se*, this Note reveals that the ultimate impact of such legislation is similar to divorcement because it permits nonintegrated retailers and wholesalers to price the refiner out of the retail market while simultaneously increasing the price of gasoline at the retail pump. Part III focuses on state and federal court treatment of state divorcement legislation. Part IV presents arguments for and against increased government regulation. The Note concludes that divorcement, as well as the proposed federal legislative response, instead of targeting its advocates' purported goals, is anticompetitive in nature and represents an attempt by market middlemen ("jobbers") to increase their profits. It is an attempt that should be thwarted.

I. DIVORCEMENT'S PLATFORM: THE PREVENTION OF MARKET CONCENTRATION

The single greatest step taken by the federal government to attack the industrial organization of the oil industry was its pursuit of the Standard Oil Company under the Sherman Act, culminating in the landmark antitrust decision handed down by the United States Supreme Court in *Standard Oil Co. v. United States*.⁸ Although this decision is the point to begin analysis of governmental efforts to change the horizontal and vertical structure of the oil industry, it also served as a climax for a twenty-one year period of growing concern over the monopolization of the oil, sugar, and whisky industries.⁹ Such concern was heightened by the frustrated

⁶ A vertically integrated company has a presence in various links of the chain necessary to bring goods to market. For example, a fully integrated oil company would be engaged in oil exploration and production, transportation of both crude oil and petroleum products, refining crude oil, and marketing refined products. Horizontal integration, on the other hand, involves increasing degrees of market concentration within a market segment. See JOSEPH L. MASSIE, *BLAZER AND ASHLAND OIL* 11 (1960).

⁷ The purpose of divorcement laws is to force oil refiners to divest their companies of owned or operated retail service stations. Specifically, divorcement can be defined as "prohibiting major oil [refining] companies from directly operating retail gasoline service stations." *Higher Gas Prices; Two Recent Government Reports Link Restrictive Gas Station Ownership Laws To Higher Consumer Prices*, BUS. WIRE, January 19, 1989.

⁸ 221 U.S. 1 (1911).

⁹ See BRUCE BRINGHURST, *ANTITRUST AND THE OIL MONOPOLY* 2 (1979) (The author notes that in "1887, fourteen corporations merged to form the sugar trust, which was capitalized at \$50 million and controlled 70 percent of American sugar-refining capacity. [Additionally], eighty-one companies [merged to form] a whisky trust that manufactured at least 85 percent of the nation's alcohol. . . .").

attempts of state agencies to break up the formidable Standard Oil trust.¹⁰

On paper, the *Standard Oil* decision appeared to be a decisive blow against the "evil consequences"¹¹ of monopoly. In reality, however, given the nature of the dissolution ordered by the Court,¹² the true victor may have been the oil industry, which even after the decision was operated "the same old way, by the same old men, with profits even greater than formerly."¹³ Although the actual effectiveness of the *Standard Oil* decision is not within the scope of this Note, the importance of this attempt by the federal government to force a restructuring of the oil industry through legislative channels cannot be overstated. It was from this precedent that future efforts to remold the vertical structure of the oil industry through proposed divorcement legislation would emerge.¹⁴

As has typically been the case, the sudden resurgence of attempts to restructure the oil industry through legislative initiatives designed to curtail the role of major oil companies within the retail marketing of gasoline is a result of a sudden crisis within the crude markets.¹⁵ Contemporary proponents of retail divorcement legislation point to the emergence of perversions in the pricing policies of major refiners during the Persian Gulf conflict as an example of this trend.¹⁶ The "perversion" that occurred in the wake of this

¹⁰ Several attempts by state agencies failed to result in any significant effect on Standard Oil's corporate structure or market concentration. See, e.g., *Standard Oil Co. v. Tennessee*, 217 U.S. 413 (1910); *State ex rel. Wachenheimer v. Standard Oil Co.*, 15 Ohio C.C. (n.s.) 212 (1907); *Standard Oil Co. v. State*, 100 S.W. 705 (Tenn. 1907).

¹¹ *Standard Oil Co. v. United States*, 221 U.S. 1, 57 (1911).

¹² See BRINGHURST, *supra* note 9, at 193-94. Several reports presented to James McReynolds, Woodrow Wilson's Attorney General, stated that the dissolution was of minimal impact because "the same stockholders owned all the Standard Oil companies." *Id.* at 194. The dissolution decree ordered by the Court essentially required that the original company's stock be broken up into new blocks of stock that would represent each of the new firms carved out of Standard Oil. Reaction to this, including the reaction from Standard Oil, was generally positive. Standard's positive and cooperative reaction to the decree may have been due to the "startling weakness of the dissolution decree . . . [as] a handful of individuals still would hold a majority interest in all the newly independent companies." *Id.* at 180.

¹³ LITERARY DIG., June 15, 1912, at 1240 (containing comments collected from the *New York Herald*).

¹⁴ Divorcement legislation was first introduced during the 1930s and interest in such legislation generally increased during disruptions in the crude markets. See Shaner, *supra* note 3, at 10. For additional information on divorcement, see *infra* part II.

¹⁵ See *infra* note 28 and accompanying text.

¹⁶ See 137 CONG. REC. S13,194 (daily ed. Sept. 17, 1991) (statement of Sen. Kasten).

crisis is known as a wholesale price inversion,¹⁷ a rare market anomaly that typically occurs after a precipitous rise in crude oil prices. During a price inversion, the typical pricing relationship between spot market, wholesaler or dealer tankwagon (DTW), and retail market becomes distorted. This results in a situation where the price jobbers pay to oil refiners for quantities in bulk becomes higher than the retail price available from branded retail outlets.¹⁸

The obvious effect of this short term market anomaly is a temporary compression that eliminates profits to the middlemen or jobbers. In light of this very real impact, it is not surprising that these middlemen, regardless of the wisdom of their position, now find themselves carrying the banner of governmental regulation.¹⁹

The theoretic platform upon which this banner rests charges that the current level of concentration in the oil refining industry is dangerous to competition. The advocates of increased government regulation predict that if concentration levels are allowed to go unchecked, consumers will suffer in the form of higher prices and reduced service in the long run.²⁰ These advocates believe that increased government involvement is necessary to ensure a competitive market.²¹ Others, however, dispute the validity of such arguments. For example, studies by Arizona, Maryland, and the federal government under both the Carter and Reagan administrations have found that state divorcement laws historically are harmful to the consumer.²²

II. DIVORCEMENT'S GOALS: THE DESTRUCTION OF THE OIL INDUSTRY'S VERTICAL INTEGRATION

The oil industry is a dynamic industry composed of thousands of businesses, ranging from sole proprietorships to enormous multinational corporations.²³ "It has been estimated that the oil industry contains approximately 17,000 firms."²⁴ Most of these companies operate within one segment of the oil industry and lack

¹⁷ See *The Price Inversion Intensifies Split Between Sectors of the Oil Industry*, ARIZ. BUS. GAZETTE, May 24, 1991, at 1.

¹⁸ See *infra* notes 123-28 and accompanying text.

¹⁹ See 137 CONG. REC. E2639-40 (daily ed. July 22, 1991) (statement of Rep. Cooper).

²⁰ See 137 CONG. REC. S13,194 (daily ed. Sept. 10, 1991) (statement by Sen. Kasten).

²¹ See *id.*

²² See *Higher Gas Prices*, *supra* note 7.

²³ See FRED C. ALLVINE & JAMES M. PATTERSON, COMPETITION, LTD.: THE MARKETING OF GASOLINE 212 (1972).

²⁴ *Id.*

significant integration into other downstream or upstream businesses.²⁵ Many oil companies, however, possess a certain degree of integration ranging from the small businessman that owns a few service stations and a fuel truck to a large multinational, such as Mobil, that has sizable operations in all segments.²⁶

Despite the longstanding coexistence between small and large operators within the oil industry, critics often cite the degree of vertical integration possessed by the larger oil companies as evidence of intolerable market concentration and power.²⁷ According to critic, oil expert, and Massachusetts Institute of Technology Professor M. A. Adelman,

The public attitude toward the multinational oil companies brings me back to the bad old days of Joe McCarthy. . . . [F]earful of the unreachable leaders of the [U.S.S.R., Americans sought] to find and bash an enemy at home. Today, unable to do anything about high oil prices, many . . . take it out on the multinational oil companies.²⁸

Advocates of divorcement legislation draw support from this popular base. Although many politicians are quick to build a platform upon such public fears, there can be no serious debate concerning the lack of similarity between the high level of industrial concentration within the oil industry prior to 1911 and the low level of economic concentration that characterizes the oil industry today.²⁹ During Standard Oil's market predominance, it could boast of refining, transportation, and retail market concentration levels hovering around ninety percent.³⁰ Today, however, the American oil giants are capable of individually controlling only a relatively

²⁵ See *id.* The oil industry is composed of four key segments. These are, ranging from upstream to downstream, exploration and production (E&P), refining, transportation, and marketing.

The term upstream relates to activities that occur prior to refining crude oil. An example of an upstream activity would be crude oil production. A downstream activity is more closely related to the marketing of refined products. One example of downstream activity is retail gasoline marketing.

²⁶ See MOBIL OIL 1990 ANNUAL REPORT (1990).

²⁷ See Richard B. Mancke, *Competition in the Oil Industry, in VERTICAL INTEGRATION IN THE OIL INDUSTRY* 35 (Edward J. Mitchell ed., 1976) (stating that critics "have been quick to . . . charge that U.S. energy problems have been caused in large part by the monopolistic abuses of the giant integrated oil companies").

²⁸ *Id.* (quoting M. A. Adelman, statement to the Senate Foreign Relations Committee, Subcommittee on Multinational Corporations January 29, 1975).

²⁹ See *infra* notes 114-15 and accompanying text.

³⁰ See *Standard Oil Co. v. United States*, 221 U.S. 1, 33 (1911).

small percentage of the refined products market.³¹ Furthermore, concentration ratios computed for the gasoline market reveal that the level of concentration possessed by refiners has fallen significantly in recent years.³² Nonetheless, many so-called "consumer advocates" and jobbers feel compelled to lobby passionately in state and federal arenas for legislation to curb purported industry excesses by forcing oil refiners to become divorced from their retail gasoline operations,³³ thereby eroding the degree of vertical integration³⁴ in the oil industry.

Maryland's divorcement statute³⁵ provides a typical example of divorcement legislation. The statute, in pertinent part, provides:

[A]fter July 1, 1974, no producer or refiner of petroleum products shall open a major brand, secondary brand or unbranded retail service station in the State of Maryland, and operate it with company personnel, a subsidiary company, commissioned agent, or under a contract with any person, firm or corporation, managing a service station on a fee arrangement with the producer or refiner. The station must be operated by a retail service station dealer.³⁶

The result of this provision is clear—if a company owns a refinery, it cannot participate directly in Maryland's retail gasoline market.

Delaware, another divorcement state, accomplished its goal of eliminating direct participation by larger, vertically integrated oil companies in the state's retail gasoline markets through a similar provision.³⁷ Section 2905(a) of the Delaware Code provides: "No manufacturer of petroleum products shall open a major brand, secondary brand or unbranded retail gasoline outlet or service station in the State, that would be operated by company personnel, a subsidiary company, or a commissioned agent."³⁸

³¹ For example, only five of the world's fifteen largest oil companies are American. Exxon, the largest American oil company, ranks third in comparison with other international oil companies. See *Only Five U.S. Oil Companies Among Top 15 In The World*, THE REUTER BUS. REP., Dec. 12, 1988.

³² J. Richard Shaner, *Is "Big Oil" Getting Bigger? Well, Yes and No; But Not Really; Growth of U.S. Oil Companies*, NAT'L PETROLEUM NEWS, November, 1991, at 42 (noting that while the assets of the fifteen largest American oil companies have increased sizably during the last twenty years, the level of concentration has declined by 16%).

³³ See *infra* notes 98-112 and accompanying text.

³⁴ For an outstanding collection of essays on the topic of vertical integration in the oil industry, see VERTICAL INTEGRATION IN THE OIL INDUSTRY, *supra* note 27.

³⁵ MD. ANN. CODE art. 56 § 157E(b) (1988).

³⁶ *Id.*

³⁷ See DEL. CODE ANN. tit. 6, § 2905 (Supp. 1990).

³⁸ *Id.*

Unlike the Maryland provision, the Delaware statute incorporates a peculiar "emergency" provision that can serve to nullify temporarily section 2905(a).³⁹ Section 2905(b) provides: "The Office of Retail Gasoline Sales shall adopt rules or regulations defining the circumstances in which a manufacturer may temporarily operate a service station in times of emergency or similar special circumstances."⁴⁰ This provision was used by the Court of Chancery of Delaware in *Atlantic Richfield Co. v. Tribbitt*⁴¹ to prevent the taking of Atlantic Richfield's property right in a station in danger of being abandoned by an independent lessee.⁴² The Court stated:

As to the argument that the statutes would deprive plaintiffs of property rights by prohibiting them from taking over the operation of a retail station in the event it should be abandoned by the independent retailer leasing it, it seems clear that the provisions of §2905(b) contemplate the adoption of administrative regulations authorizing operation by producers and refiners on a temporary basis "in times of emergency or similar special circumstances."⁴³

In addition to Maryland and Delaware, Connecticut, Virginia and the District of Columbia have enacted similar statutes.⁴⁴

Ironically, although these state laws regulate the level of vertical integration of a refiner, they make no attempt to bar integration and market concentration between the wholesale and retail markets by large jobbers. Jobbers clearly fall outside the scope of laws, such as the Delaware statute, that regulate the "manufacturer of petroleum products."⁴⁵ As a result, there is no obstacle restricting jobbers from integrating downward into retail service stations while the refiner, a major competitor, is removed from the marketplace. Although it is not argued that further regulation divorcing jobbers from their service stations should be implemented, such inconsistency must be considered when evaluating the effectiveness of divorcement statutes.

Little consideration has been given to the results of allowing jobbers a greater market concentration. Yet, numerous states and

³⁹ See *id.*

⁴⁰ *Id.*

⁴¹ 399 A.2d 535 (Del. Ch. 1977).

⁴² See *Atlantic Richfield Co. v. Tribbitt*, 399 A.2d 535, 545 (Del. Ch. 1977).

⁴³ *Id.*

⁴⁴ See Shaner, *supra* note 3, at 10.

⁴⁵ DEL. CODE ANN. tit. 6, § 2905(a).

the federal government have renewed their interest in regulatory responses which serve to accomplish similar goals. These states include Georgia, Hawaii, Iowa, Massachusetts, Missouri, New Mexico, New York, Oregon, Utah, and Texas.⁴⁶

III. DIVORCEMENT AND THE COURTS: CONSTITUTIONAL CHALLENGES TO STATE DIVORCEMENT LAWS

To date, two cases have presented constitutional challenges to state divorce laws: *Atlantic Richfield Co. v. Tribbitt*⁴⁷ and *Exxon Corp. v. Governor of Maryland*.⁴⁸

A. *Atlantic Richfield Co. v. Tribbitt*

In *Atlantic Richfield*, the plaintiffs sought a declaratory judgment from the Court of Chancery of Delaware, arguing that Delaware's divorce provision⁴⁹ was unconstitutional on a number of grounds:

[The Plaintiffs] contend . . . that the statutes deny them equal protection of the law [,] . . . conflict with the Commerce Clause . . . [and] violate the Supremacy Clause of the Federal Constitution. . . .⁵⁰

The plaintiffs also urged that the statute resulted in "a taking of property without just compensation"⁵¹ and also served to "impair the obligation of contracts in violation of Article 1, Section 10 of the Constitution."⁵² The court rejected all of the arguments in upholding the validity of the statute.⁵³

The court rejected the Commerce Clause argument presented by *Atlantic Richfield* because the Delaware act failed to affect the movement of petroleum products through the state.⁵⁴ In the words of the court:

[Section] 2905 and § 2906 do not violate the Commerce Clause . . . because they do not limit or affect the flow of gas into or

⁴⁶ See Shaner, *supra* note 3, at 10. None of the bills proposed in these states has yet come to a final vote.

⁴⁷ 399 A.2d 535 (Del. Ch. 1977).

⁴⁸ 437 U.S. 117 (1978).

⁴⁹ See *supra* notes 37-43 and accompanying text.

⁵⁰ *Atlantic Richfield*, 399 A.2d at 535.

⁵¹ *Id.*

⁵² *Id.*

⁵³ See *id.* at 549.

⁵⁴ See *id.* at 545.

out of the state; rather they only regulate an intrastate activity The effect of the legislation is not to protect Delaware business interests to the exclusion of out-of-state interests. . . .⁵⁵

The plaintiff's Supremacy Clause argument was based on the claim that the state's power to regulate retail marketing practices was preempted by both section 2(b) of the Clayton Act,⁵⁶ after amendment by the Robinson-Patman Act,⁵⁷ and the Emergency Petroleum Allocation Act of 1973.⁵⁸ The court, relying on the Maryland high court's analysis in *Governor of Maryland v. Exxon*,⁵⁹ held that the relevant text of the Robinson-Patman Act would not allow the type of conduct prohibited by the Delaware statute. Thus, there was "no conflict between the state and federal law [and therefore] no violation of the Supremacy Clause."⁶⁰ In reaching this conclusion, the Maryland court also relied on *FTC v. Sun Oil Co.*,⁶¹ which "concluded that the right to limited territorial price discrimination . . . under § 2(b) is not available . . . where a supplier reduces its price to its dealer so as to enable its dealer to meet the price of a competing dealer."⁶²

With respect to Atlantic Richfield's argument that the Delaware statute was preempted by the Emergency Petroleum Allocation Act of 1973, the court simply stated that a "federal act only preempts attempted state regulation which would be in actual conflict."⁶³ The court found no actual conflict between the state and federal statutes.⁶⁴

The court also refused to accept the plaintiff's argument that the statute amounted to a "taking of property without just compensation."⁶⁵ In making this argument, the oil company relied

⁵⁵ *Id.*

⁵⁶ 15 U.S.C. § 14 (1988) (current codification) (criminalizing price fixing, rebate schemes, and other monopolistic restraints on trade).

⁵⁷ 15 U.S.C. §§ 13-13c (1988) (current codification) (criminalizing price discrimination).

⁵⁸ Nonetheless, the Supreme Court has repeatedly held that this act does not reflect an intent of Congress for the federal government to become a price regulator. *See, e.g., Puerto Rico Dept. of Consumer Affairs v. Isla Petroleum Corp.*, 485 U.S. 495, 495 (1988).

⁵⁹ 370 A.2d 1102 (Md. 1977), *aff'd*, 437 U.S. 117 (1978).

⁶⁰ *Atlantic Richfield*, 399 A.2d at 546.

⁶¹ 371 U.S. 505 (1963).

⁶² *Atlantic Richfield*, 399 A.2d at 545-46 (construing *FTC v. Sun Oil Co.*, 371 U.S. 505 (1963)).

⁶³ *Id.* at 545.

⁶⁴ *See id.*

⁶⁵ *Id.*

heavily on its contractual right to assume the operation of abandoned retail stations.⁶⁶ Under the divorcement law, the company argued, such a contractual right would be lost.⁶⁷ After a close reading of the statute, the court rejected this argument. It held that in "special circumstances" an oil refiner would be able to assume temporarily the operation of abandoned sights under section 2905(b), which allows such activity "in times of emergency or similar special circumstances."⁶⁸

B. *Exxon Corp. v. Governor of Maryland*

The issues presented before the Court of Chancery of Delaware in *Atlantic Richfield* set the stage for a ruling by the United States Supreme Court the following year. The case that ultimately established the constitutionality of state divorcement laws was *Exxon Corp. v. Governor of Maryland*.⁶⁹

In response to Maryland's divorcement law,⁷⁰ numerous entities, including Exxon, Shell, Gulf Oil and Ashland Oil, brought suit against the Governor of Maryland in separate actions, claiming that the statute violated the Commerce Clause and the Due Process Clause of the United States Constitution.⁷¹ The separate appeals of six oil companies were consolidated and argued before the Supreme Court.⁷²

⁶⁶ See *id.*

⁶⁷ See *id.*

⁶⁸ See *supra* notes 39-43 and accompanying text. With respect to the plaintiffs' Fourteenth Amendment challenge, that the state abused its police power, the court held that the burden of proof was with Atlantic Richfield and that the "plaintiffs have [not] carried the burden required of them to establish the unconstitutionality of the enactments." *Atlantic Richfield*, 399 A.2d at 544-45.

As for the plaintiff's equal protection argument, the court found "that it can be reasonably conceived that factual necessity exists for prohibiting retail operations . . . by refiners in order to preserve . . . competition in the retail gasoline market." The Court found the divorcement statute to be an "approach [with a] . . . reasonable relationship to the prevention of the anticipated evil."

The problem with this analysis is that the law fails to make any attempt to curtail market concentration by jobbers after the enactment of the divorcement legislation. This calls into question the reasonableness of the statute in "preserv[ing] competition in the retail gasoline market." *Id.*

⁶⁹ 437 U.S. 117 (1978).

⁷⁰ See *supra* notes 35-36 and accompanying text.

⁷¹ See *Exxon*, 437 U.S. 117.

⁷² See *id.* at 122. Exxon instituted an action in the Circuit Court for Anne Arundel County and listed all other similar actions that were filed. The cases were then consolidated for trial. See *Governor of Maryland v. Exxon Corp.*, 370 A.2d 1102, 1106-7 (Md. 1977), *aff'd*, 437 U.S. 117 (1978).

The appellants argued that the act violated the Commerce Clause: "(1) by discriminating against interstate commerce; (2) by unduly burdening interstate commerce; and (3) by imposing controls on a commercial activity of such an essentially interstate character that it is not amenable to state regulation."⁷³ The Court rejected this argument in its entirety and concluded that states are not "without power to regulate in this area."⁷⁴ The Court relied heavily on the fact that the Act did not affect "interstate marketers . . . that own and operate their own retail gasoline stations."⁷⁵ The decision also noted that the Act would have no effect on interstate dealers that wished to participate in the state's retail gasoline market as long as "[the participant] do[es] not refine or produce gasoline."⁷⁶ In the words of the Court, "The fact that the burden of a state regulation falls on *some* interstate companies does not, by itself, establish a claim of discrimination against interstate commerce."⁷⁷

The Court also refused to find an impermissible burden on interstate commerce. Exxon based this allegation on the trial court's finding that as a result of the law, several refiners were exiting the Maryland products market entirely.⁷⁸ In rejecting this argument, the Court stated that although "[s]ome refiners may choose to withdraw entirely from the Maryland market[,] . . . there is no reason to assume that their share . . . will not be promptly replaced by other interstate refiners."⁷⁹ Finally, the Court rejected Exxon's argument that the cumulative effect of numerous state divorcement laws would affect national gasoline marketing efforts and therefore violate the Commerce Clause.⁸⁰ The Court found no support for the contention that the Commerce Clause "pre-empts the field of retail gas[oline] marketing."⁸¹

⁷³ *Exxon*, 437 U.S. at 125.

⁷⁴ *Id.* at 128-29.

⁷⁵ *Id.* at 125-26.

⁷⁶ *Id.* at 126.

⁷⁷ *Id.* (emphasis added). In reaching this conclusion, the Court noted in footnote 16 that the situation at issue in the case was distinguishable from the Court's decision in *Hunt v. Washington Apple Advertising Commission*, 432 U.S. 333, 347 (1977). In *Hunt*, a state statute enacted to increase the market share of goods produced within the state was found to violate the Commerce Clause. In *Exxon*, however, the Court found that because Maryland had no refining capacity of its own, the proportion of gasoline shipped in from out of state would remain the same. See *Exxon*, 437 U.S. at 126.

⁷⁸ *Exxon*, 437 U.S. at 127.

⁷⁹ *Id.*

⁸⁰ See *id.* at 128.

⁸¹ *Id.*

Further, the Court flatly rejected the substantive due process argument presented in *Exxon*,⁸² relying on the lower court's determination that Exxon's evidence concerning the irrationality of the act in light of the evidence that the presence of refiners in the retail market enhanced competition was merely an "evaluation of the economic wisdom of the statute."⁸³ Citing its 1963 opinion in *Ferguson v. Skrupa*,⁸⁴ the Court stated that the Due Process Clause does not allow the Court "to sit as a 'superlegislature to weigh the wisdom of legislation.'"⁸⁵

Although seven justices joined in the majority opinion, Justice Blackmun filed a well reasoned opinion in which he concurred in part and dissented in part.⁸⁶ Relying on numerous cases, including *Hunt v. Washington Apple Advertising Commission*,⁸⁷ *Halliburton Oil Well Co. v. Reily*,⁸⁸ *Dean Milk Co. v. Madison*,⁸⁹ and *Best & Co. v. Maxwell*,⁹⁰ Blackmun stated: "The Commerce Clause forbids discrimination against interstate commerce, which repeatedly has been held to mean that [s]tates . . . may not discriminate against the transactions of out-of-state actors in interstate markets."⁹¹

Focusing on the application of the *Hunt* decision to Maryland's divorcement statute, Blackmun noted: "If discrimination results from a statute, the burden falls upon the state or local government to demonstrate legitimate local benefits justifying the inequality and to show that less discriminatory alternatives cannot protect the local interests."⁹² Blackmun's concern is supported by the particular circumstances surrounding the *Exxon* case. First, although Maryland cited its interest in protecting its citizens from the harmful effects of purported "preferential treatment" during supply shortages,⁹³ its argument was weakened by the fact that only 36 of the 3,800⁹⁴ retail service stations in Maryland were operated by

⁸² See *id.* at 124-25.

⁸³ *Id.* at 124.

⁸⁴ 372 U.S. 726, 731 (1963).

⁸⁵ *Exxon*, 437 U.S. at 124.

⁸⁶ See *id.* at 134 (Powell, J., took no part in the consideration of these cases).

⁸⁷ 432 U.S. 333, 350-52 (1977).

⁸⁸ 373 U.S. 64, 69-73 (1963).

⁸⁹ 340 U.S. 349, 354 (1951).

⁹⁰ 311 U.S. 454, 455-56 (1940).

⁹¹ *Exxon*, 437 U.S. at 136.

⁹² *Id.*

⁹³ See *id.* at 121.

⁹⁴ See *id.* at 123.

Exxon, and these few were designed primarily to “test innovative marketing concepts or products.”⁹⁵ Furthermore, only five percent of retail service stations in Maryland were operated by refiners or affiliates when the statute was enacted.⁹⁶ Because of the tenuous connection between the intent of the statute and its actual effect on interstate commerce, Justice Blackmun, following *Dean Milk*, stated: “This Court does not . . . accept without analysis purported local interests. Instead, it independently identifies the character of the interests and judges for itself whether alternatives will be adequate.”⁹⁷

The *Exxon* court cleared a path for further enactment of state divorce laws by holding that such laws are constitutional. Nonetheless, the wisdom of such state legislative efforts is the subject of great debate.

IV. CONFLICTING VIEWPOINTS ON DIVORCEMENT LEGISLATION

A. *Arguments in Favor of Divorcement Legislation*

Advocates of forced divestment typically address two potential effects of continued participation by refiners in the retail gasoline market. First, according to such advocates, allowing refiners to continue direct participation in the retail gasoline market will cost consumers through higher prices. This higher cost will be facilitated by the increased market concentration and control over the retail gasoline market refiners will be able to amass over time.⁹⁸ Second, divorce advocates see the need to protect independent retailers from the “anticompetitive spirit . . . of the big oil companies.”⁹⁹

In support of these two arguments, divorce advocates cite the appearance of pricing anomalies, which characterize a wholesale price inversion, as indicating the desire of refiners to force jobbers out of business.¹⁰⁰ These advocates argue that the refiners seek to drive jobbers out of business in order to allow themselves to create

⁹⁵ *Id.* at 121 (footnote omitted).

⁹⁶ *Id.* at 123.

⁹⁷ *Id.* at 137.

⁹⁸ 137 CONG. REC. S13,194 (daily ed. Sept. 17, 1991) (testimony of Mr. Springer). Mr. Springer's statements were made in support of H.R. 2966, which is not a divorce bill, but a bill designed to ensure favorable pricing for jobbers. See *infra* notes 129-36 and accompanying text. But see *supra* note 32 and accompanying text.

⁹⁹ 137 CONG. REC. S13,194 (testimony of Mr. Springer).

¹⁰⁰ See *id.*

a "retail gasoline market monopol[y]." ¹⁰¹ Furthermore, it is hypothesized that the ultimate effects of uncontrolled retail marketing efforts on the part of refiners will include greater distances between service stations, and poorer overall service, especially in rural areas. ¹⁰²

Jobbers produce evidence of unfavorable pricing scenarios to support their position that refiners use anticompetitive tactics to force wholesalers out of business. ¹⁰³ For example, William Springer, treasurer-secretary of Lakeshore Oil and Tire Co. testified before the Senate Small Business Committee that on August 21, 1990, while Marathon was charging \$1.219 per gallon to consumers at its branded company operated outlets, his company was being charged \$1.2855 per gallon when it purchased gasoline in quantities as large as 8,000 gallons. ¹⁰⁴ The jobbers argue that refiners like Marathon are capable of engaging in such tactics because of their integration into market segments such as crude production. This contention is based on the theory that the retail operations of the refiner are "subsidized" by profits realized in the refiner's other operating segments. ¹⁰⁵

To further their arguments, jobbers focus on recent sales declines among wholesalers and independent retailers, citing a fourteen percent decline in sales by jobbers over the last four years while pointing to a corresponding increase in sales at refiner-operated service stations. ¹⁰⁶ Similar statistics display tremendous increases in the profits of refiners during the first quarter of 1991, which contrast with sizable declines in profits on the part of jobbers. ¹⁰⁷

In light of the recent flurry of legislative interest in divorcement laws and other measures to control the activities of refiners in retail markets, it is clear that the arguments supporting divorcement are not being made in vain. The positive reaction to these positions has not been limited to the states. ¹⁰⁸ Recently, bills have been

¹⁰¹ *Id.*

¹⁰² *See id.* (statement of Sen. Kasten).

¹⁰³ *See id.* (testimony of Mr. Springer).

¹⁰⁴ *See id.*

¹⁰⁵ *See id.*

¹⁰⁶ *See* 137 CONG. REC. E2639-40 (daily ed. July 22, 1991) (statement of Rep. Cooper).

¹⁰⁷ *See id.* at 2640.

¹⁰⁸ For a discussion of state enactments, see *supra* notes 35-46 and accompanying text.

introduced in both the Senate¹⁰⁹ and the House¹¹⁰ to address the issue.

The congressional bills approach the perceived problem from a different angle. For example, in the House version,¹¹¹ styled "The Petroleum Marketing Competition Enhancement Act," refiners are not banned from the retail market as they are in state divorcement statutes. Instead, they are subject to a pricing hierarchy under which they are mandated to charge a price no *lower* than a certain amount. Although these are not divorcement bills *per se*, the effect of the legislation would give jobbers the ability to price refiners out of the retail market.¹¹²

B. Arguments against Divorcement Legislation

The adverse effects of divorcement legislation on the consumer are often cited by oil refiners, policy analysts, and economists when arguing against such measures. Such criticism is further elevated by the fact that the primary goals of divorcement statutes, the preservation of competition¹¹³ and the prevention of consolidation within the retail gasoline markets,¹¹⁴ are being met naturally within the market. These market advocates point to the reality of modern retail gasoline marketing, which reveals that concentration ratios today are substantially below levels of the 1950s.¹¹⁵ In addition, although the Supreme Court upheld Maryland's divorcement law in *Exxon Corp. v. Governor of Maryland*,¹¹⁶ it recognized the potential harm to consumers caused by the statute, noting that "[i]t may be true that the consuming public will be injured by the loss of the high-volume, low-priced stations operated by the independent refiners."¹¹⁷

Another significant criticism of the advocates of divorcement statutes is that the timing of the attacks upon the oil industry seems

¹⁰⁹ See 60 Antitrust & Trade Reg. Rep. (BNA) 554 (1991) (bill introduced by Sen. Deconcini).

¹¹⁰ See 137 CONG. REC. at E2631 (bill introduced by Rep. Synar).

¹¹¹ H.R. 2966, 102d Cong., 1st Sess. (1991).

¹¹² See *infra* notes 130-36 and accompanying text.

¹¹³ See *Governor of Maryland v. Exxon Corp.*, 370 A.2d 1102, 1111 (1977), *aff'd*, 437 U.S. 117 (1978).

¹¹⁴ See 137 CONG. REC. S13,194 (daily ed. Sept. 17, 1991).

¹¹⁵ See Dougher & Hofmann, *Market Shares and Individual Company Data for U.S. Energy Markets: 1950-1989*, in AMERICAN PETROLEUM INSTITUTE DISCUSSION PAPER #014R, Oct. 1990, at 93.

¹¹⁶ 437 U.S. 117 (1978).

¹¹⁷ *Id.* at 128.

to suggest the presence of ulterior motives. In the words of economist Charles Doran, "We were especially conscious that the selection of the oil industry as target, the post-energy crisis timing, and the industrywide focus of divestiture suggest that this . . . is not an ordinary antitrust endeavor."¹¹⁸ Doran points to other factors suggesting that considerations other than "monopoly busting" are foremost in the minds of divorcement advocates. For example, Doran indicates that if reduction of market concentration were the true aim of divorcement advocates, it would appear to be more logical to attack far more concentrated industries like the steel, computer, aluminum and automotive industries.¹¹⁹ Furthermore, Doran argues that despite the pro-divorcement rally of the mid-70s, which sparked a debate in Congress, the "Senate hearings . . . produced no evidence of wrongdoing by the oil companies during the 1973 oil crisis . . . [and no evidence] turned up . . . that the oil companies had created the crisis or the subsequent oil shortage."¹²⁰ Finally, Doran claims that the public perception that oil company profits are "at an all-time high"¹²¹ supports the attack on major oil companies. To this, he responds that "[the belief] that current profitability is at an all-time high is but a myth."¹²²

Another attack against advocates of divorcement statutes is aimed at misconceptions surrounding the cause of wholesale price inversions. While regulation advocates argue that such inversion is caused by intentional activities on the part of oil refiners and that inversion itself is "[c]learly . . . indic[ative of] an anticompetitive spirit on the part of the big oil companies,"¹²³ free market economists cite a market force at work.

A recent work by Professor Philip E. Sorensen presents the latter position.¹²⁴ As the title, *An Economic Analysis of the Distributor-Dealer Wholesale Gasoline Price Inversion of 1990: The Effects of Different Contractual Relations*, suggests, Sorensen links the cause of the wholesale price inversion not to "Ghosts, Goblins, and Other Mysterious Creatures"¹²⁵ masquerading as oil executives,

¹¹⁸ CHARLES F. DORAN, MYTH, OIL, AND POLITICS 98 (1977).

¹¹⁹ See *id.* at 71.

¹²⁰ *Id.* at 50.

¹²¹ *Id.* at 69.

¹²² *Id.*

¹²³ 137 CONG. REC. S13,194 (testimony of Mr. Springer).

¹²⁴ See PHILIP E. SORENSON, AN ECONOMIC ANALYSIS OF THE DISTRIBUTOR-DEALER WHOLESALE GASOLINE PRICE INVERSION OF 1990: THE EFFECTS OF DIFFERENT CONTRACTUAL RELATIONS (1991).

¹²⁵ DORAN, *supra* note 118, at 5.

but to "the differing degrees of contractual price protection provided to buyers in . . . separate competitive markets."¹²⁶

As stated previously, during a wholesale price inversion the typical pricing hierarchy becomes inverted, resulting in retail prices at the pump being lower than jobber costs (DTW) and the spot market. Sorensen argues that the price inversion, which occurs during periods of rapidly escalating prices, stems from the natural inverse relationship between the strength of the contractual relationship and the lack of price protection. For example, lesseedealers of a refinery typically have the strongest contractual ties to refiners so it is logical that this group is the beneficiary of the greatest level of price protection. On the other hand, the spot market, which by definition involves a one time agreement to purchase or sell, carries no contractual obligation beyond the execution of the exchange. Clearly, in this relationship, no price protection can exist from one transaction to another. Between these two extremes lie the jobbers, who typically maintain a weak contractual relationship with several refiners.¹²⁷ According to Sorensen, these differing relationships result in the price inversion as crude supply price spikes reveal themselves more slowly to the refiner's dealers, who enjoy strong contractual ties with their supplier. With less price protection afforded jobbers, prices increase more rapidly, sometimes surpassing retail prices. Finally, the greatest volatility naturally occurs in the spot market where there is, by definition, no contractual price protection.¹²⁸

CONCLUSION

Although the arguments for government intervention on behalf of jobbers and consumers may have surface appeal, an overview of the arguments both for and against divorcement and other similar legislative tools leads to the conclusion that the debate is fueled more by the desire of market middlemen to ensure profit margins than by a desire to fight market concentration. This is particularly true of recent federal bills that serve primarily to guaranty jobbers a fixed minimum profit range.¹²⁹

¹²⁶ SORENSEN, *supra* note 124, at 6.

¹²⁷ See SORENSEN, *supra* note 124, at 3-6.

¹²⁸ See *id.* at 4-5.

¹²⁹ Both the House and Senate versions could serve to force refiners out of the retail gasoline market by requiring a minimum markup by refiners selling gasoline through refiner controlled retail service stations. In both bills, this minimum markup is based on the

This guaranteed profit floor is proposed in H.R. 2966, in its amendment to the Petroleum Marketing Practices Act.¹³⁰ The text of the proposed bill provides:

It shall be unlawful for a refiner to sell motor fuel, to any customer for resale, at a price which is higher than the refiner's adjusted retail price for the same or similar grade or quality of motor fuel sold from a direct operated outlet in the same geographic area.¹³¹

On its surface, this provision appears to do nothing more than give the jobber a statutory right to purchase gasoline at least as cheaply as the consumer. However, this is not the case. Deep in the bill's enforcement provision is a section establishing a prima facie case for violation of section 401(a).¹³² Section 403(d)(1)(A) allows for the establishment of a prima facie case when the jobber is charged more than "94 percent of [the refiner's] consumer retail price per gallon."¹³³ Furthermore, section 403(d)(1)(B) lowers this percentage to 90 percent if a "branded wholesaler" is involved.¹³⁴

Clearly, this bill seeks to provide jobbers with a tremendous competitive advantage, especially because a jobber typically "owns many of the stations he supplies."¹³⁵ Under this regulatory scheme, there exists the potential for extensive market perversion.¹³⁶

It is hoped that bills such as this will face an early demise. Typically, pointing fingers at large oil companies is a politically advantageous tactic. But, perhaps because this battle is being fought between separate segments within the oil industry, some elements of society have approached this "legislative solution" more cautiously. For example, after talks were initiated concerning the

prevailing rack price of each grade of gasoline. Even supporters of these bills acknowledge the great potential "that the margins [they] would establish might in effect become minimum markups, which would not be in the best interest of consumers." 137 CONG. REC. E2639, E2640 (daily ed. July 22, 1991) (statement of Rep. Cooper).

¹³⁰ 15 U.S.C. §§ 2801-2841 (1988).

¹³¹ H.R. 2966, 102d Cong., 1st Sess., § 401(a) (1991).

¹³² See *id.* at § 403(d).

¹³³ *Id.*

¹³⁴ See *id.*

¹³⁵ SORENSEN, *supra* note 124, at 3-4.

¹³⁶ For example, assume refiner A is selling gasoline retail for \$1.00 per gallon. This would establish, under § 403(d)(1)(A), a maximum unbranded wholesale price of \$.94 per gallon. In this scenario, there is nothing to prevent the jobber from selling gasoline through his own stations at \$.99 per gallon, undercutting the refiner's stations when the refiner is by law punished if he lowers his prices in an effort to compete. This scenario is highly likely to evolve if a bill such as H.R. 2966 becomes law.

introduction of such bills, North Carolina voters were informed by the press that elected officials were introducing legislation that would cost North Carolina constituents alone \$92 million per year.¹³⁷ Other studies by the federal government also have indicated that divorcement ultimately leads to higher consumer cost.¹³⁸

The evidence supports the determination that state divorcement laws and similar federal proposals primarily serve the product middleman at a great expense to the consumer. There is no evidence of a pronounced trend or a concerted effort on the part of oil refiners to use pricing tactics to force jobbers out of business. The call for divorcement is merely a call for subsidizing a product middleman's profits, and it is a call that, for the sake of efficiency and the consumer, should not be accepted.

Jeffrey L. Spears

¹³⁷ See *Thornburg Gasoline Plan Will Cost Tarheel Motorists \$92 Million More Each Year in Higher Prices*, PR NEWSWIRE, Sept. 7, 1990.

¹³⁸ See *Higher Gas Prices; Two Recent Government Reports Link Restrictive Gas Station Ownership Laws To Higher Consumer Prices*, BUS. WIRE, January 19, 1989.

