House Legislative Analysis Section

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OPEN SUPPLY FOR GASOLINE RETAILERS

House Bill 6012 with committee amendments
First Analysis (9-19-90)

Sponsor: Rep. James A. Kosteva
Committee: Transportation

THE APPARENT PROBLEM:

Like the gasoline price shocks of the early 1970s, Americans again face the prospect of high gasoline prices after recent tensions in the Middle East have sent the price of both crude oil and retail gasoline soaring. Since Iraq invaded the oil-rich country of Kuwait over six weeks ago the average price of retail gasoline in the state has risen over 25 cents per gallon (a 25 percent jump from before the invasion), following similar boosts in crude oil prices from just over $20 per barrel before the crisis to more than $30 per barrel today. While most people feared the invasion would affect the pump price for gasoline at some point, many are angered that prices went up so far so fast. The quick price hikes causes some to wonder if oil companies and/or retail sellers are not simply using the situation to artificially boost prices and, then, reap swift (and huge) profits. As it seems the crisis will not end soon, some people believe the state could help the situation by establishing a new system under which gasoline could be bought and sold by "franchised" retailers.

The buying and selling of refined crude oil (that is, gasoline) occurs within a complex network of relationships which are usually guided by contracts. Especially within a franchise, "franchisees" (retail sellers of a specific brand of oil) are required by the "franchisor" (the brand-name owner) to buy only from certain regional suppliers. Some people feel this puts franchised retail sellers at a competitive disadvantage by keeping them from "shopping" for the lowest price from a larger pool of wholesale sellers of the brand. (For instance, "jobbers" typically buy wholesale gasoline from among different brands and then sell to various buyers such as schools, farmers, service station dealers, and the like.) Also, as many oil companies now operate retail service stations themselves, some believe the franchise contractual system gives franchisor-operated dealers a competitive edge over franchisee-operated dealers, which impairs a free-market system within the oil industry — harming smaller businesses and, ultimately, consumers. Some people believe the contract between an oil franchisor and franchisee should not be allowed to dictate either the price at which the retailer must sell gasoline, or from where his or her supplies may be bought (as long as the company's brand is used).

THE CONTENT OF THE BILL:

The bill would create a new act to specify that, notwithstanding the terms of a franchise agreement between an oil franchisor and franchisee, a franchisor could not 1) set the retail price at which the gasoline retailer would have to sell motor fuel or 2) require the franchisee to purchase motor fuel from a specific distributor of the franchisor's brand of motor fuel, except to limit purchases to the franchisor's motor fuel. A person who violated these provisions would be guilty of a misdemeanor and could be imprisoned for up to 90 days or fined up to $500, or both. Also, the Department of Agriculture would have to promulgate rules establishing an auditing mechanism designed to ensure both the gasoline's "purity and integrity" and that it was "of the same brand."

FISCAL IMPLICATIONS:

Fiscal information is not available.

ARGUMENTS:

For:

Allowing franchisees latitude in choosing who they could buy gasoline from and in determining their own selling price could be advantageous for the following reasons:

- Franchisees would be free to shop different wholesale sellers for the best wholesale price of gasoline and pass their savings on to consumers. The market for refined crude is large and complex and involves many different sources. As the primary refiner, an oil company usually supplies its own franchised dealers as well as others. Other independent "jobbers" buy wholesale gasoline from refineries and then sell it for profit at slightly higher prices to other wholesale buyers. Depending on variables within any region, jobbers may be able to offer better deals than those offered by distributors designated by a franchisor as the sources for its franchisees. Franchised retailers, however, would still have to buy the franchise brand, thus ensuring franchisors (and their customers). that a franchisee's supplies met the standards expected from the brand.
- The tremendous economic and political influence of oil companies has worked to shift market forces in their favor at the expense of both smaller businesses and consumers. From the extraction of crude oil from the earth to the retail sale of the final refined product, oil companies have become more involved in every aspect of oil production and sales. Since the 1970s, many oil companies have begun to operate their own franchised dealers which, though it may seem odd, directly compete with their franchisee-owned retail sellers. Some people believe this comprehensive involvement of "big" oil in all areas of the industry threatens free-market forces that guide retail prices for gasoline. Not only can the influence of franchisors push up the market price of fuel, their position at all levels of the industry can be used to weaken smaller retail operators, making it hard for these retailers to stay afloat. As the industry slowly moves into the hands of a few, market forces tend to have little impact on determining prices. The bill would give franchisees the ability to search for the best deals and, thus, could let open competition help keep prices at current levels if not driving them lower. Also, a franchisor found guilty of violating the bill's provisions could be punished by up to 90 days in prison, a $500 fine, or both.

OVER

- The provision requiring the Department of Agriculture to develop an auditing system that could ensure a brand's integrity would help franchisors better regulate the purity of gasoline sold by their franchisees. Apparently, even now many franchisees will buy other cheaper brands and mix these with the franchise brand in order to reduce costs. The brand's octane quality is thus compromised and customers are misled in what they are purchasing. Recent studies by the General Accounting Office have shown the level of octane in pumped gasoline by franchised retailers is generally lower than the advertised level.

Against:

Various arguments have been raised against the bill:

- Supply shortages could result in areas throughout the state as certain distributors suddenly could become the source for a larger number of retailers. With local supplies diminished and demand higher, retail prices could actually go up, albeit temporarily, as buyers and sellers tried to adjust to new market conditions that could constantly change. Oil companies now try to tie retailers with distributors by locale in order to save on shipping costs. Though some individual retailers could find better deals in some markets, the bill could hurt the overall industry in the state.
- Service station employees could lose their jobs as new market forces could hurt retailers in some areas. Though it is difficult to determine how particular markets might react to the bill, the overall impact could be negative (especially if the price of gasoline continues to rise, and the economy gets worse). In fact, the bill cannot guarantee that prices will either stay the same or decrease. Even if some retailers were able to get better deals, they could simply choose to keep what they saved rather than passing savings on to customers. As the economy (and especially the stability of gas prices) continues to be threatened, it may not be wise now to infuse a new set of conditions into the state's system of gasoline distribution. The bill represents a radical departure from the way oil companies attempt to stabilize local markets by setting boundaries for distributors who supply gasoline retailers.
- Though many other states and the federal government have proposed similar legislation, few have actually adopted such measures. The issue should be studied further to assess just what type of impact this has had in other states and how it could affect Michigan specifically.

POSITIONS:

Representatives of the following testified before the House Committee on Transportation in support of the bill (9-18-90):

The Department of Treasury
The Service Station Dealers Association of Michigan

Representatives of the following testified in opposition to the bill:

Marathon Oil Company
Amoco Oil Company
Mobil Oil Company

The Michigan Petroleum Association opposes the bill. (9-18-90)

The Michigan Association of Convenience Stores opposes the bill. (9-18-90)