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United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs, Committee on Government Reform, House of Representatives

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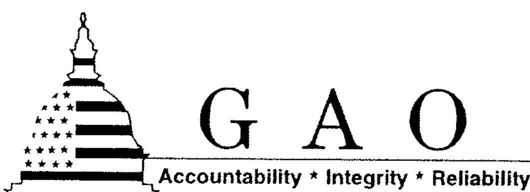
ENERGY MARKETS

Mergers and Many Other Factors Affect U.S. Gasoline Markets

Statement of Jim Wells, Director
Natural Resources and Environment



GAO-04-951T

July 7, 2004

Highlights of GAO-04-951T, a report to Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs, Committee on Government Reform, House of Representatives

ENERGY MARKETS

Mergers and Many Other Factors Affect U.S. Gasoline Markets

Why GAO Did This Study

Gasoline is subject to dramatic price swings. A multitude of factors cause volatility in U.S. gasoline markets, including world crude oil costs, limited refining capacity, and low inventories relative to demand.

Since the 1990s, another factor affecting U.S. gasoline markets has been a wave of mergers in the petroleum industry, several of them between large oil companies that had previously competed with each other. For example, in 1999, Exxon, the largest U.S. oil company, merged with Mobil, the second largest.

This testimony is based primarily on [illegible] (GAO-04-96, May 17, 2004). This report examined mergers in the U.S. petroleum industry from the 1990s through 2000, the changes in market concentration (the distribution of market shares among competing firms) and other factors affecting competition in the U.S. petroleum industry, how U.S. gasoline marketing has changed since the 1990s, and how mergers and market concentration in the U.S. petroleum industry have affected U.S. gasoline prices at the wholesale level.

To address these issues, GAO purchased and analyzed a large body of data and developed state-of-the art econometric models for isolating the effects of eight specific mergers and increased market concentration on wholesale gasoline prices. Experts peer-reviewed GAO's analysis.

www.gao.gov/cgi-bin/getrpt?GAO-04-951T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Jim Wells at (202) 512-3841 or wellsj@gao.gov.

What GAO Found

One of the many factors that can impact gasoline prices is mergers within the U.S. petroleum industry. Over 2,600 such mergers have occurred since the 1990s. The majority occurred later in the period, most frequently among firms involved in exploration and production. Industry officials cited various reasons for the mergers, particularly the need for increased efficiency and cost savings. Economic literature also suggests that firms sometimes merge to enhance their ability to control prices.

Partly because of the mergers, market concentration has increased in the industry, mostly in the downstream (refining and marketing) segment. For example, market concentration in refining increased from moderately to highly concentrated on the East Coast and from unconcentrated to moderately concentrated on the West Coast. Concentration in the wholesale gasoline market increased substantially from the mid-1990s so that by 2002, most states had either moderately or highly concentrated wholesale gasoline markets. On the other hand, market concentration in the upstream (exploration and production) segment remained unconcentrated by the end of the 1990s. Anecdotal evidence suggests that mergers also have changed other factors affecting competition, such as firms' ability to enter the market.

Two major changes have occurred in U.S. gasoline marketing related to mergers, according to industry officials. First, the availability of generic gasoline, which is generally priced lower than branded gasoline, has decreased substantially. Second, refiners now prefer to deal with large distributors and retailers, which has motivated further consolidation in distributor and retail markets.

Based on data from the mid-1990s through 2000, GAO's econometric analyses indicate that mergers and increased market concentration generally led to higher wholesale gasoline prices in the United States. Six of the eight mergers GAO modeled led to price increases, averaging about 2 cents per gallon. Increased market concentration, which reflects the cumulative effects of mergers and other competitive factors, also led to increased prices in most cases. For conventional gasoline, the predominant type used in the country, the change in wholesale price due to increased market concentration ranged from a decrease of about 1 cent per gallon to an increase of about 5 cents per gallon. For boutique fuels sold in the East Coast and Gulf Coast regions, wholesale prices increased by about 1 cent per gallon, while prices for boutique fuels sold in California increased by over 7 cents per gallon. GAO also identified price increases of one-tenth of a cent to 7 cents that were caused by other factors included in the models—particularly low gasoline inventories relative to demand, high refinery capacity utilization rates, and supply disruptions in some regions.

FTC disagreed with GAO's methodology and findings. However, GAO believes its analyses are sound.

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to participate in discussing issues related to the volatility of U.S. gasoline markets. According to data from the Energy Information Administration (EIA), the average nationwide price paid for regular gasoline (the type of gasoline used most in the United States) at the pump was as high as $2.06 cents/gallon by the end of May 2004, an increase of about 58 cents/gallon or 39 percent over the same time last year. On the West Coast, gasoline prices reached an average of $2.34 cents/gallon by the end of May 2004, an increase of about 65 cents/gallon or 38 percent over the same time last year. Although prices have recently begun to fall, elevated gasoline prices can be an economic burden to American consumers and the economy.

A broad range of factors affects the volatility of gasoline prices. These factors typically include changes in crude oil costs, limited refinery capacity, inventory levels relative to demand, supply disruptions, and regulatory factors—such as the many different gasoline formulations that are required to meet varying federal and state environmental laws. Federal and state taxes are also a component of U.S. gasoline prices, but these do not fluctuate often. We have addressed many of these issues in several studies on energy markets. Among other things, our past studies showed that

- the U.S. economy is vulnerable to oil supply disruptions that can impose significant economic costs, and in our report options were identified to mitigate their effects;
- the Clean Air Act specifically requires refiners to produce reformulated gasoline, and the requirement to provide a specific blend for a specific area can present challenges to refiners and other suppliers if there are supply disruptions;
- gasoline price spikes were generally higher in California from January 1995 through December 1999 than in the rest of the nation, partly because of the difficulty in substituting for the loss of supply of CARB, the special reformulated gasoline used in California, when there were unplanned refinery outages;
- retail gasoline prices in California rose faster than they fell in response to a delayed pass-through in changes in the wholesale price of gasoline;

- as we testified in 2001, each day vehicles in the United States consume about 10 million barrels of petroleum fuels, primarily gasoline and diesel, and according to projections, the figure will rise to about 15 million barrels per day by 2010, raising concerns about the nation's ability to satisfy this growing demand;
- the transportation sector is more than 90 percent dependent on petroleum-based fuels, such as gasoline, and this dependence contributes to our vulnerability to oil supply disruptions and related price shocks; and
- existing federal programs to promote alternative fuel vehicles and alternative fuel use in the transportation sector have faced significant barriers.

Market consolidation is another factor that can affect the price of gasoline. Our testimony today will focus on our recent study that examined the effects of market consolidation and other factors on the U. S. petroleum industry.[1]

Since the 1990s, the U.S. petroleum industry has experienced a wave of mergers, acquisitions, and joint ventures, several of them between large oil companies that had previously competed with each other for the sale of petroleum products.[2] A few examples include the merger between British Petroleum (BP) and Amoco in 1998 to form BPAmoco, which later merged with ARCO, and the merger in 1999 between Exxon, the largest U.S. oil company, and Mobil, the second largest. In general, mergers raise concerns about potential anticompetitive effects on the U.S. petroleum industry and ultimately on gasoline prices because mergers could result in greater market power for the merged companies, potentially allowing

[1]See U.S. General Accounting Office, *Energy Markets: Effects of Mergers and Market Concentration in the U.S. Petroleum Industry*, GAO-04-96 (Washington, D.C., May 17, 2004). Additional related GAO studies include *U.S. Ethanol Market: MTBE Ban in California*, GAO-02-440R (Washington, D.C., Feb. 27, 2002); *Alternative Motor Fuels and Vehicles: Impact on the Transportation Sector*, GAO-01-957T (Washington, D.C., July 10, 2001); *Motor Fuels: California Gasoline Price Behavior*, GAO/RCED-96-121 (Washington, D.C., Apr. 28, 2000); *International Energy Agency: How the Agency Prepares Its World Market Statistics*, GAO/RCED-99-142 (Washington, D.C., May 7, 1999); and *Energy Security: Evaluating U.S. Vulnerability to Oil Supply Disruptions and Options for Mitigating Their Effects*, GAO/RCED-97-6 (Washington, D.C., Dec. 12, 1996).

[2]We refer to all of these transactions as mergers.

them to increase prices above competitive levels.[3] On the other hand, mergers could also yield cost savings and efficiency gains, which may be passed on to consumers in lower prices. Ultimately, the impact depends on whether market power or efficiency dominates.

Our report examined mergers in the U.S. petroleum industry from the 1990s through 2000, the changes in market concentration (the distribution of market shares among competing firms) and other factors affecting competition in the U.S. petroleum industry, how U.S. gasoline marketing has changed since the 1990s, and how mergers and market concentration in the U.S. petroleum industry have affected U.S. gasoline prices at the wholesale level.

To address these issues, we purchased and analyzed a large body of data on mergers and wholesale gasoline prices, as well as data on other relevant economic factors. We also developed econometric models for examining the effects of eight specific mergers and increased market concentration on U.S. wholesale gasoline prices nationwide. It is noteworthy that using econometric models allowed us to measure the effects of mergers and market concentration while isolating the effects of several other factors that could influence wholesale gasoline prices, such as world crude oil costs, limited refining capacity, or low inventories relative to demand.

In the course of our work, we consulted with Dr. Severin Borenstein,[4] a recognized expert in the modeling of gasoline markets; interviewed officials across the industry spectrum; and reviewed relevant economic literature and numerous related studies. We also used an extensive peer review process to obtain comments from experts in academia and relevant government agencies. We conducted our work in accordance with generally accepted government auditing standards.

In summary, we found the following:

[3]The Federal Trade Commission and Department of Justice have defined market power for a seller as the ability to profitably maintain prices above competitive levels for a significant period of time.

[4]Dr. Borenstein is E.T. Grether Professor of Business Administration and Public Policy at the Haas School of Business, University of California, Berkeley. He is also the Director of the University of California Energy Institute.

- Over 2,600 mergers occurred in the petroleum industry from 1991 through 2000. The majority of the mergers occurred during the second half of the decade, most frequently in the upstream (exploration and production) segment of the industry. Petroleum industry officials cited various reasons for this wave of mergers, particularly the need for increased efficiency and cost savings. Economic literature suggests that firms also sometimes use mergers to enhance their market power. Ultimately, the reasons cited by both sources generally relate to the merging companies' desire to maximize profit or shareholder wealth.

- Market concentration, which is commonly measured by the Herfindahl-Hirschman Index (HHI), has increased in the downstream (refining and marketing) segment of the U.S. petroleum industry since the 1990s, partly as a result of merger activities, while changing very little in the upstream (exploration and production) segment. In the downstream segment, market concentration in refining increased from moderately to highly concentrated on the East Coast and from unconcentrated to moderately concentrated on the West Coast; it increased but remained moderately concentrated in the Rocky Mountain region. Concentration in the wholesale gasoline market increased substantially from the mid-1990s so that by 2002, most states had either moderately or highly concentrated wholesale gasoline markets. On the other hand, market concentration decreased somewhat in the upstream segment and remained unconcentrated by the end of the 1990s. Anecdotal evidence suggests that mergers also have affected other factors that impact competition, such as the ability of new firms to enter the market.

- According to industry officials, two major changes have occurred in U.S. gasoline marketing since the 1990s, partly related to mergers. First, the availability of unbranded (generic) gasoline has decreased substantially. Unbranded gasoline is generally priced lower than branded gasoline, which is marketed under the refiner's trademark. Industry officials generally attributed the decreased availability of unbranded gasoline to, among other factors, a reduction in the number of independent refiners that typically supply unbranded gasoline. Second, industry officials said that refiners now prefer dealing with large distributors and retailers. This preference, according to the officials, has motivated further consolidation in both the distributor and retail markets, including the rise of hypermarkets—a relatively new breed of gasoline market participants that includes such large retail warehouses as Wal-Mart and Costco.

- Our econometric analyses, using data from the mid-1990s through 2000, show that oil industry mergers generally led to higher wholesale gasoline prices (measured in our report as wholesale prices less crude oil prices),

although prices sometimes decreased. Six of the eight specific mergers we modeled—which mostly involved large, fully vertically integrated companies—generally resulted in increases in wholesale prices for branded and/or unbranded gasoline of about 2 cents per gallon, on average. Two of the mergers generally led to price decreases, of about 1 cent per gallon, on average. For conventional gasoline—the predominant type used in the United States except in areas that require special gasoline formulations—the change in wholesale price ranged from a decrease of about 1 cent per gallon to an increase of about 5 cents per gallon. The preponderance of price increases over decreases indicates that the market power effects, which tend to increase prices, for the most part outweighed the efficiency effects, which tend to decrease prices.

- Our econometric analyses also show that increased market concentration, which captures the cumulative effects of mergers as well as other market structure factors, also generally led to higher prices for conventional gasoline and for boutique fuels—gasoline that has been reformulated for certain areas in the East Coast and Gulf Coast regions and in California to lower pollution. The price increases were particularly large in California, where they averaged about 7 cents per gallon. Higher wholesale gasoline prices were also a result of other factors: low gasoline inventories, which typically occur in the summer driving months; high refinery capacity utilization rates; and supply disruptions, which occurred in the Midwest and on the West Coast.

- We also identified price increases of one-tenth of 1 cent to 7 cents per gallon that were caused by other factors included in our models—particularly low gasoline inventories relative to demand, high refinery capacity utilization rates, and supply disruptions that occurred in some regions.

As I noted earlier, we used extensive peer review to obtain comments from outside experts, including the Federal Trade Commission (FTC) and EIA, and we incorporated those comments as appropriate. FTC disagreed with our methodology and findings and provided extensive comments, which we have addressed in our report. Our findings are generally consistent with previous studies of the effects of specific oil mergers and of market concentration on gasoline prices. We believe, however, that ours is the first comprehensive study to model the impact of the industry's 1990s wave of mergers on wholesale gasoline prices for the entire United States, an effort that required us to acquire large datasets and perform complex analyses.

Background

Many firms of varying sizes make up the U.S. petroleum industry. While some firms engage in only limited activities within the industry, such as exploration for and production of crude oil and natural gas or refining crude oil and marketing petroleum products, fully vertically integrated oil companies participate in all aspects of the industry. Before the 1970s, major oil companies that were fully vertically integrated controlled the global network for supplying, pricing, and marketing crude oil. However, the structure of the world crude oil market has dramatically changed as a result of such factors as the nationalization of oil fields by oil-producing countries, the emergence of independent oil companies, and the evolution of futures and spot markets in the 1970s and 1980s. Since U.S. oil prices were deregulated in 1981, the price paid for crude oil in the United States has been largely determined in the world oil market, which is mostly influenced by global factors, especially supply decisions of the Organization of Petroleum Exporting Countries (OPEC) and world economic and political conditions.

The United States currently imports over 60 percent of its crude oil supply. In contrast, the bulk of the gasoline used in the United States is produced domestically. In 2001, for example, gasoline refined in the United States accounted for over 90 percent of the total domestic gasoline consumption. Companies that supply gasoline to U.S. markets also post the domestic gasoline prices. Historically, the domestic petroleum market has been divided into five regions: the East Coast region, the Midwest region, the Gulf Coast region, the Rocky Mountain region, and the West Coast region.[5]

Proposed mergers in all industries, including the petroleum industry, are generally reviewed by federal antitrust authorities—including FTC and the Department of Justice (DOJ)—to assess the potential impact on market competition. According to FTC officials, FTC generally reviews proposed mergers involving the petroleum industry because of the agency's expertise in that industry. FTC analyzes these mergers to determine if they would likely diminish competition in the relevant markets and result in harm, such as increased prices. To determine the potential effect of a merger on market competition, FTC evaluates how the merger would change the level of market concentration, among other things. Conceptually, the higher the concentration, the less competitive the market is and the more likely that firms can exert control over prices. The

[5]These regions are known as Petroleum Administration for Defense Districts (PADDs).

ability to maintain prices above competitive levels for a significant period of time is known as market power.

According to the merger guidelines jointly issued by DOJ and FTC, market concentration as measured by HHI is ranked into three separate categories: a market with an HHI under 1,000 is considered to be unconcentrated; if HHI is between 1,000 and 1,800 the market is considered moderately concentrated; and if HHI is above 1,800, the market is considered highly concentrated. [6]

While concentration is an important aspect of market structure—the underlying economic and technical characteristics of an industry—other aspects of market structure that may be affected by mergers also play an important role in determining the level of competition in a market. These aspects include barriers to entry, which are market conditions that provide established sellers an advantage over potential new entrants in an industry, and vertical integration.

Mergers Occurred in All Segments of the U.S. Petroleum Industry in the 1990s for Several Reasons

Over 2,600 merger transactions occurred from 1991 through 2000 involving all three segments of the U.S. petroleum industry. Almost 85 percent of the mergers occurred in the upstream segment (exploration and production), while the downstream segment (refining and marketing of petroleum) accounted for about 13 percent, and the midstream segment (transportation) accounted for over 2 percent. The vast majority of the mergers—about 80 percent—involved one company's purchase of a segment or asset of another company, while about 20 percent involved the acquisition of a company's total assets by another so that the two became one company. Most of the mergers occurred in the second half of the decade, including those involving large partially or fully vertically integrated companies.

Petroleum industry officials and experts we contacted cited several reasons for the industry's wave of mergers in the 1990s, including achieving synergies, increasing growth and diversifying assets, and reducing costs. Economic literature indicates that enhancing market power is also sometimes a motive for mergers. Ultimately, these reasons mostly relate to companies' desire to maximize profit or stock values.

[6] HHI is calculated by summing the squares of the market shares of all the firms within a given market.

Mergers Contributed to Increases in Market Concentration and to Other Changes That Affect Competition

Mergers in the 1990s contributed to increases in market concentration in the downstream segment of the U.S. petroleum industry, while the upstream segment experienced little change overall. We found that market concentration, as measured by the HHI, decreased slightly in the upstream segment, based on crude oil production activities at the national level, from 290 in 1990 to 217 in 2000. Moreover, based on benchmarks established jointly by DOJ and FTC, the upstream segment of the U.S. petroleum industry remained unconcentrated at the end of the 1990s.

The increases in market concentration in the downstream segment varied by activity and region.

- For example, the HHI of the refining market in the East Coast region increased from a moderately concentrated level of 1136 in 1990 to a highly concentrated level of 1819 in 2000. In the Rocky Mountain and the West Coast regions, it increased from 1029 to 1124 and from 937 to 1267, respectively, in that same period. Thus, while each of these refining markets increased in concentration, the Rocky Mountain remained within the moderately concentrated range but the West Coast changed from unconcentrated in 1990 to moderately concentrated in 2000. The HHI of refining markets also increased from 699 to 980 in the Midwest and from 534 to 704 in the Gulf Coast during the same period, although these markets remained unconcentrated.
- In wholesale gasoline markets, market concentration increased broadly throughout the United States between 1994 and 2002. Specifically, we found that 46 states and the District of Columbia had moderately or highly concentrated markets by 2002, compared to 27 in 1994.

In both the refining and wholesale markets of the downstream segment, merger activity and market concentration were highly correlated for most regions of the country.

Evidence from various sources indicates that, in addition to increasing market concentration, mergers also contributed to changes in other aspects of market structure in the U.S. petroleum industry that affect competition—specifically, vertical integration and barriers to entry. However, we could not quantify the extent of these changes because of a lack of relevant data.

Vertical integration can conceptually have both pro- and anticompetitive effects. Based on anecdotal evidence and economic analyses by some

industry experts, we determined that a number of mergers that have occurred since the 1990s have led to greater vertical integration in the U.S. petroleum industry, especially in the refining and marketing segment. For example, we identified eight mergers that occurred between 1995 and 2001 that might have enhanced the degree of vertical integration, particularly in the downstream segment.

Concerning barriers to entry, our interviews with petroleum industry officials and experts provide evidence that mergers had some impact on the U.S. petroleum industry. Barriers to entry could have implications for market competition because companies that operate in concentrated industries with high barriers to entry are more likely to possess market power. Industry officials pointed out that large capital requirements and environmental regulations constitute barriers for potential new entrants into the U.S. refining business. For example, the officials indicated that a typical refinery could cost billions of dollars to build and that it may be difficult to obtain the necessary permits from the relevant state or local authorities. At the wholesale and retail marketing levels, industry officials pointed out that mergers might have exacerbated barriers to entry in some markets. For example, the officials noted that mergers have contributed to a situation where pipelines and terminals are owned by fewer, mostly integrated companies that sometimes deny access to third-party users, especially when supply is tight—which creates a disincentive for potential new entrants into such wholesale markets.

U.S. Gasoline Marketing Has Changed in Two Major Ways

According to some petroleum industry officials that we interviewed, gasoline marketing in the United States has changed in two major ways since the 1990s. First, the availability of unbranded gasoline has decreased, partly due to mergers. Officials noted that unbranded gasoline is generally priced lower than branded. They generally attributed the decreased availability of unbranded gasoline to one or more of the following factors:

- There are now fewer independent refiners, who typically supply mostly unbranded gasoline. These refiners have been acquired by branded companies, have grown large enough to be considered a brand, or have simply closed down.
- Partially or fully vertically integrated oil companies have sold or mothballed some refineries. As a result, some of these companies now have only enough refinery capacity to supply their own branded needs, with little or no excess to sell as unbranded.

- Major branded refiners are managing their inventory more efficiently, ensuring that they produce only enough gasoline to meet their current branded needs.

We could not quantify the extent of the decrease in the unbranded gasoline supply because the data required for such analyses do not exist.

The second change identified by these officials is that refiners now prefer dealing with large distributors and retailers because they present a lower credit risk and because it is more efficient to sell a larger volume through fewer entities. Refiners manifest this preference by setting minimum volume requirements for gasoline purchases. These requirements have motivated further consolidation in the distributor and retail sectors, including the rise of hypermarkets.

Mergers and Increased Market Concentration Generally Led to Higher U.S. Wholesale Gasoline Prices

Our econometric modeling shows that the mergers we examined mostly led to higher wholesale gasoline prices in the second half of the 1990s. The majority of the eight specific mergers we examined—Ultramar Diamond Shamrock (UDS)-Total, Tosco-Unocal, Marathon-Ashland, Shell-Texaco I (Equilon), Shell-Texaco II (Motiva), BP-Amoco, Exxon-Mobil, and Marathon Ashland Petroleum (MAP)-UDS—resulted in higher prices of wholesale gasoline in the cities where the merging companies supplied gasoline before they merged. The effects of some of the mergers were inconclusive, especially for boutique fuels sold in the East Coast and Gulf Coast regions and in California.

- For the seven mergers that we modeled for conventional gasoline, five led to increased prices, especially the MAP-UDS and Exxon-Mobil mergers, where the increases generally exceeded 2 cents per gallon, on average.
- For the four mergers that we modeled for reformulated gasoline, two—Exxon-Mobil and Marathon-Ashland—led to increased prices of about 1 cent per gallon, on average. In contrast, the Shell-Texaco II (Motiva) merger led to price decreases of less than one-half cent per gallon, on average, for branded gasoline only.
- For the two mergers—Tosco-Unocal and Shell-Texaco I (Equilon)—that we modeled for gasoline used in California, known as California Air Resources Board (CARB) gasoline, only the Tosco-Unocal merger led to price increases. The increases were for branded gasoline only and exceeded 6 cents per gallon, on average.

For market concentration, which captures the cumulative effects of mergers as well as other competitive factors, our econometric analysis shows that increased market concentration resulted in higher wholesale gasoline prices.

- Prices for conventional (non-boutique) gasoline, the dominant type of gasoline sold nationwide from 1994 through 2000, increased by less than one-half cent per gallon, on average, for branded and unbranded gasoline. The increases were larger in the West than in the East—the increases were between one-half cent and one cent per gallon in the West, and about one-quarter cent in the East (for branded gasoline only), on average.

- Price increases for boutique fuels sold in some parts of the East Coast and Gulf Coast regions and in California were larger compared to the increases for conventional gasoline. The wholesale prices increased by an average of about 1 cent per gallon for boutique fuel sold in the East Coast and Gulf Coast regions between 1995 and 2000, and by an average of over 7 cents per gallon in California between 1996 and 2000.

Our analysis shows that wholesale gasoline prices were also affected by other factors included in the econometric models—particularly, gasoline inventories relative to demand, refinery capacity utilization rates, and the supply disruptions that occurred in some parts of the Midwest and the West Coast. In particular, wholesale gasoline prices were about 1 cent per gallon higher, on average, when gasoline inventories were low relative to demand, typically in the summer driving months. Also, prices were higher by about an average of one-tenth to two-tenths of 1 cent per gallon when refinery capacity utilization rates increased by 1 percent. The prices of conventional gasoline were about 4 to 5 cents per gallon higher, on average, during the Midwest and West Coast supply disruptions. The increase in prices for CARB gasoline was about 4 to 7 cents per gallon, on average, during the West Coast supply disruptions.

Mr. Chairman, this concludes my prepared statement. I would be happy to respond to any questions that you or other Members of the Subcommittee may have.

GAO Contact and Staff Acknowledgments

For further information about this testimony, please contact me at (202) 512-3841. Key contributors to this testimony included Godwin Agbara, Scott Farrow, John A. Karikari, and Cynthia Norris.

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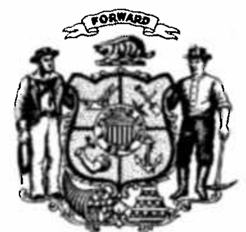


Senate Hearing
Unfair Sales Act
June 1, 2005

Dear Senators,

My name is Dave Hegenbarth. I'm a first generation small businessman, living the American Dream right here in Wisconsin. I bought my first retail grocery store in 1993, and as recently as a year ago I owned 6 small independent grocery stores, 5 in Western Wisconsin and 1 in Iowa.

I am very passionate about this issue because my dream has been altered considerably by what I consider to be the driving force behind Senate Bill 215, Mega-size business.

In 2003 Fleming Co. our supplier, the largest grocery wholesaler in the country declared bankruptcy and closed their La Crosse Distribution Center costing us hundreds of thousands of dollars. Like most small businesses we have also dealt with competitive changes in our markets like the entry of 4 Super Wal-Mart's in the last year and a half.

I now have only 4 grocery stores and live with the fact that I failed 100 employees and their families who relied on me, and trusted me for their livelihood.

In December of last year I built a small independent convenience store with gas pumps in Galesville Wisconsin just north of La Crosse.

So as you consider Senate Bill 215 please hear my thoughts.

There is an undeniable disconnect between government and small business. When convenient we hear and read local, state and federal representatives praise small business as the true catalyst of job growth. Small business the innovators, the daring entrepreneurs, the backbone of America.
Small business competing in the most dangerous, competitive cut-throat environment in history.

What you never read about is small business asking or expecting State or Local Governments for things. Things like millions of dollars in road

improvements, or concessions to help building projects or supplements to poor benefit packages. Small business relies on ingenuity and hard work. They ask the State for one thing a level playing field. They don't ask the taxpayer for anything at all.

You constantly read about small business as the community partner, the backbone of service organizations from the Chamber of Commerce to the PTO, the School Board, the Lions Club, Rotary, and Kiwanis, from the Boy Scouts, Girl Scouts, United Way and all in between. Small business truly fights the good fight, pays its own way often without recognition, without appreciation and in cases like this without sincere consideration.

Senator, your planned elimination of minimum markup will only lower gas prices for the short term. When you eliminate the protection of minimum mark up you will be responsible for advancing the elimination of small business. You will eliminate locations, and you will eliminate jobs. A strong fair small business environment means more jobs, more profit and consequently more state tax income.

The idea that your bill will protect small operators by prohibiting the sale of gas as a "loss leader" below cost insults business operators across the state.

Picture this, 75% of our sales are gas. When competitive pressures require us to sell at cost we lose 100% of our profit on 75% of our business. No gas retailer's business model shows a profit in this scenario, therefore none can survive. Unless they redirect profits from other locations or enterprises. This is exactly the definition of predatory pricing, and exactly why the Unfair Sales Act exists.

Let me share another ridiculous point. Credit Cards make up 50% or more of gas purchases. Under Senate Bill 215 Credit Card Companies with zero investment, no brick and mortar, no property taxes will make 2 to 3% on the sale of half the gasoline and your small business constituents will make nothing. They will in fact lose 2 to 3% on the sale of half the gas they sell.

If your motivation is truly to lower gas prices for your constituents than fight the battle to lower state gas taxes. If Wisconsin would match the state gas taxes of Minnesota or Iowa you would eliminate the benchmark people use to form their opinion. You would also eliminate the significant cross over effect lower gas prices have on border communities and the

resulting opportunity cost of Wisconsin citizens spending their money in neighboring states.

There is a great example to the impact of eliminating minimum markup in the La Crosse market. Since the state allows gas stations in border communities to match the retail prices in Minnesota overriding Wisconsin's Unfair Sales Act, small operators have been all but eliminated because they simply can't compete.

Does the Senate of the Great State of Wisconsin owe Dave Hegenbarth anything? No, no it doesn't, other than a fair chance, a fair chance to compete. The same chance it owes thousands of other small businesses. The same chance your noble predecessors believed in and acted on in 1939 when they wrote and passed the Unfair Sales Act. That fair chance Senators will benefit everyone you represent.

The choice you have is to help insure that the American Dream lives and prospers in Wisconsin for small business people, or will you be an accessory to the death of the American Dream at the hands of Mega-size business.

Thank you for this opportunity to address the committee.

Can I answer any questions?

FORWARD
E PLURIBUS UNUM

Jeff Wydeven
Tri County Distributors
Chair

Bob Spoerl
Premium Brands
Vice-Chair

Garry Bunz
H & M Distributing Company
Treasurer

Dan Weinstein
General Beer Distributors
Secretary

Eric Jensen
Executive Director

2005 Members
Arcadia Beverage Company
Baer's Beverage
Beer Central, Inc.
Beechwood Distributors
Beloit Beverage Company.
Bill's Distributing, Ltd.
C & H Inc. of Reedsburg
Central Beer Distributors Inc.
Dean Distributing
Flanigan Dist. of Door County
Four Seasons Beer Distributing
Frank Beer Distributors
G.B. Sales Corp.
General Beer Distributors
General Beer Dist. - Milwaukee
H & M Distributing Company
Hellman Distributors
Jozaitis Distributing
Kay Beer Distributing
LaCrosse Beverage, LLC
Larry's Distributing Company
Lehmann & Larson Distributors
M & L Brands, Inc.
Miller Beer of the Northwoods
Miller Brands–Milwaukee, LLC
Northwest Beverages
Oneida Sales & Service
Park Ridge Distributing
Pehler Brothers Distributing
Prairie Beer Dist. Company
Premium Brands
River City Distributing
S & S Distributing
Ott Schweitzer Distributorship
Stanley's Beer Depot
Superior Beverages, LP
Triangle Distributing Company
Tri County Distributors, LLC
Western Distributing Company
Wisconsin Distributors, LP
Wisconsin Wetgoods Co.
W.O.W. Distributing Co. Inc.
Zastrow the Beer Man, Inc.

TO: Members, Senate Committee on Judiciary, Corrections and Privacy

FROM: Eric Jensen, Executive Director

DATE: June 1, 2005

RE: Opposition to SB 215

Please oppose Senate Bill 215 which seeks to repeal the Unfair Sales Act for motor fuel.

Our businesses rely on fleets of vehicles - just a handful to several dozen in size. They are on the road every day delivering products and serving our customers in every part of Wisconsin. Our drivers purchase fuel when and where they need it - usually from a conveniently located, independent retailer.

The cost of motor fuel is an enormous piece of our operating expenses, and price increases directly impact our bottom line. As consumers and business owners, we greatly appreciate the efforts of those working to reduce fuel prices. *But we believe that repealing the Unfair Sales Act for motor fuel will not bring lower prices - we believe the opposite will happen*:

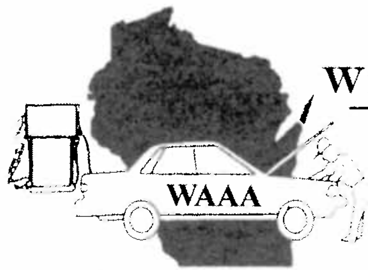
(1) Prices Will Ultimately Rise - Competition keeps prices low in any industry. Without the Unfair Sales Act small, independent retailers will be unable to compete with the mega-retailers who support its repeal. Even if sales are prohibited "at or below cost," mega-retailers will be able to sell gasoline at a bare fraction over "cost," offset the near-losses against their other high-volume sales, and ultimately run small retailers out of business. Perhaps prices may drop for a time, but absent competition what will be the motivation of those remaining to keep prices low??

(2) Access Will Be Reduced - Often forgotten in this debate, convenient access to motor fuel is at stake. Consumers love easy access to the products they use - *especially motor fuel*. When Wisconsin's independent retailers are gone, and fuel sales are concentrated at a small number of locations, that convenient access to fuel will be lost.

Neither benefits Wisconsin consumers. Neither benefits Wisconsin's long-appreciated independent family businesses. Both are likely outcomes of repeal or modification of the Unfair Sales Act as proposed in SB 215.

16 N. Carroll Street, Suite 950 | Madison, WI | 53703
ph: 608 255 6464 | fx: 608 255 6466

FORWARD
E PLURIBUS UNUM



"The Association for the Automotive Professional"

WISCONSIN AUTOMOTIVE AFTERMARKET ASSOCIATION

5330 Wall St., Suite 100 • Madison, Wisconsin 53718-7929
608-240-2065 • 800-856-9282 • FAX 608-240-2069

June 1, 2005

TO: Senate Committee on Judiciary, Corrections and Privacy
Senator David Zien
Senator Carol Roessler
Senator Glenn Grothman
Senator Fred Risser
Senator Lena Taylor

Dear Senators:

The members of the Wisconsin Automotive Aftermarket Association respectfully request that you oppose SB 215 relating to the repeal of important provisions of Wisconsin's Unfair Sales Act.

Wisconsin's Unfair Sales Act protects and promotes competition and, ultimately, benefits the consumer. Predatory pricing is a real problem in the gasoline industry, particularly when a mega-retailer enters a market and proceeds to drastically undercuts prices until it has captured the market. One the competition is eliminated, the mega-retailer typically raises the prices to level higher than before it entered the market. Consumers then suffer from fewer retail gasoline outlets, reduced competition and, ultimately, higher prices.

Wisconsin's high gasoline sales tax - one of the highest in the nation - are more to blame for Wisconsin's gasoline prices being the highest in our region. The tax, with built-in increases via indexing, has a far greater effect on gasoline prices in Wisconsin, yet this factor is rarely mentioned when gasoline prices are discussed.

An important provision in Wisconsin's Unfair Sales Act is the right to meet competition, which means if your competitor across the street is selling below cost, you are allowed to meet that illegal price in order to remain competitive. Likewise, if your competitor is across state lines (and benefits from lower state gas taxes), you can meet the price of that competitor. If Wisconsin retailers are pricing gasoline higher than their across-the-border competitors, it's very likely because of Wisconsin's higher gas taxes.

The reasons for high gas prices and price disparities with our surrounding states have more to do with supply, transportation costs, market dynamics and gas taxes than they do with the Unfair Sales Act. We urge you to consider these reasons, support Wisconsin's Unfair Sales Act, and oppose SB 215.

Sincerely,

Gary W. Manke, CAE
Executive Director

GWM:lh

Serving Wisconsin's retail gasoline dealers, service repair businesses, and independent tire dealers...

FORWARD
E PLURIBUS UNUM

Wisconsin Federation of Cooperatives

131 West Wilson Street, Suite 400 • Madison, WI 53703-3269
Phone 608.258.4400 • Fax 608.258.4407 • www.wfcmac.coop

Date: June 1, 2005

To: Members, Senate Committee on Judiciary, Corrections and Privacy

From: Bill Oemichen, President & CEO
John Manske, Director of Government Relations

RE: WFC Opposition to SB 215

The Wisconsin Federation of Cooperatives (WFC) represents more than 600 Wisconsin-based cooperatives with more than 2.9 million member-owners. Our cooperatives span across many types of businesses, including farm supply cooperatives. Our fifty local and regional farm supply cooperatives supply fuels, agronomy, feed and other goods and supplies to farmers and other residents across Wisconsin. As cooperatives, they are member-owned and member-controlled businesses and their convenience stores often provide food, fuel and other staples in small communities that do not have other grocery stores or retail fuel outlets.

WFC and our Farm Supply Committee joins the Main Street Businesses for Fair Competition in our mutual strong support for the Unfair Sales Act. **We oppose SB 215 because it will damage the protection that the long-standing law has provided for retailers and their customers in Wisconsin.** We believe that deleting the markup provisions from the law will almost certainly result in **less competition that will not benefit the consumer, but will rather substantially harm them in the long term.**

Samples of WFC member comments are as follows:

Bruce Mlsna, General Manager at River Country Cooperative, headquartered at **Chippewa Falls**, stated the following in his letter to legislators:

- "We have approximately 19,000 stockholders in our company made up of primarily Chippewa, Dunn and Eau Claire County residents. Our businesses, which were once predominately agricultural, are now primarily consumer businesses such as convenience stores and truck stops. Small businesses such as us make up the backbone of our area economy. We provide jobs and perform services in many small communities that large corporations would not. This law does not guarantee any of us a profit. What it does attempt to do is let us recover a small portion of our costs of bringing products to the consumer. It is vital to our farmers and consumers in small communities that companies such as ourselves remain in business because who will service their needs? Keeping the law means more competition in our area, more jobs and more competition means lower long-term prices and more choices for consumers."

Sam Skemp, General Manager at Frontier FS, headquartered at **Jefferson**, observed:

- "The law allows small businesses to generate enough margins to continue to operate or stay in business. If we allow big businesses to push out the small businesses then there would be no competition left and they can charge the consumer what they want. We all know that competition helps the consumer get the best price."

Don Gilles, General Manager at Tomorrow Valley Coop, headquartered at **Manawa**, stressed:

- "We operate three convenience stores in the small communities of Amherst, Scandinavia and Wild Rose. If this bill passes we will be forced to consider closing these stores because of the added pressure on our store margins. Besides closing these operations, the small rural business communities will be damaged again."

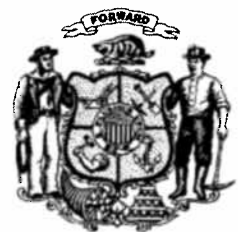
Finally, we think it is worthwhile to restate much of the legislative intent that accompanied this law because we believe it is equally valid today:

> *The practice of selling certain items of merchandise below cost in order to attract patronage is generally a form of deceptive advertising and an unfair method of competition in commerce. Such practice causes commercial dislocations, misleads the consumer, works back against the farmer, directly burdens and obstructs commerce, and diverts business from dealers who maintain a fair price policy.*

Wisconsin Statutes Section 100.30(1).

In closing, WFC respectfully asks that you not advance AB 215 out of committee. Thank you for considering the views of WFC and our members in opposition to the bill.

WISCONSIN STATE LEGISLATURE



WISCONSIN

Memorandum

TO: **Members of the Senate Committee on Judiciary, Correction and Privacy**

FROM: **Bill G. Smith, State Director**

DATE: **June 1, 2005**

RE: **Senate Bill 215 - Unfair Sales Act**

The small-business community has repeatedly stressed that the purpose of the Unfair Sales Act is to preserve competitive retail pricing and maximum choice for consumers. The purpose of the law is not to artificially increase consumer prices, but to promote a competitive marketplace that will guarantee consumers receive both competitive pricing and maximum choice for their purchasing dollars.

The members of NFIB support the current minimum mark-up law, and as it applies to the sale of gasoline, not to protect small business from the workings of a free market, but to provide small-business owners the opportunity to succeed and prosper in a market with vigorous, yet fair competition. Thousands of small business owners and consumers would be adversely affected if Senate Bill 215 is approved or the enforcement of this important law is diminished or diluted.

MORE THAN 60% OF OUR MEMBERS SAY THEY SUPPORT STRICT ENFORCEMENT OF THE LAW.

To the extent that we lose Main Street businesses to the mega-retailers and big oil interests, our small communities lose important contributors to their communities, real competition is lost and consumers lose choice, price and service.

It is true small business owners have been severely impacted by the recent dramatic increases in the cost of gasoline. However, rather than risk destroying the competitiveness of our small retail gasoline dealers, the Legislature should address our state's tax competitiveness by reducing the tax on motor fuel – one of the highest in the nation.

I encourage members of the committee **to vote against passage of Senate Bill 215.**

Thank you for your consideration.

National Federation of Independent Business – WISCONSIN
10 East Doty Street, Suite 201 • Madison, WI 53703 • 608-255-6083 • Fax 608-255-4909 • www.NFIB.com/WI

FORWARD
E PLURIBUS UNUM

22 East Mifflin Street, Suite 900
Madison, WI 53703
Toll Free: 1.866.404.2700
Phone: 608.663.7188
Fax: 608.663.7189

MEMORANDUM

TO: Honorable Members of the Senate Committee on Judiciary, Corrections and Privacy

FROM: Matthew Stohr, Legislative Associate MS

DATE: June 1, 2005

SUBJECT: 2005 Senate Bill 215

The Wisconsin Counties Association (WCA) supports 2005 Senate Bill 215 (SB 215), which eliminates the minimum mark-up on gasoline law but also, puts in place measures that protect retail entities from predatory pricing. WCA feels strongly that the current "sales below cost" statute regarding gasoline is not doing what it was originally intended to do and is having a negative impact on Wisconsin consumers and property taxpayers. According to a recent study prepared by Marquette University Economics Professors Dr. David E. Clark and Dr. Steven C. Crane for the Coalition for Lower Gas Prices, Wisconsin's minimum mark-up law costs consumers nearly 1.8¢ for every gallon of gasoline they purchase. This amounts to nearly $40 million dollars every year for Wisconsin consumers and taxpayers.

As you are aware, Wisconsin's minimum mark-up law was originally passed in the depression-era to protect small "mom and pop" establishments from large firms free reign to raise prices substantially. However, according to the Clark and Crane study, small firms have been reducing in numbers recently and the ones that still operate in Wisconsin are not in the main corridors of competition. Thus, the current law is being imposed on Wisconsin consumers and taxpayers without much benefit in return.

This issue is important to Wisconsin counties and taxpayers for two specific reasons; first, counties consume a great deal of gasoline and second, the current "sales below cost" statute creates an unnecessary inflationary mark-up on the price of gasoline. Further, the revenue that is collected due to the inflationary price does not benefit Wisconsin consumers and taxpayers since the "mark-up" goes to retail entities rather than investing in our infrastructure as the revenues from the gas tax and vehicle registration fees do. There are numerous examples of county departments that use a high volume of gasoline to provide a service. Examples include the county sheriff, highway/public works, human services (elderly and disabled transportation programs, meals on wheels, etc.) and conservation and parks departments. According to the Wisconsin Department of

Transportation (DOT), Wisconsin county highway departments alone purchased 4,599,143 gallons of unleaded fuel and 10,092,910 gallons of diesel in 2004. In many counties, the sheriffs department purchased more than twice the amount of gasoline as the highway department. If the Clark and Crane numbers are correct, and WCA is confident they are, it is clear that this law places a staggering, yet avoidable, cost onto county operations and taxpayers. It should be noted that a large percentage of the fuel purchased was purchased at the wholesale level or discounted level, however, as you are aware, Wisconsin's minimum mark-up law pertains to both wholesale and retail purchases.

In conclusion, this law is placing a burden on county efforts to provide services to citizens in the most cost-effective and efficient manner. This unnecessary law is coming at a great cost to counties and Wisconsin property taxpayers. To this end, WCA respectfully requests your support for SB 215, as it would assist counties with their efforts to reduce their costs without compromising a service that Wisconsin citizens have come to except.

Thank you for considering my comments.

Please feel free to contact me at the WCA office if you have any questions.

FORWARD
E PLURIBUS UNUM

8401 Excelsior Drive, Suite 200
P.O. Box 33
Madison, WI 53701-0033
800/236-1300

June 1, 2005

TO: Chairman David Zien and Members of the Wisconsin Senate Committee on Judiciary, Corrections and Privacy

FROM: Ernie Stetenfeld, Vice President, Corporate Relations
(608) 828-2487; estetenfeld@aaawisconsin.com

RE: **AAA Wisconsin support for S.B. 215, repealing the percentage-based minimum markup on motor fuel**

Good afternoon, Chairman Zien and members of the committee. My name is Ernie Stetenfeld, and I am vice president of corporate relations for AAA Wisconsin. On behalf of our AAA club, representing the motoring and travel interests of nearly 600,000 member-motorists in our state, I am here today to urge your favorable consideration of Senate Bill 215. This bill, authored by Sen. Zien and Rep. Jeff Wood, would help your constituents and Wisconsin consumers generally by eliminating Wisconsin's mandated minimum markup on motor fuel – while continuing to prohibit the sale of fuel at or below cost.

Current Wisconsin law saddles motorists with unnecessary cost for each gallon of gas we pump. And it is cost that buys not one inch of state highway pavement nor sends one dime to local governments to defray their transportation expenditures. The percentage-based formulas of our state's Unfair Sales Act, better known as the minimum markup law, mean that Wisconsin statutes – rather than the market – determine the minimum price above cost at which fuel retailers may sell us their product. That doesn't make sense, and it does hurt consumers.

S.B. 215 is a bill whose time has come. Wisconsin's gasoline minimum-markup law dates to 1939 and was intended to help protect small retailers from potential predatory pricing by larger operations. Many economists and consumer advocates – the Federal Trade Commission, for instance – consider our law to be antiquated, counterproductive, anti-competitive and anti-consumer. The evidence that this is true is growing.

In an October 2003 response to an inquiry from state Rep. Shirley Krug, the Federal Trade Commission critiqued Wisconsin's Unfair Sales Act and noted that the law "harms consumers and restricts competition." Minimum markup laws discourage competitive pricing and lead to higher prices for consumers, the FTC response indicated. The federal watchdog agency found that Wisconsin's law "... exacerbates these problems by employing one of the steepest minimum markups on retail fuels in the country."

FTC administrators also advised that the Wisconsin law is unnecessary because federal antitrust laws provide protection against the sort of below-cost pricing that could lead to monopoly. The administrators' letter observed that economic and legal studies as well as court decisions have indicated that below-cost pricing leading to such monopoly occurs infrequently. The FTC officials concluded, "We believe that Wisconsin's Unfair Sales Act likely harms consumers and restricts competition. Moreover, at best, the Act is unnecessary because the federal antitrust laws already protect against predatory pricing."

(— MORE —)

Last August, the Coalition for Lower Gas Prices, of which AAA Wisconsin is a member, released a pair of studies by David Clark and Steven Crane, both of Marquette University's Economics Department. That study pegged the minimum markup law's cost to Wisconsin consumers at more than $40 million per year – and that's just a conservative estimate of the markup cost added to sales of unleaded gasoline only and does not even account for impacts on the cost of diesel fuel in our state. The other study revealed that about 90 percent of the gasoline sold in our state is dispensed at stations grossing more than a million dollars a year on gas sales alone.

Gas prices have been high, of course, for many months now and are currently just a little below Wisconsin's recent all-time-high gas-price averages. Many factors – most significantly high crude-oil costs – contribute to these record prices for gasoline. In a time of high prices, however, there is all the more reason to repeal or suspend a law that unnecessarily costs consumers 1.3 to 1.8 cents per gallon – as estimated by the Clark/Crane study – each time they pull up to the pump. Previous studies by economists Ike Brannon and Frank Kelly had suggested a similar effect for our motor-fuel minimum markup law. Given that S.B. 215 would do away with a mandated percentage minimum markup while continuing to prohibit fuel sales at or below cost, and given that current federal laws also prohibit predatory pricing, AAA Wisconsin believes that this bill as law will clearly serve the interests of consumers while appropriately considering the interests of small business.

In weighing your decisions regarding S.B. 215, I encourage you to ask and answer for yourselves the following questions:

- Do you really believe that consumers in the dozens of states without minimum-markup or even sales-below-cost laws suffer from the lack of such statute-driven pricing?
- Would predatory pricing really be an effective tool working to the advantage of a large operator in an industry in which the bar to entry is not very formidable – especially when that predation would have to put closed gas stations on the market at reduced prices?
- In those areas in which smaller retailers still tend to do business, are the communities particularly attractive to larger operations inclined to invest in predatory pricing to obtain a monopolistic share of a tiny market?
- Why should motor fuel continue to be classed with only tobacco products and alcoholic beverages in the category of wares subject to a minimum markup mandate in Wisconsin?
- Upon whom does this law confer greater benefit – large retailers or small retailers?
- Why in a number of instances have smaller, lower-volume retailers trying to compete on price been sued for apparent minimum markup law violations by groups of larger, higher-volume retailers?
- Does the minimum markup law pass your own smell test? That is, can you buy the notion that a law requiring a percentage minimum markup could actually result in <u>lower</u> gas prices for Wisconsin consumers, as the law's proponents claim? (And, if it actually could reduce our fuel costs, how could that law possibly also confer some preferential benefit upon small retailers – into whose margins it would need to cut?)
- Do you really believe that your constituents are better off as fuel consumers because of Wisconsin's motor-fuel minimum markup mandate?

On behalf of our members and all motor-fuel consumers in Wisconsin, I want to express AAA Wisconsin's gratitude to Sen. Zien, Rep. Wood and the other cosponsors of S.B. 215 for their leadership on this issue. They, you and all members of the Legislature have an opportunity in this bill during this session to exert downward pressure on gas prices in our state by sending S.B. 215 to Gov. Doyle's desk. AAA Wisconsin strongly encourages you to do so, and the motorists of Wisconsin will be in your debt when our state acts to eliminate this outdated percentage-based minimum markup on motor fuel.

Thank you for your consideration of AAA Wisconsin's position in strong support of Senate Bill 215.

###

FORWARD

Senator Zien testimony before the
Senate Committee on Judiciary, Corrections and Privacy
on Senate Bill 215
June 1, 2005

Thank you fellow committee members for listening to my testimony today about a bill that could help alleviate high gas prices.

The high price of gasoline is one of the most common complaints I hear from constituents. We are looking at multiple ways to reduce this burden for consumers. I have a flyer that briefly describes my 8-point plan to reduce gas prices if anybody wants to see some of our other ideas.

3 weeks ago we had a hearing on my bill that helps gas retailers avoid credit card fees, a problem many retailers and their trade association said needed to be addressed, though I've seen little support since we introduced it.

Today we're here to talk about the Minimum Markup Law, which requires gas wholesalers to mark up their prices by at least 3% and retailers by at least 6%, for a total minimum markup of 9.18% to the price of fuel paid by consumers.

Our bill, Senate Bill 215, eliminates the state-mandated minimum markup on the price of gasoline, and continues to protect retailers from predatory pricing.

After listening to many gas station owners, Jeff Wood and I made changes to the bill draft to address their concerns. There was a uniform fear of predatory pricing by large conglomerates. Therefore, this bill contains the following protections from predatory pricing:

- It continues to prohibit the sale of gasoline below cost, and

- It prohibits the sale of gasoline at cost
- These prohibited practices are defined as loss leader

Let me clear up some misconceptions that have swirled since I first proposed repealing the minimum markup:

- This bill will only eliminate the state required minimum markup on gasoline
- This bill will not eliminate the minimum markup on general merchandise
- This bill will not eliminate the minimum markup on alcohol products
- This bill will not eliminate the minimum markup on tobacco
- This bill strengthens the prohibition on predatory pricing
- This bill will prohibit large retailers from selling gasoline below cost

These misconceptions are fostered by rhetoric like that put out by PMAW, such as this letter implying that my bill is somehow WalMart's bill. Let me be clear: my motive is to explore all options to help alleviate gas prices for consumers. I introduced this bill because the poor and elderly suffer the most from high gas prices.

Another part of this letter states, and I quote, "They want it repealed so that the hypermarkets and big box retailers can sell gas as a loss leader without penalty." THIS IS NOT TRUE. SB215 clearly strengthens the definition of a loss leader.

The letter further states, "Supporters of the bill say they've added additional prohibition against loss leaders – DON'T BELIEVE IT!" By "supporters of the bill" I can only assume they are referring to ME, because I drafted the additional prohibition right here in my bill. *I don't appreciate being called a liar.*

These misrepresentations are deceitful and a disservice to their own members who deserve honorable representation. I want these distortions to end today.

My intent is to get rid of the antiquated ~~law~~ that the Federal Trade Commission has said hurts consumers and drives up the cost of gasoline. At the same time, we want to make sure that our local gas station owners are not driven out of business by predatory pricing.

In these times of record high gas prices, we must look at any and all ways that can lower gas prices for consumers or retailers, including the minimum markup on gasoline, offering discount cash for gas, gas tax indexing, ethanol, pipeline or refinery, and terminal pricing.

I am looking forward to an honest and civil debate from both sides of the issue today.

Thank you for your time today, I'd be happy to answer any questions.

URGENT!
ACTION REQUESTED!
PLEASE CALL ON TUESDAY, MAY 31ST!

Senator Zien and Representative Wood have introduced their Senate Bill 215 to repeal the minimum markup provisions of Wisconsin's Unfair Sales Act.

This bill will have a Senate hearing, before the Committee on Judiciary, Corrections and Privacy, this coming ***Wednesday, June 1, 2005***. Unfortunately, the announcement of this bill was made just before Memorial Day weekend. While you're all busy during this heavy-travel weekend, the lobbyists for the other side are busy working the legislature. But we can overcome this obstacle – the legislature is closed on Monday, back on Tuesday when all our calls can make the most impact!

Please, if you care about this law, if you DO NOT WANT TO SEE THE UNFAIR SALES ACT REPEALED OR CHANGED IN ANY WAY, make 5 simple phone calls. These calls will go to the 5 Senators on the Committee and demonstrate the strong support our industry has for this important existing law. If EVERYONE calls before the hearing, we have a good chance of killing this bill.

MOST IMPORTANT, if you are an independent company, otherwise known as a family-owned, or small-business, or "mom & pop," it is crucial that you make these calls as soon as possible. The reason is because one of Wal-Mart's arguments is that there are no more independent retailers left in Wisconsin. They've said that independents are a quaint, antique notion that went out of business with your Grandfather's Oldsmobile. Therefore the Coalition for Lower Gas Prices argues that we no longer need an "antique law" like the Unfair Sales Act. repealed so that the hypermarkets and big box retailers can sell gas as a loss leader without penalty. Supporters of the bill say they've added additional prohibitions against loss leaders – DON'T BELIEVE IT! Make no mistake: **If Senate Bill 215 becomes law, there will be no more minimum markup and no strong prohibitions against using gas as a loss leader.**

For talking points to make to these legislators, arguing why Wisconsin's Unfair Sales Act should NOT be changed, please see the attached sheet. And please, call these 5 Senator's on Tuesday.

Senate Committee on Judiciary, Corrections and Privacy
Senator David Zien (R-Eau Claire) 608-266-7511
Senator Carol Roessler (R-Oshkosh) 608-266-5300
Senator Glenn Grothman (R-West Bend) 608-266-7513
Senator Fred Risser (D-Madison) 608-266-1627
Senator Lena Taylor (D-Milwaukee) 608-266-5810

PETROLEUM MARKETERS ASSOCIATION OF WISCONSIN | WISCONSIN ASSOCIATION OF CONVENIENCE STORES

Representing Independent Business

121 S. PINCKNEY STREET • SUITE 300 • MADISON, WISCONSIN 53703-3338 • (608) 256-7555 • FAX: (608) 256-7666 • www.pmawwacs.org

PECFA PHASEOUT

The Petroleum Marketers Assn. and some gas station owners have indicated that that PECFA might be phased out and a part of the 3-cent per gallon PECFA surcharge may no longer be necessary.

PECFA is funded from the Petroleum Inspection Fee Fund. The petroleum inspection fee is 3 cents per gallon. Part of the 3 cents may remain in place to pay for ongoing petroleum cleanup projects, but we will push for the remainder to be a direct savings for the consumer.

PIPELINE

Some gas station owners and wholesalers suggested that another crude oil pipeline be constructed in or near Wisconsin.

Another gasoline pipeline through Wisconsin could reduce the price of gasoline by reducing transportation costs.

Enbridge proposed to expand its underground crude oil pipeline system to help address current and future increases in refinery demand from Canada's oil sands. Called the Southern Access expansion, the pipeline would provide energy reliability and security of the crude petroleum supply.

The existing pipeline extending from Superior to Delavan crosses through Chippewa, Taylor, Clark, Marathon and Wood counties.

REFINERY

A new refinery has not been built in the USA since 1976, and more than half of the refineries in existence in 1981 have closed. The permitting process could be changed to promote the building of a new refinery.

A new refinery is said to cost about $2 billion, which does not include prior cleanup

President Bush has indicated an interest in locating new refineries on closed military bases.

It is important to the local economy in that they bring $918 million to Wisconsin and employ more than 8,200 people

The Badger Army Ammunition Plant (BAAAP) may be an alternative for a refinery

This is a facility operated by the United States Army, located on 7,354 acres of land in Sauk County approximately 7 miles south of Baraboo and 7 miles north of Sauk City.

The facility was constructed in 1942 and was operated intermittently over a 33-year period to produce propellant or cannon, rocket, and small arms ammunition.

Badger Ammo is currently inactive and had been maintained on standby since 1976.

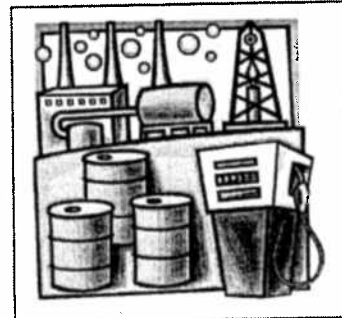
TERMINAL PRICING

Study the price disparities among brands and blends at terminals.

SENATOR ZIEN'S 8-POINT GAS PRICE AGENDA

The high price of gasoline is one of the most common complaints I hear from constituents. I am looking at multiple ways to reduce this burden for consumers.

- Minimum Markup
- Cash for Gas
- Gas Tax Indexing
- 10% Ethanol
- PECFA Phaseout
- Pipeline
- Refinery
- Terminal Pricing



MINIMUM MARKUP REPEAL (SB 215)

On November 17, 2004 I proposed suspending the minimum markup law for 1 year to conduct a study to find out if there is predatory pricing by large corporations.

A PUBLIC HEARING WILL BE HELD ON THE BILL WED., JUNE 1, 1:00 IN THE STATE CAPITOL. The public is invited to attend.

After listening to many gas station owners, Representative Jeff Wood and I proposed a bill with changes to address their concerns. There was a uniform fear of predatory pricing by large conglomerates. Therefore, our bill has the following protections from predatory pricing:

- Prohibit the sale of gasoline below cost, and
- Prohibit the sale of gasoline at cost
- These prohibited practices are defined as loss leaders

Our intent is to get rid of the antiquated law that the Federal Trade Commission has said hurts consumers and drives up the cost of gasoline. At the same time, we want to make sure that our local gas station owners are not driven out of business by predatory pricing.

Marquette University economists say the law adds 1.3 to 1.8 cents to every gallon of gas sold in Wisconsin.

$50 million/year savings for motorists

DISCOUNT GAS FOR CASH (SB 180)

Rep. Jeff Wood and I authored this bill and the committee of which I am Chairman – the Senate Committee on Corrections, Judiciary, and Privacy, held a public hearing on it May 11, 2005.

Many gas retailers indicated to us that there is a real problem with credit card fees, which add to their cost of selling gasoline. This bill would lower costs for gas retailers and could lower prices for consumers.

Credit card companies are holding gas retailers and consumers hostage under the current situation by prohibiting discount cash prices. Credit card fees add to the cost of gasoline, which are either forced on to the gas retailer or passed on to the consumer at the pump.

Large credit card companies would be prohibited from penalizing a gas retailer under contract for offering a discounted cash price. Gas retailers are forced to pay a fee for each credit card transaction, plus usually another 3% of the transaction amount.

Under the proposal, gas retailers could offer a lower price for cash payments because a cash transaction would not be subject to additional credit card fees.

This is why many large retailers offer their own credit cards so they don't have to pay the 3% markup to another credit card company, allowing the retailer to reduce the price of gasoline 3% as a savings to consumers, or keeping the price up and profiting that 3%.

GAS TAX INDEXING (SB 185)

Senator Tom Reynolds proposed a bill, which I cosponsored, that would change the automatic annual gas tax indexing. Indexing was enacted in 1985 in order to allow annual growth in revenue for transportation projects. Under SB 185, the tax rate might not be adjusted every year as it does under current law if gas tax revenue collections outpace the annual Consumer Price Index (CPI).

10% ETHANOL (AB15, SB 15)

I cosponsored Rep. Steve Freese and Senator Sheila Harsdorf's legislation requiring 10% ethanol in gasoline because oxygenated gasoline is taxed at a lower rate, thus reducing the cost of gasoline to consumers.

There was an understanding on my part that regular unleaded gasoline would still be available to those consumers who cannot run oxygenated fuel in their vehicles. I am gathering input from constituents on the workability of this concept.

3-4 cents/gallon savings (2 cents/gallon for every 5% mandated)

DAZ

Minimum Markup on Gasoline: Talking Points
March 14, 2005

The Zien/Wood proposal:

- This bill will eliminate the state required minimum markup on gasoline
- This bill will not eliminate the minimum markup on general merchandise
- This bill will not eliminate the minimum markup on alcohol products
- This bill will not eliminate the minimum markup on tobacco
- After listening to many gas station owners, we made changes to the bill draft to address their concerns. There was a uniform fear of predatory pricing by large conglomerates. Therefore, this bill will contain the following protections from predatory pricing:
  - Prohibit the sale of gasoline below cost, and
  - Prohibit the sale of gasoline at cost
  - These prohibited practices are defined as loss leaders
- This bill will prohibit Wal Mart from selling gasoline at or below cost (which has been the most cited complaint about repealing the minimum markup).
- My intent is to get rid of the antiquated law that the Federal Trade Commission has said hurts consumers and drives up the cost of gasoline. At the same time, we want to make sure that our local gas station owners are not driven out of business by predatory pricing.
- We may entertain an amendment to suspend the minimum markup law for 1 year to conduct a study to find out if there is predatory pricing by large corporations.

BACKGROUND ON MINIMUM MARKUP LAW

- The mandatory minimum markup on gasoline was enacted in Wisconsin in the 1930's to prevent large conglomerates from entering the gasoline market and driving "ma and pa shops" out of business.
- Wisconsin's law prohibits the retail sale of motor fuel below a statutory definition of "cost," where "cost" is defined with reference to the greater of (1) the vendor's invoice or replacement cost, or (2) the "average posted terminal price" at the terminal nearest the retail sale in question, PLUS a minimum markup of 3%, 6%, or 9.18% to "cover a proportionate part of the cost of doing business."

REASONS TO SUPPORT REPEAL OF THE MINIMUM MARKUP

- Consumers are paying historically high prices for gasoline. The government artificially keeping prices high with the minimum markup only hurts consumers more.
- Unlike most cost control measures that keep prices from going too high, the minimum markup ensures that the price of gasoline doesn't get too low.
- Consumers can benefit from lower prices if retailers are allowed to compete on a fair market basis without fear of predatory pricing by large conglomerates.
- According to the FTC, the minimum markup is a government guaranteed profit margin on the product at the direct expense of Wisconsin consumers.

- Economists estimate that Wisconsin consumers pay an extra $40 million a year for gasoline because the state artificially requires prices to be marked up.
- The free market, not the government, should determine how much retailers mark up gasoline prices.
- The minimum markup is an outdated law that artificially keeps prices high for consumers.
- Retailers should be able to compete at some profit level without the government mandating that level for them, just like nearly every other sector of our free market economy.
- Federal antitrust laws and our proposal specifically prohibit large conglomerates from engaging in predatory pricing, i.e. selling below or at cost as a loss leader.
- **The Federal Trade Commission report dated October 13, 2003 states the following:**
    - Wisconsin's Unfair Sales Act restricts competition and leads to higher prices for consumers.
    - Minimum markup laws likely deter pro-competitive price cutting and can ultimately lead to higher prices for consumers.
    - Unlike federal antitrust law, the Act aims to protect individual competitors, not competition, thereby discouraging pro-competitive price-cutting.
    - We (FTC) believe that the Act is unnecessary, both because scholarly studies and court decisions indicate that anticompetitive below-cost pricing happens infrequently, and because federal antitrust laws already prohibit anticompetitive below-cost pricing.
    - "[t]he minimum markup simply protects the profit margins of vendors, efficient and inefficient alike."

FAQ's and CLAIMS

Claim: *"Repealing this law would allow stores to sell fuel for cost or less."*

FALSE. Our bill specifically prohibits selling fuel below cost or as a loss leader. Also, anticompetitive below-cost pricing is already illegal under federal antitrust law.

Claim: *"WalMart will come in, sell below cost and drive the rest of the gas stations out of business"*

Our bill specifically prohibits selling fuel below cost or at cost (i.e. as a loss leader). Also, anticompetitive below-cost pricing is already illegal under federal antitrust law.

Claim: *"If there was no Unfair Sales Act, a company such as Kwik Trip could build nearby a small business like mine in (insert small city name), and they could sell in that location for a loss until the small business was out of business."*

Our bill specifically prohibits selling fuel below cost or at cost (i.e. as a loss leader). Also, anticompetitive below-cost pricing is already illegal under federal antitrust law.

Claim: *"The bigger company can survive off of the profits it's making off consumers in other markets and lower their prices drawing all business away from the smaller company."*

Our bill specifically prohibits selling fuel below cost or at cost (i.e. as a loss leader). Also, anticompetitive below-cost pricing is already illegal under federal antitrust law.

Claim: *"Wisconsin's Unfair Sales Act, above all else, protects Wisconsin consumers"*

Retailers are forced to mark up their prices because government sets the price for them. The increased cost is passed directly to, and paid for, by the consumer. Consumers pay over $50 million per year more for gasoline because of the minimum markup law.

Claim: *"While your proposal to prohibit the sale of gasoline below cost and the sale of gasoline as a loss leader may be born out of good intentions – your approach is flawed. Simply prohibiting the sale of gasoline below cost does very little to prevent the very real problem of predatory pricing..." (Source - PMAW letter to Senator Zien 1/31/05)*

PMAW acknowledges in one breath that our proposal addresses both below-cost AND at-cost sales (i.e. as a loss leader), but in the next breath says our approach is flawed for only addressing sale of gasoline below cost. Again, we outlaw below-cost selling AND at-cost sales of gasoline (i.e. as a loss leader).

Claim: *"Any business that is selling product at cost is, by definition, using that product as a loss leader, which could lead to predatory pricing." (Source - PMAW letter to Senator Zien 1/31/05)*

We agree. We've addressed this by outlawing the sale of gas at or below cost in our proposal (i.e. as a loss leader).

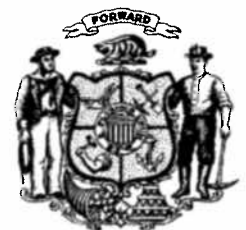
Claim: *"...it does not seem wise, in light of today's geo-political situation, that companies should be allowed to sell gasoline for less than it costs to bring the product to the consumer." (Source - PMAW letter to Senator Zien 1/31/05)*

We address this by outlawing the sale of gas at or below cost in our proposal (i.e. as a loss leader).

Claim: *Wal Mart would be able to buy cheap gas outside of Wisconsin, and sell it cheaply here.*

All sellers of gas in Wisconsin would continue to set their sale prices according to the "average posted terminal price", or "rack price" in Wisconsin the same way prices are set now.

WISCONSIN STATE LEGISLATURE



SCOTT R. JENSEN
STATE REPRESENTATIVE
MEMBER, JOINT COMMITTEE ON FINANCE

November 29, 2005

Hand Delivered

State Senator David A. Zien
Chairperson
Senate Judiciary, Corrections and Privacy Committee
Room 15 South, State Capitol
Madison, Wisconsin

RE: 2005 Senate Bill 215

Dear Senator Zien:

It has come to my attention that the Senate Judiciary, Corrections and Privacy Committee may take executive action on a compromise amendment to 2005 Senate Bill 215 that mirrors a proposal put forward by an independent group of small gas station owners. I wish to express my support for this compromise amendment.

Our constituents need gas price relief and they should not have to wait any longer for it. The state's existing minimum mark-up law denies them much needed relief and prevents retailers from offering their customers a better price on a gallon of gas. A small group of independent gas station owners have come forward with a thoughtful proposal that will provide gas price relief to consumers without putting small retailers at a competitive disadvantage.

I encourage you and your fellow committee members to approve this amendment to SB 215 so that the full Legislature can act on the bill before the end of the year. If I can be of further assistance, please let me know.

Sincerely,

Scott R. Jensen
98th District
State Representative

cc: Members, Senate Judiciary, Corrections and Privacy Committee

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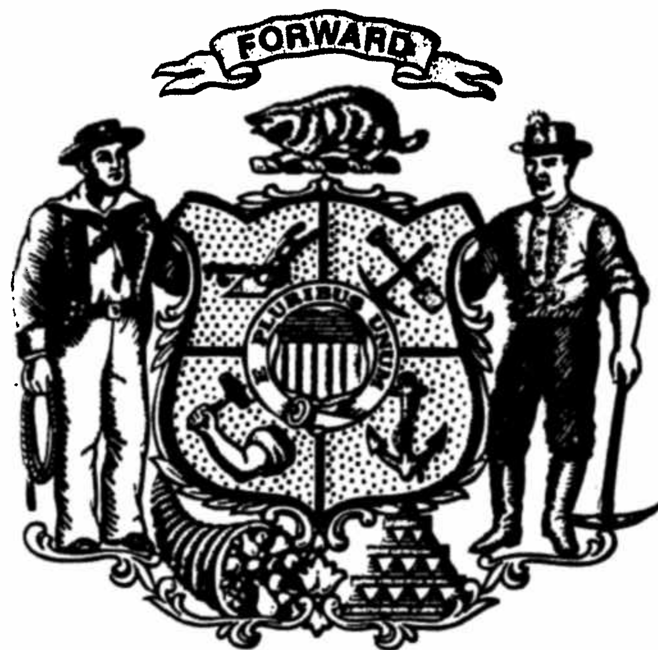
FORWARD
E PLURIBUS UNUM

STATE SENATOR DAVE ZIEN

PRESIDENT PRO TEMPORE

CHAIRPERSON
COMMITTEE ON JUDICIARY, CORRECTIONS AND PRIVACY
VICE CHAIRPERSON
COMMITTEE ON VETERANS, HOMELAND SECURITY, MILITARY AFFAIRS, SMALL BUSINESS AND GOVERNMENT REFORM
MEMBER
COMMITTEE ON JOB CREATION, ECONOMIC DEVELOPMENT AND CONSUMER AFFAIRS
SENTENCING COMMISSION
COUNCIL ON TOURISM
JUDICIAL COUNCIL
JOINT LEGISLATIVE COUNCIL
BUILDING COMMISSION
STATE-TRIBAL RELATIONS COMMITTEE

TO: Committee Members

FR: Senator Zien

DT: November 30, 2005

RE: Compromise amendment to SB 215

Senate Bill 215 repeals the 3% wholesale markup and 6% retail markup on gasoline. In direct response to concerns by gas retailers that a large corporation would sell at or below cost and drive them out of business, our bill contains protections from predatory pricing by prohibiting below or at cost sales.

The amendment we will be voting on today does the following:

- Eliminates the 3% wholesaler markup
- Reduces the retailer markup from 6% to 4%
- Requires a 3 cent markup per gallon between the retailer and the consumer
- The "meeting competition" pricing aspect of the law would be changed to read that a station shall never sell at or below cost, and the look back period changes from 10 to 7 days. (The Petroleum Marketers have requested this change)

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