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Gasoline Marketing Divestiture Statutes: A Preliminary Constitutional and Economic Assessment

Hunter M. Meriwether

James C. Smith

NOTE

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I. INTRODUCTION

The past few years have witnessed several disruptive developments in the international petroleum industry that have significantly affected the operations of many of the "major"[1] U.S. oil companies. Most notably, the recent takeover of nearly all foreign crude oil production by the OPEC nations has resulted in a quadrupling of the price of foreign crude oil,[2] on which many of the U.S. oil majors have relied heavily.[3] These developments and others[4] have led many of the oil majors to reexamine and change some of their traditional methods of operation, particularly at the gasoline marketing level.[5]

Traditionally, the major oil companies have pursued a market saturation strategy, blanketing their markets with a large number of convenient, single-brand, relatively low-volume service stations.[6] These stations have generally been operated by "independent dealers" who lease outlets and purchase gasoline from the oil majors.[7]

For a variety of reasons, most of the oil majors recently have realized that their traditional market saturation strategy is no longer efficient.[8] Consequently, many of the majors have begun

1. The term "major" (or "oil major" or "major oil company") does not appear to admit of precise definition. Two leading commentators implicitly classify the approximately 20 largest vertically integrated oil companies as "major," and classify approximately 20 smaller but integrated firms as "semimajor." F. ALLVINE & J. PATTERSON, COMPETITION LTD.: THE MARKETING OF GASOLINE 212 (1972) [hereinafter cited as ALLVINE & PATTERSON]. Despite the absence of a precise definition, the term "major" is commonly used in petroleum industry publications such as NATIONAL PETROLEUM NEWS and U.S. OIL WEEK.

No doubt due to its imprecise meaning, none of the marketing divestiture measures proposed thus far uses the term "major." *See, e.g.*, FLA. STAT. ANN. § 526.151 (Supp. 1974) ("no producer, [or] refiner . . . shall operate . . . retail service stations . . . ."). Every enacted marketing divestiture statute purports to apply to all vertically integrated oil companies. *See* notes 95-99 *infra* and accompanying text. As a recent Florida trial court opinion indicates, however, it remains uncertain whether these statutes will he applied only to "major" oil companies or to all vertically integrated oil firms. *See* note 102 *infra*. For the purposes of this note the term "major," although admittedly legally imprecise, will be used to mean the approximately 20 largest vertically integrated oil corporations to which the statutes assuredly would apply.

2. *See* BUS. WEEK, Feb. 2, 1974, at 53. For an excellent description of the OPEC nations' method of establishing the posted price of crude oil, see BUS. WEEK, Jan. 5, 1974, at 20.

3. *See* Wall Street J., Mar. 13, 1975, at 6, col. 2; Report on Competition in the Petroleum Industry, Exxon Corporation, Before the Subcomm. on the Study of Antitrust and Monopoly of The Senate Comm. on the Judiciary, 94th Cong., 1st Sess., Jan. 21, 1975, at 4.

4. In addition to the OPEC-initiated disruptions in the Middle East, the major oil companies have been confronted by a variety of domestic, public, and governmental pressures. *See* notes 74-77 *infra* and accompanying text.

5. *See* FORBES, Jan. 15, 1973, at 22-23. *See generally Plotting Marketing's New Game Plan*, NAT'L PETROLEUM NEWS, Aug. 1974, at 34.

6. ALLVINE & PATTERSON, *supra* note 1, at 3, 29.

7. *Id.* at 44-46.

8. *See* notes 62-70 *infra* and accompanying text.

streamlining their marketing systems. In order to reduce their total number of stations, many majors have begun closing their unprofitable dealer-operated outlets.[9] To further reduce marketing overheads, some of the majors have begun introducing self-service gasoline stations operated by salaried company employees rather than by independent dealers.[10]

Threatened by these emerging changes in the majors' marketing strategies, independent retail gasoline dealers associations have lobbied intensively for protective legislation, alleging that the majors' marketing changes constitute predatory activity.[11] In an atmosphere of increased public scrutiny of the petroleum industry,[12] many state legislatures have responded by considering a variety of protective measures.[13] Among the measures are marketing divestiture statutes designed to limit or prohibit ownership or control of retail gasoline service stations by vertically integrated major oil companies.[14] The proposed marketing divestiture measures have fallen into two principal categories: (1) those that would prohibit all ownership of retail-level service stations by any vertically integrated major oil company;[15] and (2) those that would prohibit[16] or restrict[17] the establishment of retail service stations operated by major oil company employees. Marketing divestiture legislation has been passed in three states,[18] rejected in eleven,[19] and awaits consideration in several others.[20] Additionally, Congress recently has begun considera-

9. *See* notes 79-80 *infra* and accompanying text.

10. *See* notes 82-85 *infra* and accompanying text.

11. *See* BUS. WEEK, Dec. 15, 1973, at 20.

12. *See* notes 74, 92-94 *infra* and accompanying text.

13. Prior to the recent introduction of marketing divestiture proposals, a number of states had enacted franchising laws affecting gasoline dealers. These so-called "Dealer Day in Court" statutes generally require that the landlord-supplier "major" make written disclosure to a prospective dealer of the material terms and obligations of the franchise agreement between them. Such laws also generally prohibit termination of or failure to renew the agreements unless justified hy "good cause." *See, e.g.*, CAL. CORP. CODE §§ 31,005, 31,101 (West Supp. 1975); MASS. ANN. LAWS ch. 93E, §§ 1-8 (1975).

14. As indicated in note 1, *supra*, it remains unclear exactly which "semimajor" oil companies fall within the ambit of the proposed marketing divestiture measures.

15. *See, e.g.*, Petroleum Industry Divestiture Act of 1974, Cal. S. 2121 (Apr. 16, 1974) (proposal later defeated).

16. *See, e.g.*, MD. ANN. CODE art. 56, § 157E *Supp. 1975.*

17. *See, e.g.*, FLA. STAT. ANN. § 526.151 (Supp. 1974).

18. As of October 1, 1975, only Delaware, Florida and Maryland had enacted marketing divestiture legislation.

19. As of October 1, 1975, the following states had rejected divestiture proposals: California, Connecticut, Georgia, Louisiana, Massachusetts, Minnesota, New York, Pennsylvania, Rhode Island, Tennessee and Wisconsin.

20. As of October 1, 1975, Arkansas, New Jersey, Vermont, and the District of Columbia had begun consideration of marketing divestiture proposals. In addition, California, Massa-

tion of several similar proposals.[21] Although divestiture has been prescribed by the courts as a remedy for antitrust violations,[22] the sanction has been directed at specific offenders. In contrast, the proposed statutes apply divestiture to an entire class of competitors within a huge industry. This Note proposes to analyze the constitutionality and potential economic effect of marketing divestiture legislation in the petroleum industry. For reasons that will be more fully explored in the following discussion, this Note adopts the position that divestiture is an inappropriate remedy for present gasoline marketing difficulties, particularly since less drastic alternatives can be fashioned to prevent alleged anticompetitive behavior by major oil companies without excluding them from the retail gasoline marketplace.

A. *Economic Background*

To fully explicate the problems that divestiture statutes purport to address, several structural aspects of the oil industry and the traditional marketing system of the oil majors must be explained; the recent developments that have disrupted the petroleum industry and the resultant changes in the majors' marketing strategies must be described; and the impact of these marketing shifts on the independent dealers must be assessed.

(1) Structural Features Affecting Marketing

Several structural features of the petroleum industry have significantly affected competition among the major oil companies, and hence have had a distinct impact on the majors' traditional methods of marketing gasoline. These features include the relative level of concentration present in the oil industry, the majors' vertically integrated structure, and the pivotal role of crude oil production in all petroleum industry activity.[23] Because the majors' general marketing strategies are in large measure a logical outgrowth of these three interrelated structural factors,[24] each factor requires description in some detail. At the outset, emphasis must be placed on the fact that the discussion of petroleum industry structure and its effect on in-

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chusetts, and Pennsylvania, three states that rejected earlier marketing divestiture proposals, have begun considering new divestiture bills.

21. An array of roughly similar divestiture bills recently have been introduced in both the House of Representatives and the Senate. *See* note 100 *infra* and accompanying text.

22. *See, e.g.*, United States v. Paramount Pictures, Inc., 334 U.S. 131, 152 (1948); Standard Oil Co. v. United States, 221 U.S. 1 (1911).

23. *See* ALLVINE & PATTERSON, *supra* note 1, at 10-11.

24. *Id.* at 9, 211.

dustry performance is based on the pre-1973 state of the oil industry. In light of the disruptive events of the past two years, particularly the changes in OPEC oil policies, significant questions have arisen concerning whether the basic structural factors that have traditionally characterized the petroleum industry will continue to exert the same effects on oil industry performance, particularly the performance of major oil companies.

The petroleum industry in the United States is dominated by fifteen to twenty vertically integrated major oil companies that rank among the world's largest business firms.[25] In 1974, for example, ten of the twenty largest U.S. industrial corporations, ranked by total sales, were major oil companies.[26] Viewed collectively, these oil majors control approximately 70 percent of all domestic crude oil production, over 85 percent of domestic refining capacity, and nearly 75 percent of all gasoline marketed to consumers.[27] These firms are remarkably similar in terms of their structural organization and general methods of operation.[28]

Although national retail gasoline market share statistics indicate that the U.S. petroleum industry is no more concentrated than many other workably competitive industries,[29] the data is somewhat misleading because most of the major oil companies are not evenly represented throughout the nation's markets.[30] For this reason, regional geographic markets, such as those in the New England or Middle Atlantic states, provide a more accurate indication of actual concentration levels within the oil industry. Only a few of the majors will be intensively represented within any given regional market and other majors will possess lesser market shares or none at all.[31] Consequently, concentration of major firms at the regional level is much greater than national statistics would indicate. The net result of this relatively high regional concentration level is that most regional markets effectively are dominated by those few intensively represented majors.[32]

Regional concentration in the oil industry has resulted in oligo-

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25. *Id.* at 10, 212.
26. FORTUNE, May 1975, at 210.
27. NAT'L J. REP., Mar. 9, 1974, at 343.
28. ALLVINE & PATTERSON, *supra* note 1, at 10.
29. For example, in 1974 Shell and Texaco possessed the largest national retail gasoline market shares; yet their respective market shares were only 8.07% and 7.39%. Furthermore, in 1974 fully 16 firms possessed at least a 1% share of the national retail gasoline market. *See* NAT'L PETROLEUM NEWS FACTBOOK ISSUE, Mid-May, 1975, at 99 (quoting Lundberg Survey Statistics).
30. *See* ALLVINE & PATTERSON, *supra* note 1, at 11-21.
31. *Id.*
32. *Id.*

polistic behavior, at least in the pricing area.[33] The majors' conscious pricing parallelism has occurred because in a concentrated market atmosphere no intensively represented firm could significantly lower its prices in order to increase its sales volume without eliciting a corresponding reaction from its competitors, resulting in the retention of original market share with lower profit margins by each major firm.[34] Consequently, the oil majors traditionally have refrained from meaningful price competition, preferring to adhere to the prices posted by those firms possessing the largest market shares within each region.[35]

It should be noted that price competition is not entirely absent from the retail gasoline market. Private-brand marketers[36] have been able to inject a measure of price competition into the market by undercutting the majors' prevailing retail prices.[37] The price marketers, however, are not involved in crude oil production activities, and therefore must purchase much of their raw material requirements from the integrated majors.[38] This costly dependency has limited the price marketers' ability to compete on a large scale with the majors. Thus, despite the presence of price marketers, the majors still control nearly three-fourths of the retail gasoline market and maintain artificially high retail price levels thoughout the nation through nonprice competition.[39]

Another structural feature which has substantially determined the traditional process by which the majors market gasoline is vertical integration. All of the major oil companies are completely vertically integrated.[40] In the context of the oil industry, vertical integration means that each company controls its own crude oil producing, refining, transporting (i.e. pipelining), and marketing levels of activity. A principal advantage of this form of organization is that it has the potential to permit each successive level of enterprise in the company to purchase its requirements from other divisions within the company rather than on the open market.[41] Thus the marketing division of a vertically integrated firm can obtain its gasoline from the refining division, which obtains its crude oil requirements from

33. *Id.* at 10, 212-14.

34. *Id.*

35. *Id.*

36. Private brand marketers are nonintegrated firms operating only at the gasoline marketing level. *Id.* at 5, 268-70.

37. *See* BUS. WEEK, May 13, 1972, at 135; FORBES, Jan. 15, 1973, at 22-23.

38. *See* ALLVINE & PATTERSON, *supra* note 1, at 240-41; text accompanying notes 46-47 *infra*.

39. ALLVINE & PATTERSON, *supra* note 1, at 240-41.

40. *Id.* at 10.

41. *Id.*

the crude oil production division. This potentially self-contained operations system[42] enables the majors to establish by managerial decision transfer prices and hence gross margins, which permits the company within broad parameters to manipulate its profits as it chooses.[43] The logic of a vertically integrated system dictates that its business behavior will be governed by its overall profitability as a company rather than by its profitability at any given level of operations. The vertically integrated firm, therefore, manipulates its profit margins among its various levels of operation seeking maximization of its overall company profits.[44]

Theoretically, vertical integration is not per se anticompetitive if all the essential levels of enterprise within the industry effectively are competitive. Indeed, a persuasive argument can be made that vertical integration permits greater firm efficiency, which produces significant cost savings at the consumer level.[45] If one or more levels of industry activity effectively are controlled by vertically integrated firms, however, these firms may be able to use their vertically integrated structure as a lever to extend their strategic advantage to other levels of industry enterprise.[46] By concentrating their profits at the level they control, the integrated firms set an artifically high price for the goods produced at that level. The nonintegrated firms must buy these products from their integrated competitors at an inflated price, which impairs the ability of nonintegrated firms to compete. By concentrating their profits at this controlled level the integrated firms effectively shrink their profit margins at the other levels of industry activity. Operations at these profit-squeezed levels are then subsidized from the outsized profits taken at the controlled level, which insulates these other activities from competitive pressures at their respective levels. This process of manipulating margins enables the integrated firms to undercut their competition not only at their controlled level but also at other potentially competitive levels of industry activity.[47]

The petroleum industry is illustrative of the kind of actual

42. A vertically integrated system will be self-contained only to the extent that each level of operation can produce all the product requirements of the next downstream level.

43. *See* ALLVINE & PATTERSON, *supra* note 1, at 10.

44. *Id.* at 269.

45. *See* note 231 *infra* and accompanying text.

46. *See* ALLVINE & PATTERSON, *supra* note 1, at 215. Achievement of this strategic advantage through the leverage of vertical integration would not necessarily require a conspiracy or other joint activity among the oil majors. Since all of the majors are vertically integrated, and therefore to some extent governed by the logic of vertically integrated methods of operation, they conceivably could attain the same aggregate competitive advantage even while acting independently of each other.

47. *Id.* at 215, 268-70.

market structure conducive to profit margin manipulation by vertically integrated firms. The major oil companies, through internal growth and merger activity, have obtained effective control of the crude oil production stage of industry operations.[48] By concentrating their profits at this controlled stage, the oil majors effectively have maintained the price of this essential raw material at an artificially high level. Furthermore, the majors have squeezed their profit margins at the "downstream" refining and marketing stages, subsidizing[49] these levels with their inflated crude oil profits, a practice which undercuts their nonintegrated competitors at the downstream levels. In this manner, the majors have combined their control of crude oil production with their vertically integrated structures to extend their realm of effective control to include the otherwise workably competitive refining and marketing levels of industry enterprise.[50]

The oil majors have chosen to concentrate their profits at the crude oil production level for several reasons. First, the majors in the aggregate have dominated most of the crude oil production activities in the industry.[51] Secondly, the majors have been able to produce crude oil at a minimal per barrel expense to themselves; by concentrating their profits at this stage they have been able to sell this essential raw material at an artifically high price to a "captive audience" (their own downstream operations, their nonintegrated competitors, and ultimately the consumer).[52] Thirdly, added incentive to concentrate profits at this level[53] is provided by a number of corporate tax laws, particularly the oil depletion allowance, foreign tax credits, and intangible tax writeoffs, all of which have singled out crude oil production activities for favored tax treatment.

This entire process of using their vertically integrated systems of operation to shift company profits to the crude oil production stage has had enormous consequences for the majors' basic gasoline marketing system. In essence, the majors traditionally have viewed their marketing operations purely as a device to maximize crude oil profits.[54] Consequently, the express purpose of the majors' marketing systems has been to move as much gasoline through their service

48. *Id.* at 218-36.

49. For a comprehensive discussion of the majors' use of price support programs to enable their dealers to compete with price marketers, see *id.* at 179-99.

50. *Id.* at 269.

51. *Id.* at 217-19.

52. *Id.* at 240-41.

53. For an excellent discussion of the tax mechanisms which effectively give preferential treatment to crude oil production profits, see *id.* at 253-68.

54. *Id.* at 268-69.

station pumps as possible. Whether or not their marketing operations produced a healthy profit at their own level traditionally has been a distinctly secondary concern to the majors, because their company-wide profits have depended on the total volume of crude oil sold, and not on the relative efficiency of their marketing operations.[55]

(2) The Majors' Traditional Marketing Strategy

When viewed in the context of the structure of the petroleum industry, it is not surprising that the basic principle underlying the majors' traditional marketing strategy has been that price competition on the retail level must be avoided because it exerts downward pressure on the majors' artificially high crude oil prices. This absence of meaningful price competition naturally has led the majors to concentrate on nonprice forms of competition in their marketing activities.[56]

Since price generally has not been a competitive factor among the majors at the retail gasoline marketing level, they have had to find nonprice methods designed to create consumer brand preference for a product whose essential physical properties are the same regardless of brand.[57] Since the correlation between market coverage and total sales volume is strong in the gasoline industry, the logical nonprice factor emphasized in the majors' marketing strategies has been convenience to the consumer.[58] Consequently, the majors' traditional marketing style has been to saturate their markets with literally hundreds of thousands of highly convenient, single-brand retail gasoline service stations. This traditional manner of marketing remains predominant among most oil majors today, and exists in marked contrast to the high volume, low profit margin, mass-merchandising techniques that have become prevalent in most other nondurable goods industries.[59]

In their push to maximize profits at the crude oil production level, the majors have established a vast network of retail outlets. Since convenience was the primary patronage tool used by the majors to build customer brand preference, the traditional marketing wisdom has been that the firm operating the most retail outlets within any given market would attract the most business and there-

55. *Id.*
56. *See* note 35 *supra* and accompanying text.
57. ALLVINE & PATTERSON, *supra* note 1, at 7.
58. *Id.* at 29.
59. *Id.* at 2-3.

fore move the greatest volume of gasoline.[60] The rationale has been correct to the extent that if the aggregate sales volume of each major's stations in a given market was compared with that of other majors, then the total volume of the more market-intensive firm would exceed that of less intensively represented firms.[61] One unfortunate consequence of this market saturation strategy, however, has been that it resulted in too many retail outlets within each market.[62] In addition to competing against other major-branded stations in the market area, the average service station also has had to compete with other nearby stations selling the same brand. Consequently, when the available demand was split among this vast number of outlets, each station sold on the average far less gasoline than it was capable of selling.[63]

The majors' high dealer turnover rate, which has averaged about 25 percent each year, and has been even greater among lower volume stations,[64] bears out this basic inefficiency in the majors' retail distribution structure. Further evidence of the inherent flabbiness of the majors' marketing system surfaced when independent "private brand" marketers, nonintegrated gasoline companies operating only at the retail distribution level, began to make significant inroads into the majors' markets by successfully introducing mass-merchandising techniques into the gasoline marketing business.[65] Although these private branders had to buy their gasoline from refineries controlled by the majors at the majors' inflated crude oil prices, they nonetheless were able to reduce their marketing overheads by using high volume, low profit margin self-service retail outlets.[66] Such low overhead marketing facilities enabled the private branders to sell their gasoline at a slightly cheaper rate than their major-firm competitors, which cut into the majors' aggregate market share. Indeed, by 1972 the private marketers had increased their share of the total gasoline market approximately 50 percent over the share held a decade earlier.[67]

Despite the obvious inefficiencies inherent in their saturation method of marketing, the majors until recently continued to main-

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60. *See id.* at 31-32.

61. *Id.*

62. *Id.* at 4-5, 32-33.

63. *Id.* at 4-5.

64. *Id.* at 5, 30. *See generally* NAT'L PETROLEUM NEWS FACTBOOK ISSUE, Mid-May 1974, at 58.

65. *See* notes 36-39 *supra* and accompanying text.

66. *See* ALLVINE & PATTERSON, *supra* note 1, at 101-02.

67. *See* BUS. WEEK, May 13, 1972, at 135; FORBES, Jan. 15, 1973, at 22-23. Exxon Corporation recently testified that the United States is presently dependent on foreign sources for nearly 40% of its petroleum needs. *See* note 3 *supra*.

tain this topheavy retail distribution system. The traditional justification for this underutilized retail capital structure was that, despite inefficiencies, the saturation system nevertheless permitted the majors to distribute the maximum volume of gasoline to the consumer, which maximized crude oil profit potential.[68] The rationale, however, was dependent upon the ability of the majors to produce a sufficient volume of inexpensive crude oil to meet the requirements of their retail outlets. During the 1950's most of the majors produced sufficient crude oil domestically to meet their marketing needs.[69] Increasingly, however, many of the majors began developing foreign crude oil production operations, most notably in the crude-rich Middle East. This shift to foreign crude production occurred because the raw material was far more plentiful abroad and could be produced more cheaply than in the United States. One significant consequence of this new emphasis on foreign crude oil was that the incentive to expand domestic crude oil exploration and production capabilities no longer existed. The Arab oil reserves seemed infinite; consequently, capital investment funds earmarked for crude oil production were diverted abroad. By 1972 the net effect of this capital investment policy in the petroleum industry was evident, since the U.S. was then importing nearly 25 percent of its oil needs from foreign oil-producing nations.[70]

(3) New Developments and Their Effect on the Oil Majors

In 1973 the OPEC nations, acting in unprecedented concert, implemented a policy that threatened the entire structure of the international petroleum industry. After instituting an oil embargo that plummented the oil-consuming nations into an energy crisis, the oil-producing nations effectively quadrupled the price of foreign crude oil by drastically increasing the taxes and royalties imposed on each barrel produced within their borders.[71] The price increase remains substantially in effect at the present time.[72]

By 1973 most of the major oil companies maintaining strong crude oil self-sufficiency positions depended heavily on their foreign operations for much of their crude oil. Since the majors' vertically integrated system of operation was predicated on an abundant supply of inexpensively produced crude oil, the OPEC-initiated increases in the cost of producing foreign crude effectively deflated

68. *See* ALLVINE & PATTERSON, *supra* note 1, at 268-69.
69. BUS. WEEK, Oct. 21, 1972, at 18.
70. *Id.*
71. *See* notes 2-3 *supra* and accompanying text.
72. Wall Street J., Mar. 13, 1975, at 6, col. 2.

much of the majors' traditionally outsized profit margins at the crude oil production level, which reduced their incentive to concentrate profits at that level of industry activity.[73]

At the same time the oil majors were being subjected to increased public and governmental pressures on the domestic front. Angered by the fuel shortages and huge major oil company profits which resulted from the OPEC embargo during the winter of 1973, legislators in Congress began initiating proposals designed to strip the oil majors of their special tax status. Most notable among these measures was a bill to repeal the oil depletion allowance and eliminate foreign tax credits.[74]

Additionally, gradual developments of the past several years had resulted in a significant fragmentation of the gasoline-consuming public.[75] Traditionally, consumer allegiance strongly was oriented toward the typical major-brand, convenience-oriented full-service style of marketing. Then the rise of price marketers began to give consumers a meaningful choice between price and service.[76] This choice became all the more significant in 1973 when events in the Middle East led to a doubling of retail gasoline prices throughout the nation. This precipitous price increase led many consumers to abandon their traditional convenience-service orientation and to begin actively seeking stations offering the lowest prices.[77]

Faced in early 1974 with the reality of vastly increased crude oil production costs, the substantial probability of loss of preferential tax treatment of crude oil production profits, and the fragmentation of consumer demand, the majors were forced to reexamine their entire vertically integrated structure and function. No longer could the majors expect to rely on their concentrated profits at the crude oil production stage to subsidize their less efficient downstream operations. Each of the levels of enterprise in the majors' vertically integrated system must show a reasonable profit in its own right.[78]

These belated realizations have led the majors to begin implementing substantial changes in their basic marketing philosophies. Profit rather than volume has become the chief marketing goal.

73. *Id.*

74. *See* Wall Street J., Mar. 26, 1975, at 34, col. 1. On March 29, 1975, the oil depletion allowance was repealed for major oil companies. Tax Reduction Act of 1975, Pub. L. No. 94-12, § 501 (Mar. 29, 1975).

75. *See* FORBES, Jan. 15, 1973, at 22-23.

76. *See* notes 65-67 *supra* and accompanying text.

77. *See* FORBES, Jan. 15, 1973, at 22-23.

78. *See Plotting Marketing's New Game Plan*, NAT'L PETROLEUM NEWS, Aug. 1974, at 36.

Since they can no longer afford to support their excessively top-heavy investment at the retail distribution level, the majors have begun closing their more marginal dealer-operated service stations.[79] Traditionally, the majors had attempted to keep these marginal outlets open in order to retain the additional volume unprofitable stations provided. Furthermore, under the traditional market saturation system, the major generally reopened the outlet under new management whenever a dealer terminated his retail operation. Under the new marketing system most of the marginal stations closed by the majors have not been reopened.[80]

Additionally, in establishing new marketing facilities, the majors recently have been guided by substantially different retailing notions. Instead of attempting to saturate their markets with an outlet on every streetcorner, the majors have been building new stations only at key locations along main traffic arteries.[81] The majors' new marketing objective is essentially to streamline their retail distribution system, retaining only those dealer-operated stations able to return reasonable profits, and introducing a few high-volume, low-overhead service stations into each market.

In changing their strategy from market saturation to mass-merchandising, the majors have begun experimenting with a variety of new retailing techniques. One of their most significant new devices is the self-service station, already successfully introduced by the private-brand marketers.[82] While the cost-efficiency potential of self-service retailing is obvious, the technique generally is limited to gasoline-only operations. This limitation has created a problem for the majors, who are unwilling to restrict themselves to gasoline sales and thereby forego other revenues traditionally realized by full-service operations such as auto repair business and tires-battery-accessory (TBA) sales. Hoping to reduce overall marketing overheads without losing non-gasoline customer patronage, most of the majors have sought to strike a balance between their gasoline-only self-service outlets and their traditional full-service stations.[83]

79. *See* Bus. Week, Dec. 15, 1973, at 20 (article quotes American Petroleum Institute statistics showing that nearly 5% of the nation's gasoline stations—over 10,000 outlets—folded during 1973 alone).

80. *See* Nat'l Petroleum News Bull. May 5, 1975, at 4; Nat'l Petroleum News Factbook Issue, Mid-May 1974, at 58.

81. For example, in 1973, according to the American Petroleum Institute, only 971 new stations were built throughout the nation. By way of comparison, in 1968, 3,740 new stations were built. *See* Nat'l Petroleum News Factbook Issue, Mid-May 1974, at 58.

82. *See* note 66 *supra* and accompanying text.

83. *See Plotting Marketing's New Game Plan*, Nat'l Petroleum News, Aug. 1974, at 39.

Several oil majors recently have begun implementing a complete departure from their traditional full-service marketing orientation. The cost efficiencies already realized in many of their self-service operations have prompted these majors to begin converting their entire marketing system into a melange of specialized outlets. Such specialization systems include gasoline-only self-service stations, minor "do-it-yourself" auto-repair shops, front-end specialty shops, and TBA retailing centers.[84]

The trend toward specialized retail service operations also has caused many majors to begin operating their new outlets on an experimental salaried employee basis rather than through "independent" dealers. The majors' justification for this potentially sweeping change is that a specialized retail operation must be administered by a specialist; to insure proper training and supervision, these new dealers should be company employees.[85]

Another equally significant reason for the majors' emerging conversion to company-operated outlets is their increasing concern over the recent proliferation of state "Dealer Day in Court" (franchising) statutes.[86] These franchising laws, designed to prevent control-related abuses on independent dealers by landlord-supplier majors, are viewed by the majors as an undue restriction on their perceived right to control the manner in which their branded gasoline is marketed. In response, many majors have begun instituting company operations at the retail level in order to avoid restrictive franchising laws.[87]

(4) Impact of the Majors' Marketing Changes on Independent Dealers

The majors' potentially sweeping marketing changes have posed a direct threat to the independent major-brand dealers. Although the typical dealer's lot under the often-marginal traditional marketing system has been no bed of roses, the dealers nevertheless have a vested interest in this full-service retailing style. As an initial matter, since many of the new marketing changes would enable the majors to avoid the dealer-independence provisions of many state franchising laws, the dealers look upon the changes as a threat to

84. *See* NAT'L PETROLEUM NEWS, Aug. 1974, at 34, 38.

85. *Id.*

86. *See* note 13 *supra*.

87. *See* Harrell & Searcy, *Current Antitrust Problems of the Antitrust Supplier*, 25 INST. ON OIL & GAS L. & TAX. 163 (1974); NAT'L PETROLEUM NEWS, Mar. 1974, at 36. Recently, Exxon announced plans to convert 1,000 of its dealer-operated stations to salaried-employee operations. NAT'L PETROLEUM NEWS BULL., Feb. 3, 1975, at 1.

their new-found economic freedom. More importantly, however, these emerging marketing changes threaten many dealers' financial existence.

Specifically, the dealers' concerns are threefold. First, they are threatened by the majors' decisions to streamline their marketing structures by operating fewer outlets. The majors' traditional strategy had been to maintain even their more marginal stations through subsidies and price protection programs.[88] The dealers over the years have come to rely on this traditional policy, and consequently feel betrayed by the majors' new decision to close the more marginal outlets.[89] Secondly, the spector of replacement of the traditional full-service marketing system with an all-specialized, company-employee-operated system at least potentially threatens to put virtually every independent dealer out of business.[90] Thirdly, even if the majors were to limit their marketing changes to the introduction of a few company-operated self-service stations in each market area, which would create a balance between the new outlets and their traditional full-service stations, the dealers nonetheless would be threatened with serious financial problems. The company-operated self-service stations, having fewer overhead expenses, would have a significant competitive advantage over the full-service dealers. Since the gasoline retailing business is often marginal at any rate, even this limited shift in the majors' market structure threatens the dealers with financial ruin.[91]

By 1974 the majors had become the object of significant public hostility arising from general dissatisfaction with oil industry performance during the energy crisis.[92] The OPEC-instituted oil embargo had resulted in doubled gasoline prices and near-critical fuel shortages throughout the nation. Additionally, independent private-brand marketers, who regularly purchased their gasoline from the majors, complained that during the fuel shortage the majors attempted to eliminate private-brand competitors from the marketplace by monopolizing existing gasoline supplies.[93] Finally,

88. *See* note 49 *supra* and accompanying text.

89. *See* BUS. WEEK, Dec. 15, 1973, at 20.

90. *See* notes 84-85 *supra* and accompanying text.

91. The basis for dealers' fear of company-operated stations is twofold. First, a successful company-operated self-service station, like its private-brander precursors, would have fewer nonproduct costs than the traditional full-service dealer operation, and thus would be able to undersell the dealer. Secondly, the introduction of a few company-operated stations into each market area raises the potential prospect of the majors using their vertical integration as leverage not only to undercut their nonintegrated competitors but also to squeeze their own more marginal dealers.

92. *See* text accompanying note 74 *supra*.

93. The outcry from private marketers and independent refiners led to the passage of

at the end of 1974 most of the majors announced record-level company profits that, in view of the year's events, appeared to have been earned at the public's expense.[94]

Faced with the threats inherent in many of the majors' marketing changes, independent gasoline dealers associations have capitalized on the already-existing atmosphere of public anger and governmental scrutiny by lobbying intensively on both state and federal levels for protective legislation. A number of legislatures have responded by proposing marketing divestiture statutes; to date three states, Maryland, Florida, and Delaware, have enacted such measures into law.

B. The Marketing Divestiture Statutes

Thus far, two basic types of marketing divestiture measures have been proposed: (1) those prohibiting all ownership of marketing outlets by vertically integrated oil companies; and (2) those prohibiting or limiting the establishment of company-operated stations by vertically integrated oil companies.

The first category is best exemplified by the California proposal that reads in pertinent part as follows:

> It shall be unlawful, after one year from the date of enactment of this act, for any person to own or control, or have any interest in any gasoline marketing outlet within the State of California who is also engaged in the business of producing, refining, or transporting petroleum.[95]

These "complete" marketing divestiture measures are clearly the more radical of the two basic categories outlined above. In addition to prohibiting the use of company-operated stations, these measures also would prohibit vertically integrated oil producers from having any ownership interest whatsoever in marketing facilities. These statutes would effectively prohibit major oil companies from engaging in marketing activities even on a dealer-operated basis, since they would be prohibited from owning any realty used for gasoline marketing purposes. Furthermore, the proposals would require the majors to divest themselves of existing service station properties. The radical nature of these proposals perhaps is reflected best by the fact that such measures have been proposed in only six

the Emergency Petroleum Allocation Act, 15 U.S.C.A. §§ 751-56 (Supp. 1975).

94. Additionally, the oil majors' claims that their profits were essential to finance increased domestic exploration and drilling were partially belied by a numher of majors' use of profits to acquire oil-unrelated companies, such as Mobil's acquisition of Marcor, Inc.

95. Cal. S. 2121 (Apr. 16, 1974). This proposal was subsequently defeated in the California Assembly.

states, and to date five states have refused to enact them.[96] One proposal is still pending.[97]

The second group of divestiture statutes contains two subcategories: those prohibiting all company-operated stations; and those limiting the number of company-operated outlets to a small percentage of the total number of stations selling that company's brands within the state. The Maryland statute is indicative of the first subcategory; its operative provisions read as follows:

> . . . no producer or refiner of petroleum products shall operate a major brand, secondary brand or unbranded retail service station in the State of Maryland, with company personnel, a subsidiary company, or a commissioned agent.[98]

The Florida statute exemplifies the second subcategory and reads in pertinent part as follows:

> After October 1, 1974, no producer, refiner, or a subsidiary of any producer or refiner, shall operate with company personnel, in excess of three percent of the total number of all classes of retail service stations selling its petroleum products, under its own brand or secondary brand. . . . Provided, however, this act shall not apply to any service station operated by a producer or refiner of petroleum products who purchases or obtains more than 90% of the unrefined petroleum products to be so refined from another producer or refiner of petroleum products.[99]

On the federal level, several roughly similar marketing divestiture bills have been proposed in Congress.[100] Each of these proposed measures, with slight variations, would effectively prohibit the ownership of marketing outlets by any firm[101] engaged in producing, refining, or transporting petroleum products. To date none of these bills has been reported out of committee.

Within the past few months, several major oil companies jointly have filed suit in the Maryland, Florida, and Delaware state courts seeking to enjoin enforcement of the statutes in those states.[101] The trial court in the Florida challenge, the only one that has proceeded to a final judgment, enjoined enforcement of the statute on state constitutional grounds.[102] Because the decision did not address fed-

96. "Complete" divestiture proposals have been defeated in California, Louisiana, Minnesota, Pennsylvania, and Wisconsin.

97. N.J. Ass. 1411 (1974).

98. MD. ANN. CODE art. 56, § 157E(c) (Supp. 1975).

99. FLA. STAT. ANN. § 526.151(1), (3) (Supp. 1974).

100. Congressional divestiture bills proposed during the present congressional session include S. 739, S. 745, S. 756, S. 1137, S. 2387, H.R. 310, H.R. 1011, H.R. 1044, H.R. 2263, H.R. 2873, H.R. 4910, H.R. 7012, H.R. 8117, 94th Cong., 2d Sess. (1975).

101. Exxon Corp. v. Connor, Case No. 74-1449 (Cir. Ct. Fla., Jan. 23, 1975); Exxon Corp. v. Mandell, Equity No. 22,069 (Cir. Ct. of Anne Arundel County, Md., filed June 17, 1974); Exxon Corp. v. Pribbett, Civil Action No. 4774 (Ch. Ct. of Newcastle County, Del., filed April 18, 1975).

102. Exxon Corp. v. Connor, Case No. 74-1449 (Cir. Ct. Fla., Jan. 23, 1975).

eral constitutional challenges and because the trial court judgment was not appealed, this initial decision likely will have a limited effect on divestiture litigation both at the state and federal level. Consequently, the constitutionality of marketing divestiture legislation remains an unresolved issue.

II. Federal Constitutional Challenges

Regardless of the form adopted, the divestiture statutes are radical economic legislation and are subject to attack on several constitutional grounds.[103] While it is the writers' opinion that the constitutionality of the statutes is unclear and ultimately will depend on the courts' characterization of the statutes' purpose and effect, this section attempts to assess the arguments, precedents, and policies that must be considered in resolving the following issues:

(1) Do the divestiture statutes deprive oil producers of property without due process of law, in violation of the fourteenth amendment?

(2) Do the statutes take private property for public use without just compensation, in violation of the fifth and fourteenth amendments?

(3) Do the statutes deny the oil producers equal protection of the laws, in violation of the fourteenth amendment?

(4) Do the statutes constitute state regulation of interstate commerce, infringing a power reserved to Congress by the commerce clause?

(5) Do the statutes constitute state regulation of an area preempted by either federal antitrust law or federal petroleum allocation?[104]

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103. This section does not attempt to assess all the possible state constitutional challenges which might be posed to the divestiture statutes. Virtually all the states have incorporated into their constitutions guarantees of due process and equal protection, but the limits imposed on the state legislatures by those provisions vary from one state's case law to another. Thus it would be impossible to analyze the constitutionality of the divestiture statutes in terms of the different standards that might be imposed by every enacting state. Moreover, the arguments made would be similar to those raised under the corresponding federal constitutional guarantees, although the result might be different, and these arguments are set out below in some detail. Nevertheless, an opponent of divestiture should be aware tbat his strongest arguments may rest on state, rather than federal constitutional grounds. *See* text accompanying note 102 *supra*.

104. This list includes each of the federal constitutional issues which in the writers' opinion merit serious discussion. It does not, however, purport to exhaust every conceivable constitutional challenge to the divestiture statutes, especially when a statute has been poorly drawn. It was argued, for example, that sections of the Florida statute, which contain criminal penalties for their violation, were so vague that they violated due process. *See* Exxon Corp. v. Conner, Case No. 74-1449 at 9-10 (Cir. Ct. Fla., Jan. 23, 1975).

A. *Due Process*

Opponents of the divestiture statutes can argue in general terms that the statutes deprive the oil producers of property rights without due process of law. Because there is no challenge to the procedural sufficiency of the state legislatures' enactment of the statutes, the argument necessarily is grounded on a denial of substantive due process. It is contended that the enacting states have an insubstantial governmental interest in enacting these statutes to override the oil producers' fundamental right to operate retail service stations.[105] If the oil producers are prohibited from operating their own stations, it is alleged that they will be unable: (1) to earn a reasonable rate of return on their substantial investments in existing stations because lessee-dealers operate many stations less efficiently; (2) to enter lease agreements for many stations now operated by the oil producers, thus forfeiting their entire interest in those stations; and (3) to adequately secure their investments because they could not take over the operation of a station for a inefficient or defaulting dealer.[106]

The fatal weakness in the due process argument is evident in the Supreme Court's refusal, since 1937, to strike down state regulation of economic activity on due process grounds.[107] In *North Dakota State Bd. of Pharmacy v. Snyder's Drug Stores, Inc.*,[108] the Court upheld legislation that required the majority of the stockholders of a corporation, applying for a permit to operate a drugstore, to be licensed pharmacists. The Court traced the course of its deliberate retrenchment from "the time when courts used the Due Process Clause 'to strike down state laws, regulatory of business or industrial conditions, because they may be unwise, improvident, or out of harmony with a particular school of thought.' "[109] Without seriously examining North Dakota's alleged interest in the legislation, that pharmacist-shareholders are "more likely to observe the

105. *See* Roe v. Wade, 410 U.S. 113, 152-56 (1973) (women's fundamental right of personal privacy held to override state's interest in regulating abortions during early stages of pregnancy).

106. *See* Brief of Piper & Marbury, *Governor's Veto Hearing on Md. Stat. 4* (Apr. 15, 1974). The latter two arguments would not be applicable if the divestiture statute allowed an oil producer to operate service stations with company personnel for a limited period of time until a satisfactory lessee could be found.

107. The era of judicial intervention in the area of state regulation of economic affairs, *see, e.g.*, Lochner v. New York, 198 U.S. 45 (1905), came to an end with the Court's decisions in Nebbia v. New York, 291 U.S. 502 (1934) and West Coast Hotel Co. v. Parrish, 300 U.S. 379 (1937).

108. 414 U.S. 156 (1973).

109. *Id.* at 165, quoting Ferguson v. Skrupa, 372 U.S. 726, 731-32 (1963).

business with an intelligent eye than a casual observer,"[110] the Court concluded that it would not sit as a superlegislature to review the legislative choice between opposing public policies. The applicant's alleged right to engage in the retail drug business was not even mentioned in the opinion.

Similarly, the Court has upheld state statutes requiring the fitting and replacement of eyeglass lenses only by licensed optometrists and ophthalmologists,[111] restricting the business of debt adjusting to attorneys,[112] and prohibiting life insurance companies and their agents on the one hand and undertaking on the other from engaging in each other's calling.[113] With *State Board of Pharmacy*, these cases are controlling here. The divestiture statutes clearly are economic regulation, and it is unlikely that the Court will regard the exclusion of the oil producers from the retail service station market as distinguishable from the exclusion of potential entrants from the retail drug, frame fitting, debt adjusting, life insurance, and undertaking markets. Fourteenth amendment due process seemingly imposes almost no restrictions on the state legislatures in this area.[114]

An argument can be made that divestiture deprives the oil producers of existing property rights in their investment and security interest in service stations, while the earlier cases only prohibited the future entry of certain persons into professions. This distinction is specious. First, it is unlikely that the enactment of the statutes upheld by the Court did not require the ouster of some disqualified persons from the regulated markets. Secondly, allowing this distinction would prevent a state from enacting any economic regulation that, although it otherwise meets the minimal due process standards, affects a vested property right. Thirdly, the argument is moot in those states in which the divestiture statutes expressly allow existing company-operated stations to remain in business.[115] Fourthly, if the deprivation of the vested property right constitutes a taking for public use, the oil producers' constitutional

110. 414 U.S. at 166-67, quoting Liggett Co. v. Baldridge, 278 U.S. 105, 114-15 (1928) (Holmes & Brandeis, J.J., dissenting).

111. Williamson v. Lee Optical Co., 348 U.S. 483 (1955).

112. Ferguson v. Skrupa, 372 U.S. 726 (1963).

113. Daniel v. Family Sec. Life Ins. Co., 336 U.S. 220 (1949).

114. Several state courts have interpreted the due process clauses in their state constitutions to impose much stricter limits on state legislatures. Some state courts, for instance, have required a showing by the proponents of a challenged statute that it serves some substantial, legitimate, and general public interest. *See* Exxon Corp. v. Conner, Case No. 74-1449 (Cir. Ct. Fla. Jan. 23, 1975); Brief of Piper & Marbury, *Governor's Veto Hearing on Md. Stat.* 4-7 (April 15, 1974).

115. *See* MD. ANN. CODE art. 56, § 157(g) (Supp. 1974).

remedy lies in the just compensation requirement of the fifth amendment, to which we now turn.

B. Taking Without Just Compensation

The argument based on an alleged taking without just compensation is a variant on the due process challenge as the fifth amendment provision[116] is applied to the states through the fourteenth amendment due process clause.[117] The cases generally have distinguished between a compensable taking and regulation, but the line is not always easily drawn. The Supreme Court has said:

> [W]e have recognized that action in the form of regulation can so diminish the value of property as to constitute a taking. . . . However, the mere fact that the regulation deprives the property owner of the most profitable use of his property is not necessarily enough to establish the owner's right to compensation.[118]

Unfortunately, the Court's decisions have acknowledged that, other than a comparison of fair market values before and after the alleged taking, clear guidelines do not exist to determine "[h]ow far regulation may go before it becomes a taking . . . ."[119] Moreover, no decisions clearly are analogous to the instant compelled divestiture situation presented because most of the decisions have involved state or local regulation for the health or safety of their citizens.

One noted commentator has devised a test which depends upon the purpose of the state action: a compensable taking consists of the appropriation of private property for the use or enjoyment of the public, while regulation denies the property owner the unrestrained use of his property or takes it from him because his use is injurious to the public welfare.[120] While this formula is subject to gradations between public enjoyment and public protection, it resolves the issue for the divestiture statutes and satisfactorily explains most of the Supreme Court decisions in the area. Excluding wars and other emergencies,[121] the Court has denied compensation when a state or local government has regulated excavation within its jurisdictional

116. ". . .[N]or shall private property be taken for public use, without just compensation." U.S. CONST. amend. V.

117. Chicago B. & Q.R.R. v. Chicago, 166 U.S. 226 (1897).

118. United States v. Central Eureka Mining Co., 357 U.S. 155, 168 (1958).

119. Goldblatt v. Town of Hempstead, 369 U.S. 590, 594 (1962).

120. 1 NICHOLS ON EMINENT DOMAIN § 1.42[2] (rev. 3d ed. 1975).

121. The Court has been reluctant to find a taking for public use when private property was appropriated or destroyed in a war or riot. *See* National Bd. of YMCA v. United States, 395 U.S. 85 (1969); United States v. Central Eureka Mining Co., 357 U.S. 155 (1958); United States v. Caltex, 344 U.S. 149 (1942).

limits,[122] enacted zoning ordinances,[123] or ordered the destruction of one species of tree from which an infection could spread to another.[124] Conversely, a taking for public use has been found not only when a governmental body exercised its power of eminent domain to condemn property, but when the public use has damaged private property. For instance, the Court has ordered compensation for the low overflight of private property by aircraft.[125]

The only Supreme Court decision that does not seem to fit the dichotomy between restriction on private use and appropriation to public use is *Pennsylvania Coal Co. v. Mahon*,[126] in which the Court found that a Pennsylvania statute which prohibited a coal company from mining under habitable structures constituted a taking for public purposes. In his opinion for the Court, however, Justice Holmes expressly recognized that this statute was regulation carried too far, because it totally destroyed the value of the coal company's reserved right to mine under the surface.

In this view, it is clear that the divestiture statutes which prohibit or limit company-operated stations are regnlation rather than a compensable taking. First, the statutes restrict the use of the stations, rather than appropriate them for public use. Secondly, in most cases dealers can be found to lease the stations, so the decline in fair market value is apt to be relatively slight.

The same conclusion is probable with regard to the divestiture statutes that forbid oil producers to own service stations,[127] although they present a closer case because the oil producers are no longer merely restricted in their use of the property. Moreover, the distress sale conditions apt to result from the enactment of such legislation will cause a greater diminution in fair market value. On the other hand, it is the oil producers' alleged marketing behavior rather than the public enjoyment of service stations that constitutes the justification for the legislation, so it exhibits a regulatory purpose. Also, the diminution of value problem can be remedied to some extent by allowing the oil producers sufficient time to sell their stations to financially able purchasers.[128]

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122. Goldblatt v. Town of Hempstead, 369 U.S. 590 (1962).

123. Village of Euclid v. Ambler Realty Co., 272 U.S. 365 (1926).

124. Miller v. Schoene, 276 U.S. 272 (1928).

125. Griggs v. Allegheny County, 369 U.S. 84 (1962); United States v. Causby, 328 U.S. 256 (1946).

126. 260 U.S. 393 (1922).

127. *See* text accompanying notes 98-99 *supra*.

128. Brief of Md. Att'y Gen., *Governor's Veto Hearing on Md. Stat.* 7 (Mar. 29, 1974).

C. *Equal Protection*

The divestiture statutes classify actual and potential competitors in the retail service stations market according to whether they produce, refine, or transport oil.[129] The fourteenth amendment equal protection challenge is premised on the contention that this classification bears no reasonable relation to the legitimate aims of the statutes.[130] If the statutes' opponents can show that the classification constitutes invidious discrimination equivalent to "suspect classifications" based on race, religion, or ethnic origin,[131] or infringes a fundamental right,[132] they can demand the Supreme Court's strict scrutiny of the legislation.

When examining state economic legislation, however, the Court has been as unresponsive to equal protection arguments as it has to due process challenges.[133] Several of the cases involving state restrictions on entry into businesses found no violation of either due process or equal protection. For example, in *Williamson v. Lee Optical Co.*,[134] the case sustaining Oklahoma's regulation of eyeglass frame fitting, the opponents of the statute argued that it violated equal protection because it regulated opticians but exempted sellers of ready-to-wear glasses from coverage. Justice Douglas, writing for the Court, disagreed:

> The problem of legislative classification is a perennial one, admitting of no doctrinaire definition. Evils in the same field may be of different dimensions and proportions, requiring different remedies. Or so the legislature may think. . . .Or the reform may take one step at a time, addressing itself to the phase of the problem which seems most acute to the legislative mind. . . .The legislature may select one phase of one field and apply a remedy there, neglecting the others. . . .The prohibition of the Equal Protection goes no further than the invidious discrimination. We cannot say that that point has been reached here.[135]

The *Williamson* decision demonstrates the Court's extreme deference to the legislative judgment in enacting classifications having an economic impact.[136] Not only will the Court tolerate an underin-

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129. *See* text accompanying notes 95-99 *supra*.

130. *See generally* Tussman & tenBroek, *The Equal Protection of the Laws*, 37 CALIF. L. REV. 341 (1949).

131. *See, e.g.*, Frontiero v. Richardson, 411 U.S. 677, 682 (1973) (plurality opinion holding classification based on sex to be inherently suspect); Graham v. Richardson, 403 U.S. 365, 376 (1971) (classification based on alienage held to be inherently suspect).

132. *See, e.g.*, Dunn v. Blumstein, 405 U.S. 330, 336, 338 (1972) (right to vote and right to interstate travel held to be fundamental).

133. *See* text accompanying notes 107-14 *supra*.

134. 348 U.S. 483 (1955).

135. *Id.* at 489 (citations omitted).

136. *See* McGowan v. Maryland, 366 U.S. 420, 426 (1961) (Sunday closing laws upheld;

clusive classification that attacks only part of an economic problem,[137] but it also will refuse to find invidious discrimination by going behind the statute to examine the legislature's motive. In *Daniel v. Family Sec. Life Ins. Co.*,[138] the South Carolina statute prohibiting undertakers and insurance agents from engaging in the others' profession was challenged by the state's only seller of funeral insurance on the ground, among others, that the insurance lobby had extracted the discriminatory classification from the legislature. The Court's curt reply: "We cannot undertake a search for motive in testing constitutionality."[139] With similar reasoning, the Court has upheld state statutes prohibiting the licensing of women bartenders not the wife or daughter of the male owner of a licensed bar,[140] and the licensing of river pilots by their relation or friendship with incumbent pilots.[141]

One interesting deviation from the pattern, however, lends some support to the divestiture opponents. In *Morey v. Doud*,[142] the Court invalidated an Illinois statute which exempted the American Express Company from a regulatory scheme designed to insure the solvency of companies selling money orders. Although American Express was conceded to be a company whose present solvency was unquestionable, the discrimination was found to bear no reasonable relation to the legislative goal of affording continuing protection to the public. The opinion surmised that American Express might subsequently lose its financial strength, its regulated competitors might acquire equal strength, or American Express might sell its money orders through irresponsible outlets. The thrust of the opinion, however, seems to lie in the Court's antipathy to a "closed class" consisting of a single large company who, by legislative fiat, gains a significant competitive advantage over its smaller rivals.[143]

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state regulation of economic matters is presumed constitutional "if any state of facts reasonably may be conceived to justify it.").

137. *See* Tussman & tenBroek, *supra* note 130 at 348-51.

138. 336 U.S. 220 (1949).

139. *Id.* at 224.

140. Goesaert v. Cleary, 335 U.S. 464 (1948).

141. Kotch v. Board of River Port Pilot Comm'rs, 330 U.S. 552 (1947).

142. 354 U.S. 457 (1957).

143. The divestiture opponents' argument gains some additional support from language in Lynch v. Household Fin. Corp., 405 U.S. 538, 552 (1972), in which the Court declared that the dichotomy between personal liberties and personal rights in property is false. This statement suggests that if the oil producers can show that their alleged right to own and operate retail service stations is a property right within the meaning of the fourteenth amendment, *see* text accompanying note 106 *supra*, the Court will subject any legislation affecting that right to the same scrutiny it now applies to infringements of fundamental personal liberties. *See* note 132 *supra*. The applicability of the *Lynch* pronouncement is doubtful, however, because that case dealt with the narrow issue whether a federal district court has jurisdiction

Even with *Morey* in the balance, it is unlikely that the Court will consider the exclusion of a class of competitors from the retail service station market to be violative of equal protection. The enacting states can allege a reasonable relation between their classification and the aims of the statutes simply by pointing to the vertical integration of the affected major oil producers and arguing that vertical integration has resulted in anti-competitive market behavior. The legislative choice seems well within the area of economic policy judgment to which the Court consistently has deferred. Furthermore, earlier cases indicate that the Court is not apt to be receptive to the arguments that the legislatures' classification deals with only part of the vertical integration problem, or that its true motive is to protect smaller dealers from the major oil companies' competition at the retail level.

A more serious threat to the constitutionality of divestiture statutes is the closely-related argument that the oil producers excluded from local retail markets are engaged in interstate commerce, but the dealers allowed to remain are predominantly domestic companies. Consequently, the effect of the statutes is to discriminate against interstate marketers, although no such purpose appears on their face. This argument, though, customarily has been raised under the commerce clause.

D. Commerce Clause

The commerce clause provides that "The Congress shall have Power . . . To regulate Commerce . . . among the several States."[144] Although it places no express limitation on the states' police powers, Chief Justice Marshall's landmark decision in *Gibbons v. Ogden*[145] established that the affirmative grant of power to Congress precludes the states from imposing undue burdens on interstate commerce. The same opinion, however, also reaffirmed the states' authority over "completely internal commerce."[146] As the means of transport and communication have improved, the scope of Congress's power has steadily, and at times even dramatically, increased.[147] Concurrently, the area of possible conflict with the

under 28 U.S.C. § 1343(3) to enjoin a prejudgment garnishment allegedly violative of fourteenth amendment due process.

144. U.S. CONST. art. I, § 8, cl. 3.

145. 22 U.S. (9 Wheat.) 1 (1824).

146. *Id.* at 194.

147. *Compare* United States v. E.C. Knight Co., 156 U.S. 1 (1895) (holding the manufacture of sugar not to be "commerce" and, therefore, not within the reach of the Sherman Act), *with* Wickard v. Filburn, 317 U.S. 111 (1942) (wheat grown for a farmer's own consumption affects the total wheat supply and market, and thus is within Congressional commerce power).

states has grown, so that any state legislation that affects interstate commerce is subject to challenge.

The free trade policy underlying the commerce clause and the Supreme Court's interpretation of the limits on state regulation was eloquently stated by Justice Robert Jackson:

> The Commerce Clause is one of the most prolific sources of national power and an equally prolific source of conflict with legislation of the state. While the Constitution vests in Congress the power to regulate commerce among the states, it does not say what the states may or may not do in the absence of congressional action, nor how to draw the line between what is and what is not commerce among the states. Perhaps even more than by interpretation of its written word, this Court has advanced the solidarity and prosperity of this Nation by the meaning it has given to these great silences of the Constitution. . . .
>
> When victory relieved the Colonies from the pressure for solidarity that war had exerted, a drift toward anarchy and commercial warfare between states began. . . . The desire of the Forefathers to federalize regulation of foreign and interstate commerce stands in sharp contrast to their jealous preservation of the state's power over its internal affairs. . . .
>
> [The] principle that our economic unit is the Nation, which alone has the gamut of powers necessary to control of the economy, including the vital power of erecting customs barriers against foreign competition, has as its corollary that the states are not separable economic units. . . . The material success that has come to inhabitants of the states which make up this federal free trade unit has been the most impressive in the history of commerce, but the established interdependence of the states only emphasizes the necessity of protecting interstate movement of goods against local burdens and repressions. . . .
>
> [The] distinction between the power of the State to shelter its people from menaces to their health or safety and from fraud, even when those dangers emanate from interstate commerce, and its lack of power to retard, burden or constrict the flow of such commerce for their economic advantage, is one deeply rooted in both our history and our law. . . . This Court consistently has rebuffed attempts of states to advance their own commerical interests by curtailing the movement of articles of commerce, either into or out of the state, while generally supporting their right to impose even burdensome regulations in the interest of local health and safety. . . .
>
> Our system, fostered by the Commerce Clause, is that every farmer and every craftsman shall be encouraged to produce by the certainty that he will have free access to every market in the Nation, that no home embargoes will withhold his exports, and no foreign state will by customs duties or regulations exclude them. Likewise, every consumer may look to the free competition from every producing area in the Nation to protect him from exploitation by any. Such was the vision of the Founders; such has been the doctrine of this Court which has given it reality. . . .[148]

Consistent with this view of the commerce clause, two distinct arguments can be made against the constitutionality of the divestiture statutes:

(1) The statutes place an undue burden on the stream of petroleum products in interstate commerce.

148. H.P. Hood & Sons v. Du Mond, 336 U.S. 525, 533-39 (1949).

(2) The statutes shelter local service station dealers from out-of-state competitors and thereby discriminate against interstate commerce.

These contentions can be met at the threshold by arguing that the divestiture statutes regulate only retail marketing through local service stations. This arguably is business activity that is purely intrastate and therefore outside the scope of the commerce clause. Although the petroleum products sold at service stations move in interstate commerce, they have come to rest within the state when they reach the market level affected by the statutes.[149] Thus, the statutes' effect on interstate commerce, if any, is only incidental.[150]

This argument is premised on a narrow view of interstate commerce that is now apparently obsolete. It has been recognized in several statutory contexts that Congress's power to regulate under the commerce clause extends even to local retail activity when a sufficient nexus between that activity and interstate commerce can be found.[151] Perhaps the closest analogy to the divestiture case is found in two Supreme Court decisions construing the reach of the 1964 Civil Rights Act, *Katzenbach v. McClung*[152] and *Daniel v. Paul.*[153] In both cases it was contended that the local businesses charged with racial discrimination, a small diner and a lakeshore "club," had too little impact on interstate commerce to be constitutionally subject to the Act. The Court disagreed in both cases, looking not only to the interstate sources of the products sold but also to the number of interstate travelers patronizing the businesses.

The divestiture situation presents a similar pattern. Retail service stations sell almost exclusively products that have moved in interstate commerce, and many of their customers are themselves interstate travelers or transporters. Moreover, there is a third nexus not present in *Katzenbach* and *Daniel*: service stations fuel and service automobiles and trucks, which are major instrumentalities of interstate commerce.

It can be argued that the scope of the commerce clause is not as broad when it is employed to invalidate state legislation as it is

149. *See* Schechter Poultry Corp. v. United States, 295 U.S. 495 (1935) (commerce power does not extend to regulating the marketing of commodities after they have left the "flow" of interstate commerce).

150. *See* Bradley v. Public Util. Comm'n, 289 U.S. 92 (1933) (when denial of a carrier's application to operate on state's highways was based on public safety, burden on interstate commerce held to be only incidental).

151. *See, e.g.*, United States v. Frankfort Distilleries, Inc., 324 U.S. 293 (1945) (retailing held to be interstate commerce within the scope of the Sherman Act).

152. 379 U.S. 294 (1964).

153. 395 U.S. 298 (1969).

when used to uphold congressional action. This position, however, could lead to the frustration of federal legislation enacted near the periphery of congressional power by inconsistent state legislation regulating the same subject and yet not reachable by a federal court. The proper accomodation seems to have been achieved by the balancing of state and federal interests on the periphery, as described below.

Assuming a sufficient nexus with interstate commerce, the challenges to the divestiture statutes suggest two related but separate groups of decisions, the first involving impediments to the physical movement of goods across state lines, the other concerned with the access of out-of-state competitors to local markets and resources.

The physical movement, or stream of commerce, cases date from *Gibbons*. Like *Gibbons*, which dealt with navigation,[154] many of these cases have involved state regulation of shipping, railroads, trucking and other means of interstate commerce.[155] Another group of decisions have examined state regulation directed at specific articles in commerce and restricting their movement into or out of the state.[156] Through the stream of commerce cases, the Court has evolved a balancing process. It first determines whether the regulation furthers a legitimate state interest, and then weighs that interest against the burden imposed on interstate commerce.[157] Although there is a presumption of constitutionality, the extent of the burden that will be tolerated depends on the nature of the local interest involved. Public health, morals, and safety, for example, have traditionally been considered more appropriate for regulation by state and local government than have economic matters.[158]

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154. In *Gibbons*, the Court held that New York could not grant a monopoly on navigation of the Hudson River if it excluded a ship holding a federal license.

155. Firemen v. Chicago, R.I. & Pac. R.R., 393 U.S. 129 (1968) (railroad); Huron Portland Cement Co. v. City of Detroit, 362 U.S. 440 (1960) (shipping); Bibb v. Navajo Freight Lines, Inc., 359 U.S. 520 (1959) (trucking); Southern Pac. Co. v. Arizona, 325 U.S. 761 (1945) (railroad); South Carolina State Highway Dep't v. Barnwell Bros., 303 U.S. 177 (1938) (trucking).

156. *See, e.g.*, Pike v. Bruce Church, Inc., 397 U.S. 137 (1970) (exporting of cantaloupes); Parker v. Brown, 317 U.S. 341 (1943) (marketing of raisins).

157. *See* Huron Portland Cement Co. v. City of Detroit, 362 U.S. 440, 443 (1960). Compare the less useful direct-indirect burden dichotomy of Di Santo v. Pennsylvania, 273 U.S. 34 (1927).

158. *See* Breard v. Alexandria, 341 U.S. 622, 640 (1951). It is interesting to compare the Court's critical attitude toward state economic regulation that affects interstate commerce with its extreme deference toward such legislation when it is challenged on due process or equal protection grounds. *See* text accompanying notes 107-14 and 133-41 *supra*. Paradoxically, the areas tbat the Court has characterized as most appropriate for state and local action—public health, morals, and safety—have frequently drawn its closest scrutiny under the fourteenth amendment. *See, e.g.*, note 105 *supra*.

All this suggests that the general, stream of commerce challenge to the divestiture statutes is unlikely to prevail. First, the decisions in this category are not analogous to compulsory divestiture, because the divestiture statutes place no restrictions on the movement of petroleum products into the enacting states. The oil producers remain free to import and sell in the wholesale market as much product volume as their dealers can handle. Secondly, divestiture opponents must overcome the presumption of constitutionality. They are aided somewhat by the economic nature of the divestiture statutes, but this characterization is insufficient in itself to warrant invalidation.[159] Finally, not only the economic interests of the enacting states' independent gasoline dealers are at stake, but also the welfare of its consumers for whom the statutes allegedly insure a steady supply of petroleum products at reasonable prices.[160] Weighing these asserted state interests against the minimal hindrance to the physical movement of goods in interstate commerce, the Court is likely to uphold the divestiture statutes.

The discrimination argument, however, presents a much more serious threat. When it is established that a state statute discriminates against interstate commerce, on its face or in fact, the Court will not undertake the balancing test because a state's interest in shielding its domestic industries and markets from interstate competition is per se insufficient to override the federal policy against barriers to interstate commerce.[161] Even when the state asserts a health or safety justification for legislation that has a protectionist effect, it must establish that a less restrictive alternative does not exist.

In *Dean Milk Co. v. City of Madison*,[162] the Court struck down a municipal ordinance that required all milk sold in the city to be bottled at an approved plant within five miles of the city center, effectively excluding from the area milk market the plaintiff, an Illinois corporation operating a bottling plant sixty miles away. The Court relied heavily on two earlier decisions invalidating state discrimination in the milk industry, *Baldwin v. G.A.F. Seelig, Inc.*[163]

159. The Court has acknowledged that the states have a legitimate interest in the economic welfare of their local producers. The firmness of the Court's position on this score, however, appears to have waned substantially since the Depression. *Compare* Parker v. Brown, 317 U.S. 341 (1943), *with* Pike v. Bruce Church, Inc., 397 U.S. 137 (1970).

160. *See* text accompanying notes 218-19 *infra*.

161. *See* Polar Ice Cream & Creamery Co. v. Andrews, 375 U.S. 361 (1964); Dean Milk Co. v. City of Madison, 340 U.S. 349 (1951); H.P. Hood & Sons v. Du Mond, 336 U.S. 525 (1949); Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511 (1935); Buck v. Kuykendall, 267 U.S. 307 (1925).

162. 340 U.S. 349 (1951).

163. 294 U.S. 511 (1935) (invalidating a New York statute prohibiting the domestic sale

and *H.P. Hood & Sons v. Du Mond*,[164] but the *Dean Milk* case added a new element to the previous decisions.[165] The city admittedly possessed a strong and legitimate interest in regulating the pasteurization of milk through the regular inspection of bottling plants, and it contended that without the five mile limitation its inspectors could not readily visit each of the plants. Justice Clark's opinion, however, dismissed this argument, maintaining that the local interest could be served as well by reasonable nondiscriminatory alternatives. The city could have adopted the Public Health Service's Model Milk Ordinance, which allows the local sale of milk only if it has been pasteurized under standards at least as stringent as the standards adopted by the enacting city. Or, if the city insisted on relying upon its own inspectors, it could hire more of them and charge the actual and reasonable cost of such inspection to the importing milk processors.[166]

In reading the opinion, it is difficult to avoid the conclusion that the Court was suspicious of the avowed local interest. Not only does the Court examine closely the selection of statutory means to accomplish a legitimate state objective,[167] it declares the intent to look beyond the face of the ordinance to discover the motive for its enactment:

> A different view, that the ordinance is valid simply because it professes to be a health measure, would mean that the Commerce Clause of itself imposes no limitations on state action other than those laid down by the Due Process Clause, save for the rare instance where a state artlessly discloses an avowed purpose to discriminate against interstate goods. . . . Our issue then is whether the discrimination inherent in the Madison ordinance can be justified in view of the character of the local interests and the available methods of protecting them. . . .

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of milk purchased out of state if the dealer paid less than the minimum price required to be paid to domestic farmers).

164. 336 U.S. 525 (1949) (refusal of New York Comm'r of Agriculture and Markets to license a Massachusetts milk dealer to operate a milk receiving depot in New York held violative of commerce clause).

165. It had been argued in *Baldwin* that the New York statute protected the health of its citizens, but the contention was based solely on the premise that the prosperity of local dairy farmers insured the wholesomeness of their milk. The Court had little difficulty in disposing of this classic protectionist argument. 294 U.S. at 523-24.

166. Unfortunately, the sad tale of dairy industry discrimination against interstate commerce did not end with *Dean Milk*. In Polar Ice Cream & Creamery Co. v. Andrews, 375 U.S. 361 (1964), the Court struck down a Florida statute requiring all dealers selling in the Pensacola market to purchase all of their milk requirements from high-priced local producers and to take all excess milk offered by those producers at prices set by the State Milk Commission.

167. Justice Black in his dissent noted that "No case is cited, and I have found none, in which a bona fide health law was struck down on the ground that some other method of safeguarding health would be as good as, or better than, the one the Court was called on to review." 340 U.S. at 358.

> . . .
> To permit Madison to adopt a regulation not essential for the protection of local health interests and placing a discriminatory burden on interstate commerce would invite a multiplication of preferential trade areas destructive of the very purpose of the Commerce Clause. Under the circumstances here presented, the regulation must yield to the principle that "one state in its dealings with another may not place itself in a position of economic isolation. . . ."[168]

The Court's "process of psychoanalysis,"[169] evidenced in its willingness (1) to seek out the state's discriminatory motive in enacting statutes that appear nondiscriminatory and (2) to search for less restrictive alternatives, holds profound implications for the divestiture statutes. Although neutral on their face, the statutes will unquestionably have the effect of shielding local gasoline dealers from the competition of major oil producers engaged in interstate commerce. Whatever the enacting states' asserted interest in insuring motorist-consumers an uninterrupted supply of reasonably priced petroleum products, the independent dealers' lobbyist groups have supplied the primary impetus for the enactment of the divestiture statutes.[170] Consequently, the Court would not be straining the scope of *Dean Milk* if it found that the divestiture statutes were "inherently discriminatory."

Secondly, there are reasonably nondiscriminatory alternatives to compulsory divestiture, which will be treated at length in Section III.[171] None of these alternatives distort the avowed legislative purpose any more than the nondiscriminatory alternatives advanced in *Dean Milk.*

Dean Milk, however, does not settle the discrimination issue, because in the same year the Court decided *Breard v. Alexandria.*[172] In *Breard*, a seller of magazines, engaged in interstate commerce, attacked the constitutionality of a local Green River ordinance that prohibited door-to-door sales without the prior consent of the property owner. In upholding the ordinance, the Court stressed the strong state interest in protecting the privacy of its citizens and found no discrimination against interstate commerce; "regulation that leaves out-of-state sellers on the same basis as local sellers cannot be invalid" merely because house-to-house solicitation is the most productive sales technique for interstate publishers.[173] The Court refused to question the legislative motive: "We are not willing

168. *Id.* at 354, 356 (citations omitted).
169. United States v. Constantine, 296 U.S. 287, 299 (1935) (Cardozo, J., dissenting).
170. *See* text accompanying note 11 *supra*.
171. *See* text accompanying notes 266-68 *infra*.
172. 341 U.S. 622 (1951).
173. *Id.* at 638.

even to appraise the suggestion, unsupported in the record, that such wide use [of the Green River type of ordinance] springs predominantly from the selfish influence of local merchants."[174]

The *Breard* opinion distinguishes *Dean Milk*, and with it the divestiture statutes, on two grounds. First, the *Dean Milk* ordinance had discriminated against interstate commerce, although the distinction seems specious after reading the *Dean Milk* facts because the discrimination in the city ordinance was no more apparent on its face than the alleged discrimination in *Breard*. Rather, the distinction was based on the conclusion that the Court reached after tracing the effect of the regulation. Secondly, and more significantly, the *Breard* Court found no reasonably nondiscriminatory alternatives to the Green River ordinance.

A third possible distinction between *Breard* and the divestiture statutes lies in the Court's acknowledgement that the states have a peculiar interest in the health, morals, safety, and tranquility of their citizens that does not extend to their economic well-being: "When there is a reasonable basis for legislation to protect the social, as distinguished from the economic, welfare of a community, it is not for this Court because of the Commerce Clause to deny the exercise locally of the sovereign power of Louisiana."[175] In sum, the *Breard* decision differs in several significant respects from compulsory divestiture, while *Dean Milk* appears to be controlling. If the Court characterizes the divestiture statutes as inherently discriminatory, the per se rule of unconstitutionality will require their invalidation.

No cases discussed to this point have treated the commerce clause issues raised by state antitrust legislation, into which category the divestiture statutes fall. The primary difficulty is that state antitrust legislation has rarely been challenged on commerce clause grounds in the federal courts.[176] This dearth of litigation is undoubt-

174. *Id.* at 639.

175. *Id.* at 640.

176. Two Supreme Court decisions on the validity of state antitrust statutes deserve mention, despite their inapplicability to the divestiture situation. In Standard Oil Co. v. Tennessee, 217 U.S. 413, 421-22 (1910), the corporate defendant was convicted under a state antitrust statute of offering free oil to local dealers inducing them to cancel orders placed with a competitor in Pennsylvania. The defendant argued that the statute as applied constituted an impermissible regulation of interstate commerce because the offense, if any, was against interstate commerce alone. Writing for the Court, Justice Holmes could find no regulation of legitimate business but only the removal of an interference with commerce. He likened the defense to "an answer to an indictment for forgery that the instrument forged was a foreign bill of lading, or for assault and battery that the person assaulted was engaged in peddling goods from another State." 217 U.S. at 422. Although commentators have frequently considered *Standard Oil* as a precedent establishing the lack of federal preemption of the antitrust

edly due to the close adherence of the state statutes to the federal acts,[177] so that any private action that runs afoul of a state statute also presumably would violate federal law assuming that the party is engaged in interstate commerce. In these circumstances, it is difficult to argue that the state law unduly burdens or discriminates against interstate commerce when Congress, acting under the commerce clause, has enacted essentially similar legislation.

The divestiture statutes, however, represent a radical departure from traditional state legislation in the antitrust area, and they have no parallel in federal law. Thus, no inference can be drawn from the previous lack of successful commerce clause challenges to state antitrust legislation.

The possibility exists, however, that Congress will enact legislation similar to the state divestiture statutes,[178] which will put the federal imprimatur on the policy choice of the enacting states. If congressional action precedes judicial consideration of the constitutionality of the divestiture statutes, the Supreme Court's decision in *Parker v. Brown*[179] will cast the foregoing commerce clause analysis in a different light. In *Parker*, California enacted a comprehensive marketing quota and prorate program to maintain the price of raisins during the Depression of the 1930's. A local raisin producer challenged the Program on the grounds that it violated both the

area, the scope of its holding appears to be considerably narrower. The unlawfulness of the defendant's act was clear under either state or federal law, and the defendant's conduct—contrasted to the state's regulation of that conduct—obstructed interstate commerce. Moreover, the federal and state policies were in agreement. Thus, the decision can scarcely be considered controlling in a case where the state antitrust legislation arguably both discriminates against interstate commerce and contravenes federal antitrust policy.

In Flood v. Kuhn, 443 F.2d 264, 264-67 (2d Cir. 1971), *aff'd*, 407 U.S. 258, 284-85 (1972), a professional baseball player sued to set aside the major leagues' reserve system on both federal and state antitrust grounds. Both the Second Circuit and the Supreme Court admitted that the baseball exemption under federal law was an anomaly, but they refused to overturn it in the face of overwhelming contrary precedent. Addressing the plaintiff's state law claim, the Second Circuit looked to the restrictive effect of enforcing individual states' antitrust statutes against a business which depended on a league structure operating in many states. Since the leagues would be forced to comply with the strictest state law and the states' interest in antitrust enforcement is not as great as their legitimate concern for the safety and health of their citizens, "the burden on interstate commerce outweighs the states' interests in regulating baseball's reserve system, [and] the Commerce Clause precludes the application here of state antitrust law." 443 F.2d at 268. The Supreme Court summarily affirmed on this point, but with the significant qualification, "as applied to organized baseball." 407 U.S. at 284. This qualification and the lack of any interdependent structure in the oil industry equivalent to baseball's league system renders the *Flood* decision of little precedential value in the divestiture context.

177. *See generally* ABA ANTITRUST SECTION, STATE ANTITRUST LAWS (1974).

178. *See* text accompanying notes 21, 100-01 *supra*.

179. 317 U.S. 341 (1943).

commerce clause and the Sherman Act.[180] On the commerce clause issue, the Court employed a balancing process and found that the production of raisins was a concern more peculiarly local than national, although 95 percent of the raisin crop entered interstate or foreign commerce and the program admittedly raised the price of raisins to consumers in other states. Two factors supported the Court's conclusion. First, due to a rapid drop in the price of raisins, the industry's plight was critical and governmental intervention seemed necessary for its survival. Secondly, and more importantly, the Court found a consistent congressional policy expressed in the Agricultural Marketing Agreement Act and the Agricultural Adjustment Act, which established marketing procedures similar to the California statute but covered other commodities. In conclusion, the Court said:

> This history shows clearly enough that the adoption of legislative measures to prevent the demoralization of the industry by stabilizing the marketing of the raisin crop is a matter of state as well as national concern and, in the absence of inconsistent Congressional action, is a problem whose solution is peculiarly within the province of the state.[181]

Parker, of course, is distinguishable from the divestiture situation on several grounds. First, the California raisin marketing system was a direct response to a severe and immediate situation that threatened to ruin the regnlated industry. It is arguable whether the petroleum industry, or even independent gasoline dealers, face a similar threat today. Secondly, discrimination against out-of-state competitors was neither alleged nor discussed in *Parker*. *Parker* involved the rare situation in which virtually all of the producers in an industry were located in the regulating state, so that the challenger, a local producer, was treated like his competitors. Thirdly, the possibility of less restrictive alternatives was never raised. These factors aside, *Parker's* holding on the commerce clause issue stands for the proposition that a federal policy consistent with the challenged state legislation and expressed in a congressional enactment will create a heavy presumption that the state legislation does not violate the commerce clause.

Parker is perhaps even more significant for its holding on the challenger's alternative argument, that the California program violated the Sherman Act. This is essentially an argument grounded on federal preemption of the antitrust area, and deserves further development.

180. For a discussion of the Sherman Act issue, see text accompanying notes 196-99 *infra*.

181. 317 U.S. at 367.

E. *Federal Preemption*

When Congress, in exercising a power granted to it by the Constitution, enacts legislation that conflicts with state regulation in the same area, it may invalidate not only state statutes that are clearly inconsistent with the federal law, but also those that violate a federal policy implicit in the Congressional action.[182] This doctrine of federal preemption is based on the supremacy clause, which provides that the Constitution and laws of the United States are the supreme law of the land.[183]

While the source of federal preemption is clear, its application by the Supreme Court is often confusing. The Court has relied on several factors in determining whether state laws are invalid on this ground, including: (1) evidence of congressional intent to preempt an area;[184] (2) an actual conflict between the state and federal laws;[185] (3) a clear potential conflict between state and federal law;[186] (4) an actual or potential conflict between state law and the policy implicit in federal law;[187] (5) a need for a uniform, exclusive regulatory scheme;[188] or (6) a dominant federal interest in the area being regulated.[189]

(1) Preemption of State Antitrust Legislation

None of these factors, however, has yet been applied to invalidate state statutes alleged to be in conflict with the Sherman Act[190]

182. *See generally* Note, *Pre-emption as a Preferential Ground: A New Canon of Construction*, 12 STAN. L. REV. 208 (1959).

183. U.S. CONST. art. VI, § 2.

184. *See* Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 143 (1963); California v. Zook, 336 U.S. 725, 731 (1949).

185. *See* Perez v. Campbell, 402 U.S. 637, 652 (1971).

186. *See* Hines v. Davidowitz, 312 U.S. 52, 67 (1941).

187. *See* Teamsters Local 24 v. Oliver, 358 U.S. 283, 295-97 (1959) (conflict between state antitrust law and duty to bargain under NLRA); Hines v. Davidowitz, 312 U.S. 52, 67 (1941).

188. *See* City of Burbank v. Lockheed Air Terminal, Inc., 411 U.S. 624, 639 (1973).

189. *See* Rice v. Santa Fe Elev. Corp., 331 U.S. 218, 230 (1947).

190. The Sberman Antitrust Act, 15 U.S.C. §§ 1-7 (1970), is the principal concern in the preemption area for three reasons. First, courts bave held repeatedly that when Congress passed the Sherman Act it intended "to go to the utmost extent of its Constitutional power" under the commerce clause. United States v. South-Eastern Underwriters Ass'n, 322 U.S. 533, 558 (1944). The broad reach of the Sherman Act creates the greatest possibility of conflict with state laws regulating interstate commerce because other federal antitrust statutes are more restricted. For instance, the "in commerce" language of the Robinson-Patman Act, 15 U.S.C. § 13(a) (1970), has been construed narrowly in the recent decision in Littlejohn v. Shell Oil Co., 483 F.2d 1140 (5tb Cir.), *cert. denied*, 414 U.S. 1116 (1973). Secondly, most state antitrust enforcement is directed at activities that fall concurrently within the scope of the Sherman Act. Thirdly, the federal policy against exclusion of competitors that the divestiture statutes allegedly violate is grounded on the anticonspiracy and antimonopoly provisions

or other federal antitrust statutes,[191] and it is widely assumed that federal law does not preempt the antitrust field.[192] Not only did state prohibition of monopolies and trade restraints predate federal intervention in the area,[193] but most states have now enacted statutes modeled on the federal laws.[194] Thus, federal and state regulation of the antitrust field is regarded as complementary rather than conflicting.[195] This alignment of federal and state purposes has blunted the preemption factors used to invalidate state laws in other areas.

Moreover, the Supreme Court consistently has failed to find in the enactment of the Sherman Act any evidence of congressional intent to limit state action, even when a state statute seems clearly inconsistent with the federal policy favoring free competition among firms engaged in interstate commerce. The clearest statement of the Court's hands-off attitude was enunciated in *Parker v. Brown*.[196] The challenger argued that the California raisin prorate system attempted to legalize price-fixing and therefore conflicted with the Sherman Act. The Court admitted that the program would constitute an unlawful combination in restraint of trade if undertaken by private persons. Moreover, the Court assumed that Congress could prohibit a state from enacting a market quota system because of its effect on interstate commerce. But the instant challenge was di-

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of §§ 1 and 2 of the Sherman Act. *See, e.g.*, Associated Press v. United States, 326 U.S. 1, 13-14 (1945).

191. Two Supreme Court decisions have invoked the "general federal policy favoring free competition" to overturn state decisions based on common law that contravened the federal patent laws. In Sears, Roebuck & Co. v. Stiffel Co., 376 U.S. 225 (1964), the Court held that a competitor could lawfully copy an unpatented and unpatentable lamp despite its violation of Illinois unfair competition law. In Lear, Inc. v. Adkins, 395 U.S. 653 (1969), the California Supreme Court had ruled that a patent licensee was estopped to raise the invalidity of the licensor's patent as a defense to an action to recover royalties. The United States Supreme Court reversed, holding, *inter alia*, that "the Sherman Act made it clear that the grant of monopoly power to a patent owner constituted a limited exception to the general federal policy favoring free competition." *Id.* at 663.

192. *See* Mosk, *State Antitrust Enforcement and Coordination With Federal Enforcement*, 21 ABA ANTITRUST SECTION 358, 361 (1962); Note, *The Commerce Clause and State Antitrust Regulation*, 61 COLUM. L. REV. 1469 (1961). Some commentators have cited the early *Standard Oil* decision for the lack of federal preemption, although the opinion in that case was too narrow to support the general proposition that the Sherman Act does not preempt the antitrust field. *See* note 176 *supra*. United States v. South-Eastern Underwriters Ass'n, 322 U.S. 533, 548 (1944) is also relied upon, although that opinion held only that state regulation of the insurance industry was not necessarily incompatible with the federal antitrust laws. It did not declare that state *antitrust* laws were valid.

193. *See* Note, *The Commerce Clause and State Antitrust Regulation*, 61 COLUM. L. REV. 1469 (1961).

194. *See* note 177 *supra*.

195. *See* Mosk, *State Antitrust Enforcement and Coordination With Federal Enforcement*, 21 ABA ANTITRUST SECTION 358, 360 (1962).

196. 317 U.S. 341, 350-52 (1943).

rected at state governmental action and the Court indicated that Congress had expressed no intention to preempt the field:

> But it is plain that the prorate program here was never intended to operate by force of individual agreement or combination. It derived its authority and its efficacy from the legislative command of the state and was not intended to operate or become effective without that command. We find nothing in the language of the Sherman Act or in its history which suggests that its purpose was to restrain a state or its officers or agents from activities directed by its legislature. In a dual system of government in which, under the Constitution, the states are sovereign, save only as Congress may constitutionally subtract from their authority, an unexpressed purpose to nullify a state's control over its officers and agents is not lightly to be attributed to Congress.
>
> The Sherman Act makes no mention of the state as such, and gives no hint that it was intended to restrain state action or official action directed by a state. . . .
>
> There is no suggestion of a purpose to restrain state action in the Act's legislative history. The sponsor of the bill which was ultimately enacted as the Sherman Act declared that it prevented only "business combinations" . . . That its purpose was to suppress combinations to restrain competition and attempts to monopolize by individuals and corporations, abundantly appears from its legislative history. . . .[197]

In dictum, however, the Court's opinion limits the power of the states to enact anticompetitive legislation: "[A] state does not give immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful."[198] In other words, a state cannot legitimize private acts expressly proscribed by the Sherman Act. But state action that is generally anticompetitive or that even runs counter to a strong federal policy implicit in the general language of the Sherman Act, such as the rule of per se illegality for price fixing, appears to be condoned by *Parker*.

Although the *Parker* decision has been criticized,[199] the Court has never re-examined it. Meanwhile, the lower federal courts, exploiting the implications of the Court's broad pronouncement that the Sherman Act is not aimed at state action, have expanded *Parker* beyond its factual context, in which the anticompetitive California legislation was at least consistent with federal agricultural price support programs.[200] For instance, in *Gas Light Co. v. Georgia Power*

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197. *Id.* at 350-51 (citations omitted).

198. *Id.* at 351, citing Northern Sec. Co. v. United States, 193 U.S. 197, 332, 344-47 (1904).

199. For an excellent recent analysis of the *Parker* decision and its progeny, see Slater, *Antitrust and Government Action: A Formula for Narrowing Parker v. Brown*, 69 Nw. U.L. REV. 71 (1974), in which the writer proposes that the Supreme Court adopt a balancing process similar to that now employed in commerce clause cases, *see* text accompanying note 157 *supra*, weighing the alleged state interest against the anticompetitive effects of the state action.

200. *See* text accompanying notes 179-81 *supra*.

Co.,[201] the plaintiff, a distributor of natural gas in the area of Columbus, Georgia, charged that the defendant, a regulated utility selling electricity in the same area, had unlawfully sought to eliminate natural gas as a competitive energy source.[202] The Fifth Circuit Court of Appeals, however, found that the five alleged exclusionary practices involved rate and service matters that had been reviewed and approved by the state regulatory commission. This, the court held, constituted state activity that fell squarely within the *Parker* "exclusion" from illegality under the Sherman Act.

Despite *Parker* and its progeny, opponents of the divestiture statutes may argue that the exclusion of oil producers from the retail market, resulting in the loss of a significant class of actual and potential competitors, conflicts with the strong federal policy of encouraging competition at all levels of production and marketing.[203] This contention, of course, must meet or avoid the governmental action doctrine at the outset. The opponents could maintain that *Parker* should be overruled or at least modified to allow an accomodation of conflicting federal and state policies in the antitrust area.[204] Alternatively, *Parker* and the decisions based on it might be distinguished on the ground that the divestiture statutes do not purport to serve any legitimate state interest other than the elimination of an alleged anticompetitive, vertically integrated market structure. Even if Congress intended to allow the states to pursue other valid legislative objectives despite their conflict with the federal antitrust laws, it did not intend to approve the enactment of state antitrust statutes that interfere with federal antitrust law.

Both of these arguments probably would fail. The governmental action doctrine appears to be too deeply entrenched to be dislodged at this late date, and a distinction based on the purpose—as opposed to the effect—of state legislation that conflicts with federal policy seems specious. Moreover, even if the opponents succeed in overcoming the hurdle posed by *Parker* and the governmental action

201. 440 F.2d 1135 (5th Cir. 1971), *cert. denied*, 404 U.S. 1062, *rehearing denied*, 405 U.S. 969 (1972).

202. The complaint asserted that the defendants' conduct violated §§ 1 and 2 of the Sherman Act and § 3 of the Clayton Act, 15 U.S.C. § 14 (1970).

203. *See* note 191 *supra*. It has been held consistently per se illegal under section 1 of the Sherman Act for competitors to combine to exclude another competitor from the market. *See, e.g.*, Associated Press v. United States, 326 U.S. 1 (1945). Moreover, the Court's merger decisions have shown a special sensitivity to the lessening of competition by the elimination of actual or potential competitors from a market. *See* Ford Motor Co. v. United States, 405 U.S. 562 (1972).

204. *See* note 199 *supra*.

doctrine, it can be argued in favor of the divestiture statutes that they are not in conflict with federal antitrust policy. While they exclude oil producers from the retail market, the exclusion is only incidental to their primary purpose, which is the weakening of the anticompetitive, vertically integrated oil industry structure. This aim, the argument goes, is fully consistent with federal antitrust policy.

Unfortunately, a full explication of the debate on the competitive merits of the divestiture statutes could prematurely involve aspects of the problem reserved for discussion in Section III.[205] Nonetheless, some observations on the present state of federal antitrust case law may help to resolve the dispute over the state of federal antitrust policy. First, there is a clear, general policy against the exclusion of actual or potential competitors from a market, whether it is done by agreement among the other competitors or by the merger of one competitor into another.[206] Secondly, it is equally well-established that protection of competition is the ideal, not the protection of competitors.[207] Unlawful anticompetitive behavior is not excused by showing that its purpose was to protect weaker competitors who otherwise would be unable to compete effectively with their larger rivals.[208] Combining these principles, it is fair to say that federal policy—at least as propounded by the federal courts—condemns the exclusion of strong competitors from a market in order to foster competition among the weak; the law will not cut down trees to allow saplings to compete for sunlight.

The courts' attitude toward vertical integration is more ambivalent. Vertical integration is not unlawful per se.[209] Several decisions have acknowledged, however, that the danger of anticompetitive behavior increases as a firm becomes vertically integrated and acquires leverage potential,[210] although these cases have involved vertical mergers attacked under section 7 of the Clayton Act.[211] No case has yet required a firm that had become vertically integrated through internal expansion to divest itself of assets on the sole ground that it was vertically integrated.

Thus it appears, from weighing the relevant federal policies,

205. *See* text accompanying notes 222-36.

206. *See* cases cited in note 203 *supra*.

207. *See* United States v. Topco Associates, 405 U.S. 596, 610-11 (1972); Brown Shoe Co. v. United States, 370 U.S. 294, 344 (1962).

208. United States v. Topco Associates, 405 U.S. 596, 610-11 (1972).

209. *See* United States v. Arnold, Schwinn & Co., 388 U.S. 365, 381 (1967); United States v. Columbia Steel Co., 334 U.S. 495, 519-26 (1948).

210. *See* Brown Shoe Co. v. United States, 370 U.S. 294, 328-34 (1962).

211. 15 U.S.C. § 18 (1970).

that the divestiture statutes probably contravene those policies, but not sufficiently to override the deference shown in *Parker* to state governmental action, an attitude grounded in the basic division of powers inherent in a federalist system. This appraisal will be reinforced if Congress enacts divestiture legislation to eliminate vertical integration in the oil industry[212] because that action would constitute a clear, specific statement of federal policy consistent with the state divestiture statutes.

(2) Preemption by the Emergency Petroleum Act

The opponents of the divestiture statutes also have contended that the statutes are preempted by the Emergency Petroleum Allocation Act of 1973.[213] Section 4(a) of the Act directs the President to promulgate regulations for the mandatory allocation and pricing of petroleum products. Pursuant to this grant of authority, the Federal Energy Administration (FEA) has established a complex system that seeks to insure the fair allocation and pricing of petroleum products among competing uses and regions.[214] These rules constitute a comprehensive, nationwide scheme that could be thwarted by inconsistent state legislation.[215] In fact, section 6(b) of the Act expressly provides that this scheme preempts conflicting regulations by the states.

The difficulty with this argument is that the divestiture statutes contain no provision that is inherently incompatible with the federal allocation and pricing rules.[216] These rules do not contemplate static retail markets; section 4(b) of the Act in fact, directs the FEA's regulations to provide, to the maximum extent possible, for a competitive, efficient petroleum industry, with special concern for the viability of branded and nonbranded independent marketers. The federal scheme does not control entry into or exclusion from the retail market; it merely attempts to insure fair pricing and

212. *See* text accompanying notes 21, 100-01 *supra*.

213. 15 U.S.C.A. §§ 751-56 (Supp. 1975).

214. 10 C.F.R. §§ 210-13 (1975).

215. *See* text accompanying note 188 *supra*.

216. This is not the case for state franchising and divestiture statutes that require the majors to allocate or price the gasoline supplied to their dealers in a specified manner. For example, the Maryland divestiture statute provides that every producer, refiner and wholesaler shall extend all voluntary price allowances uniformly and apportion gasoline among dealers uniformly and on an equitable basis during periods of shortage. MD. ANN. CODE art. 56, § 157E(d), (f) (Supp. 1975). It has been argued persuasively that this state action trenches too closely on the federal regulatory scheme, which prescribes much more specifically how prices and allocation are to be determined. *See* Brief of Piper & Marbury, *supra* note 106, at 13-17.

allocation of available gasoline supplies among those who happen to be in the market.

F. Assessment

On balance, it appears likely that the divestiture statutes will be upheld if challenged on federal constitutional grounds. Under the fourteenth amendment due process and equal protection clauses, the Supreme Court grants extreme deference to any economic policy judgment made by state legislatures. Furthermore, divestiture does not constitute a taking for public use that must be compensated, but is more properly characterized as regulation of a property right that allegedly threatens the economic welfare of the enacting states.

The commerce clause presents a more serious problem. The divestiture statutes may be invalidated on this ground if they are found to discriminate against out-of-state competitors. This view, however, would require the Court to examine the legislatures' purposes in enacting the statutes, because they are nondiscriminatory on their face. Although the Court delved into legislative motivation in *Dean Milk*, a major factor in its decision was the existence of less restrictive alternatives. Less restrictive alternatives are suggested in Section III of this Note, but it is uncertain whether the Court would accept this solution. Moreover, the possibility exists that Congress will enact divestiture laws, implicitly approving the states' actions. According to the *Parker* decision, this weighs against a finding that the state statute infringes congressional commerce clause power.

The federal preemption argument, though apparently sound on policy grounds, is snagged by the *Parker* government action doctrine and the Court's reluctance to declare that antitrust is a preempted area. Federal intervention in the regulation of petroleum pricing and distribution is a much more recent development, but is not yet comprehensive enough to suggest any serious conflict with the divestiture statutes.

Assuming that the divestiture statutes will withstand the constitutional arguments, there is a need for an analysis of the economic policy justification offered in support of the statutes.

III. THE COMPETITIVE IMPACT OF DIVESTITURE AND LESS RESTRICTIVE ALTERNATIVES

In evaluating the overall validity of marketing divestiture statutes, their potential effect on competition in the retail gasoline marketplace is an essential consideration.[217] Thus far this Note has fo-

217. As indicated in the text accompanying notes 15-17 *supra*, two types of marketing

cused on the gasoline marketing situation largely from the competing perspectives of two special interest groups—the major oil companies and their independent retail dealers. While these special interests are clearly relevant to the problems posed by divestiture legislation, an implicit axiom of antitrust policy is that the public interest normally must predominate over special interests. This is particularly true when all relevant interests can be articulated clearly, and the special interests are or may be in conflict with the public interest.

In the context of gasoline marketing, the public interest can best be expressed in terms of "consumer want satisfaction."[218] The gasoline-consuming public has a paramount interest in obtaining an adequate supply of desired petroleum products and services at the lowest possible price. This consumer interest is best effectuated through the preservation of workable competition[219] at all levels of production and marketing.

Theoretically, workable competition is the end result of the

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divestiture statutes have thus far been proposed: (1) those limiting or prohibiting the use of company-operated stations by vertically integrated oil firms, and (2) those prohibiting vertically integrated oil companies from possessing any ownership interest whatsoever in retail gasoline marketing facilities. Although many of the competitive-impact arguments discussed in this section are relevant to both types of statutes, this section is primarily concerned with the economic effect of these statutes directed toward the use of company-operated stations by major oil firms. The writers have adopted this limited focus because to date none of the proposals calling for complete marketing divestiture has been enacted into law.

Nonetheless, several competitive-impact issues peculiar to the complete divestiture proposals must be articulated. It initially would appear that complete marketing divestiture is justified because it would eliminate any possibility of control-related abuses of dealers by their landlord-supplier majors. However, closer analysis makes this initial conclusion less clear, because enforcement of a complete divestiture statute would necessarily entail a massive liquidation by the majors of their existing marketing facilities, possibly under distress sale conditions. Most independent dealers would be unable to make the capital investment necessary to purchase the stations they operate. At best, these independent dealers effectively would be eliminated as competitors from the retail gasoline market. At worst, their stations would be acquired by large retail chains, since such chains would be the most likely potential service station buyers, having both the capital to purchase them and the interest in operating them. This, in all likelihood, would result in the substitution at the gasoline marketing level of one oligopoly for another. Furthermore, the substitution of retail chain conglomerates for oil majors at the marketing level probably would not affect significantly gasoline prices, since the retail chain service station operators would still bave to purchase gasoline from the oil majors. Thus, upon careful scrutiny, it appears that complete divestiture would benefit neither the independent dealers nor the gasoline-consuming public.

218. Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division*, 75 YALE L.J. 373, 375 (1966).

219. The term "workable competition" is not being employed in this Note as a precise economic term of art. Workable competition is intended to mean that competition that results in "general economic welfare," since this definition reasonably reflects the basic goals of antitrust policy. See P. AREEDA, ANTITRUST ANALYSIS 37 (1974) [hereinafter cited as AREEDA].

successful interaction of several related economic factors. The first prerequisite is relatively free entry into the marketplace by would-be competitors. Free entry will encourage a maximum number of firms to compete in the marketplace, and this competition will ultimately result in product sales at the lowest possible selling price. Inefficient competitors will be unable to return a reasonable profit by selling their goods at this low price, and consequently will be forced to withdraw from the marketplace, leaving only the efficient competitors. At this point the market will reach a state of equilibrium that may be characterized as workable competition.

It must be emphasized that workable competition is not necessarily equivalent to a market with the maximum number of competitors. Workable competition presupposes only a maximum number of efficient competitors. Accordingly, for competition-protection purposes a distinction must be made between efficient and inefficient competitors. In this regard, laws of antitrust significance should neither protect inefficient competitors from the hazards of legitimate competition nor exclude efficient competitors from the marketplace.[220]

This simplified analysis ignores the problem created by the efficient competitor who employs its structural advantages in an anticompetitive manner designed to remove other efficient competitors from the marketplace. This problem is particularly relevant to the present gasoline marketing situation because the major oil companies, by virtue of their size, concentration, vertical integration, and control of essential "upstream" levels of industry activity, appear to be capable of eliminating other efficient competitors at the marketing level.

This state of affairs in the petroleum industry poses a dilemma to the thoughtful legislator considering proposed divestiture legislation. On one hand, the efficiencies made possible through the oil majors' large-scale, integrated methods of operation enable them to pass on potentially significant cost savings to the consumer. On the other hand, the majors, under certain circumstances at least, appear to be capable of destroying needed competition at the marketing level. Given this conflict, the legislator is perhaps understandably uncertain whether enactment of such legal barriers to entry as divestiture legislation is economically wise.

It is interesting to note that all of the marketing divestiture measures proposed thus far have by their terms been specifically

220. *See, e.g.*, Brown Shoe Co. v. United States, 370 U.S. 294, 344 (1962) (Warren, C.J.: "It is competition, not competitors, which the Act protects").

confined in applicability to vertically integrated firms.[221] This implicitly reveals a belief on the part of the proposals' drafters that vertical integration is the evil that must be removed from the gasoline marketplace. As the following discussion will show, the truth of this legislative assumption is far from clear, particularly when examined in the context of the petroleum industry's multiplicity of structural market-influencing factors.

A. *The Effect of Vertical Integration on Gasoline Marketing*

The debate on the competitive merits of vertical integration has occupied some of the finest legal and economic minds and has consumed countless pages of text. The majority view asserts that a firm possessing monopoly power[222] at one level of production or marketing acquires additional power through vertical integration that enables it to extend its monopoly control to a downstream level.[223] This process of leverage, as it is called, is said to occur through various mechanisms, two of which are relevant to petroleum marketing.

(1) In a price squeeze, an integrated producer not only sells to independent dealers but competes with them through its own company-operated retail outlets. If the producer has monopoly power at the production level, it has some control over the price and quantity of the product being supplied. Sales to the independent dealers are made at an inflated monopoly price, which must be reflected in the dealers' retail prices if they are to make a profit. The integrated producer's own outlets, however, do not actually pay the inflated price, so they are able to undersell the independent dealers. Even if the integrated producer sets a transfer price to its own outlets equal to the price paid by the independent dealers, it is a bookkeeping transaction only; the integrated firm is paying the monopoly price to itself. The result is that the integrated firm's

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221. *See* notes 95-101 *supra* and accompanying text.

222. As used in tbis subsection only, tbe term monopoly power refers solely to a firm's ability to affect the price of its product by varying output. In this technical sense, monopoly power is possessed by oligopolists wbo recognize their interdependence and expressly or tacitly collude in setting aggregate output to maximize their joint profits. *See* AREEDA 260-62. This is the pattern in the oil industry at the production, pipeline, and refining levels. This definition of monopoly power must be distinguished from the term monopolization as used in the context of § 2 of the Sherman Act. *See* text accompanying note 258 *infra*.

223. *See* W. ADAMS, THE STRUCTURE OF AMERICAN INDUSTRY 364-66 (1974); J. BAIN, INDUSTRIAL ORGANIZATION 360-62 (2d ed. 1968); C. KAYSEN & D. TURNER, ANTITRUST POLICY 119-23 (1959); Adelman, *Integration and Antitrust Policy*, 63 HARV. L. REV. 27, 41-53 (1949); Blake & Jones, *Toward a Three-Dimensional Antitrust Policy*, 65 COLUM. L. REV. 422, 440-58 (1965); Kessler & Stern, *Competition, Contract and Vertical Integration*, 69 YALE L.J. 1, 14-21 (1959); *Hearings on the Impact Upon Small Business of Dual Distribution and Related Vertical Integration Before Subcomm. No. 4 of the House Select Comm. on Small Businesses*, 88th Cong,, 1st Sess. (1963).

presence in the retail market constitutes a threat that allows the integrated firm to eliminate or discipline the independent dealers. The power it acquires on the retail level will be similar to the monopoly power it already possesses on the production level, and to maximize its own profits it is likely to minimize retail competition.

(2) Because the integrated firm has the power to set the quantity and price of the product being supplied, any potential entrant at the retail level must enter also at the production level to compete effectively. The additional capital required to enter at both levels, combined with the existing barrier to entry at the production level that enabled the integrated firm to acquire its monopoly position at that level, will discourage potential competitors and further minimize competition at the retail level.

This pattern has been documented in studies of the cement[224] and steel industries,[225] but it has been most apparent in oil refining.[226] The major oil companies systematically used their control of crude production and pipelining to liquidate independent refiners and acquire their assets. The recent FTC study concluded, "the system contained all the elements essential to a squeeze on refining profits and could be overcome only if the potential refining entrant could enter on a vertically integrated basis."[227] The independent retail gasoline dealers argue that the integrated oil companies now are trying to implement a similar squeeze at their level, and that the divestiture statutes are needed to prevent the majors from acquiring the necessary leverage.

Opposed to the view that vertical integration is an anticompetitive evil is a school of thought that denies that leverage is a valid analytical concept.[228] According to this view, vertical integration confers no more anticompetitive power on an integrated firm than it already possesses as a result of a monopolistic position at one or more levels of production. What appears to be the use of leverage

224. Allen, *Vertical Integration and Market Foreclosure: The Case of Cement and Concrete*, 14 J.L. & ECON. 251 (1971).

225. Adams, *Vertical Power, Dual Distribution, and the Squeeze: A Case Study in Steel*, 9 ANTITRUST BULL. 493 (1964); Adams & Dirlam, *Steel Imports and Vertical Oligopoly Power*, 54 AM. ECON. REV. 626 (Sept. 1964).

226. W. ADAMS, THE STRUCTURE OF AMERICAN INDUSTRY 365-66 (1974); M. DE CHAZEAU & A. KAHN, INTEGRATION AND COMPETITION IN THE PETROLEUM INDUSTRY (1959).

227. FTC, REPORT ON CONCENTRATION LEVELS AND TRENDS IN THE ENERGY SECTOR OF THE U.S. ECONOMY 26 (1974).

228. PUBLIC POLICY TOWARD MERGERS 139-76 (J. Weston & S. Peltzman, eds. 1969); Bork, *Vertical Integration and the Sherman Act: The Legal History of an Economic Misconception*, 22 U. CHI. L. REV. 157, 194-201 (1954); Bowman, *Contrasts in Antitrust Theory: II*, 65 COLUM. L. REV. 417 (1965); Posner, *Exclusionary Practices and the Antitrust Laws*, 41 U. CHI. L. REV. 506, 523-27 (1974).

by an integrated firm could be undertaken by a nonintegrated firm with equivalent monopoly power in a totally unrelated market. An alleged price squeeze is simply predatory price cutting undertaken by a competitor whose losses in one market happen to be financed with monopoly profits upstream. Vertical integration per se adds nothing to the firm's anticompetitive capability,[229] and the firm can only reap one monopoly profit. Since transfer prices between levels of production and marketing within the same firm can be determined without regard to market forces, however, the integrated firm can allocate its monopoly profit as it chooses, so that its source may be concealed.

On the barriers to entry issue, this group of commentators argue that the alleged obstacles to potential competition are due solely to the horizontal monopoly existing at the upstream level, not a vertically integrated structure. If the upstream level were competitive, the potential entrant at the retailing level would have numerous suppliers and would not be affected by the integrated firm's distribution to its own outlets.

In summary, this school has demonstrated theoretically that a profit-maximizing, vertically integrated firm should set output and price at each level of production and marketing as if that level were independent of the others. A rational, vertically integrated monopolist will behave like a monopolist, but only at the levels where it enjoys monopoly power. The implications for public policy toward vertical integration are claimed to be simple: "the appropriate vertical integration policy is, in fact, no policy at all."[230]

Some commentators have gone further and suggested that there are real economies inherent in vertical integration that make it a procompetitive rather than an anticompetitive force in an industry.[231] The integrated firm can avoid the expenses and uncertainties associated with the procurement of essential inputs and the marketing of intermediate goods. Furthermore, it is able to spread its administrative overhead over several stages of production. The extent to which this may be true of the oil industry apparently has not been studied, but it is clearly a possibility that a legislature should not ignore when considering forced divestiture statutes.

Without attempting to reconcile these views, it is fair to con-

229. This statement must be qualified to the extent that real economies resulting from the integration increase the firm's overall profitability and its staying power in the retail market.

230. PUBLIC POLICY TOWARD MERGERS, *supra* note 228, at 176.

231. Brodley, *Oligopoly Power Under the Sherman and Clayton Acts—From Economic Theory to Legal Policy*, 19 STAN. L. REV. 285, 315-16 (1967).

clude that the vertically integrated structure of the oil industry is not anticompetitive per se. Nevertheless, integration combined with the majors' monopoly power at the upstream producing, pipelining and refining levels creates the potential for the majors to engage in exclusionary and predatory practices at the marketing level. Divestiture attempts to eliminate the potential for abuse by excluding vertically integrated oil companies from the retail market, but it also significantly alters the structure of the market by barring a large class of efficient potential competitors. A less restrictive legislative alternative should focus on the majors' alleged anticompetitive behavior without eliminating them as competitors.

To illustrate, consider two hypothetical situations that attempt to draw the fine line between the aggressive, healthy price cutting that characterizes workable competition, and the threat of predatory, below-cost pricing that is an element of anticompetitive behavior. In Situation I, the Arab-Eskimo Oil Company (Aresko), a hypothetical, vertically integrated major is contemplating opening several company-operated service stations in areas where there are already independent, dealer-operated stations under Aresko and other major brands. These company-operated stations will offer both self-service gasoline pavilions and specialized repair services. From its market analysis, the Aresko management believes that its company-operated stations will be more efficient[232] than the dealers' stations. Because their costs will be lower, the company-operated stations will be able to undersell their competitors and still return a profit. Consequently, many price-conscious consumers will be lured away from the dealers' station, and some of the marginally profitable dealer stations will fail. The more efficient, surviving dealers will probably lower their prices in an attempt to meet the lower price of the company-operated stations. Because the market now will be shared by fewer stations, however, the surviving dealers may fare as well as they did before.

In this situation, an examination of Aresko's books would reveal that the gross profits it could fairly attribute to its retail operations in each market area exceed its overhead costs at that level. If the company-operated station in an area sells gasoline at 52 cents per gallon, and Aresko sells gasoline to its branded dealers at 45 cents per gallon, 7 cents per gallon gross profit can be fairly attributed to Aresko's retail operations regardless of the artificial transfer price

232. "Efficiency" is used in a broad sense to mean lower costs of operation, elimination of unprofitable services, a favorable location, and consumer appeal resulting in a greater volume of gasoline sold.

at which it "sells" gasoline to the company-operated stations.[233] To show a net profit at this level, this 7 cents per gallon must cover all of the station's overhead expenses, including salaries, maintenance and depreciation of the station, taxes, and insurance. An efficient dealer-operated station, which will have similar expenses, will also show a net profit at this price differential, while the marginal dealer will be unable to cover his higher costs.

The policy implications of Situation I are clear. The entry of Aresko into the retail market has resulted in lower prices for gasoline and a greater variety of service tailored to meet fragmented consumer demand. Aresko's entry has capitalized on efficient marketing techniques, maximized competition at the retail level, and has benefited consumers. Thus, compulsory divestiture would not be in the public interest.[234]

In Situation II, Aresko strategy is to minimize future competition at the retail level by squeezing existing dealers and limiting future entry. The Aresko management realizes that direct coercion applied to its own dealers—threats of nonrenewal of lease and limiting gas supplies—will run afoul of existing franchising, allocation and antitrust statutes and will not affect dealers of other brands. Thus it plans to open company-operated service stations to acquire leverage at the retail level. Even if the company-operated stations are no more efficient than many dealer stations, Aresko can afford to operate them at below aggregate cost and absorb the loss through the monopoly profits it reaps upstream. If the company stations continue to operate at substantially below cost for extended periods, the independent dealers, beginning with the least efficient, will eventually be forced to leave the market. Aresko probably will stop short of destroying all of its retail competition; not only would this be very costly, but it would constitute a blatantly unlawful attempt to monopolize.[235] Some of the more efficient dealers will be allowed to survive and share the market, but the threat of future predatory

233. If Aresko can sell all the gasoline it refines to its brand dealers at 45¢ per gallon, it loses 5¢ per gallon if its transfer price to its company stations is only 40¢ per gallon. Of course, it recoups that paper loss by showing an offsetting increase in the profits of the company-operated station. The point is that both the loss and the profit are artificial; it is the actual price at which the intermediate product is sold to the dealers that most closely approximates its value at that point and gives the truest picture of the company-stations' profitability.

234. *See* Statements of Professor Charles H. Berry, Dr. Matityahu Marcus, and Charles J. Irwin to New Jersey Assembly Committee on Commerce, Industry and Professions on Assembly Bills 159 and 1411, Sept. 25, 1974; Statements of BP Oil Inc. and Kayo Oil Company at the Maryland Governor's Veto Hearing on House Bill 918 and Senate Bill 465, May 24, 1974.

235. *See* text accompanying notes 263-65 *infra*.

pricing effectively will discipline the survivors, who are likely to follow the company-operated stations' price leadership thereafter. After establishing the threat, Aresko will probably set a higher price level that will maximize its own retail profits while minimizing competition.[236] Potential entrants, however, even if they can purchase gasoline from Aresko or another major, will be discouraged by the aggressive Aresko presence in the retail market.

Even on these assumptions, the predatory nature of Aresko's activities might be difficult to detect. The subjective intent of the Aresko management will be extremely difficult to prove unless overt threats are made or a conspiracy among the surviving competitors is undertaken. The only objective indication will lie in a comparison of the relative costs and revenues of Aresko from its retail operations during the period of predatory pricing, and these may be disguised. For example, Aresko may "charge" its company-operated station a transfer price of only 40 cents per gallon, creating a paper profit at that level at the expense of upstream profits, or the company may charge certain expenses associated with its retail operation, such as the depreciation of its station facilities, to general accounts that include all of the company's operations or assets. In both cases, Aresko is in reality subsidizing its predatory behavior in the retail market with upstream monopoly profits.

The policy implications of Situation II are unclear, because there exists here an anticompetitive problem requiring a legal remedy. The legislative task is the creation of a remedy that will allow Situation I, but enable independent dealers to enjoin or recover damages for the predatory and exclusionary behavior of the major in Situation II.

B. Less Restrictive Legislative Alternatives

At this point two related quesions arise: (1) what adequate remedies under already-existing state and federal laws are available to the independent dealer who has been injured under Situation II circumstances; and (2) if no such remedy already exists, what additional legislation is needed to adequately protect dealers from Situation II practices.

236. The two prerequisites for a successful predatory pricing campaign are greater staying power than the competitors and a future payoff. *See* AREEDA, *supra* note 219, at ¶ 606. There is considerable debate in the literature, however, concerning whether predatory pricing, even if it were legal, would be a rational, profit maximizing strategy. *See* Posner, *supra* note 228, at 515-23.

(1) Enforcement of Existing Federal and State Statutes

The dealer injured under Situation II circumstances probably would look first to state "Dealer Day in Court" (franchising) statutes for relief,[237] assuming such statutes exist in his state. Such litigation, however, is primarily designed to prohibit overtly coercive activity by the majors in their roles as landlord/suppliers of the independent dealers. If a major arbitrarily terminated a dealer's service station lease without proper notice and economic justification or refused to supply the dealer's gasoline requirements unless the dealer complied with the major's pricing desires, the Dealer Day in Court statute likely would afford relief. Likewise, if an injured dealer could prove that a major sold gasoline to a competing company-operated station at a lower price than to the dealer, the franchising laws might afford relief to the dealer. Given the intra-enterprise nature of transfers between vertically integrated oil producers and their company-operated stations, however, it is unlikely that an injured dealer could find clear evidence of such price discrimination by the majors. Thus it is unlikely that the dealer would be able to obtain relief under the franchising laws for injury resulting from Situation II activity.

Federal or state allocation laws[238] are likewise inappropriate to the dealer's Situation II dilemma. These laws are designed only to insure that the major's supply of gasoline is fairly allocated to company-operated, dealer-operated, and "independent" stations. Consequently, the allocation laws would have no applicability to Situation II predatory pricing activity.

Several state[239] and federal statutes of antitrust significance are relevant to this issue. Section 2(a) of the Robinson-Patman Act[240] prohibits price discrimination affecting competition among sellers or buyers. Thus an independent dealer might allege that his seller (the major) violated section 2(a) of the Act by selling gasoline to company-operated stations at a lower price than to independent dealers in the same market area. Assuming that the dealer could meet the complex "in commerce"[241] prerequisites for Robinson-

237. *See* note 13 *supra*.

238. *See* notes 213-16 *supra* and accompanying text.

239. *See* note 177 and text accompanying note 194 *supra*.

240. 15 U.S.C. § 13 (1970).

241. The "in commerce" element of a § 2(a) violation is exceedingly difficult to establish. A full analysis of the relevant case law interpreting the "in commerce" element is beyond the scope of this Note. It is sufficient to note here that in "secondary line" (buyer-level) discrimination cases, at least one of the purchases complained of by the plaintiff must have been in interstate commerce (i.e. crossed a state line). *See* Littlejohn v. Shell Oil Co., 483 F.2d 1140, *cert. denied*, 414 U.S. 1116 (1973).

Patman Act coverage, however, it is unlikely that he would be able to fulfill the Act's other jurisdictional requirements. Specifically, the Act requires that the plaintiff prove that two or more "purchases"[242] were made from the "same seller."[243] The dealer thus would have to establish that the discriminatory transfer of gasoline from the defendant major to its company-operated station constituted a "purchase." Since enterprise tranfers generally do not constitute "purchases" within the meaning of the Act,[244] it is unlikely that an injured dealer would be able to establish a prima facie case under the Robinson-Patman Act.

The dealer also might look to section 5 of the Federal Trade Commission Act[245] for relief. Section 5 prohibits "unfair methods of competition in commerce," and is often used to proscribe anticompetitive behavior similar to but more incipient than conduct violative of the Sherman and Clayton Acts.[246] While the types of conduct with which section 5 is designed to deal appear similar to the practices of which the dealer might complain, private actions for damages unfortunately are not available under the FTC Act.[247] Consequently, the dealer must seek his remedy under section 5 through FTC enforcement proceedings. Given resource allocation limitations it is highly unlikely that an individual dealer could reasonably expect the FTC to come to his aid. Furthermore, even if the FTC filed suit against the dealer's major, no money damages would be involved.[248] Thus the FTC Act, while substantively apposite to the dealer's plight, offers little prospect for adequate relief.

Unlike the FTC Act, the Sherman Act[249] does provide for private remedies. The Sherman Act permits any person injured as a result of Act violations to sue for treble damages.[250] The Act has two provisions relevant to a potential cause of action by the aggrieved dealer. Section 1 prohibits contracts, combinations and conspiracies

242. *See, e.g.*, American Can Co. v. Bruce's Juices, Inc., 187 F.2d 919 (5th Cir. 1951).

243. *See, e.g.*, Baim & Blank, Inc. v. Philco Corp., 148 F. Supp. 541 (E.D.N.Y. 1957).

244. *See, e.g.*, Reines Distributors, Inc. v. Admiral Corp., 256 F. Supp. 581 (S.D.N.Y. 1966); Danko v. Shell Oil Co., 115 F. Supp. 886 (E.D.N.Y. 1953).

245. 15 U.S.C. § 45 (1970).

246. *See* FTC v. Cement Inst., 333 U.S. 683, 694 (1948) ("although all conduct violative of the Sherman Act may . . . come within the unfair trade practice prohibitions of the Trade Commission Act, the converse is not necessarily true. It has long been recognized that there are many unfair methods of competition that do not assume the proportions of Sherman Act violations . . . .").

247. A. NEALE, THE ANTITRUST LAWS OF THE U.S.A. 5 (2d ed. 1970).

248. *Id.*

249. 15 U.S.C. §§ 1-7 (1970).

250. Section 7 of the Sherman Act, providing for private treble damage actions, has been superseded by § 4 of the Clayton Act. 15 U.S.C. § 15 (1970).

in restraint of trade or commerce. Section 2 prohibits monopolization or attempts to monopolize any part of trade or commerce. Both sections are potentially applicable to the Situation II problem confronting the dealer; however, both sections involve highly complex matters of proof.

The chief difficulty facing the dealer attempting to state a cause of action under section 1[251] would be that the activity about which the dealer complains in Situation II is essentially unilateral action by the major, and not a conspiracy as proscribed under section 1. Nevertheless, a dealer at least could attempt to establish a conspiracy from the facts presented in Situation II. The dealer's argument might proceed as follows: the company-operated station entered the market and sold its gasoline at prices significantly lower than those previously prevailing in that market; other dealers in the market area followed the company station's price leadership; the more marginal dealer-operated stations failed because they were unable to return a profit at these lowered prices; after several such stations failed the company station then raised its prices to previously prevailing levels and the surviving dealers followed suit. This pattern of activity would clearly support a finding of "conscious parallelism."[252] It is problematical, however, whether the conduct alone would lead to an inference of agreement necessary to establish a conspiracy under section 1.[253] At this point several considerations would be relevant in the dealer's case. First, the fact that the consciously parallel behavior involved pricing is entitled to significant weight.[254] Secondly, if the dealer could show that a large number of dealers in the area followed the company station's price leadership, an inference of agreement would be strengthened.[255] Finally, if the dealer could introduce evidence tending to show that the other dealers adhered to the company station's prices because the activities of the company station had a chilling effect on these other dealers, then the plaintiff-dealer's conspiracy case might prevail.[256]

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251. 15 U.S.C. § 1 (1970).

252. *See, e.g.*, Theatre Enterprises, Inc. v. Paramount Film Distrib. Corp., 346 U.S. 537 (1954); Interstate Circuit, Inc. v. United States, 306 U.S. 208 (1939).

253. No Supreme Court case has yet held as a matter of law that mere parallel business behavior, without more, is sufficient to constitute a conspiracy under § 1 of the Sherman Act. Theatre Enterprises, Inc. v. Paramount Film Distrib. Corp., 346 U.S. 537, 541 (1954).

254. *See, e.g.*, Morton Salt Co. v. United States, 235 F.2d 573, 577 (10th Cir. 1956).

255. *See* cases cited in note 22 *supra*.

256. Essentially, the plaintiff must introduce evidence that will make the parallel behavior appear sufficiently complex in nature so that "a web of circumstantial evidence" will permit a valid inference of conspiracy. Delaware Valley Marine Supply Co. v. American Tobacco Co., 297 F.2d 199, 205 n.19 (3d Cir. 1961), *cert. denied*, 369 U.S. 839 (1962).

Under the most favorable Situation II facts a dealer would encounter excessive difficulty in establishing a conspiracy charge under section 1. Any significant factual ambiguity likely would spell defeat for the dealer. Moreover, the average dealer would probably not command the legal resources needed to prove such a case. Thus section 1 of the Sherman Act does not appear to be an appropriate source of relief for a Situation II victim.

Should the injured dealer seek to bring an action against a major for monopolization under section 2 of the Sherman Act,[257] he must prove two basic elements. First, the dealer must establish that the defendant oil major possessed monopoly power in the relevant product and geographic markets.[258] In the context of the gasoline marketing industry, the relevant product market (automotive gasoline) would admit of simple definition; however, the relevant geographic market may be exceedingly difficult to define.[259] Furthermore, even assuming that the product and geographic markets can be defined, existing case law provides no clear-cut definition of what constitutes monopoly power.[260]

The second primary proof element for a section 2 monopolization charge requires that the dealer establish that the defendant, while possessing monopoly power, engaged in exclusionary practices, *i.e.* conduct designed to exclude competitors and/or control prices.[261] The plaintiff-dealer's burden of proof on this point would likely be somewhat simpler because the courts have taken the view that monopoly power, if actively exercised at all, shifts the burden of proof to the defendant to show that his exercise of monopoly power involved no exclusionary practices.[262] In this context any oil major possessing monopoly power and engaging in either Situation I or II type conduct likely would be found in violation of the section 2 prohibition against monopolization.

The inherent difficulty facing a dealer attempting to establish a cause of action for monopolization under section 2 is that regardless of the definition of relevant geographic market employed, no

257. 15 U.S.C. § 2 (1970).

258. *See, e.g.*, United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377 (1956).

259. *See, e.g.*, United States v. Grinnell Corp., 236 F. Supp. 244 (D.R.I. 1964), *aff'd except as to decree*, 384 U.S. 563 (1966) (findings 4 and 40 in the opinion deal with problems of geographic market definitions).

260. *See* United States v. Aluminum Co. of America, 148 F.2d 416, 424 (2d Cir. 1945) ("The percentage [share of the market] we have already mentioned—over ninety— . . . is enough to constitute a monopoly; it is doubtful whether sixty or sixty-four percent would be enough; and certainly thirty-three percent is not.")

261. *See, e.g.*, United States v. Griffith, 334 U.S. 100 (1948).

262. *See* United States v. United Shoe Mach. Corp., 110 F. Supp. 295 (D. Mass. 1953), *aff'd per curiam*, 347 U.S. 521 (1954).

single major oil company is likely to possess a market share sufficient legally to constitute monopoly power. Thus a plaintiff-dealer injured as a result of Situation II conduct likely would fail to sustain a section 2 monopolization charge on the ground that the existence of defendant's monopoly power was not established.

A section 2 attempt to monopolize[263] charge under the Sherman Act likely would confront the dealer with equally difficult matters of proof. A cause of action for attempt to monopolize must contain two basic elements—a specific intent to monopolize, and a "dangerous probability" that the intended result will occur.[264] The courts generally will infer the requisite intent if clearly predatory pricing activities are proved;[265] however, the Situation II facts present a more ambiguous picture. Because the distinction between valid price competition and predatory activity is often unclear, the courts are likely to be reluctant to simply infer specific intent to monopolize unless the dealer can demonstrate that the defendant's Situation II use of company-operated facilities clearly involved predatory activity. Furthermore, it is difficult to predict whether the dealer could establish "dangerous probability" of defendant's success in achieving monopoly power. The major's activity, even if predatory, is arguably designed more toward replacing its dealer-operated stations with company outlets than toward obtaining a monopoly in the gasoline distribution market. Thus to show specific intent to monopolize, the injured dealer would likely have to show not only that the major engaged in predatory activity but also that the predatory conduct was likely to improve the major's competitive position vis-a-vis its other major competitors.

In sum, while a cause of action for attempt to monopolize appears most closely designed to deal with the dealer's Situation II type of injury, the required elements of proof probably would be more than the average independent dealer could establish.

Having discussed the applicability of each of the principal antitrust laws to the injured dealer's situation, several conclusions are apparent. As a general matter, it seems fair to conclude that an antitrust suit against a major oil company for Situation II abuses is probably beyond the reach of the average independent dealer's legal resources. This means that as a practical matter, these suits would have to be instituted either through dealer associations or on a class

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263. 15 U.S.C. § 2 (1970).

264. *See, e.g.*, American Tobacco Co. v. United States, 328 U.S. 781, 785 (1946); Swift & Co. v. United States, 196 U.S. 375, 396 (1905).

265. *See* Turner, *Antitrust Policy and the Cellophane Case*, 70 HARV. L. REV. 281, 305 (1956).

action basis. Moreover, even assuming adequate resources, additional difficulties remain. Each of the existing causes of action under the federal antitrust laws involve substantial proof problems particularly with regard to specific intent. Furthermore, the dealers are likely to encounter substantial difficulties in coping with the large corporate bureaucracies of major oil companies, which will inhibit the dealers' use of discovery procedures.

These inherent difficulties inexorably lead to the conclusion that existing law simply does not provide an adequate and accessible remedy for the dealer injured under Situation II circumstances.

(2) Proposed Predatory Pricing Amendment

Considering the practical inadequacy of existing legal remedies, it is the writers' opinion that federal and state statutes aimed at attempts to monopolize or unfair methods of competition—section 2 of the Sherman Act and section 5 of the Federal Trade Commission Act[266] and their state counterparts—can be amended to reach the major oil companies' alleged anticompetitive behavior at the retail marketing level. Under the proposed amendment, an independent dealer or a group of dealers would make out a prima facie case of attempted monopolization by demonstrating that a company-operated station in the same market area and for a stated period of time had sold gasoline at retail prices below the total of (1) the wholesale price the offending major charges its own independent branded dealers, plus (2) a stated percentage of the complaining dealers' non-product (overhead) costs that would reasonably be incurred also by the company-operated station, divided by the volume of gasoline sold by the complaining dealers before the alleged attempt to monopolize occurred. Upon this showing, the burden would shift to the major to prove by a preponderance of the evidence that its retail price in that content area was reasonably related to the *total* costs that fairly could be attributed, under accepted accounting principles, to the operation of its company stations during the period in question. If it failed this test, the major would be subject to appropriate injunctive relief and liable for treble damages.[267]

This amendment would allow the complaining dealers to employ their own cost experience as a rough gauge to indicate whether the company-operated station was engaging in predatory pricing.

266. Section 5 of the FTC Act would require an additional amendment allowing private actions to he hrought under the proposed provision.

267. *See* 15 U.S.C. § 15 (1970).

Procedurally, this would carry them over the initial burden of proof that otherwise would require expensive and time-consuming discovery of the major's records. To prevail on the merits, the major then would be forced to document its costs and justify its pricing decision.[268]

To illustrate, assume that in Situation I the prevailing retail price in a certain market is 55 cents per gallon before Aresko opens a company-operated station. The company-operated station immediately posts a price of 52 cents per gallon. This price is maintained for a period of ninety days, which is assumed to be the statutory period. A marginal, independent Aresko brand dealer, who by definition was barely covering his costs at the 55 cents price level, fails and brings an action under the amendment. He demonstrates that he paid Aresko 45 cents per gallon and that his overhead costs were 10 cents per gallon before he lost several customers to the company-operated stations. However, the hypothetical state law amendment under which he sues allows him to add only 50 percent of his overhead costs to his cost for gasoline, because the legislature has determined that at least half of a marginal dealer's overhead cost per gallon—assuming that the marginal dealer will be the most likely to sue under the amendment—may be due to his inefficient method of operation. Thus the dealer's costs for the purpose of the statutory presumption total 50 cents per gallon, which is less than the company-operated station's posted price. In this case, then, the burden of proof would not shift to Aresko.

Assume, however, that the company-operated station maintains a price of 49 cents per gallon. If the same dealer brought an action here, the burden of proof would shift to the major to show that the company station's retail price is reasonably related to its total costs of operation. In Situation II, Aresko presumably would fail. It would be forced to document its expenses; if it omitted an essential cost, the complaining dealer could bring this out at trial. There might be differences of opinion among accountants concerning which of Aresko's overhead costs fairly should be attributed to its retail operation, but this proof problem is no more difficult than others calling for expert testimony.

Aresko should not be able to demonstrate lower costs at the retail level by assigning an artificially low transfer price to the gasoline supplied to the company-operated stations. To prevent this

268. This requirement should not be unduly burdensome to the majors, because the regulations of the Federal Energy Administration already require them to keep detailed records showing that the prices they charge and the amounts of gasoline they sell are in compliance with the pricing and allocation regulations. 10 C.F.R. § 210.92 (1975).

element of the price squeeze from becoming an effective defense to the dealer's action, the court should, as a matter of law, set the transfer price to the company-operated station at the price actually paid by the independent dealer under that major's brand in the same market area.

The retail price of the company-operated station, however, must only be *reasonably related* to total retail costs; it need not always exceed them. Thus the proposed amendment would be flexible enough to allow the operation of company-operated stations in special nonpredatory competitive circumstances. For example, Aresko may be able to demonstrate that it made a good faith error in market analysis and opened a company-operated station that could not be operated profitably. However, the station's marginal revenues (the retail price per gallon of gasoline) exceed its marginal costs (primarily the transfer price of gasoline supplied to the station), so the major minimizes its losses on the station by continuing to operate it. In this case, the pricing history of the company station and the experience of the independent dealers in the area may be relevant in showing that the major made an initial good faith effort to operate the station profitably. Nonetheless, because the burden will be on the major to prove its good faith, this situation is apt to be a narrow exception to the general rule that pricing substantially below aggregate costs for an extended period is predatory.

The majors will argue in opposition to the proposed amendment that it will unleash a flood of harassment actions brought by disgruntled dealers who have been undersold by more efficient company-operated stations. There is a threefold answer to this contention. First, the amendment clearly is less restrictive than divestiture statutes, which prohibit company-operated stations outright. Secondly, the price test for shifting the burden of proof is objective, so that the dealers cannot prevail on mere allegations that the major is attempting to monopolize a market through the use of company-operated stations. They must document the price at which the major is selling to its independent, their own costs, and the volume of gasoline they sold before the alleged predatory pricing occurred. Thirdly, the enacting legislature has substantial discretion to determine the period of time over which the alleged predatory pricing must occur and the percentage of dealers' overhead costs that can be included in the computation. By setting a longer period of time and a lower percentage of overhead costs, the amendment can be adjusted to allow the burden of proof to shift only in those cases in which predatory behavior clearly is involved. Thus the proposed amendment offers a viable method of legislatively balancing the consumers' interest in allowing a maximum number of efficient firms to compete in the retail gasoline market, and the independent dealers' need for an effective remedy to anticompetitive behavior by the vertically integrated oil companies.

IV. Conclusion

This Note has traced the recent developments in the oil industry and in gasoline marketing that have led to the enactment of divestiture statutes in three states and their consideration by the legislatures in many others. The statutes are essentially of two types: those prohibiting the owning or leasing of marketing outlets by vertically integrated oil companies and those prohibiting or limiting the operation of retail outlets with company employees. Both types of statutes, however, have as their primary aim the exclusion of the majors as competitors at the retail level. This is thought to be necessary to prevent anticompetitive behavior that results from the majors' vertical integration combined with their oligopolistic control of crude oil producing, transporting, and refining.

Although the divestiture statutes have been challenged in the states where they have been enacted, the courts have not handed down a definitive ruling on their constitutionality. While it is impossible in a general discussion of the statutes to determine their validity under the constitution of every state where they have been enacted or proposed, this Note has attempted to consider the federal constitutional arguments that might be raised against them. The United States Supreme Court decisions on substantive due process, equal protection, and taking without just compensation appear to present minimal obstacles to state legislatures in enacting statutes that regulate economic affairs. The commerce clause, however, limits the states' power to affect interstate commerce, and there is precedent from which the Court could find that the divestiture statutes discriminate against out-of-state competitors, although it is uncertain whether the Court would choose to characterize the statutes in this way. Finally, the doctrine of federal preemption would require the invalidation of the divestiture statutes if they were found to violate a strong policy expressed in federal law. The government action exception to the antitrust laws, however, combined with the lack of any precedent holding that the antitrust area has been preempted, makes this an unlikely result. Furthermore, the regulatory scheme for petroleum allocation authorized by Congress in the Emergency Petroleum Allocation Act is not so comprehensive as to be inconsistent with divestiture.

Assuming that the divestiture statutes withstand the constitutional challenges, the Note considered whether divestiture is justified in the public's economic interest. Since consumers are best served by workable competition at the retail marketing level, the legislature should seek the solution which maximizes the number of efficient competitors who can enter the market without permitting predatory or exclusionary behavior. Divestiture is a radical remedy directed solely at a vertically integrated industry structure. Yet the question of whether vertical integration hampers competition, promotes competition, or is entirely neutral in its effect has provoked considerable debate. Consequently, it is the writers' opinion that divestiture should be rejected in favor of a less restrictive alternative that does not exclude an entire class of efficient competitors from the market, but provides a remedy for the majors' alleged anticompetitive behavior. Existing federal and state laws offer some relief, but substantive uncertainties, procedural technicalities, and difficulties in proof effectively put them beyond the reach of the small independent dealers injured by the anticompetitive practices of a major oil company. Thus an amendment to existing statutes is needed. The legislative proposal suggested by this Note would allow the complaining dealers to shift the burden of proof to the offending major after satisfying a rough objective test that indicates predatory pricing by company-operated stations. It is hoped that this amendment will balance the competitive scales in the retail gasoline market without eliminating the major oil companies as competitors.

HUNTER M. MERIWETHER

JAMES CARLOS SMITH*

* Messrs. Meriwether and Smith received the *Robert A. Nailling Award* for this Note in the academic year 1974-75.—eds.