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THE FEA AND COMPETITION IN THE OIL INDUSTRY

HEARING

BEFORE THE

SUBCOMMITTEE ON CONSUMER ECONOMICS

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NINETY-THIRD CONGRESS

SECOND SESSION

JUNE 13, 1974

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE

41-661 WASHINGTON : 1974

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402 - Price 75 cents
Stock Number 052-070-02715

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THURSDAY, JUNE 13, 1974

THE FEA AND COMPETITION IN THE OIL INDUSTRY

THURSDAY, JUNE 13, 1974

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON CONSUMER ECONOMICS,
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room 1202, Dirksen Senate Office Building, Hon. Hubert H. Humphrey (chairman of the subcommittee) presiding.

Present: Senators Humphrey and Javits; and Representative Brown.

Also present: William A. Cox and Larry Yuspeh, professional staff members; Michael J. Runde, administrative assistant; Lesie J. Bander, minority economist; and Walter B. Laessig, minority counsel.

Chairman HUMPHREY. We have Mr. Sawhill, Mr. Peterson, and Mr. Dryer, is that correct?

Is Mr. Peterson here?

Mr. PETERSON. Yes, sir.

Chairman HUMPHREY. And Mr. Dryer?

Mr. DRYER. Yes, sir.

Chairman HUMPHREY. Thank you very much.

Mr. Sawhill, we welcome your testimony at this time.

OPENING STATEMENT OF CHAIRMAN HUMPHREY

First, I have a little brief opening statement here.

COMPETITION IN THE OIL INDUSTRY NEEDS REVIVAL

I have called this hearing to deal with a matter that always has been of concern but that now has become critical—namely, the revival of competition in the oil industry.

Since the days of John D. Rockefeller, control of the oil industry has been heavily concentrated and continues to get more concentrated. Yet a few independent competitors have remained at each stage of its operations—in crude production, refining and marketing. There are just enough such competitors, in fact, to inject a degree of competition into what otherwise would be very tightly knit oligopoly.

The number of competitors diminishes year by year. I think this is a matter of concern for the Government and a matter of concern for the Justice Department. Take a look at what is happening to so-called competitive free enterprise. Most of the exponents of our enterprise system like to talk about it being free enterprise but they leave out the word "competitive" and without competition it can't be free.

The tight supply situation beginning in late 1972 brought very harsh consequences for many independent refiners and marketers. They could not obtain adequate supplies, and many independent marketers perished in the squeeze. It was at this point that both Houses of Congress saw fit to pass, over the administration's strenuous objections, the Mandatory Petroleum Allocation Act of 1973.

I might add that without that act I think we might have had a catastrophy.

This act required the administration to impose mandatory supply allocation with the purposes, among others, of:

(1) Preserving the competitive viability of independent refiners, small refiners nonbranded independent marketers, and branded independent marketers; and

(2) Equitable distribution of crude oil * * * and refined petroleum products at equitable prices among all * * * sectors of the petroleum industry, including independent refiners, small refiners, etc. * * *

This language seems clear enough, and one might have thought that it would suffice to see that these objectives would be carried out. The mandatory allocation program authorized by the act has been in effect now for several months. With the development of the two-tier price system for crude oil and many divergent prices for products, however, most independents found themselves obliged to depend on higher proportions of high-priced oil than major oil companies. This is in part because many of them depend heavily on very high-priced imports.

With the relaxation in April of the most extreme part of the shortage, the independents' market share began to erode sharply again as they were underpriced by the majors. First they were squeezed out by the majors. Now it appears that most of those independent refiners and marketers who have survived may be wiped out by their inability to compete in terms of price.

I think it is the duty, may I say, Mr. Sawhill, and to the others from the Government—because these hearings are always peppered with what I call "the agency spies"—I think it is the duty of the Federal Government to take a good, hard look at what is happening and not to have to rely on hearings like this to call it to their attention. What is happening is the double squeeze. First they squeeze them out by withholding supplies and now, when the oil pressures are less, the majors come in and undercut them and drive them out. It is a contemptible situation and we intend to explore it.

MAJORS HAVE CAPTURED ONE-THIRD OF THE INDEPENDENT NONBRANDED GASOLINE DEALERS MARKET

A consultant's report to the FEA, which Mr. Sawhill made available, shows that the market share of independent nonbranded gasoline marketers slumped from nearly 28 percent in May 1972—just 2 years ago—to about 22 percent in March 1974. Between March and April, however, it is estimated to have plummeted to the range of 18 percent, and this decline is continuing.

This is what I mean by the lack of competition. So the big oil companies already have grabbed over one-third of the independents' gasoline market. A similar encroachment is occuring at the refining level. If anything is to be done to stabilize the situation, it better be done fast.

The major companies also are expanding their control at the expense of their own franchised dealers. In other words, a kind of economic cannibalism of eating up their own. In a limited but growing number of cases, successful stations have been taken over by the companies, and the men who have built up the businesses have been turned out. I understand that the companies then can declare themselves to be "new customers" under the FEA rules and can assign the station a larger supply quota than it previously got. Other ruses of this kind keep cropping up whereby the majors are extending their grasp on the refining and marketing sectors of the business even during this period of supply controls.

My question is, what is the Federal Energy Administration doing, meanwhile, to help to maintain the independents as a viable force as required by the law, by the Allocation Act?

It has taken a few halting steps to try to make oil available to companies with supply deficiencies, but its steps to date have not come to grips with the problem of widely diverse prices. Today we want to ask when this problem will be addressed effectively.

FEA NOT WILLING TO HELP THE INDEPENDENTS

Many independent operators who have been forced by circumstances to turn to FEA for help have reported previously little willingness to help in that organization. Now, they are here to make their own case. This is what we have heard, though, Mr. Sawhill, and you may be one to refute that.

In one case that I have documented here, the applicant was told that he would have to be showing actual losses before lower cost supplies could be assigned. Another apparently was told to use up all his inventories and to cut his ties to his regular suppliers before help would be forthcoming.

Now the first case was the Sav-Mor Co. and the second was the Time Oil Co. Now, that kind of help won't do the job.

In general, the FEA seems to be very reluctant to use the power that it clearly has to force the major companies to cooperate to carry out the objectives of the Allocation Act. It is time to ask Mr. Sawhill. Why this timidity? Why this halting pace and these long delays in taking action?

Before we turn to questions, however, let us give Mr. Sawhill an opportunity to express his views on this situation.

Now I posed these questions because in the front room over here, as I look out, these independent people have come to us with complaints and the staff has been listening patiently; trying to find some answers.

The Joint Economic Committee has a responsibility in this matter. As chairman of this subcommittee, I have a responsibility in this matter and today we want some answers to the questions and I hope, Mr. Sawhill, that since you have always been cooperative with our committee, that you will see fit to give us the answers to the kinds of concerns that I have voiced in the statement as a result of our preliminary investigation. You may proceed.

STATEMENT OF HON. JOHN C. SAWHILL, ADMINISTRATOR, FEDERAL ENERGY OFFICE, ACCOMPANIED BY DAVID G. WILSON, DEPUTY GENERAL COUNSEL FOR REGULATION; AND DANIEL RATHBUN, DEPUTY ASSISTANT ADMINISTRATOR FOR DATA

Mr. SAWHILL. Thank you. I am delighted, Mr. Chairman, to have this opportunity to appear before you to outline our approach to you, which I think, or I hope, you will conclude, when we have finished, is not an approach of timidity, but frankly a very bold approach to carry out the mandate that the Congress has given us to protect the very important and vital independent segment of the industry, to which we have responded with great concern.

Historically, the majority of retail outlets in the petroleum industry have been owned by the major oil companies and leased to operators, or so-called "branded independents." Throughout the 1950's and 1960's there was a surplus of domestic refinery capacity due to the fact that it was found to be uneconomic to make other than major expansions of refinery capacity.

Chairman HUMPHREY. May I interrupt a minute? Since these hearings frequently are attended by only one Senator or Congressman, I want the staff of the committee to feel free to participate. You may sit here and feel free and come on up here and participate, because I know we are going to be having rollcalls and quorum calls that I might have to attend to. I want you to feel free, Mr. Cox, or Mr. Thurber, to feel free to participate.

Go right ahead. Excuse me for the interruption.

DISAPPEARANCE OF EXCESS REFINING CAPACITY—DRIED UP SUPPLIES FOR NONBRANDED INDEPENDENTS

Mr. SAWHILL. Well, as I was saying, when a company expanded its refinery capacity in a large increment, for a period of years, it had overcapacity. In order to keep unit costs as low as possible, most companies attempted to run their refineries at close to capacity, selling product over and above the needs of their own marketing network on the open market.

The availability of surplus gasoline at favorable prices created an attractive opportunity for independent marketers. Independent refiners, by processing the readily available crude, also sold products to the independent marketers.

As a result of the shortages which began to be felt in 1973, however, the majors were no longer in a position to continue to sell outside their distribution systems and, at the same time, meet their own current requirements of their own outlets.

Moreover, the Arab oil embargo, coupled with increasing demand, threatened to substantially reduce crude supplies to small and independent refiners, upon whom nonbranded independent marketers and nonmajor branded independent marketers traditionally relied. The situation of the independents has, therefore, changed in a short time from one of relative abundance and security to that of increasing scarcity and insecurity.

In this context Congress enacted the Emergency Petroleum Allocation Act of 1973 and directed the President to devise allocation regulations which, to the maximum extent possible, would preserve the competitive viability of independent refiners, small refiners, nonbranded independent marketers, and branded independent marketers.

ACTION TAKEN BY FEO TO DAMPEN EFFECT OF OIL SHORTAGE ON INDEPENDENTS

First, crude oil allocation regulations: In our initial regulations, we imposed a freeze on supplier-purchaser relationships for crude oil in effect on December 1, 1973, principally to protect small and independent refiners from losing access to needed supplies.

These regulations, incidentally, were resisted strongly by the independent producing sector of the industry, but we felt we had to promulgate them in order to protect the independent refiners. We also required refiners above the national crude oil supply-to-refinery capacity ratio to sell crude to refiners below the national ratio.

Most of the refiner-buyers who benefited from this program were small and independent refiners. For the period February 1, 1974, through April 30, 1974, the small and independent refiners realized a net gain under this program of about 30 million barrels of crude oil.

After the embargo was lifted, we revised the crude oil allocation program to allocate crude oil only to small and independent refiners in order to guarantee small and independent refiners supplies of crude on the basis of their 1972 supply levels.

It also should be noted that this program tends to reduce the average cost of crude to small and independent refiners. The crude is provided at the average cost of the seller which is generally below the cost of crude to the purchasing refiners.

Chairman HUMPHREY. Explain that. What do you mean by that?

Mr. SAWHILL. In other words——

Chairman HUMPHREY. Incidentally, our impression here is that most of the independent refiners get their crude as imported crude, correct?

Mr. SAWHILL. Much of it does come from imports.

Chairman HUMPHREY. Therefore, it is much higher than domestic?

Mr. SAWHILL. Yes, imported crude is higher than domestic.

Chairman HUMPHREY. Considerably higher?

Mr. SAWHILL. Yes, but I would say in our crude oil allocation program, when we require the major companies to sell to the small and independent companies, we require them to sell at their weighted average price. So this enables the small, independent refiner to buy from the majors at a price equivalent to the price of the majors, and therefore this does result in some advantage to the small and independent refiners.

And I might point out that in a Wall Street Journal article on either Monday or Tuesday of this week, Mobil Oil Co. severely criticized us for this crude oil allocation program, which is taking crude from the majors and giving it to the small and independent refiners. So that there is considerable concern amongst the major oil companies about these allocation regulations and the crude oil area.

Nevertheless, we felt it important to have these regulations in order to protect this small, independent segment.

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OIL PRICES

Chairman HUMPHREY. Would you give us some benchmark figure as to what a barrel of that blended crude would be for the majors as to the independent refiner?

Mr. SAWHILL. I would say it is in the $8 to $9 range.

Chairman HUMPHREY. $8 to $9 range?

Mr. SAWHILL. Yes.

Chairman HUMPHREY. And domestic crude is what, $5 and what?

Mr. SAWHILL. $5.25, but it averages at about $7 when you average the higher cost of the new and released crude with the $5.25 old crude.

Chairman HUMPHREY. That is right. I never could understand why the Government was so opposed to the rollback—letting them have the $8 when you now tell me it is averaged at about $7, but that is another issue.

You know, I never believed all that garbage that came out about the rollback. You just indicated right now that the blended price was about $7 and we were talking about a rollback to the possibility of $8 and we were told that would just put them on their tail and would just be unfair.

And I just thought I would get it into the record here that the fact is that blended price is around $7 and the rollback price, where you could have put it up to a maximum $8, there would have been no real serious penalty upon the majors or independents or anybody else with that.

Mr. SAWHILL. I think the independent producers were quite opposed to the rollback. They felt that they needed the higher price for new crude in order to provide the necessary initiative and profitability to pay for the very risky and expensive business of exploration.

Shall I continue?

Senator HUMPHREY. Please do.

Mr. SAWHILL. Now I would like to talk—I have talked about the crude program and how that is a program that the major oil companies are sharply critical of, but we have initiated to help the small, independent refiners and——

Chairman HUMPHREY. I am going to make this rather informal, Doctor, but——

Mr. SAWHILL. Yes, sir.

Senator HUMPHERY [continuing]. How much of the total amount of crude that goes to the independent refiner is blended type of crude, that is blended in price and how much of it is just plain imported crude? What is the percentage?

Mr. SAWHILL. I don't have figures on that.

Chairman HUMPHREY. This would be rather significant to know.

Mr. SAWHILL. And it would vary of course, significantly, from company to company.

HIGH CRUDE PRICES MAKE COMPETITION DIFFICULT

Chairman HUMPHREY. You take for example now with the Canadian crude going up very significantly, the people in my part of the country are having to pay exorbitant prices for crude. How are they going to compete?

Mr. SAWHILL. Well, that is obviously the problem that we face.

Chairman HUMPHREY. Yes, that is the problem and in the meantime, you know, a competitor goes down the drain.

Mr. SAWHILL. What we have done is tried to isolate those refineries that have this very high cost, such as some in the northern tier that have to buy from Canada.

Chairman HUMPHREY. Yes.

Mr. SAWHILL. It seems to us that probably the solution to the problem is to find some way of helping those particular refineries get a more equitable cost in order to enable them to compete. We could put in a very complex administrative crude equalization program, and I am afraid that would then put us into the regulatory business of crude oil for good, because it would create vested interests in maintaining this program and I think it would hurt the growth of this industry. And, after all, if we are going to move toward energy self-sufficiency, we've got to permit the oil industry to grow and expand and continue its exploration and build new refineries and that is not going to take place unless there are some profit incentives to do it.

Chairman HUMPHREY. I understand the complexity; but I have already had people come to me, Mr. Sawhill, and I am sure you have too, from the Northern States, where we have these small refineries, and they are the only real sure source that we have of certain petroleum products——

Mr. SAWHILL. Yes.

Chairman HUMPHREY. They come to me and say, look, we are facing the kind of competition where the majors will come in here now with a much lower priced product. They get much of their crude domestic and they come on in here and they underprice us and we are then out of the business.

Once those small refiners are out of the business in Minnesota and Wisconsin, the majors will take us for the biggest ride we ever had in our life. And I am not about to let that happen and I want to know what you are going to do about it.

FEA MONITORS GASOLINE PRICES CHARGED BY BOTH THE MAJORS AND INDEPENDENTS

Mr. SAWHILL. Well, I am not ready to let it happen, either, and it is something that I am watching very closely. One of the ways I try to monitor that is to conduct a price survey and look at the prices charged by the independents compared to prices charged by the major oil companies.

Chairman HUMPHREY. Are you talking about crude, now?

Mr. SAWHILL. No, I am talking about gasoline.

Chairman HUMPHREY. Oh, yes, well go ahead.

Mr. SAWHILL. For example, in Milwaukee, according to a recent survey that we took at the end of May for regular gasoline the price charged by the majors was 55.2 cents. The price charged by the independents was 51.4 cents, indicating that the independents were able to compete effectively and charge a lower price. I don't have a figure here for Indianapolis, so I can't——

Chairman HUMPHREY. Well, I think you do have to keep in mind two things: First, these independents are trying to compete. There is no doubt about that, and sometimes their operating costs are a little bit less. For example, a station way out on highway 12 in Delavan, Minn., is run by a father and two sons and his wife. It is a family operation and the gas price there last weekend was 49.9–50 cents a gallon, and I know the prices down the road were a little higher.

But the point is that the big company gets a much bigger profit and utimately you just go out of business.

I run a small business and I know what it is. You can compete for a while and you can use up your reserves, but what I am getting at is what is the major company paying for that product that it put into its outlets, as compared to what the independent has to pay for the product?

Mr. SAWHILL. Well, Senator, I do agree that we need to be conscious of that clearly. But as you point out, the independents do have lower operating costs. That is why they have been able to be successful.

And right now, at least in most parts of the country that we have recently surveyed, the independents are charging lower prices than the majors, indicating to us that——

Chairman HUMPHREY. That is the retailers?

Mr. SAWHILL. Yes.

Chairman HUMPHREY. What about the independent refiner?

Mr. SAWHILL. There are a number of independent refiners, roughly 15, that appear to us to be at some kind of a serious price disadvantage and those are the ones that clearly we have got to do something for. We've got to provide for them.

Chairman HUMPHREY. I understood from our independent people here, who will testify here in a few minutes, that a number of the independent stations do have to charge higher prices than the majors, that there are areas in which there are some differences.

Mr. SAWHILL. Well, that may be true. A survey we took around the country indicated that the only case where we found independents charging higher prices than majors was here in Washington and the price differential there was very small, less than 1 cent.

Chairman HUMPHREY. I don't think we ought to use Washington as an example of anything that is normal in the country.

Mr. SAWHILL. I don't either.

Shall I proceed?

Chairman HUMPHREY. Yes, proceed.

ALLOCATION OF CRUDE OIL AND REFINED PRODUCTS

Mr. SAWHILL. I would like to talk about the allocation of refined products. We have specified that allocated products would flow according to base period—1972—supplier-purchaser relationships as a measure to protect independent marketers who were experiencing disruptions in their supply during 1973.

Under our allocation regulations, independent jobbers and marketers, as well as small and independent refiners, who purchased finished product in 1972 are entitled to receive allocations based on such purchases from their 1972 suppliers. As a further means to protect small and independent marketers, we had determined that spot purchases in 1972 are a basis upon which an allocation entitlement may be premised. Our allocation regulations are basically designed to allocate petroleum products to the independent sector at 1972 levels.

Chairman HUMPHREY. Now having said that, it is my understanding that you used, as your base point, you used December of 1973?

Mr. SAWHILL. That was for the crude.

Chairman HUMPHREY. The crude. Yes.

Mr. SAWHILL. The crude program. Now we are talking about the allocation of products in which we used 1972

Chairman HUMPHREY. Now how does that work? I am not trying to be critical here. You used one base period for the crude, which is of course what comes to the refiners.

Mr. SAWHILL. No, perhaps I said it wrong; 1972 is basically the base period for crude and all products. All I said was that on December 1, 1973, we froze the supplier-purchaser relationships.

Chairman HUMPHREY. Right.

Mr. SAWHILL. In the crude area. So that if I was a producer of crude petroleum selling to a small refiner on November 30, 1973, I had to continue selling to that refiner.

Chairman HUMPHREY. I see.

Mr. SAWHILL. But the independent producers don't like that. They would like to start their own refineries. You know, they say that this is their crude, why should they have to sell it to somebody that the Federal Government tells us to?

Chairman HUMPHREY. I get your point.

Mr. SAWHILL. But we have protected these independent refiners.

The allocation programs were also designed to permit the independent sector to preserve its market share vis-a-vis the majors, because we in a sense froze the allocation at the 1972 level.

The regulations provide that major oil companies must treat each of their owned and operated gasoline retail outlets as a separate wholesale purchaser and may not shift allocations among their outlets in order to compete fairly against smaller chain marketers, or operators of single service stations. We made special provisions included in the regulations, however, to allow independent marketers to shift allocations among their outlets wherever necessary to maintain their competitive position. In other words, we let the independents do something that we didn't let the majors.

Additionally, with respect to independent marketers, a wholesale purchaser-reseller may, with FEO approval, close one or more of its retail sales outlets and adjust the base period volumes of its remaining retail sales outlets. Further, the new allocation regulations allow independent marketers to petition FEO for an adjustment in their allocation entitlement to reflect changed conditions.

So, in every case we have disadvantaged the majors to the benefit of the independents, to enable them to be more flexible and to shift supplies around to compete with the majors, which is something we don't allow the majors to do.

THE INDEPENDENTS' MARKET SHARE

Chairman HUMPHREY. I notice, Mr. Sawhill, in your statement, you say "FEO allocation programs were also designed to permit the independent sector to preserve its market share vis-a-vis the majors."

Now, you wouldn't say it has been able to preserve its market share, would you?

Mr. SAWHILL. I am not sure of the answer to that question. As you know, we had a study on done by in-house consultants, indicating there had been a decline in marketers, as you pointed out in your opening statement, but on the other hand we just don't have very good data on market shares. We are trying as hard as we can to develop that data. We are required to develop by the act and we are delinquent in developing it.

On the other hand it is really hard to define market share right now, because data was never provided in the categories contemplated by the act and that is what we are trying, very hard, to get right now.

Chairman HUMPHREY. Didn't the act require you to report that share on a monthly basis to the Congress?

Mr. SAWHILL. Yes; and we are delinquent in doing that because the data are just not available.

Chairman HUMPHREY. Why don't we get the data?

Mr. SAWHILL. We are moving as rapidly as we can to get it.

Chairman HUMPHREY. This oil industry is about as slow in getting data as the White House is in handing over transcripts. You know, we don't get data from the majors. You started, Mr. Sawhill, with Mr. Simon?

Mr. SAWHILL. Yes.

Chairman HUMPHREY. You remember when in the early testimony the Government said, well, we just don't have the data, we don't have the facts; that the oil companies had this in their possession.

Is it a fact you did have a difficult time and you did start to get some of those data in?

Mr. SAWHILL. Yes.

Chairman HUMPHREY. The lack of data on the relationship here of the independents to the majors—really, what I am trying to point out is that this industry has got a lock on us someplace around here and, good Lord, I can't believe that the Government of the United States can't get data on this. They can get it on any private citizen they want. Any time they want to rack you up and put you on the block, they can do it.

Mr. SAWHILL. Well, I don't think it is a question of the industry keeping those data from us. It is really a question of reporting in categories that are required now that were never required before. We are looking at whole new sectors of industry.

For example, the branded independent, which the act defines, consists of a number of different classifications. It consists of those stations that lease from the majors. It also consists of companies that sell under the Exxon name but are actually owned by wholesalers. So we are conducting a survey, not of the major oil companies, but we are taking a survey of gasoline stations to try to really find out what the situation is.

Chairman HUMPHREY. Are you pursuing this now?

Mr. SAWHILL. Yes.

Chairman HUMPHREY. Because of the law itself that requires it?

Mr. SAWHILL. Yes. We have given a timetable to the Congress for reporting back results. Now, admittedly we are delinquent——

Chairman HUMPHREY. Six months.

Mr. SAWHILL. Yes; 6 months delinquent.

Chairman HUMPHREY. Do you really feel that the independents haven't lost a share of the market as compared to the majors?

Mr. SAWHILL. I am concerned about it, but I am reluctant at this point to say that they have lost market share, because I look at prices and see that they have been able to price their products below the majors and, to the extent that they are doing that, I would think they would be able to retain their market share. On one hand, we do have some data indicating they have lost market share; but on the other hand, we have data indicating their prices remain competitive and below the majors', which suggests that they are able to maintain or should be able to maintain market share.

Chairman HUMPHREY. Or that suggests that if you have driven enough independents out of business in a particular community, you can get your price up. And the independent has trouble in getting the supplies he needs. You know, you go around and the filling stations are closed on Sunday, they are closed on Saturday. And many times you will see a sign of a station being closed, and it is independent. You know, the old game is the big discount houses and the big shots come in and drive the price down temporarily to drive the little guy out and, after they've got the market sealed up, they get their price up and increase their profit margins.

And according to what I read, the oil companies are doing rather well on the pricing margin. They are not qualifying for the poverty program. That's for sure.

Mr. SAWHILL. Their profits are up significantly.

Chairman HUMPHREY. Significantly! That is a very polite word, expletive deleted, but I am really worried about this pricing thing, Mr. Sawhill.

I am going to put this independent representative on here in a little while, because I want to have you folks mix it up a little bit and be a little informal about this. Is the independent ready?

I don't want you here right now, but are you ready?

Mr. DRYER. I am prepared.

Chairman HUMPHREY. Okay. I am going to have you come on up and testify, because it is your complaints that precipitated this hearing. I don't mean to say the complaints weren't justified. Go ahead——

Mr. SAWHILL. I should say to you, Mr. Chairman, and I tried to point out previously that in my job, everybody complains. The major oil companies complain. As I say, Mobil Oil Co. had an article blasting our crude program and saying it was unfair to the majors. You say it is unfair to the independents. To some extent, we have to try to seek solutions which we believe are fair to all sectors of the industry and also permit this industry to move forward without being completely strapped by Government regulation.

Chairman HUMPHREY. Well, Doctor, I haven't been your sharpest critic. I am just being the devil's advocate here to try to get the facts out, but I am going to bring in the main force in a little while.

Mr. SAWHILL. I can feel the heat on my back already.

We are processing as expeditiously as possible thousands of requests for assignments and adjustments under our allocation programs—principally from independent marketers.

Incidentally, this is one reason why we need to maintain our regional office structure around the country. There have been those in Congress and other places that have felt we should abandon our regional offices, but I think it is terribly important that we maintain these regional offices, because they are the people out there. It is not us in Washington; it is the people out there working with the independents that are going to solve these problems.

Chairman HUMPHREY. I agree with that.

Mr. SAWHILL. In certain regions where the independent sector appears to be sustaining a chronic supply insufficiency, special task forces have been established to process requests by independent marketers for increases in base period volumes and we supply this to new suppliers. We have done this in California, for example. Where independents had been dependent during the base period on sources of supply such as imports of finished product, the supplies have been tight and carried a higher price. Consequently, in circumstances involving hardship or gross inequity, we have reassigned portions of an independent wholesale purchaser's base period volume from high price suppliers to low price suppliers, assuring total supplies at a reduced price. And obviously this is what we've got to do with the 15 refiners that we identified earlier that are at a serious price disadvantage.

FEA PRICE REGULATIONS

Turning now to price regulations, price regulations provide that crude oil sold by majors to small and independent refiners under the crude oil allocation program must be sold at the majors' average weighted cost rather than at the highest incremental cost.

They also maintain customary pricing differentials in effect among classes of purchasers by requiring increased product costs to be applied equally to the May 15, 1973, prices for a product to all classes of purchaser.

This mechanism protects independent marketers against disproportionate price increases.

In order to alleviate the profit squeeze experienced by independent marketers as a result of increased marketing costs and decreased supplies, we promulgated several amendments to the price regulations to permit price increases for nonproduct costs.

And, incidentally, I outline these here in my statement, but I have been severely criticized by those who feel that consumer prices have gone up too rapidly; criticized for allowing these price increases, which have primarily benefited the independent segment again.

We permitted gasoline prices to go up 3 cents to compensate them for reduced volume and we are under criticism for that.

Chairman HUMPHREY. Does that have the effect of triggering increased price on the majors too? Don't misunderstand me, I am not being critical of your decision.

Mr. SAWHILL. Not of the company-owned stations of the majors, just at lessee stations.

Chairman HUMPHREY. Franchised stations, the lessee?

Mr. SAWHILL. Yes, but not at the company-owned stations. And if you look at the margins of gasoline stations, overall they have gone up from somewhere around 7.5 cents last fall to about 11 cents today. So their margins have increased significantly.

And at my confirmation hearings yesterday, one of your colleagues pointed his finger at me and said, why don't you roll back those prices and squeeze the margins of the independents?

At the wholesale level, we allowed marketers to increase their prices slightly and again we spelled this out here.

PRICE POSITION OF THE INDEPENDENT AFFECTED BY DISPARITIES IN DOMESTIC AND IMPORTED CRUDE PRICES

I would like to talk about the two-tier price system.

The price position of the independents has been affected by the existence of disparities in the price of domestic and imported crude oil, as you pointed out. Crude oil price controls establish in effect a two-tier pricing system. "Old" domestic crude is subject to a price ceiling under our regulations. Stripper well oil, on the other hand, is uncontrolled by statutory exemption and, well, crude crude was decontrolled by the Congress and imported crude is controlled only in the sense that companies may only pass through increases in the landed cost of imports.

Consequently, these crudes sell at market prices. As a result of the dramatic and unforeseen increases in foreign crude oil prices, wide disparities have developed between old domestic crude and the prices of stripper and imported crude. And of course the old oil is $5.25 per barrel and the uncontrolled price that Congress decontrolled in imported oil is the $8 to $14 per barrel range. About twice the ceiling price for old domestic crude.

During the severe shortages of the past winter, the price disparities which developed had little effect on the market shares of the independents, since availability, not price, was what determined market share. You could sell all you wanted at any price.

However, as the shortages have receded and supplies return to normal, these disparities can have a significant impact, and this is really our problem today. Those refiners and marketers having access to a high proportion of low-priced old domestic crude oil have a tremendous advantage over those who must rely to a large extent on new and released, stripper and imported crude at prices double or more, the old oil ceiling.

As a result, notwithstanding our efforts to prevent price inequities, branded and nonbranded marketers supplied by certain small and independent refiners are sustaining product costs which require them to charge retail prices several cents per gallon above the prevailing prices charged by most major branded independent outlets.

Achieving a greater degree of price uniformity at all levels of the distribution system will be a very difficult practical and conceptual problem for us. We have not yet been able to fully resolve these issues, and we are actively exploring further price control measures designed to preserve the competitive viability of the independent sector.

I guess what I am suggesting here is we have isolated those refiners that appear disadvantaged and I think what we will do will be to promulgate regulations which will permit us to average out and average down the higher costs of oil for these few refineries, rather than to install a system which would unnecessarily complicate the whole refinery mechanism in this country.

Chairman HUMPHREY. We really have a three-tier system, in a sense, don't we?

Mr. SAWHILL. Yes.

Chairman HUMPHREY. Because you have the domestic, the old crude.

Mr. SAWHILL. And the new.

Chairman HUMPHREY. And then the imports?

Mr. SAWHILL. Yes.

Chairman HUMPHREY. And your problem in this area is a number of the companies, particularly some of the majors, have relied a good deal upon the domestic fuel, the old, the domestic crude?

Mr. SAWHILL. They have greater access, yes.

Chairman HUMPHREY. They had greater access to it over a long period of marketing and processing and distribution?

Mr. SAWHILL. Of course their argument is they have had the foresight to make the investment in exploration in this country and developed its crude oil. When we come out with regulations that take this away from them and give it to the small independents in order to maintain a competitive viability of the independents, we are confiscating the crude from the majors and basically giving them a disincentive to go out and find more.

Chairman HUMPHREY. What about companies like Shell and Exxon and others that we constantly read about and hear about that have huge foreign investments, aren't they bringing in that imported crude?

Mr. SAWHILL. Yes; they are bringing it in, but they can average that in with their lower cost domestic crude. In other words, they also have substantial supplies of domestic product.

Chairman HUMPHREY. So they do get it then, even at a blended price, they do get an advantage because of their development and their contracts over the years?

Mr. SAWHILL. Yes, and what we found is that you can't put all the majors in one category and all the independents in another. Some of the majors are paying higher prices. Some of the majors don't have the same access to the domestic crudes others do.

Therefore, it seems to us the thing to do is isolate those refineries that appear to be at a serious disadvantage and do something for them. And that is what we are currently working on. And I would say that within the next 30 to 60 days, we will begin to promulgate a program which will work to assist these disadvantaged companies.

We are undertaking a substantial data collection effort to monitor the success of our programs affecting independents and to determine what steps need to be taken in the future in this area. Monitoring is, of course, essential to know whether our programs are adequately protecting the independents and to determine whether some additional steps by our office are required.

This effort coincides with our responsibility to submit to Congress reports required by the Emergency Petroleum Allocation Act of 1973 on the relative market shares, which I have discussed previously.

We are having some difficulty, as I described, in collecting data, because the definitions required in the act and the definitions that we need right now are not the traditional definitions in the industry.

FEA STUDIES WAYS TO IMPROVE ITS DATA BASE

We have commissioned studies to provide specific proposals for improving our data base. We will explore the feasibility of:

(1) Direct surveys of retail marketers through their prime suppliers or wholesale distributors.

(2) More comprehensive reporting by refiners to trace sales by "branded independents" marketers.

(3) Sampling techniques based on direct surveys or State tax data.

We are hopeful that these efforts will result in more reliable and useful information with which to access the competitive structure of the petroleum industry.

In the meantime, we plan to further analyze existing data and to supplement it with direct surveys, and on this basis we expect to prepare and file with Congress interim reports based on this data. We expect to have reports covering each month from January 1972 through March 1974 in about 2 months.

The reports will provide rough but usable historical comparisons between the early months of the allocation program and the comparable base period month of 1972. They will also show trends that are developing during the period prior to the establishment of the allocation program.

Although these reports will not be as comprehensive as the data system we ultimately expect to put in place, they will provide us with an answer to the marketing question and give us data useful for policymaking purposes.

And in the meantime, we will be working to even out the price disparities that we have discussed.

THE SAV-MOR OIL CO. CASE

Chairman HUMPHREY. Thank you very much, Mr. Sawhill. Earlier in my commentary this morning, I mentioned a letter that we had received from, I believe it is the Sav-Mor Oil Co. of Los Angeles, Calif. I just got it. It is dated June 10, so I haven't had a chance to refer it to your office. It is a rather extensive letter signed by Mr. Jack E. Dailey. It ends up by saying, "Sav-Mor needs help and needs it now."

The letter starts out saying: "Sav-Mor Oil Co. has had its FEO–17 form filed in San Francisco since February 1974. To this date, it has received no help whatsoever from FEA. I was naturally hopeful that my meeting with Mr. Harper and Ms. Schol would produce some constructive action," and apparently they met at the regional office with these people.

Mr. SAWHILL. Yes, sir, Mr. Harper is here in Washington.

Chairman HUMPHREY. And it states: "The intent of the meeting was to solve the following problems of Sav-Mor Oil Co.: (1) Low allocation fraction —55 versus 85 percent State fraction; (2) Better product distribution; (3) Price inequity."

There is a very extensive letter here, which I will not burden you with at this moment, but we will refer to you for comment.

Mr. SAWHILL. Yes.

Chairman HUMPHREY. To your office. And he says here:

> Sav-Mor has begged and pleaded with both the regional and Washington FEA offices for positive, solid help. The FEA Region 9 cannot or will not make a move without Washington's approval. Washington is afraid to make a decision in favor of the unbranded independents because of the possible repercussions from the major oil companies. There is no equity of supply or price to Sav-Mor. The mandatory allocation takes our suppliers away and FEA won't equalize our position. Public Law 93–159 clearly outlines the obligation the FEA has in regard to supply distribution and price.

Now, I think we had a letter here too, that is from another company, Time Oil Co. I will have to get that one to you too.

Mr. SAWHILL. We will respond to them expeditiously. I don't know the particular circumstances around these two companies, but we have had teams of people out in California working with the independents. I met with a California independent as recently as last night, discussing some of their problems.

There have been more independents in California than in other areas of the country and they were severely hit by the embargo and we have been trying to redirect supplies from the majors to the independents to compensate them for the cutoffs that they experienced.

Chairman HUMPHREY. This letter points out that on Friday, May 31, the correspondent, Mr. Dailey, visited your Mr. Harper:

> On Friday, May 31, I returned to Mr. Harper' soffice, together with Mr. Jerry Olf of Time Oil Co. Time Oil supplies Sav-Mor most of its gasoline in region 9. Mr. Harper informed Mr. Olf and me that he had the solution to our problems. He said that Time Oil/Sav-Mor Oil's problem could be handled two ways. One, FEA would issue an order to Time Oil Co. for Time Oil Co. to draw down its inventories in the Northwest and, secondly, Time Oil Co. was to release its base period suppliers. It was apparent that Mr. Harper's intent was to eliminate all Time Oil Co. inventories and have Time Oil Co. cancel its suppliers so that it could apply under a hardship. John Harper said "we won't let you go belly up; we guarantee that". How can he make that guarantee, when he can't get us gasoline?

It is quite an interesting letter. So we will get it to you.

Now, Mr. Peterson and Mr. Dryer, just pull up two chairs there. Just grab those two right off the side there please and any others that want to come up here.

The reason I want to do this is because I found out in my experience that lots of these problems have cleared up if we take a little time and talk it out.

Mr. Peterson, you are here on behalf of the Independent Gasoline Marketers Council?

Mr. PETERSON. Correct.

Chairman HUMPHREY. Mr. Dryer, you are from the Independent Refiners Association of America?

Mr. DRYER. Correct.

Mr. PETERSON. There is no chairman to our group. The chief executive officers meet to see what we can do about——

Chairman HUMPHREY. You are representing that group?

Mr. PETERSON. Right.

Chairman HUMPHREY. And Mr. Dryer?

Mr. Dryer. Yes, sir.

Chairman HUMPHREY. You are the general counsel for the Independent Refiners Association?

Mr. DRYER. Right. I am the executive secretary.

Chairman HUMPHREY. And you speak for that group?

Mr. DRYER. I can speak for that group and I will express views that were arrived at in meetings, which we had over the last 2 months.

Chairman HUMPHREY. All right. How do you want to proceed? Which of you has preference.

Mr. DRYER. I am prepared to make four brief comments with respect to Mr. Sawhill's testimony so that we will be immediately responsive.

Chairman HUMPHREY. Very well. Let's go ahead then, Mr. Dryer.

TESTIMONY OF EDWIN JASON DRYER, GENERAL COUNSEL AND EXECUTIVE SECRETARY, INDEPENDENT REFINERS ASSOCIATION OF AMERICA

Mr. DRYER. I think Mr. Sawhill's statement at two places may have inadvertently given the wrong impression with respect to how the program gets oil to the small and independent refiners at the average weighted cost of the majors.

DRYER REACTS TO SAWHILL'S TESTIMONY ON PROBLEMS OF THE INDEPENDENT REFINERS

It is correct that this rule, which provides that the selling major company can charge only its weighted average costs, applies to those transactions which are effected through the buy-sell list. But in his statement it is noted that "30 million barrels of crude oil moved on the buy-sell list" and that is approximately 333,000 barrels a day or less than 10 percent of the actual crude oil used by the small and independent refining companies.

Now, how did they get the rest of their oil? They got it under that very important part of the allocation program which in effect freezes the flow of crude oil to oil refiners, which was in existence on December 1. But for that oil, over 90 percent of the oil used by the small, independent refining companies, they pay whatever the lawful price is for the oil actually delivered to them.

If the selling company picks the high priced oil, they pay the high price. And in case after case we have documented—and I refer to some of these cases in my prepared testimony—we, independent refiners, are ending up with 95 percent, 85 percent and so on of our crude oil input being high priced exempt oil, compared with the national average of exempt oil of 29 percent.

So that the regulations really are wide open on the great disparity of costs between the majors and the independents as a result of the two-tier system.

Now, the second thing that disturbs me is Mr. Sawhill's comment that instead of the one or another of the various crude oil cost equilization programs, which have been under consideration within his agency for the last 2 months at least, he apparently is going to abandon that approach and is going to take care of 15 identified refiners, who are disadvantaged.

Well, I will tell you, Senator, our independent refiners do not want to come hat in hand and, if our coats are tattered enough, perhaps we can get a crumb from the major companies' banquet table. All we want is cost equalization; treatment of majors and independents alike and from there we will compete.

We do not want to come in and get a handout, if we can prove, as in the case of the 15 disadvantaged refiners, that we qualify for some kind of industrial welfare program.

WEIGHTED AVERAGE COSTS OF CRUDE OIL

Mr. SAWHILL. I might, rather than use those kinds of words, because I don't think they help the debate very much, just give you some statistics.

The weighted average cost of the 15 majors is $8.70 a barrel. There are 100 companies, including many small and independent refiners, that have a weighted average cost below $8.70. There are 31 small and independents above that, that have a weighted average cost above $8.70 and those are the ones that I think we have to be concerned with.

But rather than put a very complex administrative system in place, which I think would be detrimental to all of the industry, I think there are ways that we can bring down the weighted average cost of these few small and independent refiners that are above $8.70. I don't mean the ones that are close to it now, but the ones significantly above, to pull their costs down without bringing them to the banquet table or whatever other words you were using.

Mr. DRYER. Well, Mr. Chairman, we have tried to consider a variety of programs which would effectively and in a manner that is administratively simple accomplish some measure of cost equalization. Our people have been working on this problem. We have been conferring at the staff level with the FEO people and we thought we had reached a point in which there was an administratively simple mechanism.

Lord knows our people don't want to get any further involved with Government regulations than is absolutely necessary, but we think that the program that was being developed here up until recently is simple, workable and it doesn't involve determining whether or not a company is in a loss position.

A company that has a crude oil cost that is unfair and is at a disadvantage ought to be able to make money even if it is——

Mr. SAWHILL. Well, I think we all agree that there are certain refiners that are disadvantaged and we have to do something for them. The specifics of the program is not what we are here to debate, but rather to recognize the problem and to gain some commitments from the FEO to do something about it, and I think we do have that commitment.

Mr. DRYER. Well, one of the things we ought to have is a commitment in terms of time. You see, we are out of the difficult period in which our independent refiners could sell at the higher lawful price, because they had this cost disadvantage. We are out of that period, Mr. Sawhill mentioned. So the time is now in terms of cost equalization.

Chairman HUMPHREY. What is your time frame, Mr. Sawhill?

Mr. SAWHILL. Well, I said within the next 30 to 60 days we would be in a position I thought to put a program in place. And we will try to do it as quickly as we can because I do recognize this problem.

Mr. DRYER. That is not soon enough, Senator.

Chairman HUMPHREY. Well, the price differential is removed when?

Mr. DRYER. What was that?

Chairman HUMPHREY. You said something about the price differential being removed very shortly.

Mr. DRYER. No, what I meant was that the independent refiners throughout the last winter paid the higher price for their crude oil and then had a legal right to charge the higher price and they could do it.

Chairman HUMPHREY. Yes, but Mr. Dryer, they can't do it now that supplies are in better balance. And the majors will be pricing below them.

Mr. SAWHILL. But, there are many of them, of course, that are below the majors right now.

Chairman HUMPHREY. But what is your answer to the statement of Mr. Sawhill, that many of the independents—I don't know about most—but at least many of the independents are actually pricing below the majors?

Mr. DRYER. Well, I think the chairman put his finger on it when he pointed out that that was the only way these people could still sell gasoline. As supplies get into better balance, they have to price right and therefore they are absorbing these higher costs, but they cannot go on absorbing these costs indefinitely.

Mr. SAWHILL. Well, their margins have increased over what they were last fall. Their margins were 7 cents, at least at the gas pump.

Mr. DRYER. I am talking about the refinery level now.

Mr. SAWHILL. They were 7 cents and they are now 11 cents and we have been under criticism for the fact that we have allowed these margins to increase so much. You know, we recognize that there is a problem and we will be doing something about it.

Chairman HUMPHREY. Do the companies' margins apply to the independents, as well?

Mr. SAWHILL. Yes.

Chairman HUMPHREY. Across the board?

Mr. SAWHILL. Yes, these are an average of all margins that I am citing to you.

Chairman HUMPHREY. They are averages?

Mr. SAWHILL. Yes, there are obviously going to be some that are narrower and some that are wider, but we are looking at them on a regional basis as well, and they are fairly uniform around the country.

Chairman HUMPHREY. Mr. Dryer, do you have any other questions you want to put to Mr. Sawhill.

ALLOCATION FRACTIONS

Mr. DRYER. Yes, sir; two of them. The key to monitoring the FEO program is the allocation fraction. A company which has an allocation fraction meaning, let's say, that is taking care of 100 percent of the proved requirements of the customers, is obviously in better shape than a company with a 45-percent allocation fraction and this is the signal to the FEO as to disparities, but we on the outside don't know what those allocation fractions are. We do know in individual cases, but they are greatly divergent.

One company I cite in my prepared statement has less than 50 percent of the gasoline to serve its proved requirements compared with a figure closer to 100 percent for his major company competitors. We would like to see a list of the allocation fractions. We would like the FEO to move ahead then and move aggressively to even these allocation fractions out among companies.

Mr. SAWHILL. Well, that is proprietary data to the individual companies, so we do not make that available. The individual company allocation fractions are not made available, but many of the companies make them available.

PRICE DISPARITIES

Chairman HUMPHREY. Mr. Sawhill, to come back on this pricing situation, you said that 30 to 60 days time would enable you to come forth to alleviate the problem of price disparities.

Mr. SAWHILL. This is a major step for us to move from allocating supplies to allocating based on price. It is a whole change in direction of our program. That is why, you know, I am not prepared to say we can do it tomorrow or in 2 or 3 days. It will be quite a major decision for us to make on exactly how to accomplish this without hopelessly bogging down the industry with further regulations and without implementing a program which defeats the purpose of expanding supplies in this country.

Chairman HUMPHREY. Doesn't the law require this?

Mr. SAWHILL. The law requires us to protect the independent sector. We are moving aggressively, first, to determine the market share of the independent sector and to work with those refineries that appear to be at a disadvantage. I think that it is obvious that some of the small refiners are at a disadvantage. I can't deny that. We will be working very rapidly to try to alleviate their situation.

Chairman HUMPHREY. The law requires the availability of supplies and equitable prices to the independents?

Mr. SAWHILL. Yes.

Chairman HUMPHREY. I just think we do have to face up to this——

Mr. SAWHILL. It is equitable. It is not equal.

Chairman HUMPHREY. No, I said equitable prices.

Mr. SAWHILL. I think we've got to allow some range.

Chairman HUMPHREY. We are behind 6 months on certain data?

Mr. SAWHILL. Yes.

Chairman HUMPHREY. There is a time lag here again in adjusting price for the crude, for the refiner? I mean, for these refiners, that are in a precarious situation. I just hope that you will appreciate the urgency of it. We get all kinds of complaints, as you know, we individual Senators and Members of Congress.

Mr. SAWHILL. Yes, so do I.

Chairman HUMPHREY. I know you get them too, but something has to be done.

Mr. SAWHILL. Yes.

HUMPHREY REQUESTS 30-DAY ACTION FROM SAWHILL

Chairman HUMPHREY. Thirty to sixty days you say, maybe longer. I think we ought to say that it is going to be within 30 days and try to get it done.

Mr. SAWHILL. I certainly think we can take some action within the next 30 days to help those particular refiners that are at a serious disadvantage. I am looking every day at companies that are seriously disadvantaged and making decisions on what we can do to alleviate their problems.

Chairman HUMPHREY. Mr. Dryer, do you have any other questions?

Mr. DRYER. No, except that we did have 16 of our people in to confer with the FEO staff for 2 days on this subject; these are practical businessmen. If they thought there was a program in draft stage which was workable—these people also included people who had been former Government officials and who knew the problems on the Government side. I think the FEO ought to give serious consideration to the views of these practical businessmen as to what might be a workable program.

Mr. SAWHILL. We do.

Chairman HUMPHREY. I suggest you two groups get back together promptly and continue this negotiation and get this thing worked out because this has got to be answered sooner or later. In the meantime, an awful lot of inconvenience is incurred and a lot of profit and capital is consumed. We are getting that complaint now.

Mr. Peterson, you have a prepared statement; don't you?

TESTIMONY OF R. J. PETERSON, INDEPENDENT GASOLINE MARKETERS COUNCIL

Mr. PETERSON. Yes, Mr. Chairman, I do have a prepared statement.

Chairman HUMPHREY. But would you like to ask Mr. Sawhill any questions?

DATA PROBLEM IS SIGNIFICANT

Mr. PETERSON. I would like to ask him some questions. I would like to preface any questions or remarks that I might make, Senator, as far as Mr. Sawhill is concerned, by saying that I am sincerely appreciative of the magnitude of his job. It is a horrendous job. Particularly, I do appreciate the lack of data. I am critical, very critical, of the data they are using, because I feel that the old data we have available does not separate an independent from a major fully integrated company. It doesn't separate independents by brand from those that are independent in fact. By that I mean, if the Wisconsin data you use shows an "independent" that happens to be owned totally by a major oil company, it is damned poor data.

Mr. SAWHILL. I think you are right. I am glad you are pointing this out to Senator Humphrey, because this is important.

Mr. PETERSON. But let me say the reference to margins is only valuable as an average. It isn't worth a damn to the independent who is trying to survive in the marketplace.

Let me give you, if I can, an example off the top of my head. I would have to deal with my own company, because those are the only facts I can pull out. I can't set it down to one tenth of a cent, but our delivered cost in Chicago is over 50 cents a gallon, including taxes, to our service stations.

Gulf Oil Co. operating through its "Easy Go" stations, their gasoline is 49.9. Now, if I have an 11-cent margin, it doesn't help. It doesn't help me much.

Mr. SAWHILL. Yes.

Mr. PETERSON. I would like also to respond to the extreme efforts you have made on task forces—and again I am hestitant to be critical, knowing the problem—but I will be damned if I don't want some different kind of action than we have had.

We have been very slow to go to the FEO with our problems. We could forecast what was happening to us fairly well, and we have been given a good many assurances, but it just didn't develop.

When we got on the wait-list, we seemed to be the ones who were carrying all the waiting. In the instance of our company in California, we went forth, hat-in-hand, with an FEO–17, which is an appeal for product from a different source or from somebody who you can get it from, and our market in California at that time had only gone down about, if I remember right, at that time it had only gone down about 50 percent.

By the end of the following month, it was down, and I am not saying we had 90 percent left, but it was down 90 percent. We had 10 percent left of our market.

Along with my reading of those devastating numbers, we get a memorandum from the FEO in California saying your petition has been denied.

We delayed here with our major problem, and when it became a problem, I personally came to Washington to see what steps I should take. We prepared a bunch of information, not a petition. We said, "Here are our facts. I would like you to take time to study them and tell us what, in your view, we should do. We think we should be entitled to some relief and the assignment of a new supplier. Our old suppliers' products should be taken from him by a major and redistributed, because it would not effect their total average cost that much."

We were told by Mr. Harper—we were then told we can't get a new supplier. Mr. Harper assured us that he didn't want us to apply on the basis that we couldn't market because our costs were too high, because that would bring upon the agency too many appeals.

Now, I submit there may be 50 independent operators who might be in this position. I mean truly independent marketers. I doubt that there can be any more.

"Will you," says Mr. Harper, "reverse your position, and instead of a request predicated upon price to the FEO, go to the exceptions board and be classified an exception so that we can handle you separately?"

Well, we protested. In fact, we refused to do it for a period of time because I don't think it is a lawful requirement and because of our prior dealings with the CLC, now a division of the FEA.

Chairman HUMPHREY. Will you continue on this? I am going to step out. I want Mr. Cox to follow up on this, and I will be right back.

PETERSON—TRUE INDEPENDENTS HAVE LOST THEIR MARKET SHARE AND FEA WILL NOT TAKE ACTION

Mr. PETERSON. Yes, we learned that you've got to provide every financial bit of information, which I don't see required in the legislation, as to whether we are alive or dead financially before we can get help. But Mr. Harper said to us, "Look, this won't happen. We guarantee we will have you out of here in 10 days. The information you have given is adequate. Just restate that information."

Well, believing he could do this, we departed. When I got home, the first thing I got was a telegram about half as long as your arm asking for every bit of financial information our company had.

We happen to be a privately owned company. It has been the policy of our company not to disclose financial information, good or bad. So we were trapped in the delay of what we were willing to submit and what we were not willing to submit.

But beyond that, Mr. Sawhill, the day after we were there, a memo went out to every region saying: "Do not issue any relief predicated on price."

Now, our business in total is not as bad as our business in California. Our business in its total is down only about 67 percent by the end of last month. In our primary market of Chicago, our business was off the end of May, 70 percent to its normal.

Now, I don't think that you have to have all kinds of financial data to conclude from the data that we have provided, which includes all of this information, that we have lost our market share. That is all we say. We want to have reasonably what our market share was and should be.

And I don't want to get into any argument about that with you.

Mr. SAWHILL. OK.

Mr. PETERSON. I am still sympathetic with your problem, and I have so indicated many times. But if you keep delaying, particularly considering our particular company and the many like us, we will be in some other business besides the gasoline business, And that has been our primary business for years, for 45 years.

Mr. COX. Mr. Sawhill, I think Mr. Peterson's comments were representative of those that we heard from a number of other independent gasoline distributors concerning the problem of getting action out of FEA.

Mr. SAWHILL. I think he is right as far as price allocation is concerned. We have provided allocation to help those who have not had adequate supplies. We have not, in the past, made allocations strictly based upon price disadvantage.

INDEPENDENT'S PRICE DISADVANTAGE

Mr. PETERSON. Let me explain what that price disadvantage can be. Our primary supplier is a northern tier company, and they are, I think, about 92 percent dependent on Canadian crude.

I am not sure of that percentage, but I think that is what they told us. I believe their cost of crude is in the area of $12 a barrel. If you take again, as an example, the retail price of Gulf Oil Co. through their "Easy Go" stations in Chicago and back the taxes off and the transportation off, at their refinery, you will find that they recover less than $10 a barrel at the refinery without any profit levels taken into consideration.

Now, that is the case. And if it is the case, how then does a margin help us. How then does it help being told to get product from people, like northern tier refineries or independents, whose costs are as high as 44 cents or 42 cents a gallon? We cannot do it.

Mr. SAWHILL. No, clearly I think the problem is finding some way to provide lower cost supplies to the northern tier refiners, because they are the ones that seem to be at a particular disadvantage.

Mr. PETERSON. Well, we are talking about the problem of the independents.

Of course, we believe with Mr. Dryer that a crude cost equalization program of some kind might allow you to do a lot of things that you never will be able to do otherwise.

AD HOC DECISIONMAKING INADEQUATE TO RESPOND TO THE INDEPENDENT OIL MARKETERS PLIGHT

Mr. Cox. Mr. Sawhill, I think we ought to address ourselves to this question. You have referred to your intention now to turn to an ad hoc solution for the refineries by selecting individual refining companies which need help. It is not at all clear to me how that will be accomplished.

It seems in the process of developing FEA's policy on this issue, a great deal of ad hoc decisionmaking is involved.

Mr. Sawhill. The refiner sells to the marketer. And if the refiner has supplies at costs that are the same as his competitors, he can sell to his marketers at the same price, and therefore his marketers are going to be not at a competitive disadvantage.

Mr. Cox. But it still leaves the marketer that depends more heavily on imports, in a bind. The 15 small refiners, assisting of them is not going to even out the costs of all of the marketers.

Mr. Sawhill. Yes, because the refiner—you see gasoline is not really imported. It is refined in this country.

Mr. Peterson. May I take exception to that for our company? We import many millions of gallons normally.

Mr. Sawhill. Well, our imports of gasoline are about 1 percent.

Mr. Peterson. Yes, I agree.

Mr. Cox. It is true our imports of gasoline taken as a fraction of our total consumption are quite small, but in proportion to the remaining, whatever it is, the 18- to 20- percent market share of the independent marketers, and particularly as to shares of the supplies running through certain individual companies, it is a much more significant matter.

Mr. Peterson. Mr. Sawhill, I don't want to embarrass you and ask a question you might not have the data on, but do you know or do some of your staff know what prices those independents in Wisconsin were charging where you found they were marketing below the majors? And who they were?

Mr. Sawhill. I don't have them.

Mr. Peterson. Well, we can't do it. And most of those independents that I would know within 100 miles of the Chicago area, or 200 miles, which would, of course, include Wisconsin, could not do it.

Now, I know there were several independent brands up there that are owned 50 to 100 percent by majors and maybe they could do it. And that gets back to the problem on data, which I am totally sympathetic about.

Mr. Cox. Are you considering drawing up a list of independent marketers that may also acquire supply assistance?

Mr. Sawhill. Not at this time, we are not. I think we've first got to attack the refiner problem, because I think that is the bulk of our problem and we can handle the rest through our exceptions process.

Mr. Peterson. Mr. Sawhill, is it out of order to consider some kind of a committee made up of some true independents, that might help your staff define an independent?

Mr. Sawhill. No, that wouldn't be out of order. I think it might be a good idea.

Mr. Peterson. I think that is the problem, defining what an independent marketer is. An independent marketer, as I state in my prepared statement, is not related to a refinery by anything other than a long term agreement, a buying agreement, a historic agreement of some kind. He is not related to crude oil. He has to buy his product in the marketplace and his policies are not set by anybody except himself. This generally is not the case with those branded people that are considered independents.

Mr. SAWHILL. Yes, I recognize that and I think you have a good suggestion.

Chairman HUMPHREY. I am going to move along here. I wanted this little interchange, because I do think it is helpful.

Mr. SAWHILL. I do, too.

Chairman HUMPHREY. It is helpful that we use Mr. Sawhill's wisdom constructively and your time this way, to try to resolve certain questions.

I saw in the Wall Street Journal an article of Friday, June 7, which says the Federal Energy Office may phase out controls and allocations for some of the fuels. It goes on to say, "Officials say that the agency is working on a plan to selectively decontrol prices of oil and petroleum products, possibly to begin at the end of the summer and phasing through next February 28, when the law for such authority expires."

It goes on to say: "However, sources say that either step will be enacted before the fall."

SHOULD OIL ALLOCATION AND PRICE CONTROLS CONTINUE?

I guess what I am asking you is, do you feel that we should continue our program of allocations?

Mr. SAWHILL. Well, the President directed us to come up with a plan for deallocating in view of the fact that the law does expire in February of 1975. As to whether we need an extension of the act or not, it is a little hard for me to say right now because it will depend somewhat on the supply and demand conditions and the market share of the independents between now and the expiration of the act.

Chairman HUMPHREY. Mr. Sawhill, the dismantling, or the expiration of oil price controls, which was suggested as a possibility, would that not mean another windfall of about $10 billion per year to domestic crude oil producers as the prices of so-called old crude go up to the price level of uncontrolled oil set by the OPEC cartel?

Mr. SAWHILL. It would mean a substantial windfall. And therefore I would think that any action to do that should be coupled with some kind of a windfall profits tax.

Chairman HUMPHREY. Windfall profits tax?

Mr. SAWHILL. A tax that would tax away the profits of the excess price of the crude oil.

Chairman HUMPHREY. We have some trouble getting that kind of legislation, as you know.

Mr. SAWHILL. Yes, sir.

Chairman HUMPHREY. And the last one we had was vetoed?

Mr. SAWHILL. Well, the last windfall profits tax we had was a very unusual kind of tax.

Chairman HUMPHREY. That is the problem of windfall profits taxes. It is always very difficult.

Mr. SAWHILL. Yes, but I think that the veto was predicated more on the price rollback than on the windfall profits provision, although the windfall profits provision was unworkable in my view.

Chairman HUMPHREY. But it is a fact that if the controls were taken off, there would be a windfall of about $10 billion? Isn't that correct?

Mr. SAWHILL. Yes, sir. It is somewhere in that range.

Chairman HUMPHREY. Between $9 billion and $10 billion?

Mr. SAWHILL. I would certainly favor a windfall profits tax, coupled with any action to decontrol prices.

Chairman HUMPHREY. Given the present refinery shortage in the United States and the major companies apparent intention to move more into the refining and marketing end of the business, do you think that the end of governmental allocations will mean that the independent supply problems again will become critical?

Mr. SAWHILL. It would all depend on the overall supply and demand situation in the country. I mean the independents grew up at a time when there was some excess supply and they were able to grow because, as I said in my testimony, because the refineries produced excess product and put it on the marketplace and sold it to the independents at market prices.

Now if we get into a situation like that again, and we could, then the independents would continue to have that source of supply.

Chairman HUMPHREY. Do you think there is much chance we will get into that situation?

Mr. SAWHILL. It depends on our ability to significantly expand our imports and also on our conservation program, but frankly I would have to reserve judgment on that until I had a little better chance to see what happens to world supply and demand. That is why it is hard for me to say at this time whether or not and in what form we would need an extension of the Allocations Act.

Chairman HUMPHREY. Well, I am disturbed by your comment because on the one hand you and others are saying that the oil crisis is still with us and we've got to remember that and that it can get worse before it gets better——

Mr. SAWHILL. Yes.

Chairman HUMPHREY. And everything I have heard indicates that, every bit of testimony that has come before any of our committees.

Mr. SAWHILL. Yes; and what we are really saying is that we just can't allow ourselves to continue to get ever more dependent on the rest of the world. We have to expand our domestic supplies.

Chairman HUMPHREY. Yes, but how much expansion of that domestic supply is taking place? Neglible, isn't it?

Mr. SAWHILL. Yes, the opposite, as a matter of fact.

Chairman HUMPHREY. It is declining?

Mr. SAWHILL. Yes.

Chairman HUMPHREY. And until we are able to get Alaskan oil and until we are able to do something about oil shale and until we are able to do something about other forms of energy, we are in an energy pinch, aren't we?

Mr. SAWHILL. Yes.

Chairman HUMPHREY. Well, I just think we had better face up to the problem and not go around looking through rose colored glasses hoping that somehow or other we can maybe get rid of these allocations.

Mr. SAWHILL. Well, there are certain products, such as aviation fuels and residual oils where we do have adequate inventories and no longer need an allocation program. In those sectors where we have more independent elements, such as heating oil and gasoline, I would agree with you that we need, at least for some time, an allocation program.

Chairman HUMPHREY. Is there any practical alternative to mandatory allocation? For instance, it has been suggested that the Federal royalty oil could be made available for independent refiners to use and to trade for oil they can use. This is an appealing idea when you first look at it, but I fear that it would not be adequate, especially for the independent marketers.

Mr. SAWHILL. Yes, I don't think that would be a viable alternative.

Chairman HUMPHREY. Are there any other ideas that might permit FEA to sustain the viability of the independent sector without continuing mandatory allocations?

SAWHILL PREFERS WORKING WITH INDEPENDENTS ON EXCEPTIONS BASIS

Mr. SAWHILL. I think what we do need probably is some kind of allocation where we can work with the independents on an exception basis, as they have problems, rather than maintaining a control over the entire industry. That is, I think, the kind of program we will evolve into as we move into the fall and next year.

Now, any change on our part in the allocation program, any consideration we might give to suspending the allocation program for a particular product prior to the expiration of the act, requires us to announce our intentions, conduct public hearings, and then come to the Congress with a finding that supplies are adequate and we can meet the requirements of the act.

So in the event that we decide it and determine that it was appropriate to deallocate a particular product, we would, of course, go through those procedures and have public hearings and recorded testimony and come to the Congress and lay this before the Congress before we took any action.

Senator HUMPHREY. Well, I think you should and you do know, of course, that certain Members of the Congress are considering extension of the Allocations Act?

Mr. SAWHILL. Yes.

Chairman HUMPHREY. And I am sure that we will be expecting testimony from you and others on it. I frankly don't see any other way out of it.

Mr. SAWHILL. I just think we might want to change or modify the existing act.

Chairman HUMPHREY. Yes.

Mr. SAWHILL. I mean this was written quickly, as it had to be, and we didn't know as much then as we do know now. And so I think any modification should be accompanied by some careful changes in the act, and I am really not prepared at this point to talk about what those changes might be.

Chairman HUMPHREY. Is it true, as alleged, that the FEA has ordered its regional offices not to act on any applications for assignment of suppliers based on pricing problems?

NO ALLOCATIONS STRICTLY BASED ON PRICE

Mr. SAWHILL. Yes, that is correct. At this point we have said that we do not have an agency-wide policy of allocating strictly based on price. Our allocations in the past had always been to provide supplies to those suppliers which were being disadvantaged because they did not have adequate supplies. We haven't allocated to people who clearly had adequate supplies, but whose supplies were at a higher price.

Chairman HUMPHREY. So the part of the law wherein you are required to have supplies at equitable prices is really being handled very softly, if handled at all?

Mr. SAWHILL. Well, it is being handled, as Mr. Peterson pointed out, through the exceptions process. We had established in the FEO by congressional directive, an Office of Private Redress and Appeals, or Private Redress and Grievances, which does operate to handle these cases on an exceptions basis.

Chairman HUMPHREY. But that is really just a hardship operation?

Mr. SAWHILL. Pardon me?

Chairman HUMPHREY. That is basically just a hardship operation?

Mr. SAWHILL. Yes, sir, it is based on hardships. In other words, if we find someone——

Chairman HUMPHREY. And it has to be a very much hardship?

Mr. SAWHILL. Pardon?

Chairman HUMPHREY. I mean, hardship of a severe degree?

Mr. SAWHILL. Oh, well, hardship, yes, of a severe degree. A hardship of, you know, a company that clearly is having difficulty and hard times of making a go of it.

Chairman HUMPHREY. But that isn't what the law says. The law doesn't talk about hardships per se. It talks about equitable pricing.

Mr. SAWHILL. Well, I think what we tried to do is to define, in administering our program, exactly what equitable prices means. It doesn't mean equal.

Chairman HUMPHREY. No.

Mr. SAWHILL. But it means within some range, and that is what the definition we are trying to come up with now is.

Chairman HUMPHREY. But all of these allocations don't mean very much unless there is equitable pricing?

Mr. SAWHILL. You see, formerly, they did. Now, we moved into a new period, and rather than let each of our regional offices operate independently in this regard and develop its own pricing policy in different areas of the country, we felt we had to give some uniformity to this.

Chairman HUMPHREY. When are you going to do that?

Mr. SAWHILL. Well, we are doing this through, as you call it, this hardship office. Now, we will be, as I say, within the next 30 to 60 days, promulgating policies on exactly how we handle this price disparity question, but it is not an easy question.

Chairman HUMPHREY. I realize it is not an easy question, and I understand that. And as has been said here, your task is a monumental one, but there is a law——

Mr. SAWHILL. Yes.

Chairman HUMPHREY [continuing]. There is a requirement under the law. The law is very specific as to the concern of the Congress over the maintenance of competition in the oil industry and the maintenance of adequate supply of equitable prices for independent refiners and marketers and distributors, and I think we have just got to bear down on it.

Now, the major companies don't really have those problems to the degree that the independents have?

Mr. SAWHILL. Well, the major companies, you know, claim that they have very severe problems. You know, we are not here to talk about the problems of the major companies, but to the extent that we take supplies away from the majors, we detract from their incentive to develop additional supplies. To the extent that we take crude oil from the majors, that they have produced and as a result of their investment, and give it to the independents, what we are doing is discouraging the production of additional refineries or the development of additional refineries by the major companies.

Now, maybe we've got to do something. We clearly do have to do something, but the question is, how much?

MARKET SHARES

Chairman HUMPHREY. Just a few more questions, and this question is really actually on my part a statement of my concern.

The Allocations Act provides that the mandatory allocation program will make supplies available in equal proportions to all competitors in the oil industry.

As a matter of fact, the independent gasoline marketers are operating at a far lower fraction of their 1972 levels than major companies. And the fact that their market share has slipped is prima facie evidence that the intent of the act is not being fulfilled.

Mr. SAWHILL. If the market share has slipped, that would indicate that, yes.

Chairman HUMPHREY. But what preliminary evidence we have even from your own reports——

Mr. SAWHILL. Yes; that is correct.

Chairman HUMPHREY [continuing]. Indicates that the market share has slipped.

Mr. SAWHILL. Yes; that is correct.

Chairman HUMPHREY. And therefore, I believe that it is the purpose of this hearing to act as a sort of monitoring device on the part of the subcommittee over the office to see that these provisions of the act are fulfilled or, if the act needs to be changed because it is inoperative to change it.

Mr. SAWHILL. No; I think the act provides adequate authority. I don't think it is the problem of the act. I think it is a problem of getting data and in showing ourselves and determining exactly what the market share situation is.

Chairman HUMPHREY. Yes; I gather you understand that we feel that the effort to get that data is of very major importance?

Mr. SAWHILL. I do understand.

Chairman HUMPHREY. And you will act accordingly, because the point has been made here about the lack of adequate data, by Mr. Peterson.

Yes, sir, Mr. Peterson.

Mr. PETERSON. Mr. Sawhill, I heard you just comment that the independents bought "surplus" gasoline at, did you say, a "very favorable" price?

Mr. SAWHILL. Yes.

Mr. PETERSON. I hear that statement being made very frequently and I would like to refute it. We have several million dollars invested in terminals and we enter the marketplace the same as anybody else.

The FEO must recognize that simply having enough gallons or barrels available in the United States will not of itself assure the preservation of market shares. Because of the structure of the industry, independents may be in short supply. I am a critic of the major oil companies' market behavior, and, our Government has adequate laws to police them, but they don't.

In my view, our Government is overreacting to the position of the majors. The majors are the only people that are going to take us out of this trouble in the final analysis. But, simply to allow them to provide more barrels is not, under the present integrated structure, going to be a solution. The problems we are facing involve discrimination against independents, price protection, and profits in crude oil.

And, if you say they have not been able to build refineries because of lack of profit in refineries or lack of ability to make money in refineries, I don't agree.

ALLOCATION OF OIL SUPPLIES AND THE INDUCEMENT TO EXPAND CAPACITY

Mr. SAWHILL. No; I didn't say that. What I said was that to the extent we allocate supplies away from them, supplies that they could be selling through their own distribution systems, we are taking away their incentive to build additional refineries.

Mr. PETERSON. They operated refineries on a very little profit basis for years.

Mr. SAWHILL. Yes.

Mr. PETERSON. And that is why we don't have refining capacity. My own company has been trying to build a refinery for at least a decade and every time we have figured the cost of buying crude oil from the market and trying to make a profit at a refinery, we found it is impossible to amortize our costs. Until the market behavior patterns of the majors are changed so that profits can be made in refining, on a continuing basis or reasonably continuing basis, so you've got a reasonable chance in the market, the only people in the business of refining will be the majors.

So far, the program you followed in FEO is going to continue to assure that situation.

Mr. SAWHILL. I will say that 50 percent of the new refining capacity currently planned or under construction is not by the majors but by the independents, so some independents must be finding it possible.

Chairman HUMPHREY. Congressman Brown is here.

By the way, Mr. Sawhill, I know you have an appointment and we will try not to extend your testimony, but I am going to turn it over now to Congressman Brown.

Representative BROWN. I am sorry to be late, but I have been involved in a number of other subcommittees this morning on the House side, so I have very little time I am sure to ask questions, but I do want to get a couple of questions in.

I am concerned about the fact that some companies, which have followed a policy of developing domestic supply from their own refinery system and then selling through their own stations and independents, are now in a position where they must sell some of their output to majors or other companies, and therefore wind up with higher prices because they must go out and buy on the foreign market.

Now, is there any way out of that trap or how do we resolve that problem.

Mr. SAWHILL. Well, that is the very trap that we are creating here this morning.

There are some companies—and you are right—that have developed their own supplies. And we are forcing those companies to take their supplies, which are at low cost, and sell those to other companies who don't have access to the same low cost supplies.

Representative BROWN. In the interests of equalizing distribution?

Mr. SAWHILL. Yes; and prices. You see, what happens is, as we force these companies to allocate their lower cost supplies to higher cost refineries, we remove their incentive and we, in other words, remove their competitive advantage, if you will.

Representative BROWN. Is that the fault of the law?

Mr. SAWHILL. No; because the law, as Senator Humphrey was previously saying, because the law says that we should provide equitable prices. You know, this question of prices is very difficult. It is not as difficult to allocate based on supply. If you find someone who doesn't have adequate supplies, you can make an allocation to them. But when you get into this area of price allocation and you say, here is a man that has supplies that are at $10 and another man with supplies at $7, so we will take some of that $7 oil away and give it to the person with $10 and force them to mix it all together, you get a very complex and difficult situation.

Representative BROWN. But that is the result of the law, is it not, or are you making that decision yourself?

Mr. SAWHILL. Well, we are interpreting the law. The law speaks very broadly of providing equitable prices.

Representative BROWN. Should we modify the law in some way, or is there some recommendation that might be made to the Congress that we could resolve this problem?

Mr. SAWHILL. No; prior to your coming, we discussed the problem of the independents and the fact that they are at a price disadvantage. And I have said that we recognize that problem, and we are trying to ascertain the extent of that problem and we are going to be prepared to do something about it. We are not recommending a change in the law, however.

Representative BROWN. Would one way to do something about it be to phase out the control system altogether?

Mr. SAWHILL. Yes.

Representative BROWN. Is that in prospect prior to the expiration of the law?

Mr. SAWHILL. Yes; we have a plan for beginning to phase out controls on certain products.

COMPANY WITHDRAWALS FROM CERTAIN MARKETS

Representative BROWN. What is being done, or can be done, as long as the allocation is mandatory, about the situation which existed prior to the imposition of mandatory allocation and mandatory equalization of prices where some of the majors were phasing themselves out of certain uneconomical markets, of markets that were for them uneconomical?

Mr. SAWHILL. Yes?

Representative BROWN. And under the law they are required to continue to serve those distribution outlets and then presumably, when you phase out the allocation activities of the FEA, they will continue to withdraw from those markets because they are uneconomical.

Now, how will that market in those uneconomical places be served?

Mr. SAWHILL. Well, perhaps there needs to be some extension of the law which requires, as we do now, that companies not withdraw from markets.

Representative BROWN. Well, is that really economic? I'm trying to balance the economic service and the provision of supply to those areas. For instance, in the Midwest, Sunoco, Cities Service, and in some areas I understand Mobil and Gulf, they were actually moving out of parts of previous markets because it was no longer economical for them to serve them.

Mr. SAWHILL. Yes.

Representative BROWN. Presumably in a free system, somebody else would move in if they had supply. Now, is there a way that we can deal with that problem so that, if it is an independent service agency that moves in or if it is a smaller company that is willing to move in, we can provide that market opportunity for them?

Mr. SAWHILL. Yes; we can through our allocation program. We can do that without an allocation program. The forces of the market would have to operate to do that though.

Representative BROWN. Is there any provision now for your allowing them to move out and others to move in with reference to how you are allocating fuel?

Mr. SAWHILL. Yes; they are permitted to move out, but they have to keep supplying the market. They can close down stations, but they have to keep providing the supplies to others that might move in and use these supplies.

So if company A moves out, company B moves in, and then company A has to insure that it is supplying the same volume to the market through the outlets of company B.

Representative BROWN. Now, how does it do that?

Mr. SAWHILL. By selling gasoline or whatever product we are talking about to company B.

Representative BROWN. And what about the transportation of that or what about the refining capacity? In other words, can you adjust that through the refinery capacity in certain areas?

Mr. SAWHILL. Well, you can usually do it by swaps or exchanges.

Representative BROWN. Are we winding up, as the result of the administration of this legislation by FEA, with more economical distribution patterns or less?

Mr. SAWHILL. Oh, they are probably less economical because of distortions you get through an allocation program. You know, you would probably be more economical if you let the forces of the market operate.

Representative BROWN. Well, nothing you said really encourages me to want to continue this in existence for long.

Mr. SAWHILL. Good.

Representative BROWN. You have something else to do, I guess?

But I gather what you are saying is that you are ready and willing to go out of business as fast as you can, as fast as the Congress will let you, as fast as the distribution requires?

Mr. SAWHILL. Well, the act expires on February of 1975.

Representative BROWN. I understand that.

Mr. SAWHILL. Yes, sir.

Representative BROWN. But are you telling me that you are going to continue to control the whole market as long as the act exists?

Mr. SAWHILL. No. What I said was we have a program of phasing out of the allocation of certain products.

ALLOCATION IN OHIO

Representative BROWN. Well, let me ask specifically about the Midwest and in Ohio. Do you intend to take less active a part in the allocation and control of prices in the Ohio situation, because it seems to be currently well supplied?

Mr. SAWHILL. No, I think that probably for gasoline, if that is what you are referring to, that it would be a little premature to move away from the allocation program right now because we do have some severe problems in maintaining the independent sector of the industry, as we heard this morning.

Representative BROWN. But is your policy designed to maintain the independent sector?

Mr. SAWHILL. Yes, and the act requires that.

Representative BROWN. I find some difficulty in that answer and the first answer that says that we are in effect making it less economic.

Now, where the price advantage runs against the independent, where a company has had a policy of developing its own domestic supplies and developing its own refining capacity and distributing through independents, then its price situation is in some instances less favorable which has not had that distribution policy?

Mr. SAWHILL. Well, you know, it is our responsibility to maintain the independent sector of the industry. Certain independents are being disadvantaged right now because they are forced to rely on imported product or higher cost domestic product.

Representative BROWN. Because they must supply some major oil companies?

Mr. SAWHILL. No, not for that reason. Because they don't have any other sources of supplies.

Representative BROWN. Well, I can give you an example specifically of a company which I understand was being obliged to supply some major companies, and is therefore forced to go out in the foreign market and buy for that purpose.

Mr. SAWHILL. Well, I don't know of any independent that is forced to supply majors——

Representative BROWN. Not an independent, a small company which has generally been supplying independents, and in order to supply the independents——

Mr. SAWHILL. What company?

Representative BROWN. Marathon.

Mr. SAWHILL. Is forced to supply majors or what?

Representative BROWN. In order to keep the balance of distribution in Ohio——

Mr. SAWHILL. Well, they are a seller. I mean, they are a major company.

Representative BROWN. Well, I don't know. They are not a major when you compare them to Esso or Exxon.

Mr. SAWHILL. Yes, but they are a very, very large company compared to the independent companies we've got represented here today.

Representative BROWN. But they have been in the habit of supplying independents with products.

Mr. SAWHILL. They are one of the 15 largest oil companies in the country.

Representative BROWN. My predicate is they are their own refineries and have been in the habit of supplying independent companies with products.

Mr. SAWHILL. Yes, and many of the other large 15 companies have, too. I mean, Marathon isn't unique in this respect.

Representative BROWN. I don't know if they are unique, but they probably supply more independents than, for instance, Exxon does?

Mr. SAWHILL. No, much less.

Representative BROWN. Much less proportion of their product?

Mr. SAWHILL. I don't know what the proportion is.

Representative BROWN. I don't think that is correct, Doctor. More of a proportion of their product goes to independents.

NONBRANDED VERSUS BRANDED INDEPENDENTS

Mr. SAWHILL. That could be. I don't know that.

Representative BROWN. More than the proportion of, say, Exxon's product goes to the independents.

Mr. SAWHILL. Well, what you are talking about—you see, Exxon supplies branded independents. Marathon supplies nonbranded independents. They are both independent so they are both supplying independents.

Representative BROWN. That is right, independent without their own Marathon supply?

Mr. SAWHILL. Yes, but that is a distinction without a difference, to my way of thinking.

Representative BROWN. Well, I am not sure that our independent friends would agree with that.

Mr. SAWHILL. Well, whether you are talking about an Exxon station, run by an independent businessman who leases his station from Exxon or another station, an ABC station, leased from Marathon, it doesn't seem to me to be——

Representative BROWN. Well, I am not talking about either one, Doctor. I am talking about independent brands which buy product from Marathon.

Mr. SAWHILL. Yes, as opposed to an independent businessman that buys product from Exxon?

Representative BROWN. As opposed to the Exxon independent who is selling Exxon product.

And it seems to me that is more than a distinction without a difference. I think there is a rather significant difference there, isn't that correct?

Mr. PETERSON. Well, I am thinking, Mr. Sawhill—I would like to explain that there is a substantial difference between a "branded" independent and a "nonbranded" independent.

Mr. SAWHILL. Well, I understand that.

Mr. PETERSON. Well, perhaps you can explain to me then why you say there is no difference? There is a fundamental and substantial difference.

Mr. SAWHILL. Yes.

Mr. PETERSON. And it is in the market behavior of the major oil companies to give price protection to the branded independent dealers. They have a guaranteed margin. And I think that Mr. Brown is correct, in saying that as far as private brands are concerned, Marathon does supply substantially more than most any other major oil company in the business.

On the other hand, they also supply many seemingly private branded companies, which indeed are their own.

Mr. SAWHILL. Yes, that is really what I was talking about.

Representative BROWN. As I understand it, they have now in this circumstance been obliged to also supply, because they do have refinery capacity, some other major companies——

Mr. SAWHILL. That is incorrect.

Representative BROWN. [continuing]. With product.

Mr. SAWHILL. No, that is incorrect. They have been forced to supply independents with product, but we don't require majors to sell to other majors. We do require in our crude program, majors to sell to independents.

Representative BROWN. Well, I must be incorrect then, because I understood in the effort to allocate or balance supply, that they were obliged to provide supply to other major companies.

Mr. SAWHILL. That is not correct.

Representative BROWN. All right. Then that completes my questioning, Mr. Chairman. And I appreciate your patience in giving me the extra time, and I apologize again for being late.

Mr. SAWHILL. Well, I should point out that Congress required us to classify Sohio and Ashland as independents. So Marathon does have to supply Sohio and Ashland. By your definition you required us to establish them as independents.

Representative BROWN. Let me conclude by making the comment that I sort of share Mr. Sawhill's view in general terms, and that is that the sooner we are out of this business of determining from the Federal level what the supply and price of product is, perhaps the better.

Now, it is only the better if by that time we have an adequate supply. And I would hope that Congress and Mr. Sawhill and whoever else in the administration is concerned with this problem is successful in assuring that we get that adequate supply, whether it is from the effort to conserve fuel or the effort to stimulate a return to the supply that we once enjoyed from abroad, and domestically at prices which all of us can feel are a little bit more comfortable than the ones we have been through. Thank you.

Chairman HUMPHREY. Thank you, Congressman Brown. Senator Javits has just a few questions of Mr. Sawhill.

I would indicate, Senator Javits, that Mr. Sawhill has some appointments, and I am sure he is very patient with us and still has some time.

Senator JAVITS. Just 5 minutes?

Mr. SAWHILL. Yes.

Senator JAVITS. Well, I will simply rest on the record my colleagues have made on this matter on independents, and how to handle them.

We have an enormous problem in New York that I am going to tell you about, and that is the dismantling of franchised dealers, and hence the existence of great pressure. One, on the small businessman to dismantle; and two, the price problem, which you mentioned in your statement on the independent dealer who has to receive supplies from the noncontrolled price sources.

But as I say, we have dealt with you on that outside of the hearings, and I will rest on the record which my colleagues have made about those particular matters.

CONSERVATION EFFORTS

I would like to ask you about conservation as FEO is handling it. One nation is on the verge now of bankruptcy because of the high price of oil, and it could easily drag the world with it yet. The American people seem to so quickly to have forgotten our problem of fuel and particularly gasoline in terms of one, the danger of another shortage, and two, of the danger that we will have no real impact on prices until we can materially reduce consumption.

Could you tell us your own view of that and whether my feeling, that we, as a Nation and as an administration, are being highly derelict in that? I don't know whether it is because the President is preoccupied with his own fate or what. But it seems to me the leadership seems to have departed completely on this highly urgent question of conservation.

Mr. SAWHILL. Well, we have tried very hard to continue to provide leadership in conservation, both in the short and the long run.

In the short run, we have talked about turning up thermometers to 78°, which the Congress apparently has not seen fit to comply with. We do comply with it in our own office, and in other agencies of the Federal Government. We have asked the Congress to permanently extend the 55-mile-an-hour speed limit, which I would urge you to seriously consider, because that is an important conservation measure, and an important shortrun measure.

We are continuing to pursue our lighting standards, because they can save fuel in the short run.

Now in the longer run, I think we have two things we can do. One is—well, there are three really three. One is: I am meeting today and starting a series of meetings with the automobile industry with the intent of establishing goals for more energy efficient cars over the next 5 to 10 years. That should save significant amounts of fuel if we can achieve the goals that I have in mind.

Second, I will be meeting with heads of the major energy consuming industries of the country in attempting to establish similar goals for more efficient use of energy in these industries which use 41 percent of our total energy in this country.

Third, we are working on plans to encourage the retrofitting of existing homes with more energy efficient storm windows and insulation so that we can save energy in the residential sector.

Senator JAVITS. Well, Mr. Sawhill, would it be feasible to provide for us an analysis of conservation efforts, including what Congress needs to do about it?

Mr. SAWHILL. Yes, sir.

Senator JAVITS. And second, with the savings which are inherent in each phase of that effort, and third, the impact which those savings could have, both on our balance-of-payments problems, and the very high price levels still continuing to be maintained by the basic producers?

Mr. SAWHILL. Yes.

Senator JAVITS. And then I would undertake to take a look at that and we need that in the Senate, because I really think this is an area in which we are terribly derelict and we are going to pay for it very, very dearly.

And as I pointed out, the first oil crisis may not be our last one.

Mr. SAWHILL. I agree with you completely on the need for conservation. As I say, I have spoken out on this and am trying to lead an effort in our office. We do appreciate very much the opportunity of doing this.

Senator JAVITS. Thank you very much.

Chairman HUMPHREY. Certainly, and I want to associate with your request.

What does worry me, Mr. Sawhill, and I don't know what you personally can do about it, is that throughout the country there is a feeling of total relaxation about the so-called energy problem. In other words, it has just sort of gone away. The fact that the filling stations aren't open on Sunday doesn't bother them. People say that is just because people want to take it a little easier.

Now I would like to believe that is the case. As we recall, last winter we had the warmest winter in the history of all recorded temperatures in the Midwest, and it has precipitated other problems, we are seeing this year, of weather. We can't be sure there is going to be another one.

As I say, it was the warmest winter that we had.

Mr. SAWHILL. Yes.

Chairman HUMPHREY. We may very well return to normal temperatures, and, if we do, we are going to have to solve our fuel oil problems. Is there any way that you know that we can accentuate the necessity of this conservation program?

You know, nobody drives at 55 miles per hour on the highway. If you drive at 55 miles an hour on the highway, you would almost think your car had stopped. You would open the car and get out and get run over, I guess.

Mr. SAWHILL. I think the States have become much more responsive. I sent a telegram to each State Governor urging them to enforce the 55-mile-an-hour limit. I can't say it is being done everywhere, but I think we are getting more enforcement.

In your State of Minnesota the Governor has set up a conservation agency, and I think it is moving ahead on conservation programs and seems to be quite supportive.

Chairman HUMPHREY. The thing that really got the people concerned was when the television stations and radios were pounding away at them and letting them know that you've got to conserve, and if you don't, you are going to get in trouble. We now are accustomed to paying the 50 cents or 50-some cents for gasoline. And each time it is going up a little more, and diesel costs are going up, and everybody complains about it, but it's sort of like, you know, if you have a pain in your back, you can get used to it after a while. You don't really know how good it was without it.

Mr. SAWHILL. Yes.

RENEWAL OF SERVICE STATIONS LEASES BY MAJOR OIL COMPANIES

Chairman HUMPHREY. Well I do have a number of questions I want to submit to you in writing because I don't want to detain you any longer. The one question that worried me was whether or not the major oil companies have been renewing fewer leases, since the energy problem hit the United States, and what they have been doing in terms of taking over the market.

I will send these to you so that you can get on your way. I do have six questions that relate to this. I will have Mr. Cox, of the staff, submit them to you. And if somebody in your staff could supply us the answers, we will appreciate it.

Mr. SAWHILL. We will.

[The following information was subsequently supplied for the record:]

RESPONSE OF HON. JOHN C. SAWHILL TO ADDITIONAL WRITTEN QUESTIONS POSED BY CHAIRMAN HUMPHREY

JUNE 18, 1974.

Hon. JOHN C. SAWHILL,
Administrator, Federal Energy Administration,
Washington, D.C.

DEAR JOHN: I wish to thank you very much for your patience and cooperation in testifying at last Tuesday's hearing of the Subcommittee on Consumer Economics and in responding to the questions and problems raised by representatives of the independent oil refiners and marketers. I hope that this direct exchange of information will help lead toward a solution of the problem of sustaining competition in the oil industry.

As agreed at the hearing, I am submitting the enclosed series of questions for your written response to be included in the printed record of the Subcommittee proceedings. Also, for your information, I enclose an addendum to the prepared statement by Mr. R. J. Peterson of the Independent Gasoline Marketers Council containing up-to-date information on the increases in dealer tankwagon prices for gasoline to major-brand dealers and to non-branded independent marketers respectively. It shows that tankwagon prices to non-branded independents have increased about twice as fast since 1972 as prices to major-brand dealers. In my view, this constitutes clear evidence that the equitable pricing provisions of the Emergency Petroleum Allocation Act is not being adequately observed.

Thank you again for your cooperation.

Sincerely,

HUBERT H. HUMPHREY,
Chairman, Subcommittee on Consumer Economics.

Enclosures.

On Service Station Leases From Major Oil Companies

1. Have the major oil companies been renewing fewer leases since the energy problem hit the United States.
2. Please submit for the record the number of previously independently operated stations that have been taken over by the major oil company with whom the independent had his lease. The list should be organized according to oil company.
3. If a major oil company chooses not to renew an independent operator's lease, does the operator have any recourse to prevent the loss of his station?
4. Do you foresee the possibility of most major oil company service stations being owned and operated by the corporation?
5. What action will the FEA take to prevent independent major oil company franchisers from being eliminated completely?

Tires, Batteries, Accessories Questions

6. Many oil companies have recently directed their member stations to sell only the company's brands of tires, batteries, and accessories. Does the independent leasee have any recourse but to purchase the major oil company's brand of tires, batteries, and accessories when ordered by the company to do so?
7. What government action would you suggest to prevent this kind of directed buying to give the independent operator freedom to sell whatever auto parts he wants and to give the consumer the widest range of choices in purchasing repair parts?

Addendum to Prepared Statement by Mr. R. J. Peterson

Mr. Chairman, may I divert just a moment from my prepared statement to inform the Committee that major-brand dealers' cost of product is represented by dealer tankwagon prices. These prices are posted for 55 major city market areas across the country. Taking an average of these figures for the first quarter of 1972, major-brand dealers during that period of time paid 17.64 cents per gallon for regular gasoline. Since then, the Platt's postings have risen to an average of 27.11 cents per gallon during the first quarter of 1974. Thus, product costs to major-brand dealers across the country have risen only about 53%, whereas our costs have risen over 109%. Moreover, in April, a comparison of dealer tankwagon prices in 1972 with the same prices in 1974 shows that the prices rose from 17.2 cents per gallon to 29.7 cents per gallon. This is an increase of only 72%. Whereas the increase to the nonbranded independent marketer is over 135%.

Federal Energy Administration,
Office of the Administrator,
Washington, D.C., August 23, 1974.

Hon. Hubert H. Humphrey,
U.S. Senate, Washington D.C.

Dear Senator Humphrey: Thank you for your letter of June 18, 1974, and your favorable comments on my testimony at the hearing of the Subcommittee on Consumer Economics. I appreciate having the addendum to the prepared statement by Mr. R. J. Peterson of the Independent Gasoline Marketers Council.

As you know, the price of oil to the independent marketer depends upon the percentages of "old" and "new" domestic crude and foreign crude that have been purchased by the refiner. Since these prices and percentages vary from lot to lot and distributor to distributor, depending upon which refiner supplies the particular lot, it is extremely difficult to set an average price that can form the basis for a uniform selling price without harming some part of the industry or the consumer. A noteworthy amount of equalization has already been accomplished, I think, by requiring each refinery that has sources of both low and high priced oil to establish a weighted price for all of its refined products. This prevents the refiner from passing through in the crude oil program the higher cost oil to independents while providing its own dealers with products from the lower priced crude.

In addition, on May 16, 1974, I sent to the Federal Register a proposed rule that would impose a limit on intra-corporate transfer pricing of imported crude oil and products. This transfer pricing restriction, when implemented into a regulation, should help reduce the prices of imported oil.

These efforts show that we are abiding with the Emergency Petroleum Allocation Act, to the "maximum extent practicable." I want to hasten to add that I am in no way satisfied with the prevailing uneven prices, nor will I be satisfied until the security of the independent marketer in the petroleum industry is assured, normal competition is restored, and the supply and prices of petroleum products to the public are stabilized at a reasonable level.

Following are the responses to the seven questions submitted in your letter:

1. Whether the major oil companies have been renewing fewer leases since the energy problem hit the United States: the answer is yes. The companies maintain that they have been closing some of their unprofitable units.

2. We are in the process of compiling a list of previously independently operated stations that have been taken over by the major companies. A copy will be sent to you as soon as it is completed.

3. Regarding independent operator's recourse if a major oil company chooses not to renew the operator's lease, his allocation entitlement is protected under subsections (c), (d), and (e) of Section 211.106 of the regulations. Also, Section 210.61 of the regulations prohibits retaliatory actions where that can be shown.

4. As to whether I foresee the possibility of most major oil company service stations being owned and operated by the corporation, the answer is an unequivocal no, because it would not be tolerated.

5. Regarding the action FEA will take to prevent independent major oil company franchises from being eliminated completely, I believe that this was already covered under the answer to question number 3, that we are protecting them under the allocation regulations.

6. Regarding oil companies that have directed their member stations to sell only the company's products, I believe that the courts have already ruled that this is not allowable. The FEA also takes the position that the member stations cannot be forced to limit their product lines to the company's brands as a condition of continued supply of allocated products.

7. On the course of government action giving the independent operator freedom to sell whatever auto parts he wants; it would seem the independent operator has recourse to the government to prevent unlawful directed buying. Agencies such as the FEA should take every opportunity to be sure these operators are aware of their rights and make every effort to enforce regulations which protect the independents and the best interests of consumers.

I hope that these answers are helpful.

Sincerely,

JOHN G. SAWHILL,
Administrator.

Mr. SAWHILL. On that one question, we are currently surveying the companies to find out the answer to it, so we will have an answer to it.

Chairman HUMPHREY. This, as you know, has been a matter of great concern.

Mr. SAWHILL. Yes, sir. Well I do appreciate this opportunity to have had this dialog this morning, and also to have had the dialog with Mr. Peterson and Mr. Dryer. It was very helpful to me.

Thank you.

Chairman HUMPHREY. Thank you. Mr. Sawhill, thank you very much.

Gentlemen, there is a vote now in the Senate, and we will recess here for a very few minutes and I shall be right back. If you will be kind enough to take it easy, I will be right back.

[A short recess was taken.]

Chairman HUMPHREY. The subcommittee will be in order.

All right, gentlemen, I am sorry that I kept you waiting, but we had two rollcalls down there.

Mr. PETERSON. Mr. Chairman, I congratulate you on your rapid return. I don't know how you did it that quickly. You must be lighter of step than I.

Chairman HUMPHREY. Yes, sir, I guess I am lighter of step.

Now we go on with Mr. Peterson. Mr. Peterson, you have a statement that you want to read for the record. We may have some questions of you in light of the discussion this morning.

Mr. PETERSON. I would invite you to interject questions, as far as I am concerned, at any time, Senator.

INDEPENDENTS HAVE GAS TO SELL BUT CAN'T SELL IT

I would like to make an observation on what has been stated so far in this hearing. It just seems to me that the flow of conversation might lead to a belief that the problem of market share for the independents, and indeed competition within the industry, will be solved by the return of an adequate supply. This is not the case. We, as an example, at the present time have, for the first time in our lives, had to borrow money. We have a $2,000 a day inventory interest expense because we have so much gasoline we don't know what to do with it. We can't sell it.

It is not a question of supply, it is a question of price. We have been priced out, and we cannot, so far, get the FEO to recognize that an economic shortage is the same kind of a shortage as a physical shortage. The only difference is that when we had empty tanks, we didn't have an interest expense.

So we would almost welcome the empty tanks in contrast to our present position, except, however, that then we would destroy our relationship with our supplier.

The statement was made by Mr. Sawhill that the independents were underselling the majors in Wisconsin. He picked out a very unique place. I inquired of the independents who were with me if they happened to be at 50 cents, 51 cents, or 52 cents, and I think you were. Would you like to respond to this, Mr. Holdgraf?

Chairman HUMPHREY. Sir, will you please identify yourself for the record.

TESTIMONY OF M. B. HOLDGRAF, EXECUTIVE VICE PRESIDENT, HUDSON OIL CO., KANSAS CITY, KANS., ACCOMPANIED BY ROBERT NUNN, COUNSEL, WASHINGTON, D.C.

Mr. HOLDGRAF. Yes, Mr. Chairman, my name is Maurice B. Holdgraf.

Chairman HUMPHREY. And you are from where?

INDEPENDENTS' MARGINS

Mr. HOLDGRAF. Hudson Oil Company, Kansas City, Kans. We market in Wisconsin and also in Minnesota and actually, in 36 States.

Now we indeed are pricing at 51.9 in Wisconsin. The reason being that up until the 10th of this month, which was Monday, we were at our legal limit. We were sitting 3 cents to 5 cents above our competition in 35 to 36 States. On Monday we reduced our prices, and are now operating a little under 5-cents-a-gallon margin in Wisconsin, and that is done to move our allocation. We are on less than 5-cents-a-gallon margin, and that is to move our allocation, Senator.

That is why that price is 51.9. We are not on a 10-cent margin or 9-cent margin. We are on less than 5 cents.

Chairman HUMPHREY. That is gross margin?

Mr. HOLDGRAF. Yes, sir. Operating on about 3 cents.

Chairman HUMPHREY. You were with Shell Oil Co. for——

Mr. HOLDGRAF. Thirty years. Yes, sir, I was marketing vice president of the United States.

Chairman HUMPHREY. For 30 years?

Mr. HOLDGRAF. Yes, sir, and I have now been going on 4 years with the Hudson Oil Co.

Chairman HUMPHREY. Tell me, in light of what Mr. Peterson has just said, what has caused this sudden increase in the supply of gasoline to which you referred?

Mr. HOLDGRAF. Well, I believe, at this point in time, it is a combination of, one, conservation and two, a lifting of the embargo and the importation of high-priced crude. Consequently, we are in the same position as my associate here, Mr. Peterson.

In Kansas City we are paying 50 cents a gallon delivered into our tanks, including tax, and the retail market is 49.9 cents.

Chairman HUMPHREY. What?

Mr. HOLDGRAF. The market is 49.9 and we are buying from the same people that he buys from.

Chairman HUMPHREY. And you are paying 50 cents?

Mr. HOLDGRAF. Yes, sir. You know, the 11-cent margin is only on the paper.

Chairman HUMPHREY. This is what disturbs me about these hearings, and these discussions we have with Government officials. The margin is theoretical?

Mr. HOLDGRAF. Yes, sir.

Chairman HUMPHREY. It isn't a practical economic fact?

Mr. HOLDGRAF. For the independent that is correct, yes, sir. It is indeed true that there has been a 3-cent increase by the FEO, but that is only if the market price will support it. We have sat for 10 days at 3 cents to 5 cents over the major competition in 35 to 36 States.

Chairman HUMPHREY. Now the majors, how is their margin? What would you estimate their margin is?

Mr. HOLDGRAF. I would imagine the dealer margin is probably a gross margin of somewhere to around 10 cents to 11 cents, possibly up to 13 cents.

Chairman HUMPHREY. That is because they can buy their refined product cheaper?

Mr. HOLDGRAF. Yes, sir; and I am not at all sympathetic with the idea that the major oil companies are hurt by having to buy foreign crude. They have a tremendous system of billions of gallons of gasoline sold and they are able to take that foreign crude and splice it through their entire system where it only adds a very fractional increase to their cost because of their wide distribution and enormous volumes involved.

Chairman HUMPHREY. I see, Because of the volume?

Mr. HOLDGRAF. Absolutely correct. Yes, sir; billions of gallons.

Chairman HUMPHREY. Now, you heard the discussion this morning that relates to the pricing system that relates to the refiners?

Mr. HOLDGRAF. Yes, sir.

Chairman HUMPHREY. Would you like to make any comment along that line? I heard what Mr. Peterson had to say and also what Mr. Sawhill had to say. Mr. Sawhill's proposal was sort of a bailout of those that they listed as casualties or hardship cases.

Mr. HOLDGRAF. Yes, sir. Well, I am thinking of 23 suppliers in the United States—and that is more than 15, and my prices were 3 cents to 5 cents over competition until the 10th of the month, except in the State of Florida. And I had 23 suppliers with no reduction in cost whatsoever. Actually, in June we got increases again in our cost of gasoline. And we buy historically from independent refiners, Marathon, Ashland, Triangle, Tenneco, La Gloria, Empire, Oil Transit, Derby, Northwestern—up in your State—and the like. So we are the recipients of this two- or three-tier crude, if you like. We and our suppliers are getting the heavy end of the crude, the price. And consequently, we have to pass it on.

And I have a strong feeling why the FEO finds certain suppliers with gasoline being folded up, and that is probably because they can't sell it any more than we can sell it, and their gasoline is beginning to back up on them, and that is why the gasoline is available.

Chairman HUMPHREY. I heard that it is beginning to back up, so to speak, in the tanks and pipelines.

Mr. HOLDGRAF. But there must come a day when there has to be crude cost equalization. Now we are willing to take on anybody on the competitive basis of equitable pricing, not equal but equitable. I am not worried about that, but it has to be pretty near. We will let our efficiency stand up against anyone in the Nation.

Our company was known historically for 40 years as the most price conscious company in this industry, in the country.

Chairman HUMPHREY. That is Hudson?

Mr. HOLDGRAF. Yes, sir; and that is not the case today.

Chairman HUMPHREY. And you are a marketer?

Mr. HOLDGRAF. Yes, sir.

Chairman HUMPHREY. Not a refinery?

Mr. HOLDGRAF. That is correct. We are only a marketer. Strictly gasoline. We buy from the refiner. We have no vested right at all in crude oil or refining. We are independent, not integrated.

Chairman HUMPHREY. Mr. Dunlop of the Cost of Living Council said that the 1974 average volume was less than 7 cents—I should say average margin was less than 7 cents.

Mr. HOLDGRAF. That is correct.

Chairman HUMPHREY. Now it is about 10 to 11 cents?

Mr. HOLDGRAF. Yes, sir; that is the theoretical level.

Chairman HUMPHREY. The theoretical level?

Mr. HOLDGRAF. Yes, sir.

Chairman HUMPHREY. So, for your kind of operation, that markup is not a reality?

Mr. HOLDGRAF. No, sir.

Chairman HUMPHREY. In fact, you are operating at a slight loss?

Mr. HOLDGRAF. That is correct. Well, actually I will use a round figure for operating costs of 3 cents.

Chairman HUMPHREY. I see.

Mr. HOLDGRAF. And so, across the Nation, we are probably under, somewhere under 6 cents.

Chairman HUMPHREY. Would you say that the majors where they own stations, to use a simple phrase, are getting fat?

Mr. HOLDGRAF. There is no question about it. Independents, such as myself, Mr. Peterson, and others in the Nation, lost 30 percent of our volumes last year. That is 30 percent of our 1972 base period shares.

Chairman HUMPHREY. Now, why doesn't Mr. Sawhill's group know this?

Mr. HOLDGRAF. I don't know why. I think they do know. It is very obvious that our type of operation lost 30 percent of the volume against the base period of 1972.

My own company lost more than that.

ALLOCATION ACT NOT BEING ENFORCED—INDEPENDENTS LOSING THEIR SHARE OF THE MARKET

Chairman HUMPHREY. That means that the provision of the Allocation Act—namely, the provision is to preserve the relation of the independent operator and see that he does not lose out in the market picture—that part of the law is not being enforced?

Mr. HOLDGRAF. It is not being enforced. Now again, to get back to the argument of the independents, sure, most of the major oil companies have an "independent" arm. Mobil has one, Exxon has one, Shell has one; right. You go all through the Nation, and they have cutrate stations which are their own company-operated operations, plus they have their own dealer operation. But there is no such thing, Mr. Chairman, as an independent dealer associated with a major oil company. Believe me, there isn't.

Chairman HUMPHREY. That is the point that Mr. Peterson or Mr. Dryer or one of the others was making here, that you need a true definition of an independent.

Mr. HOLDGRAF. Yes, sir. And the person who leases a station from a major oil company is a "captive" of that oil company.

And there is no such thing, Mr. Chairman, and never in the history of the oil companies has there ever been a surplus of gasoline. Those were economic premeditated decisions to manufacture and sell that gasoline. There was no such thing as "excess" or "surplus" or "spot" buying. Our company has never had a piece of paper indicating "spot" buying, and we have bought from certain refiners for 40 years and 20 years and 10 years. I don't consider that "spot" buying.

Chairman HUMPHREY. And you know a bit about this?

Mr. HOLDGRAF. Yes, sir, I have some insight.

Chairman HUMPHREY. You were with a big oil company?

Mr. HOLDGRAF. Yes, sir, for 30 years.

Chairman HUMPHREY. Is it true that these inventories that are being built up now at rather high prices, that you might very well get caught with some softening of price?

Mr. HOLDGRAF. I am not sure that will happen. I think the industry knows very well how to manage this thing, as they did starting with 1972. It just happens to be maybe a coincidence now, but the major oil companies are now in a process of turning around the refineries.

Chairman HUMPHREY. Turning around what?

Mr. HOLDGRAF. Refineries, which means they can't produce gasoline. This is a way of pulling down inventories.

Chairman HUMPHREY. I see.

Mr. HOLDGRAF. This is the way of pulling them down, and it will happen again, as it happened in the fall. This freak they contend was a price crisis in the fall or summer of 1973 did not exist. It existed because in the first half of 1972 they were running less than they were running in 1971. They tore up their inventories. They disengaged themselves from it all over the country.

Some pulled out of the Midwest; Gulf pulled out of the Midwest; Citgo pulled out of the Midwest; and Phillips pulled out of the Northwest; Amoco pulled out of the west coast; Exxon reduced its operation there, and so on.

WITHOUT THE ALLOCATION ACT, INDEPENDENTS WOULD GO BROKE

Therefore, they drew themselves back to their areas of competitive strength, and there they sit. And we would not be here today, Mr. Chairman, if it wasn't for the Allocation Act. We would just be broke. If it goes off the record, we will be broke.

Chairman HUMPHREY. That was my judgment. As much as I don't like all of these rules and regulations——

Mr. HOLDGRAF. And we agree.

Chairman HUMPHREY. It is sort of like a fellow with disabilities. As much as you don't like the disabilities, if you get something that will help you a little bit, it is better than not having any help at all.

Mr. HOLDGRAF. That is correct, Mr. Chairman, there has never been to my knowledge competition in the marketplace among major oil companies. Never. There is no such thing as competition. The only competition that has ever entered into the marketplace was the result of the efficiency of the operating practices of the independents.

Chairman HUMPHREY. That is our judgment.

Mr. HOLDGRAF. There is no question about it. I defy anyone to examine the books of all the major oil companies. See if they don't parallel almost. Let's say it is coincidence.

Chairman HUMPHREY. How many years were you marketing manager?

Mr. HOLDGRAF. I was marketing vice president of the United States.

Chairman HUMPHREY. For Shell?

Mr. HOLDGRAF. For Shell Oil Co.

Chairman HUMPHREY. Well, if you don't know what is going on, then nobody does.

Mr. HOLDGRAF. Well, I have some insight, I think, sir.

Chairman HUMPHREY. All right. I really appreciate this very much. I wish to goodness that we had more people listening. But when we try to summarize this testimony for our colleagues, they will listen. But the important thing I want to say to you is you need to be in touch with your Members of Congress.

Mr. HOLDGRAF. We are doing that the best we can.

Chairman HUMPHREY. The individuals. Because there is going to be a scrap over this allocation program.

EXTENDING THE LIFE OF THE ALLOCATION ACT

I asked questions this morning of Mr. Sawhill about the Allocation Act because it expires in February. The Federal Energy Office expires June 30 of 1976. It seems to me that we at least ought to extend the Allocation Act.

Mr. HOLDGRAF. Yes.

Chairman HUMPHREY. You know, we ought to extend it temporarily on the basis of the expiration date of the Federal Energy Office so that they go together.

Mr. HOLDGRAF. Right, I agree. We support that completely.

Chairman HUMPHREY. Even though there may be some changes needed in that law. We can devise those out of hearings.

Mr. HOLDGRAF. Yes.

Chairman HUMPHREY. Senator McIntyre of New Hampshire and myself have been considering an extension. In fact, I have right here, a bill to amend the Emergency Petrolum Allocation Act of 1973 by striking out February 28, 1975, wherever it occurs and inserting in lieu thereof June 30, 1976.

Mr. PETERSON. We support that.

Mr. HOLDGRAF. We support that.

Chairman HUMPHREY. That would extend the Emergency Petroleum Act to June 30, 1976, which is at the same time for the expiration of the Federal Energy Administration. So it would be coterminous with the Federal Energy Administration.

Do you feel that that would be a desirable move?

Mr. HOLDGRAF. Yes, sir.

Chairman HUMPHREY. Is that the general view of the independents?

Mr. HOLDGRAF. Yes; Mr. Peterson, of course, represents our council.

Mr. PETERSON. That is a totally accepted view with no dissenters ever registered to my knowledge. My reason for concern about the volume available, Senator, is that I do not believe that the expiration of the act should be based on available supplies. Unless equitable distribution is coupled with those available supplies, the independent is not going to survive.

We may criticize the act, but it is the only thing that has allowed us to be here.

Chairman HUMPHREY. And one of the things that we have been driving for out of this subcommittee, gentlemen, is closer cooperation between the Federal Energy Office and the independents, like you suggested today, Mr. Peterson, that there be a committee that works with Mr. Sawhill really to define the independent and make it clear what this is all about.

Mr. PETERSON. We have an advisory committee that was appointed some time back. I have attended every one of those meetings. At the last meeting we had, at that time, I was advised that FEO officials had been asked a question: How soon can we get this committee dissolved and eliminated?

We will do all that we can to give currently available data to the FEA.

Chairman HUMPHREY. Well, I want to make a suggestion to you with reference to Members of Congress. Your groups and you as individuals ought to address personal letters to every single Member of the Congress.

Mr. PETERSON. Yes.

Chairman HUMPHREY. Letters relating to the importance of this allocation program and its extension, because if you don't, I think the move is underway now to phase it out.

Mr. PETERSON. We agree, and we need your help in this area desperately.

Chairman HUMPHREY. And any premature phasing out would be terrible, would work a terrible hardship on the independent.

Mr. PETERSON. And I hope that somebody is able to field the question of volume as related to the need for continuing the act, because volume alone is not the answer, as to whether or not the independent survives.

Chairman HUMPHREY. You can survive?

Mr. PETERSON. We have survived. That is right.

Chairman HUMPHREY. I think that is indicated by what you are pointing out here.

Mr. PETERSON. Correct.

Chairman HUMPHREY. And what the real true margins are.

Mr. HOLDGRAF. Mr. Chairman, one of the basic problems when we are confronted with this surplus gasoline or additional supplies or adequate supply, is that the major oil companies control 93 percent of all of the stations in the United States. The independents have 7 percent. So you can have adequate supply served through 90 percent of all the stations in the United States, which are majors. The independents, we only have 7 percent. So we have a disproportionate share of the market because we have had something to offer the consumer and we grew disproportionately because we did have something to offer.

Now I am very certain that a lot of people would like to see the 7 percent of the stations disappear, but they do give competition, and the customers then would not be served if they are done away with.

Chairman HUMPHREY. We know that we have had a terrible casualty list of independents.

Mr. HOLDGRAF. I am very well aware of this.

Mr. PETERSON. Our source of supply is primarily in your State, Senator, and we are viewing with a lot of concern what the refineries' position is. We meet with them and we have been willing to go along with them even on these terribly high prices that they are obliged to charge. We can't quarrel with them in their prices to us. We don't have any quarrel with that, but we can't sell it.

Chairman HUMPHREY. Well, I talked to their refinery people from my part of the country here just the other day and that is why I was putting some of these questions here. It is perfectly obvious that their costs are very high, and they are having to buy high-priced crude. We have to get most of our crude now, as you know, from Canada. And our refineries just can't compete, and they are going to have to force you, as retailers or jobbers or marketers or whatever you are calling yourselves, to buy at a higher price and that cuts your margin out and you just can't make it.

Mr. PETERSON. That is correct. We are glad to see you sympathetic to that because we are concerned about it.

Chairman HUMPHREY. Do you want to go down your statement here, Mr. Peterson?

Mr. PETERSON. I think, if it is all right with you, Senator—have you read the statement yourself?

Chairman HUMPHREY. Yes; we have gone over it and marked it up here pretty well.

Mr. PETERSON. You have taken a great deal of time with us, and in a way that I think has been very helpful to not only this subcommittee but also to the leadership of the FEO. If you have no objection, I will simply file my statement with you.

Chairman HUMPHREY. Yes; I want to have you do that, and I would suggest you might want to get the list of the entire committee and send a copy of this to each member.

Mr. PETERSON. We have that list, and we will do that.

Chairman HUMPHREY. Just making note that you regret that they were not in attendance and that you understand their problem, but that you do want to bring to their attention certain facts. I think that would be helpful.

We will be obviously summarizing this for our membership too, but it is obviously a little more impressive when it comes from our witnesses.

Mr. PETERSON. One thing I would like to point out is that the facts in my statement are current facts. They show the trend. But, the trend is getting so much more acute for us as each month rolls by. Sixty days in one's lifetime isn't very long, but 60 or 65 days with no survival kit is a long time.

Chairman HUMPHREY. You bet it is.

Mr. PETERSON. I would hope the FEA could get moving quicker than that.

Chairman HUMPHREY. We are going to keep on their backs. That is why I asked them questions this morning about the time period, because 60 days of high-interest charges on inventory can just rub a lot of people out and maybe some people can take it, but you haven't even any assurance that you are going to be better off after the 60 days.

Mr. PETERSON. That is right.

Chairman HUMPHREY. I notice here you said that the market share of the nonbranded independent is rapidly approaching 75 percent of what it should be.

Now what do you mean by that?

Mr. PETERSON. Gasoline sales volume relative to 1972 for the Nation as a whole, on the FEA's own number, is over 101 percent. We in 1972 had an even 100 percent. The average of the independents now shows that we are rapidly going toward 75 percent.

Chairman HUMPHREY. So what you are saying is that you are losing out?

Mr. PETERSON. The majors are holding their shares and we are losing ours.

Chairman HUMPHREY. The majors are holding their shares and you are dropping?

Mr. PETERSON. Right. Obviously the majors are surviving on better than 101 percent. In addition to which the information that Mr. Sawhill declined to give us is: What is the base period gallonage? Because the major oil companies, indeed any company, has some privileges which placed their base period allocations on the high side for 1972. As an example, I know of one major company that selected the 2 largest months out of the year as the base period and then their customers could select. Either the average of those 2 months for the total 12 months could be selected or they could use their 1972, which-ever they chose. So you see they could have a 20 percent start, a lead to begin with, because of the months of volume in a service station, say from February to December, you know.

Chairman HUMPHREY. On your suggestion here that the FEO should adopt a system of allocating so-called old domestic crude oil so that the weighted average cost of all refinery feed stocks may be approximately equalized throughout the refining segment of the industry, well, that is a matter to which we directed our attention this morning.

Mr. PETERSON. I think that route to me, to my view, is good. And the FEA has developed, out of their own group, what they call a crude oil entitlement program. I think that that position would allow everybody to share the shortage of products both financially and volumewise. I would support that.

PRICE IS IMPORTANT NOW

Chairman HUMPHREY. Yes, I think the point that you made here that the FEO should realize the inherent relationship between price and supply is the crux of the problem.

Mr. PETERSON. Correct.

Chairman HUMPHREY. As it is now.

Mr. PETERSON. Correct.

Chairman HUMPHREY. A few months ago it was strictly supply.

Mr. PETERSON. Correct.

Chairman HUMPHREY. But now it is obviously price and supply.

Mr. PETERSON. Our company, our own company, happens to be in the terminal business. We have five terminals in the Midwest, and we have been suffering this economic shortage since the imposition of the oil import program. And one of our problems has been that we don't have a free market for crude oil, as I am sure you know.

Chairman HUMPHREY. That is right.

Mr. PETERSON. It is either owned or controlled basically by the integrated companies, by the few integrated companies.

Chairman HUMPHREY. You also propose, and I want to make this a special reference in our record, that the Emergency Petroleum Allocation Act specifically require the FEO to calculate the market share of nonbranded independent marketers as a class, to protect such marketers, and to report to Congress on any changes in their status, nationally or regionally.

And of course this has not been done.

Mr. PETERSON. Indeed, Mr. Sawhill is correct, they don't have the correct data. They have been relying on it and we have been suffering because of that reliance, but they do not have the correct data, and I appreciate their problem of trying to accumulate it.

Chairman HUMPHREY. Yes, it is difficult, and I recognize that, but in the meantime there is an awful lot of misery that is taking place.

Mr. PETERSON. Right.

Chairman HUMPHREY. Thank you very much; your prepared statement will be included in our hearing record. It is jampacked with solid information, for which we are very grateful, and I believe we covered most all of the points that you have raised in here in our discussion this morning with Mr. Sawhill.

Mr. NUNN. Mr. Chairman, there is a supplemental statement relating to very recent pricing data which gives a comparison between the nonbranded independent markets and their pricing costs and the costs of the integrated companies, and so on.

PRODUCT COSTS FOR MAJORS UP 53 PERCENT, FOR INDEPENDENTS UP 109 PERCENT

Chairman HUMPHREY. Very good; I will just read it in so we can make sure we have it. It reads:

Mr. Chairman, may I divert just a moment from my statement to inform the subcommittee that major brand dealers cost of product is represented by dealer tankwagon prices. These prices are posted for 55 major city market areas across the country. Taking an average of these figures for the first quarter of 1972, major brand dealers during that period of time paid 17.64 cents per gallon for regular gasoline. Since then the Platt postings have risen to an average of 27.11 cents per gallon during the first quarter of 1974, thus product costs to major brand dealers across the country have risen only about 53 percent, whereas our costs have risen over 109. Moreover, in April a comparison of dealer tankwagon prices in 1972 with the same prices in 1974 shows that the prices rose from 17.2 cents per gallon to 29.7 cents per gallon. This is an increase of only 72 percent whereas the increase to the nonbranded independent marketer is over 135 percent.

Those are very startling and convincing figures. That is the crux of the problem.

Mr. PETERSON. That is the problem.

Mr. HOLDGRAF. Precisely.

Mr. PETERSON. That is a problem you grasped very quickly and we have not so far been able to communicate to the FEA.

Chairman HUMPHREY. I think that we will want to make sure that goes over to the FEA office. We will send that on over to Mr. Sawhill.

Mr. PETERSON. We are prepared to back those statements up with good factual background.

Chairman HUMPHREY. All right. Now, Mr. Dryer, do you have any further testimony you want to say?

Mr. DRYER. Mr. Chairman, I think your arrangement for the colloquy this morning was very helpful to all concerned and most of the points I had were covered in it, and I would like to submit my statement as prepared with two corrections: In the paragraph beginning, "How severe" next to the last line, where I give a series of percentages, there was inadvertently omitted a 95 percent figure, which happens to apply to refiners in your part of the world.

Chairman HUMPHREY. Is that where you have "They have inputs of high-priced oil"?

Mr. DRYER. Yes, sir, and I would like to include the figure of 95 percent.

Chairman HUMPHREY. Whereabouts?

Mr. DRYER. Just before the term "87.5 percent".

Chairman HUMPHREY. So it will say, "such percentages as 95 percent"?

Mr. DRYER. Right, sir.

Chairman HUMPHREY. And then the next figure would be 87.5 percent and so on?

Mr. DRYER. Right.

Chairman HUMPHREY. I've got a question on that that the staff brought to my attention. Do these figures in this same paragraph of your prepared statement, the one giving percentages of high-priced crude oil being used by independent refiners include those inputs consisting of imports? If so, wouldn't the comparable national figure, as stated at the end of that same paragraph, be considerably higher than 29 percent?

Mr. DRYER. Most of our refiners actually use domestic oil, domestic or Canadian, but overall it is mostly domestic oil. And the difference is essentially between domestic old oil, which is price controlled, and uncontrolled domestic oil.

Chairman HUMPHREY. Where you have the Canadian oil—you do have a considerable higher figure?

Mr. DRYER. That is right.

Chairman HUMPHREY. Our people in the Northern Tier would think that that national average would be considerably higher than 29 percent. As far as they are concerned, it isn't a national average, it is an average for them that is considerably higher.

Mr. DRYER. Yes, the average for them is considerably higher than 29 percent.

Chairman HUMPHREY. It is sort of like out when I am talking to my farm folks—and I am going out there tomorrow—and I give them what the Wall Street Journal says are the market prices from Chicago. And an old fellow named Orville Dagusnus came up to me and said: "Humphrey, well, they don't know anything about hogs in the Wall Street Journal." And I said: "Well, what do you mean?" And he said: "Well, those figures you quote aren't accurate. Let me show what I really get for my hogs when I take them into South St. Paul." He said: "That is where I sell my hogs. I don't sell my hogs in Chicago. I live in Winthrop."

You know, these general figures, they are all right for studying the economics, but they are not very good for running the business. I think that is about it——

Mr. DRYER. There is one other correction I would make, Senator, and that is at the end of my prepared statement in which I show the most single and most pressing item on which congressional action is needed, and that being the extension of the allocation authority. It is possible that that could be construed to be the single most pressing problem period. That is not the case. The emphasis in that term is the single most pressing item on which congressional action is needed. We do have an immediate and most pressing problem, which is within FEO authority, and that is this cost equalization.

I think my formal statement should have added to it: "There is one problem even more immediate and pressing than that, but it does not require congressional action, unless FEO continues to drag its feet, and that problem is cost equalization, to eliminate the competitive disadvantage which independents suffer today."

Chairman HUMPHREY. Without objection, the prepared statements of Mr. Dryer and Mr. Peterson will be placed in the record at this point.

[The prepared statements of Mr. Dryer and Mr. Peterson follow:]

PREPARED STATEMENT OF EDWIN JASON DRYER

My name is Edwin Jason Dryer and I appear as General Counsel and Executive Secretary of the Independent Refiners Association of America. We have had meetings of our membership several times in the last two months to discuss the problems faced by independent refiners and marketers and our testimony today reflects the views expressed and conclusions reached in those meetings. Unfortunately, the timing is such that we could not have the President of our Association or other key officials present for the hearing today. We shall, however, obtain for your use any information which is not presently available, and about which they might have testified directly.

We very much appreciate your concern about the plight of the independent refiner and marketer, as evidenced by these hearings and the topics to which these hearings are addressed. We hope that the discussion of these problems will lead to some solutions by the Congress and the Executive Branch.

At the outset we would like to express some general comments about the subjects for which these hearings were convened—and then we will list a number of specific items which require either Executive or Congressional action, or both, to insure that the basic objectives of the Emergency Petroleum Allocation Act of 1973—to preserve the independents—are fulfilled.

ALLOCATIONS MUST BE CONTINUED

We believe that the survival of the independent refiner and the independent marketer has depended, and will depend for some time yet, upon government action to allocate crude oil and petroleum products. We said this a year ago—before the Arab embargo. We said it then because shortages of domestic crude oil were forcing independent refiners to operate way below the levels of their major oil company competitors. And the independent marketers supplied by us suffered accordingly—in addition to cutbacks in their supply from major oil companies.

The Arab embargo intensified the situation and put pressure behind the enactment of the Emergency Petroleum Allocation Act of 1973. That Act then led to the existing system of allocations. That system has worked generally, with some notable exceptions which we discuss below, to provide the independent refiner and marketer with crude oil and product which, without such allocations, they would surely have been denied.

Because we had a problem even before the Arab embargo, we are very much concerned when we hear, now that the Arab embargo is over, that FEO specifically plans to phase out the crude oil allocation program between now and next February. A formal statement to this effect appeared in the announcement of the current allocation program by FEO on May 14th. It was subsequently confirmed by FEO Administrator Sawhill in testimony before the Senate Interior Committee on May 29, when he advised that the President, on the previous weekend, had directed him to effect a phase-out of all the allocation programs.

While it is true that the affirmative Congressional mandate *for* allocations expires next February, it does not follow that Congress has mandated *against* allocations after that date. Accordingly we believe that the present actions by the President and Mr. Sawhill give clear evidence of an over-zealous desire on their part *to terminate these allocation programs by that date irrespective of the impact upon the independents*. You can be sure that if the President and Mr. Sawhill wanted an extension of allocations beyond February 1975, they wouldn't be talking and acting in this way; they would be up here seeking an extension of the allocation authority. But apparently with the big embargo-related problems faced by the major oil companies temporarily over, the President and Mr. Sawhill aren't really concerned about the impact of remaining shortages upon the independent refiner and marketer.

In sum, we need to have allocations continued beyond February 1975 in order to assure a fair share of limited supplies of crude oil and products for the independent refiners and marketers. We need Congressional action thus to extend the Emergency Petroleum Allocation Act of 1973 and we need a Federal Energy Office which will administer these allocations with zeal, rather than reluctance and timidity.

THE GROSS DISPARITY IN FEEDSTOCK COSTS

On the price control front, we have additional problems. We can understand the national concerns which have led to price controls on petroleum and, in particular, to the two-tier system of price controls where the price of some oil is controlled and the price of other oil is exempt. But this system has had a devastating impact upon independent refiners and marketers for they have ended up buying disproportionately more of the high-priced, price-exempt oil and disproportionately less of the low-priced, price-controlled oil. This is true for crude oil acquired by independent refiners and it is true for independent marketers insofar as they must purchase their petroleum products from independent refiners operating with that cost disadvantage (in addition to the price disparities which the independent marketers suffer who buy products from abroad).

How severe is this problem? Member after member of our Association has reported to us the high prices for price-exempt crude oil in his area—$10 to $12 per barrel or more for price-exempt oil versus about $5.00 for price-controlled oil. Our members have also reported the very high percentages of their inputs represented by such high-priced oil. They have inputs of high-priced oil in such percentages as 95%, 87.5%, 63%, 59%, 52%, 51% and 50%, to quote some actual examples. Compare these figures with the FEO announced national average of 29% of all domestic oil as price-exempt.

There is a solution to this problem. Several mechanisms have been designed which would equalize feedstock costs for all refiners and which would thus eliminate existing competitive inequalities and permit the independent refiner to price his products competitively. These mechanisms would also, of course, end the present price discrimination suffered by those independent marketers historically supplied by independent refiners. While several schemes have been designed, the important thing is that no such mechanism has been adopted yet. There should be no further delay in solving this important problem which is so readily solvable.

THE INDEPENDENTS' LOSS OF MARKET POSITION

Finally by way of general comment, we wish to say a word about the independents' market share and the extent to which the independents are losing market position. As a result of their disproportionately high feedstock costs, our independent refiners have a theoretical lawful price level for their products which is often 5¢, 10¢ or even more above the price level of the majors. How can the independent refiner stay in business charging such prices? The answer is simple: he cannot. And he can't stay in business by absorbing these costs, either. That's why we say the independent's lawful price is theoretical.

The only situation in which the independent could, in fact, charge more than his major company competitor is in a very tight supply situation such as we experienced this past winter. Even then, it should be emphasized, there was some significant loss by the independents. Now, with supplies in somewhat better balance, albeit still short, our independent refiners advise us that they cannot possibly realize the lawful prices which would recover their costs. They advise us that, if some action is not taken to equalize their costs, the shutdown of retail outlets must accelerate and indeed refining plants too will be forced to close down. The fact that these independents could at times charge more in last winter's shortage situation should not lead to false conclusions on this important issue. And it is too soon at this date to measure the full extent of shutdowns which will occur if these gross disparities in price between the majors and the independents continue.

There is a further dimension to this problem of price disparity. While some independent refiners and marketers were able to recover their higher costs by higher prices during the extreme shortages of last winter, they have probably done so with serious long-term harm to their market position. The customer who was accustomed to an independent's competitive price and was then forced to pay 15¢ to 20¢ per gallon more than the major's during the acute shortage now has a very bad image of his independent supplier. Although these higher prices were no fault of the independent and merely served to recover out-of-pocket higher costs, the customer feels abused and angry. This long-term harm to the independent is beyond measurement at this time—but our members all agree that it is serious.

Against this background we would like to list a number of specific instances where changes and improvements in the Federal allocation and price control programs are needed—needed to avoid harm to independent refiners and marketers and instead to help them, as contemplated by the Emergency Petroleum Allocation Act of 1973.

1. Allocation program extension.

First and foremost is the need to look beyond February 1975 and recognize that allocations will be necessary after that date. Both the Congress and the Federal Energy Office should plan and act accordingly. Having discussed this in our preliminary remarks, we need not elaborate further here.

2. Need for feedstock cost equalization.

Also in our opening remarks we pointed to this critically important matter. We merely refer to it here as the second item in our agenda for FEO and, where appropriate, Congressional action.

3. Definite allocations for refinery expansions.

FEO's present crude oil allocation program does include an appropriate provision for crude oil for new or expanded refinery capacity. Also, from time to time official statements are made indicating the Administration's concern for incentives for such construction and for an independent refiner role in such construction. We are disturbed, however, about some underlying reluctance on the part of FEO to move forward vigorously and affirmatively along these lines. We have found repeatedly, for example, that rules as initially proposed did not recognize or take care of new or expanded capacity. In talking with some FEO officials, it appears that the absence of provision for expansions in the proposed rules has been more than mere oversight; it represents rather some disinclination to do anything more for the independent refiner than the minimum required by the statute (and the statute unfortunately sets a minimum measured by 1972 operating rates). While this was corrected in the rules as ultimately issued in respect to construction which was substantially completed by May 1, 1974, there is a big question about future refining capacity. FEO, itself, raised the question, pointing out that the Allocation Act extends only through February 28, 1975 and there could be no assurance beyond that date. Clearly, a long-term Federal policy and a long-term program are needed, if the visions about an independent refiner role in future expansion are to become a reality.

4. FEO allocation actions should be more vigorous and effective.

A great deal of careful planning went into the allocation rules. They are designed to accomplish a fair sharing of crude oil and petroleum products by those engaged in their manufacture and distribution. But, in actual implementation, all too often there is doubt, hesitation and timidity. We were shocked, for example, to have the view expressed to us that FEO would not issue directives unless they had previously determined that the company to whom the directives was addressed would willingly comply with it!

The net result of such timid use of FEO's statutory authority has been a failure to achieve the fair sharing which the statute expects. In one case, for example, an independent refiner who is a net purchaser of gasoline, has enough gasoline to meet less than 50% of his customers' approved requirements—compared with percentages near 100% for that company's major company competitors. Simply put, FEO was impotent! We expect that the independent marketers will cite many similar situations to you.

5. Natural gasoline should be brought under effective control.

The handling of natural gasoline by FEO since mid-January is an administrative disgrace. The express will of the Federal Energy Office, both as to policy and law and consistently since January 15, 1974, has been effectively thwarted by persons not desiring the allocation of natural gasoline. The various roadblocks to effecting control of this commodity were overcome, we thought, by mid-March when we received formal confirmation of that fact from Duke Ligon of FEO. Indeed, a proposed rule, published on March 29, would, when promulgated, have solved the problem. Instead, however, we find that the promulgation on May 6, 1974 omitted the proposed language. And in another proposal published on May 21, 1974 we found a most astounding declaration from FEO:

"The proposed Subpart E, however, reflects FEO's view that it does have authority to allocate natural gasoline. Notwithstanding this fact FEO invites comments as to whether the allocation of natural gasoline is within the scope of FEO's jurisdiction."

In our view, it is up to the Government agency concerned to construe its own jurisdiction under the applicable statute—subject in turn to review by the courts. In our view, this is merely another stall after four months of stalling. We wonder: what will be the next excuse?

6. Eliminate retroactive price increases.

One absurdity in the present price program is that it not only permits, but gives an excuse for retroactive price increases by crude oil suppliers. Independent refiners are being presented with invoices for millions of dollars in crude oil costs going back three and four months—long after the crude oil has been processed and the refined products sold. A major FEO official concerned with price policies agrees with us that action can be taken simply and he said that action would be taken soon—but no action has been taken yet, six weeks later.

7. There should be an immediate recovery of known cost increases.

Present rules permit the recovery or pass-through of a refiner's feedstock cost increases experienced up to the "month of measurement" which is the *preceding* month. This has the justification that the increased price is deferred until the increased costs are known. But the reasoning behind this rule simply does not apply in the case of cost increases which it is known will occur, such as formally notified tax increases. Our independent refiners using Canadian oil, for example, have been faced with very substantial tax increases and they have been forced to absorb these increases and delay cost recovery for 30 days. This does not really protect the consumer; it merely hurts the independent refiner.

8. Remove the exemption for released oil.

This exemption from price control, of old oil in an amount equal to new oil developed, was intended as an additional bonus for finding new oil. It has proved to have three serious deficiencies: (1) it discriminates against the producer who does not own old oil, (2) the price of new oil is already high enough to serve every stimulating purpose, and (3) it unnecessarily raises the cost of crude oil to independent refiners and their customers.

9. Price rules should give effect to quality differentials.

The price control structure in respect to allocated oil recognizes differences in transportation and API gravity but not differences in crude oil quality—which may normally (in a free market) be accompanied by substantial differences in price. Quality differentials have long been recognized within the industry. They should be recognized by the price control program. Failure to do so penalizes especially those small and independent refiners operating with low quality crude oil, who may be required to pay an abnormally high price, considering the quality thereof.

10. No real need for price control on small and independent refiners.

In addition to these comments on the prices *paid* by small and independent refiners, we think the prices *charged* by them could be exempt from price control without affecting the price control system. This is because prices are set primarily by the major oil companies (when supplies are reasonably in balance) with independents pricing below the majors. In these circumstances, control over the prices charged by small and independent refiners represents merely additional paperwork without any tangible results.

Thus far we have commented upon allocation and price matters within the jurisdiction of the Federal Energy Office—but a number of other government programs can operate to help or hurt the independent refiner: access to Federal royalty oil; access to deepwater port facilities; incentives and financial assistance for refinery expansion; the choice between continuation or arbitrary end of the import fee system with its fee-exempt licenses of some considerable importance to independents; unnecessary application of lead additive and unleaded gasoline availability rules to the independents, etc., etc. A Federal Energy Office, with focal concern for all energy problems and fully motivated to fulfill the Congressional objectives for independents, might well take a constructive initiative in these other areas too.

Because of its immediacy before the Congress, let me call particular attention to one of these "other" Federal programs which could seriously hurt or help the independent refiner and the independent deepwater terminal operator. I refer to the pending legislation to require a fixed percentage of oil imports to move in U.S.-flag tankers. If that legislation is enacted, we know who'll end up with a disproportionate share of the higher cost ocean transportation. Accordingly, we have drafted and recommend an exemption for these independents (which will not, however, reduce the total volume required to be carried in U.S.-flag tankers).

In closing let me say that we shall also be happy to work with members of this Committee in drafting a suitable bill to extend the existing allocation authority—since that, as we pointed out at the start, is the single, most pressing item on which Congressional action is needed. There is one problem even more immediate and pressing than that, but it does not require Congressional action, unless FEO continues to drag its feet, and that problem is cost equalization, to eliminate the competitive disadvantage which independents suffer today.

Prepared Statement of R. J. Peterson

Mr. Chairman and members of the committee, I am pleased to have this opportunity to explain to you what has happened to the nonbranded independent marketer under the Mandatory Allocation Program.

At the outset, may I remind you that companies classified as "nonbranded independents" do not own any refining capacity, nor are they owned by any refinery. They are truly "independent." They do not market gasoline under a refiner's brand name. In no sense are they "integrated." Instead, they own their own brand names, and they are not subject to any franchise or dealership arrangements, which inevitably place considerable economic control in the refiner-supplier. Traditionally, the nonbranded independent marketer is the true price competitor. Consumers depend upon him to keep the market honest.

Since January 15th, 1974, for the past five months, the industry has lived under a system of mandatory allocation and price regulations. The aim of those regulations, as prescribed by the Emergency Petroleum Allocation Act of 1973, was to preserve the competitive position of nonbranded independent marketers, and the independent refiners who traditionally supply them, by preserving their market shares. The realistic understanding of the Congress is reflected in a few words from the Conference Report, at page 25, ". . . it does no good to require the allocation of products if sellers are then permitted to demand unfair and unrealistic prices." And, at page 26: "By requiring that both allocations and prices be covered in the regulations . . . Congress intends to force the Administration to rationalize and harmonize the objective of equitable allocation . . . with the objectives of the Economic Stabilization Act."

With those points in mind, I want to announce, for the first time, the statistical findings of the Independent Gasoline Marketers Council on the subject of market shares. Our figures are based upon regular gasoline sales volumes of nonbranded independent marketers operating nearly 2,500 service stations from coast to coast. Industry figures are taken from recognized sources.

With regard to volumes, during the first quarter of 1974—January, February, and March—the nonbranded independents sold only 82.9% of their 1972 first quarter sales volumes. Moreover, as time goes on the obvious downward trend continues. In April of 1974, sales by nonbranded independents fell to 77.6% of the comparable base period sales in 1972.

By way of comparison, industry volumes as a whole, between the first quarter of 1972, and the first quarter of 1974, have not declined. They have held up at a level of 100.3% of the comparable base period. Moreover, things seem to be getting better. Comparing April 1974 to April 1972, the current level is up to 101.7% for the industry as a whole. These figures come from API and the Bureau of Mines, as reported by the Federal Energy Office, in the PIMS Monthly Petroleum Report, dated April 30, 1974, at page 16. As a statistical matter, it should be noted that the industry figures as a whole include the declining volumes of the nonbranded independent marketers. Thus, the comparison is conservative, and the position of the nonbranded independents is not overstated.

With regard to product costs, during the first quarter of 1974, the nonbranded independents paid an average of 26.6 cents per gallon at wholesale for regular gasoline. In the corresponding period of 1972, the average cost was 12.7 cents per gallon. The first quarter cost is, therefore, 109.4% over the comparable 1972 cost. Moreover, in April of 1974, the trend worsened. The average cost during that month increased 135.2%, that is, 30.1 cents per gallon, as compared to 12.8 cents in April 1972. At this very moment, many nonbranded independents are obliged to pay over 42 cents a gallon.

In a nutshell, the market share of the nonbranded independent is rapidly approaching 75% of what it should be. The industry as a whole remains above 100%. The high cost of product has become the critical problem. Many of us are paying more for gasoline than some of our branded competitors are selling it for at retail. The fully integrated oil company is benefiting from these conditions. The independent is being badly hurt. This is precisely what the Allocation Act was supposed to prevent.

The burning question is "what should be done about it?"

The first thing to be done is to extend the life of the Emergency Petroleum Allocation Act of 1973. By its own terms, it now expires on February 28, 1975. However, the Federal Energy Administration Act of 1974 provides that the administrative agency shall continue in existence until June 30, 1976. Accordingly, the Council strongly recommends that the Allocation Act be extended so as to be conterminous with the Federal Energy Administration.

There is one fundamental reason in support of this recommendation. Sovereign authority must be exercised to direct the equitable allocation of crude oil and finished products so long as it is possible for the major, fully integrated, international oil companies to exercise, to the detriment of independent refiners and independent marketers, the extraordinary economic power which they enjoy by reason of a governmental policy which condones vertical integration.

In many respects, we may complain about the regulatory system of allocation and price controls. But, we are aware of the basic reality that we could not expect to survive without a regulatory system.

Our objective is to make the regulatory system work. Although there are many ways that the system favors the integrated marketer, the basic ideas are workable. What is needed most is administrative realism. The FEO seems never to have learned about the perilous consequences of vertical integration in the oil industry. When the suppliers to nonbranded independent marketers are also their competitors in the retail marketplace, the administration of the regulatory system must be sophisticated.

What should be done?

Basically, the FEO should pay more than lip service to the statutory objectives of protecting the market shares of the nonbranded independent marketer and the independent refiner. The FEO should realize the inherent relationship between price and supply. The FEO should be sensitive to the economic power of the majors and the consumer interests in the independents.

First, the FEO should adopt a system of allocating so-called "old" domestic crude oil so that the weighted average cost of all refinery feedstocks may be approximately equalized throughout the refining segment of the industry.

Second, the FEO should amend its regulations so that the central purpose of the Act is expressly affirmed and certain protective procedures are carried out. I refer to the preservation of market shares. The Council has proposed a provision which would state that "the allocation of motor gasoline shall be administered so as to preserve the base period market shares of nonbranded independent marketers, branded independent marketers, and all other persons engaged in marketing or distributing." But, no such language can be found in the regulation. I also refer to the fact that the Act specifically requires the FEO to calculate the market share of nonbranded independent marketers as a class, to protect such marketers, and to report to Congress on any changes in their status, nationally or regionally. I submit, Mr. Chairman, that none of those things have been done.

Third, the FEO should acknowledge that the assignment of a substitute supplier for some or all of the commitment of a base period supplier whose price is not competitive is essential to the preservation of the market share of the independent nonbranded marketer. If the cost of gasoline is too high, the economic effect is the same as if the gasoline did not exist. Yet, the FEO has expressly ordered its regional offices not to act upon any assignment of supplier cases based on cost. If the cost of gasoline is wholly noncompetitive from one supplier, the FEO will not assign a different, lower-cost supplier. The FEO has ordered that all such cases be presented only in the form of "serious hardship" or "gross inequity" cases.

The FEO appears to be primarily concerned with developing an administrative system which will result in the fewest number of cases. It wants to avoid opening "Pandora's Box" and avoid the hypothetical charge that it is a "welfare agency" for independent nonbranded marketers. The FEO, therefore, appears to be narrowing its attention to threatened bankruptcies and financial disaster situations. In other words, the FEO expects the independent private brand marketers to be at death's door before it will order Exxon, Shell, Mobil, Gulf, Texaco, Amoco, Socal, or any other crude-strong, fully integrated, supplier to divert and sell a relatively small quantity of gasoline to such a marketer, even though his market share is slipping away because his cost of gasoline from one or more of his base period suppliers is noncompetitive because of high-cost crude oil. Moreover, even if the FEO acknowledges a "serious hardship," by the time the apparent tests are met, the nonbranded independent marketer will have lost his market share for good. If the FEO were realistically sensitive to the economics of marketing, declining market share could be reversed. There may not be more than fifty such cases calling for market share relief. But, positive action is not forthcoming. Some or all of the base period volume of a high-cost supplier should be assigned to a low-cost supplier. And, the high-cost supplier should be free to sell to anyone. And, the Administrator should urge the majors to buy such high-cost product. Their weighted average prices would not be measurably increased. If the majors refused to cooperate in this manner, the Administrator should then call upon the Congress to make their cooperation mandatory.

Mr. Chairman, may I conclude by explaining the situation in which my company finds itself. To illustrate the central problem faced by other Council members as well, Martin Oil Service has traditionally purchased gasoline from, for example, Koch Industries, among many other suppliers. Koch relies heavily upon Canadian crude oil, which is one of the most expensive sources in the world. Thus, Koch's price to Martin is such that Martin is obliged to sell gasoline at 8 cents to 10 cents a gallon higher than its major-brand competitors. The result, through no inefficiency nor lack of diligence on the part of Martin, is a loss of its market share. Indeed, in our primary market area, around Chicago, we calculate that by the end of March, the first quarter of 1974, we had lost 61% of our 1972 base period share and, by the end of May, we had lost 70%. This loss is due solely to the fact that the crude costs to our refiner-suppliers are not equalized with those of other refiners. And, even as a temporary expedient, product costs to us are not being recognized as a basis for an allocation order temporarily assigning some of Koch's commitment to some other low-cost supplier. Indeed, the FEO is so insensitive to the cost-price impact that Koch has been assigned as a substitute supplier to other reseller-customers on the theory that its allocation fraction is 1 or over 1, and the shortage can thereby be alleviated. If Koch has an allocation fraction of 1, then we are told we have no shortage. If our loss of market share is because of price, then we are told it is not going to be corrected unless, of course, we can show a financial hardship that is so severe that relief would not establish a precedent for other cases.

Gentlemen, I submit, this is not the equitable treatment one should expect from an agency whose statutory duty is to preserve competition for the benefit of consumers.

Chairman HUMPHREY. I want to assure you, as chairman of this subcommittee and a member of the Joint Economic Committee, we will press relentlessly on the FEO to get some action on this cost equalization. I think you documented your information well, and I think Mr. Sawhill admitted this has to be done. There is no argument about that. It is just a question of getting the formula and getting it done.

If you keep pressing through your respective associations and with your contacts with the staff at FEO day in and day out, we might get this problem solved. We will do exactly the same thing here. And we will call to the attention of Mr. Sawhill some of this other information that you have given to us.

Thank you very much, gentlemen, the hearing is adjourned.

[Whereupon, at 1:10 p.m., the subcommittee adjourned, to reconvene subject to the call of the Chair.]

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