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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

ENERGY AND MINERALS
DIVISION

MAY 22, 1980

B-198754

The Honorable Stanley N. Lundine
House of Representatives



112396

Dear Mr. Lundine:

Subject: Gasoline Pricing Disparities
Between Adjacent Areas of New York
and Pennsylvania (EMD-80-77)

Your letters dated September 21, 1979, and February 11, 1980, requested that we determine why retail gasoline prices in the Southern Tier areas of New York are higher than in northwestern Pennsylvania even though a substantial amount of the gasoline requirements of both areas is furnished by the same refinery--United Refining Company in Warren, Pennsylvania.

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Retail gasoline prices can vary for a number of reasons including differences in wholesale prices, retail margins, and gasoline taxes. We found, at the end of January 1980, that New York State's gasoline sales tax accounted for the slightly higher gasoline prices at United's New York retail stations.

We also found wholesale pricing differences between United and other oil companies serving the two counties even though a substantial amount of the gasoline came from the United refinery. This is because United supplies gasoline to other companies under an exchange system whereby the gasoline was priced by the receiving oil company in accordance with its overall pricing structure. Consequently, other companies could charge either higher or lower prices than United's.

Our examination of United's gasoline prices in the Southern Tier areas of New York and northwestern Pennsylvania was limited to Chautauqua County, New York, and Warren County, Pennsylvania. We selected these two counties because of complaints from Chautauqua County residents concerning apparent gasoline pricing disparities and because we believe these two adjacent counties to be representative of United's market areas.

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We discussed with United officials the company's method of distributing and pricing gasoline, the retail pricing differences between Chautauqua and Warren Counties, and the causes of the differences. We also discussed with them gasoline exchanges and their impact on prices.

We obtained detailed January 1980 data from United on all of its retail stations in the two counties, including the number and type of stations, gasoline deliveries, wholesale prices, retail margins, retail prices, and applicable gasoline taxes. We verified United's retail pricing data by examining records at about one-third of United's retail stations located in the two counties. We also obtained January 1980 data on United's gasoline exchanges with other oil companies, including Exxon, Atlantic Richfield, and Mobil.

BACKGROUND

The United refinery is located in Warren, Pennsylvania, with distribution storage terminals in Rochester and West Seneca, New York, and Erie, Williamsport, and New Kingston, Pennsylvania. United serves most of Pennsylvania, western New York, eastern Ohio, and to a limited extent Delaware. Much of the gasoline distributed in Chautauqua and Warren Counties comes from United; some is sold by other oil companies after being obtained from United under an exchange system. In January 1980, United sold about 68 percent of its total gasoline in Pennsylvania, about 20 percent in New York, and the remaining 12 percent in Ohio and Delaware.

United markets its gasoline through about 650 retail stations--363 company owned and operated (company operated) and 287 company owned and dealer operated (dealer operated). About 90 percent of United's gasoline is sold through company operated stations under several brand names--Beaver, Falcon, Kwik-Fill, Minute Man, and Skat--and the remaining 10 percent is sold by Keystone dealer operated stations.

GASOLINE PRICING DISPARITIES BETWEEN UNITED RETAIL STATIONS IN THE TWO COUNTIES

Our analysis of end of January 1980 pricing data for 32 of United's 45 stations in Chautauqua and Warren Counties showed that the average retail prices for gasoline, excluding taxes, ranged from 2.5 cents to 3.4 cents per gallon less in Chautauqua County. However, Chautauqua County's average

retail gasoline prices, including taxes, were about 1.5 cents per gallon higher. Thirteen dealer operated stations were not included in the analysis because of closures, non-delivery of gasoline during January 1980, or small volume and unavailability of data. The results of our analysis are shown in the following table.

<u>Kind of station</u>	<u>Number of stations</u>	<u>End of January 1980 average retail prices</u>			
		<u>Regular grade</u>		<u>Unleaded grade</u>	
		<u>Excluding all taxes</u>	<u>Including all taxes</u>	<u>Excluding all taxes</u>	<u>Including all taxes</u>
Company operated:					
Chautauqua	11	\$.952	\$1.142	\$1.009	\$1.202
Warren	5	.977	1.127	1.038	1.188
Dealer operated:					
Chautauqua	7	.978	1.168	1.029	1.227
Warren	9	1.012	1.165	1.062	1.209

Average retail gasoline prices are the sum of wholesale prices paid by retail stations, retail station margins, ¹/_{and} gasoline taxes. Wholesale prices paid by United retail stations were about the same in both counties; retail margins were larger in Warren County; and gasoline taxes were higher in Chautauqua County. These pricing factors are discussed below.

Differences in State gasoline taxes

New York's retail gasoline prices were higher than in Pennsylvania because of New York's higher gasoline taxes. New York's gasoline excise tax is a fixed 12 cents per gallon--4 cents per gallon Federal excise tax and 8 cents per gallon State excise tax--plus a 7-percent sales tax

¹/The retail margin is the retailer's selling price less the cost of gasoline. From the retail margin, the retailer must pay operating costs. The remainder, after deducting these expenses, is the retailer's net profit margin.

which is applied to the total sales price minus the State excise tax. Thus, in New York the impact of the sales tax becomes increasingly greater as the price of gasoline rises. On the other hand, Pennsylvania's gasoline excise tax is a fixed 15 cents per gallon--4 cents per gallon Federal excise tax and 11 cents per gallon State excise tax. Rising gasoline prices do not increase the amount of tax in Pennsylvania.

The impact of gasoline taxes is shown in the hypothetical example below. Assuming that retail gasoline sale prices, excluding taxes, are \$1.00 per gallon in both New York and Pennsylvania, New York's higher gasoline taxes will cause its retail gasoline pump price to be 4 cents per gallon higher.

	<u>New York</u>	<u>Pennsylvania</u>
	(per gallon)	
Sales price excluding taxes	\$1.00	\$1.00
Federal excise taxes	.04	.04
State excise taxes	<u>.08</u>	<u>.11</u>
	1.12	1.15
Sales tax (7 percent)	<u>.07</u>	<u>-0-</u>
Retail gasoline pump price	<u>\$1.19</u>	<u>\$1.15</u>

Wholesale prices

United's wholesale prices had little, if any, impact on retail pricing variations between the two counties. United's average wholesale selling prices to dealer operated stations in Chautauqua County were only about 0.1 cents per gallon higher than to similar stations in Warren County. This negligible pricing difference was caused by a historical price variance which was frozen by Department of Energy's 1973 gasoline pricing regulations. United's prices to company operated stations, which sell most (78 percent) of its gasoline in Chautauqua and Warren Counties, were exactly the same for both counties.

Retail margins

Current two-tier Federal gasoline price ceiling regulations permit a higher ceiling margin for dealer operated stations than for company operated stations. We found that

average retail margins of dealer operated and company operated stations in Warren County were higher than in Chautauqua County.

Dealer operated stations

Prior to August 1, 1979, retail gasoline dealers used their May 15, 1973, selling price as a base, and were permitted to add any increased product costs plus 3 cents a gallon for increased marketing costs. Certain rent increases and costs of installing vapor recovery systems could also be recovered. Dealers were also permitted to "bank" 1/ any unrecovered product cost increases. This pricing structure caused retail prices to vary widely, created much confusion among both dealers and the public, and was difficult to enforce.

As a result, the Department of Energy (DOE) instituted a new pricing system for independent gasoline retailers (i.e., stations other than those owned and operated by wholesalers or oil companies) which became mandatory on August 1, 1979. The maximum allowable price for each grade of gasoline became the acquisition cost, plus Federal, State, and local taxes, plus a 15.4 cents a gallon margin. This margin is revised every 6 months beginning December 15, 1979, to reflect increases in the domestic inflation rate. It is currently 16.1 cents a gallon and can be revised again on June 15, 1980. Independent retailers can no longer "bank" costs; they must be passed through when incurred or foregone.

Our analysis of proprietary retail margin data for the 16 United dealer operated stations in the two counties showed that the average retail margins in Warren County ranged from about 3.3 cents to 3.4 cents per gallon higher. Our analysis also showed that stations in both counties were in compliance with the Federal maximum legal selling prices.

1/Banks represent DOE allowable costs which have not yet been passed through by the retailer.

Owner operated stations

The rule changes did not affect oil company owned and operated retail stations. An Economic Regulatory Administration official told us that oil company stations were not included because of the difficulty in establishing a transfer price between the refiner and the retail station. Since the gasoline is owned by the oil company from its production until its sale to a consumer, a selling price is not recorded when the gasoline is delivered to the retail station. This selling price is the essential ingredient in determining maximum allowable retail selling price under the new rule. Since it would be difficult to establish what this price might have been for a company owned and operated station, these stations were exempted from the new rule. As a result, there is a dual pricing system at the retail level.

Our analysis of proprietary retail margin data for the 16 United company operated stations in the two counties showed that the average retail margins in Warren County ranged from about 2.5 cents to 2.9 cents per gallon higher. Our analysis also showed that company operated stations in both counties were in compliance with Federal maximum legal selling prices.

GASOLINE EXCHANGES WITH
OTHER OIL COMPANIES

United does not sell gasoline to other oil companies, but does supply gasoline to other companies having local retail outlets in the Southern Tier areas of New York and northwestern Pennsylvania under an exchange system. In return, United receives equal volumes of gasoline at its distribution storage terminals in other areas of New York and Pennsylvania.

The wholesale price for the gasoline United exchanges with the other companies may differ significantly from United's wholesale price because once gasoline is exchanged, it is priced by the receiving oil company in accordance with its overall pricing structure.

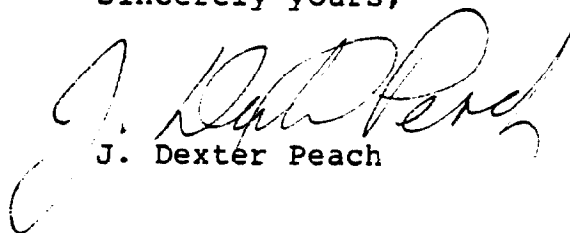
Gasoline exchange agreements are a common nationwide oil industry practice whereby one company provides gasoline to another oil company in exchange for an equal amount of gasoline at another location. According to United's Executive Vice President, much of the gasoline distributed in Chautauqua and Warren Counties comes from United's Warren,

Pennsylvania, refinery, even though it is sold by other oil companies. Neither United's nor the other oil companies' wholesale prices are affected by the exchange agreements, which are made primarily for the purpose of reducing oil company transportation costs.

Wholesale gasoline prices charged to retail dealers can vary significantly because of the Federal ceiling price regulations which permit pass-through of cost increases which have occurred since the May 15, 1973, base price was established. For instance, the April 11, 1980, issue of the "Lundberg Letter" 1/ disclosed that wholesale prices of gasoline vary by as much as 17 cents per gallon between major brands in the same market.

We discussed this report with United officials, who indicated general agreement with the factual data presented. Our policy is to make reports resulting from request assignments available for unrestricted distribution at the time they are issued to the requestor, or within a few days after issuance. Those reports which are initially restricted generally will be made available no later than 30 days after the date of the report. We will contact your office regarding distribution arrangements.

Sincerely yours,



J. Dexter Peach

1/A weekly publication specializing in quantitative analyses of gasoline marketing.