

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF INDIANA  
INDIANAPOLIS DIVISION

DONALD ADAMS, et al )  
Plaintiffs, )  
) CAUSE NO. IP97-1422 C M/S  
)  
vs. )  
)  
SHELL OIL COMPANY and )  
EQUILON ENTERPRISES, L.L.C.)  
)  
Defendants. )

REPORT OF JAMES M. PATTERSON

Professional Background

1. I am professor emeritus of marketing in the Kelley School of Business at Indiana University, Bloomington. I have been on the faculty there for 40 years. My academic research, study and writing for more than 30 years has focused on the marketing practices of the petroleum industry.

2. I presently reside at 46 Bangs Shore Road, Orr's Island, Maine 04066-0224 from May until November and at 1303 Dreams Landing Way, Annapolis, MD 21401-1035 during the rest of the year. Since 1960, I have been assistant professor, associate professor, or professor of marketing at the Kelley School of Business at Indiana University. From 1994-1997, I was director of the Indiana University Institute for Advanced Study. Prior to 1960 I was an instructor at Northwestern University and a lecturer at Cornell University. and for one semester, a lecturer at the University of Chicago's Center for Governmental Programs. I have a Ph.D. and M.B.A. from Cornell University and a B.S. from the United States Merchant Marine Academy.

3. My principal area of academic research and scholarship is the marketing of gasoline and other petroleum products in the United States. I have written extensively on petroleum marketing, including the following books and publications: (with Fred C. Allvine), Competition Ltd. The Marketing of Gasoline, Bloomington, Indiana University Press, 1972; ( also with Fred C. Allvine), Highway Robbery: An Analysis of the Gasoline Crisis, Bloomington, Indiana University Press, 1974; "Vertical Integration, Product Shortages and the Marketing

of Gasoline," in John W. Wilson (ed.), Proceedings of the British Columbia Energy Conference, University of Victoria, Institute of Policy Analysis, 1974; "Strategy and Structure in the Gasoline Industry," in Hans B. Thorelli (ed.), Strategy + Structure = Performance: The Strategic Planning Imperative, Bloomington, Indiana University Press (1977); "Changes in Gasoline Marketing: An Evaluation," in Norman Kangun and Lee Richardson (eds.), Consumerism: New Challenges for Marketing, Chicago, American Marketing Association (1978); "Gasoline Marketing During the 1980s," Association of Petroleum Industry Marketing Attorneys, Alexandria, Virginia, (1980); "Should Vertical Price-Fixing be a Rule-of-Reason Offense?" and "Vertical Price-Fixing Agreements and Refusals to Deal: Should the 'Colgate Doctrine' be Changed?" Association of Oil Marketing Lawyers (1986).

4. I have also taught university courses and seminars on various subjects related to the marketing of petroleum products in the United States and the competitive practices of the major oil companies. I have presented statements on petroleum marketing before the U.S. Senate Committee on the Judiciary, Subcommittee on Antitrust and Monopoly (July 31, 1975 and August 6-9, 1975); the U.S. House of

Representatives Committee on the Judiciary, Subcommittee on Antitrust and Monopoly (July 31, 1975); and the U.S. Senate Committee on Interior and Insular Affairs (1974). I have served as a consultant on petroleum marketing to the Maryland Attorney General on petroleum industry divorcement litigation (1975); the Federal Trade Commission Bureau of Competition on oil industry litigation (1977-1981); the Ohio Attorney General on the Mobil Oil Company-Marathon Oil Company merger (1981); and the Canadian Office of Consumer and Corporate Affairs Petroleum Industry Task Force (1982-1983).

5. The opinions expressed in this report are based in part on my personal research and investigation into the American petroleum industry and the marketing of gasoline and other petroleum products by the major oil companies, as well as on the research and investigation of numerous government agencies and individuals. They are also based on the documents, exhibits and depositions generated by this case and other cases in which I have been involved.

6. I have testified as an expert witness in a dozen or so lawsuits involving gasoline marketing and given depositions in numerous others. I have testified on behalf

of major oil companies such as Sun Oil Company, and on behalf of dealers and jobbers such as North Penn Oil, Mid-State Oil, Simmons Oil, Texas Discount Gas, and Five Star Gasoline Company. I have also testified on behalf of the State of Maryland in connection with a challenge of their retail divorcement legislation, and against the State of Maryland in connection with their anti-conversion statute. I testified previously in the initial stages of this case in 1998.

7. I have now been asked to review and comment on the Robinson-Patman claim in this litigation

8. To that end I have visited all of the plaintiff-dealer stations (many for the second or third time) and numerous other Shell stations, including several jobber and company operated stations, that could be regarded as competitors of specific plaintiff-dealer stations.

9. I have reviewed the pleadings and numerous other materials filed in connection with this case. In addition, I have carefully studied maps and traffic and commuting information in order to form a judgement as to

the probable consequences of observed supply-price differences. I also have used materials prepared from earlier stages of this case. My assumption is that sustained supply price differences between competing retailers of Shell gasoline (whether sourced directly from Shell or indirectly from Shell branded or unbranded jobbers) injure competition when certain of these retailers are systematically required to pay their supplier substantially more than their competitors have to pay. Underlying this assumption is the notion that competing resellers are entitled to equal treatment and that systematically favoring one at the expense of the other harms competition between them.

#### The Changing Nature of Gasoline Marketing

10. In order to understand some of the various features of this case, it may be useful to recall some of the major changes that have taken place in the marketing of gasoline over the last few decades. The forces of change which had begun in the early 1970's, but which had been partially frustrated by the Energy Department's regulation of gasoline marketing during the spate of supply crises during

the 1970's, virtually exploded after President Regan removed gasoline marketing controls soon after his inauguration in early 1981. Marketing arrangements which had been frozen during the regulatory period were suddenly open to radical change, and change they did. Mass merchandising techniques including the shift to self-service became widespread. Convenience food items replaced auto care as the tie-in of choice. Brand preference diminished in importance and price assumed a new importance. With the repeal of the percentage depletion allowance in 1972 and the nationalization of much overseas crude production in the mid-70's, the incentive to maximize crude flows at all costs ended. In a period of gasoline shortages and price controls, it no longer made sense to subsidize volume. Marketing was now obliged to stand on its own feet and compete for corporate resources on the basis of functional profits at the marketing level. Long-standing subsidized rent programs were reviewed and new rent programs developed.<sup>1</sup> Price support programs which had been a

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<sup>1</sup> After decades of charging cents-per-gallon station rentals, Shell and other oil companies began to switch to "economic" flat rentals by the mid-1970's. The aim was to achieve enhanced return on their real estate investment in the face of price controls and supply restrictions. However, these plans were short-lived. Shortly after decontrol in early 1981, many big refiners quickly shifted to so-called variable rent programs. These variable rent programs were aimed at stimulating the dealer to shave margins and increase volume. Shell shifted to flat rents in 1977 and to volume-based variable rents in May, 1981. The programs are ingenious. They are designed to reduce the dealer's margin while allowing the refiner to maintain their wholesale price. They force dealers to cut prices or suffer higher rents. Variable rent programs are an alternative to cutting wholesale prices. But they have the advantage of motivating the dealer to cut his/her margin while a price cut might not. A rent reduction based on volume is equivalent to a price cut of like

major feature of the 1960's were abandoned. New pricing methods were explored. The strategy of a station on every corner and a presence in every state was abandoned with refiners withdrawing from those markets where they lacked a critical marketing mass or economical supply arrangements. Tens of thousands of low-volume stations were closed.<sup>2</sup> Shell closed more than 60% of its branded outlets between 1970 and 1996.<sup>3</sup> As a result average volume at Shell stations rose substantially. All of these changes and many more<sup>4</sup> placed extreme pressure on Shell marketing executives to restructure the marketing system to fit these new imperatives and to meet ambitious performance goals. The impact of this restructuring on franchised lessee-dealers has been extreme. Margins have been squeezed. Rents have doubled and redoubled. Incentive programs have been withdrawn. Couple all of these changes with the consequences of systematic supply price discrimination which is the thrust of this case, and the result is the

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amount From the standpoint of profit and loss, it doesn't make any difference which is lowered, price or rent. (NPN, April 1985, p. 44)

<sup>2</sup> The total station population declined from a high of 226,000 stations in 1972 to about 180,000 today. NPN Market Facts, 1999, P.116.

<sup>3</sup> According to the NPN Factbook, 1970, p60, Shell gasoline was sold through 22,000 branded outlets. By 1996 the number was only 8,609. NPN Market Facts, 1997, p.42. (Data for later years not available.)

<sup>4</sup> For a more extensive discussion of these changes, see my essay in Hans B. Thorelli, *Strategy = Structure = Performance: The Strategic Planning Imperative*, Bloomington, Indiana University Press (1977) as well as the associated comments by Willard Burnap, then Chairman of Conoco .

destruction of the ability of many of the plaintiff dealers to compete, or even to survive.

### The Rise of Company Operations

11. Another especially significant development for this case that has grown out of the pressure to show strong marketing profits has been the dramatic rise in the number of refiner operated stations.<sup>5</sup> This is especially true in the Indianapolis district where 10 of the 81 Shell stations are operated by Shell employees or agents.<sup>6</sup> In these Shell "company stores," all pricing and marketing decisions are made by Shell marketing executives. Competing with these Shell "Company stores" obviously poses special problems for Shell franchised dealers who must pay station rent unilaterally determined by these same Shell executives and who are obliged to pay a dealer tankwagon price for their gasoline which is also set by these executives. Thus, the dealer "cost of goods sold" is largely determined by Shell on the one hand and resale prices are indirectly controlled by the presence of a large

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<sup>5</sup> The number of Shell employee operated "company stores" increased from 4 in 1970 to 108 in 1996. NPN Factbook, 1970, p. 60 and NPN Market Facts, 1977, p. 41.

number of strategically placed Shell company stores on the other. Couple this with systematic geographic price discrimination between competing Shell retail outlets and one can see how the ability of franchised Shell lessee-dealers to compete is being harmed.

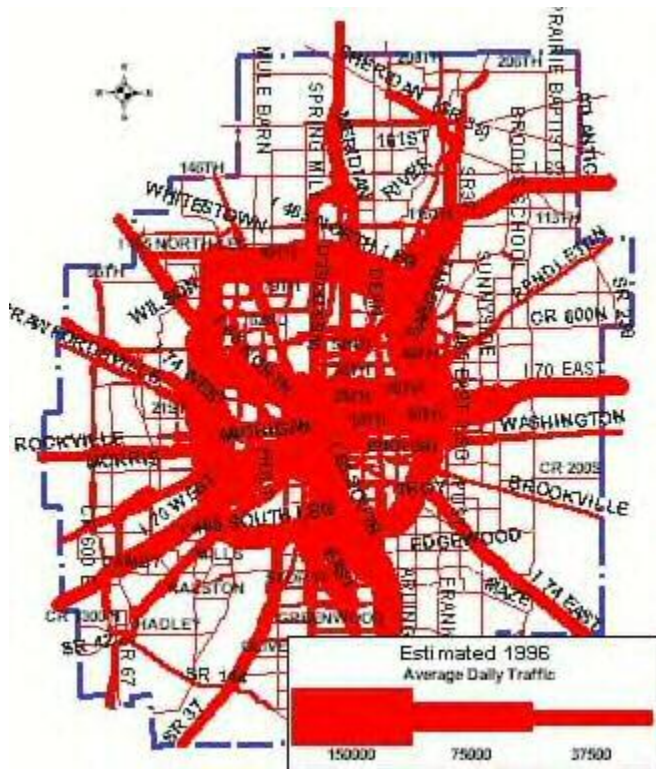
#### The Central Indiana Gasoline Market

12. Indianapolis and its satellite cities represent a dynamic gasoline market. From the motorists' standpoint, there is a good balance between major-brand and secondary-brand and private-brand marketers. Major brand marketers such as Shell and BP-Amoco are obliged to compete with strong secondary marketers such as Marathon/Speedway, Clark, Phillips and Citgo. Also, there are numerous private brand chains and convenience store chains and discount stores that retail gasoline at a discount. As a classic "Central City," there is much commercial interaction between Indianapolis and its surrounding communities as well as extensive cross-city traffic patterns. Competition is strong, but not destructive. However, because of the interconnectedness of the greater Indianapolis market, (See map below) prices are critical and supply price advantages

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<sup>6</sup> MPSI Exhibit, 1997.

even at considerable distance can harm disadvantaged retailers. This is especially true in the case of several



first-rate vertically integrated Shell jobbers in the counties surrounding Indianapolis. Some operate more than a hundred company stores under multiple brands including Shell and supply still other Shell "open dealers." Many of these jobber stores are state-of-the-art properties. Two Shell jobbers in particular factor importantly into the claims in this case--Big Foot/Johnson Oil to the south and Herdrich Oil to the south and east. For many plaintiff dealers who compete with these jobber outlets for commuting traffic, the preferential supply price they receive from

Shell harms competition between many of the outlets they service and the plaintiff dealers. It is a price difference not available to the plaintiff dealers who are not permitted to buy from the Shell rack or from a favored Shell jobber.

### Differential Pricing Systems

13. There are several ways for systematically implementing a pattern of differential prices in vertical marketing systems such as the marketing system established by Shell in this case:

#### A. Trade Discounts

14. Systematic differences in supply prices charged by refiners for petroleum products of like grade and quality arise when supply prices are based on trade status, branding, and marketing function. For example, Shell charges its direct-served branded retailers a Dealer Tankwagon price for specific grades of gasoline. This DTW is a delivered price and is uniform for all retailers within a designated geographic trade area. In the case of sales of gasoline to branded jobbers or wholesalers (some

of whom are heavily vertically integrated into retailing and thus properly should be classified as chain retailers) Shell charges a different and much lower "jobber buying price" for the same product. This jobber buying price is F.O.B. at the designated terminal, i.e., the jobber arranges to take title and delivery at the terminal loading rack and absorbs the freight cost from the terminal to the retail location or jobber's storage facility--if any. In the case of unbranded gasoline of like grade and quality, a still lower supply price is charged and is referred to as the "unbranded rack price. " It is also sold F.O.B. Before the 1980's Shell and most other major brand refiners offered their jobbers a so-called "functional discount" off of the DTW, but such DTW based functional discounts are no longer common. Also, since the base DTW was a delivered price, the refiner typically offered its jobbers an additional "hauling allowance" to compensate for the fact that the jobber took delivery of the product at the terminal and thus incurred a delivery cost. Often this "hauling allowance" was larger than the actual cost of delivery. The price differentials between Dealer Tankwagon Price (DTW,) "branded jobber buying price" and "unbranded rack price" for similar products of like grade and quality can be and often are substantial (See Table below) and have

the potential for harming competition between jobber dealers and jobber integrated retail locations and Shell's lessee dealers. The extra margin systematically afforded jobber competitors allows them to price aggressively in both their wholesale and retail marketing. To the extent that these jobbers and their dealer customers compete with the plaintiff dealers in the retail market, the presumption of adverse effect on competition is appropriate.

**Spreads Between Buying Price and Average  
Retail Sales Price**

	1994	1995	1996	1997	1998
Dealer Gross margin	5.1	5.9	5.4	6.2	6.4
Integrated Jobber GM	14.2	14.0	13.2	13.2	13.9
Unbranded Retailer	18.7	18.5	19.0	18.1	NA

Source: NPN *Market Facts*, 1997 p104; 1998, p.108;1999, p 100

B. Geographic Discounts

15. Systematic price differentials between competitors also arise when competing resellers are charged different prices for gasoline of like grade and quality on the basis of their geographic location. Shell for example arbitrarily divides its markets into numerous trade areas and then sets different delivered DTW prices for retailers located within different trade areas. When the arbitrary boundaries of these trade areas result in different supply prices being charged to competing retailers, harm can be

done to competition between these competing retailers who receive different supply prices.

C. Rent Rebates

16. According to Shell documents, 59 of the 81 Shell service stations in the Indianapolis district are owned (or leased) by Shell and re-leased to franchised lease-dealers. In these so called "investment stations," Shell is not only the supplier of gasoline and the provider of the franchised marketing program, but also the landlord. As a consequence, in these lessee-dealer stations, Shell determines two of the principal components of a dealer's operating cost. Thus if there is any discrimination in the price (DTW) of the gasoline or in the rental charge for the station, competition between effected Shell dealers is harmed.

17. From Shell's perspective, it makes no difference if it captures the return on its investment in the station from the increased sales of gasoline to the lessee-dealer, or from the rent it charges him/her. To quote Shell's own words, "it is a matter of indifference." The effect on the bottom line is the same. However, the way the rental return

on investment is captured does make a difference in the behavior of the dealer since some rental plans contain strong incentives for dealers to behave aggressively in increasing volume while in others, the more the dealer sells, the more rent he/she pays. This can be seen by looking at the three different types of rent programs that Shell has used in the past.

18. For decades before the mid-1970's Shell and other major gasoline marketers used a simple "cents/gallon program." Each lessee-dealer was charged a low basic rent coupled with a predetermined cents/gallon add-on for all gasoline sold. Such a rent program was ideally suited to Shell's strategy of maximizing gasoline sales through intense market coverage, and to a lesser degree for motivating the dealer to increase gasoline volume. This volume incentive is demonstrated in the two charts below. In Chart 1, which looks at the rent program from Shell's perspective, it can be seen that the more the dealer sells, the more Shell makes. From Chart 2, one can see that as the dealer works harder and trims his/her mark-up over DTW to sell more gasoline, the rental cost per gallon drops and then flattens. Obviously, there comes a time when further margin cuts and increased marketing effort costs the dealer

more that the increase in volume is worth. At this point, the motivation to increase volume disappears. Such plans are dysfunctional from Shell's perspective if this point comes before the station volume reaches its maximum potential volume.

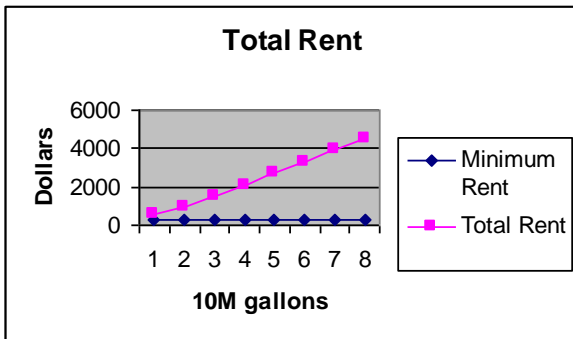


Chart 1

Shell's Perspective

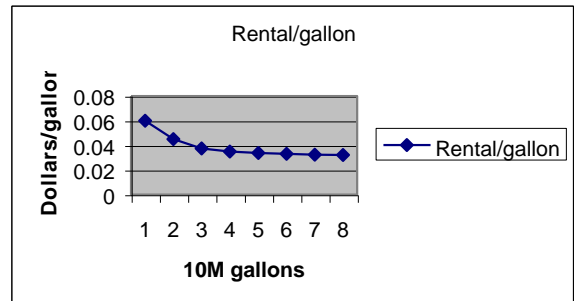


Chart 2

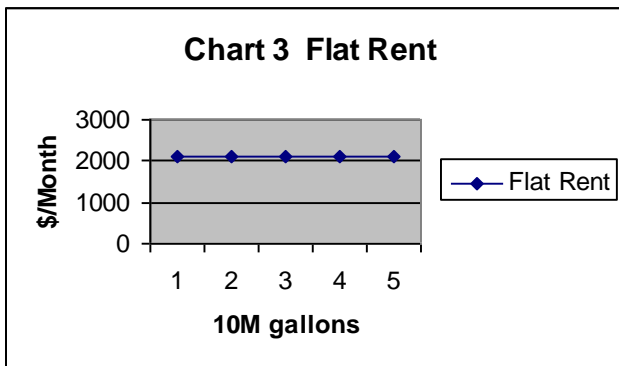
Dealer's Perspective

19. The incentives in the plan can be manipulated by altering the base rental or cents/gallon rental charge. In those days, the rental plan was often accompanied by rental and price subsidies to encourage the dealer to expand sales volume even more than would make sense under the rental program alone.

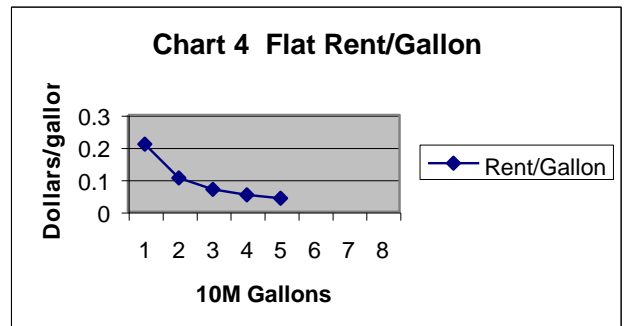
20. As noted, this cents-per-gallon (CPG) program was well suited to the integrated oil company strategy of maximizing crude flows in order to exploit the percentage depletion tax

shelter and to spread their huge fixed costs in refining, transportation and production. By the mid-1970's however, this type of rental program no longer made sense. For all practical purposes, since long-standing crude oil tax shelters had been eliminated and short supplies of gasoline had to be allocated, increased volume was no longer an appropriate objective. The need was for a different type of rent program that focused on return rather than volume. As a consequence Shell and many of the other major marketers shifted to so-called "Flat" or "Economic" Rents. The effect of these plans can be seen in the next two charts.

21. In Chart 3, which shows the effect of flat rents from Shell's perspective, rental return has been completely



Shell's Perspective



Dealer's Perspective

divorced from sales volume. This made sense during regulated period since Shell could sell all the gasoline it could refine --and more-- at the highest price allowed by the government. Shell had no interest in trying to increase retail throughput. It charged as much as was allowed and then added on a fixed rent that was independent of volume. However from the dealer's perspective, there was still a modest incentive to increase volume, at least up to the total allocation, but certainly not by cutting price or increasing marketing effort by much since this was not needed in a time of shortage. In fact the opposite was typically true. Still, there was a latent volume incentive in the flat rent program as is shown in Chart 4. Since the rental cost/gallon declines as sales volume increases up to the allocated volume, dealers were at least motivated to market hard enough to reach that volume.

22. All of this changed in early 1981 after the inauguration of President Reagan who, in one of his first acts as president, completely deregulated gasoline marketing. From that point on dealers could set price where they wanted and sell as much as the market would accept, given their price and their marketing skills. This

meant that under the flat rental programs, dealer rental costs/gallon would continue to decline until they reached the station potential, or until the additional cost of trying to sell more gasoline approached the gain from spreading the fixed rent over greater volume.

23. While a flat rental program motivates the dealers to try to sell more gasoline, the rental return recovered by Shell remains flat since by definition, it is independent of sales volume-- though of course Shell profits from the sales of the incremental gasoline volume. As a consequence, Shell and the other major integrated marketers began to develop new rental programs which would cause total rental return to rise with increased volume. Most major integrated marketers (including Shell) sought the answer in so-called "Variable Rent Programs." See Table 1. Shell's program was introduced in May 1981, and continued

<b>Comparison of Majors' Station Rental Programs*</b>										
	Amoco	Arco	Chevron	Exxon	Mobil	Shell	Sohio	Sun	Texaco	Union
Company disclosure	✓	✓	✓							✓
No disclosure				✓	✓	✓	✓	✓	✓	
Cover occupancy costs	✓			✓		✓				
Return on investment	10%									
Return on market value		10-13%	10%	✓		✓				
Percentage of gross					20%					
Motor-fuel profit center					✓			✓		✓
Allied profit center			✓		✓			✓		✓
Economic flat rent	✓	✓	✓	✓	✓	✓		✓	✓	✓
Cents-per-gal. rent										✓
Variable incentive rent			✓		✓	✓				
Uneconomic rents not allowed		✓								
Many uneconomic rents			✓	✓					✓	

\*Many programs' features unavailable either through company or independent sources.

in force with annual changes until the summer of 1998 when Shell terminated its VRP and returned to a flat rent" program the a much higher "Contract Rent" level.

24. Basically, what Shell tried to do with its Variable Rent Program (VRP) was to fine-tune its total take from each of its leased stations and to squeeze retail margins in order to increase gasoline sales. Shell's VRP was a modified flat rent program, except that the "flat rent" component now consisted not only of a "minimum occupancy rent", but also an undisclosed "net indifference rent," plus a so-called "contract rent." This "contract rent" could be partially offset by a rent rebate which depends on volume increases beyond a calculated threshold level up to a maximum volume beyond which no additional rent rebate would be paid. The following chart shows the components of the plan. Even though the VRP was labeled "voluntary," if a dealer opted not to participate, he/she would still have to pay the higher "contract rent" without the benefit of a rebate which would be a "nobrainer."

25. The purpose of the shift to a VRP is clear. Rather than trying to increase station volume by lowering the DTW

(which may or may not be passed through to the customer given the individual dealer's right to set the pump price) the VRP merely raises the "contract rent" and then gives part of the increase back to aggressive dealers in the form of a rent rebate. In this sense, a rent rebate amounts to an implicit price cut. The difference is that the law would not allow the supplier to make the granting of a price cut conditional on a pass-through, but the VRP achieves the same result. In fact this approach is even better for Shell since the dealer in effect has to underwrite his/her own rebate by taking less margin in order to achieve the higher volume.

26. In spite of its aggressiveness, there is probably nothing illegal about such a plan if it is administered evenly and fairly and without discrimination or deception. However, given the complexity of Shell's VRP, and given Shell's refusal to fully explain the plan to its dealers, or even to reveal the basis for its own managerial inputs into the rent formula, or to allow dealers to see how it works, the prospect of discrimination and deception are quite high. Moreover, Shell's failure to reveal the implicit rental component in the DTW amounts to deceit.

27. In an NPN-National Petroleum News article about "The Rental Revolution," the writer said:

"Shell may have reached the practical limit in how complicated a rental structure can be. No dealer is known to understand it. No outside person is known to understand it. Studying it in any depth isn't ordinarily possible because documentation is not allowed to leave the hands of sales representatives." (National Petroleum News, April 1985, p.42.

28. I agree with the judgement expressed in this quote. Without having a full explanation of how the complex rebate formula works, and how the key variables are derived, it is not possible for anyone to understand its operation or to judge its fairness. And of course, once the formula is fully disclosed and the way the key variables are determined, it becomes increasingly clear that the prospect of discriminatory treatment of competing lessee-dealers is all but inevitable. Dealers were never given the chance to assess the annual "proprietary inputs," or to question or assess them. Even within Shell, checks and balances on managerial discretion was largely absent.

29. In order to demonstrate the likelihood of intentional or unintentional discrimination, I have reconstructed plaintiff Kristine Becher's actual April, 1997 rent calculation, and then have tried to show how even a small

misjudgment about the "optimal volume" input by a Shell manager could result in radical differences in the net rent paid by competing lessee-dealers. Just as it would be easy for discriminatory property tax assessments to be made without full disclosure of the way the inputs and outputs are determined, and without revealing the resulting assessments of comparable properties, so it is in the case of secretly determined rents. Shell's refusal to discuss the operation and results of its VRP with its dealers in an open way is bound to lead to abuse and to harm competition between its lessee dealers.

30. First--in a way never disclosed to Ms. Becher--here is how her rent for April 1997 was determined:

**Comparison of Kristine Becher Station with Identical Competitor to  
Show How Estimated Optimal Volume Differences Affect Net Rent Paid**

<b>Net Rent Calculation</b>	Becher	Competitor
<b>1 Optimal Volume Estimate (Gallons/Month)</b>	<b>195,000</b>	<b>180,000</b>
2 Market Equalization Factor	1.07	1.07
3 Station Indifference Volume (1 x 2)	208,650	192,600
4 Rent Reduction Rate	\$ 0.045	\$ 0.045
5 Indifference Rent (3 x 4)	\$ 9,389	\$ 8,667
6 Less Contract Rent	\$ 8,518	\$ 8,518
7 Equals Net Indifference Rent	\$ 871	\$ 149
8 Rent Reduction Rate (# 4 above)	\$ 0.045	\$ 0.045
9 Threshold Volume (7 divided by 4)	19,361	3,311
10 Threshold Volume Rounded	19,000	3,000
11 Actual Volume From Becher records	139,954	139,954
12 Threshold Volume (# 10 above)	19,000	3,000
13 Gallons Earning Rent Reduction (11-12)	120,954	136,954
14 Rent Reduction Rate (# 4 above)	\$ 0.045	\$ 0.045
15 Rent Reduction (13 x 14)	\$ 5,443	\$ 6,163
16 Contract Rent (# 6 above)	\$ 8,518	\$ 8,518
17 Less Rent Reduction (# 15 above)	\$ 5,443	\$ 6,163
<b>18 Net Rents (16-17)</b>	<b>\$ 3,075</b>	<b>\$ 2,355</b>

**Minimum Occupancy Rent Calculation**

19 Indifference Rent ( #5 above)	\$ 9,389	\$ 8,667
20 Minimum Occupancy Rate	0.05	0.05
21 Minimum Occupancy Rent (19 x 20)	\$ 469	\$ 433

**Minimum Occupancy Rent Volume Level Calculation**

22 Contract Rent (# 6 above)	\$ 8,518	\$ 8,518
23 Less Minimum Occupancy Rent (#21 above)	\$ 469	\$ 433
24 Maximum Rent Reduction Possible	\$ 8,049	\$ 8,085
25 Divided by Rent Reduction Rate ( #4 above)	\$ 0.045	\$ 0.045
26 Max Gallons on which Rent Reduction Applies	178,856	179,659
27 Plus Threshold Volume (# 10 above)	19,000	3,000
28 MOR Volume Level	197,856	182,659

31. Next, for purposes of exposition, assume that Ms. Becher competes with an identical Shell station a mile down US 31, who for reasons known only to the Shell manager, is assigned an "optimal volume" of 180,000 instead of the 195,000 assigned to Ms. Becher.

32. The column labeled "Competitor" shows that this modest difference results in a significant difference in occupancy cost. (See Line 18 in the chart above). This difference has the same effect as a discrimination in price, and has the same potential to harm competition between the two stations. Had Ms. Becher seen these calculations, she would at least have been able to protest the differences to Shell and if she could establish comparability between the stations, to seek redress. Without such disclosure, the discrimination is perpetuated and Ms. Becher's ability to compete is harmed. She can't make a case without the facts. Similar results could be achieved by manipulating "Contract Rent" or "threshold volume."

33. By Shell's own admission, and implicit in the definition of "indifference rent" in the VRP formula above, Shell acknowledges that rent reductions are the equivalent

of price cuts. I quote from Attachment II, p.1 in a January 16,1990 Shell "InterOffice Memorandum from the Manager, Head Office Retail and Advertising, to Retail District Managers:

...The concept of the VRP is based on Shell's "indifference as to the source of income from each service station. Theoretically, our income requirements may be satisfied totally from the sale of gasoline, totally from rent income, or from a combination of the two. However, the VRP does require the payment of a Flat Facility Rent, regardless of the volume attained"

34. Thus rent discrimination has the same potential for harming competition between Shell dealers as does price discrimination. Rent discrimination and price discrimination should be treated the same. If Shell decides to take a greater return from gasoline and less from station rents, that is Shell's business. But, if they do so, they must administer the rent rebate program in such a way as to avoid discriminating between competing dealers.

35. A station-by-station analysis of the other Shell stations that competes with each of the plaintiff lessee-dealer stations follows. Each competitive Shell station has been selected on the basis of proximity, traffic patterns, commuting data and survey information. Individual maps

showing the spatial relationship between each of the plaintiff stations and its competitors is attached.

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James M. Patterson

3/30/00