



**House
Legislative
Analysis
Section**

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**INCREASE MOTOR FUELS
STANDARDS; FEES; PENALTIES**

**House Bill 5005 as enrolled
Public Act 13 of 2002
Second Analysis (2-12-02)**

**Sponsor: Rep. Larry Julian
House Committee: Transportation
Senate Committee: Transportation and
Tourism**

THE APPARENT PROBLEM:

According to *National Petroleum News Market Facts 1999* and as reported during committee testimony, Michigan ranks seventh among the 50 states in gasoline consumption with over 4.8 billion gallons of gasoline sold annually. An individual consumer purchases about 750 gallons of gasoline a year. Unlike most commodities sold in the state, gasoline is bought sight-unseen, although its quality becomes apparent after purchase if damage to a motor vehicle's engine or fuel system develops.

Gasoline marketing is aggressive and variable, since the industry is driven exclusively by price competition. Consequently, the industry is not self-regulating. While many federal and state agencies are involved in monitoring the transportation, distribution, and sale of gasoline, the responsibility for regulation of gasoline's quality falls to the Michigan Department of Agriculture.

Within the department, the Motor Fuels Quality program historically has received about 1,000 consumer complaints lodged each year against retail gasoline dealers. Complaint investigations are carried out in seven regions of the state, and three of the regions account for 81 percent of the complaints about fraud. See *BACKGROUND INFORMATION* below. The number of complaints increased by 30 percent beginning in May 2000, and that increase has been sustained throughout calendar year 2001.

In addition, during fiscal year 2000, over 300 gasoline marketers were investigated for quality fraud that was discovered during routine complaint investigations and program sampling. Those investigations resulted in fines for 97 firms with \$52,726 in fines collected by the department. Gasoline also was embargoed at 37 locations, and another 135 locations were put on notice that quality violations existed at their sites.

Despite stepped-up enforcement efforts which have resulted in a 50 percent increase in fine collections for 1999 and 2000 over previous years, quality violations continue to rise. Indeed, 14 percent of all gasoline samples tested (including those sampled at random, those sampled by complaint, and those sampled by follow-up after a period that enables compliance) were in violation of standards. Octane failures account for 80 percent of all violations found.

Consumer complaints against retailers remain high, as consumers report their growing concerns about violators. Legislation has been introduced that would raise gasoline standards and increase the penalties for violations of those standards, in order to maintain consumer confidence in the gasoline industry.

THE CONTENT OF THE BILL:

House Bill 5005 would amend the Motor Fuels Quality Act to increase the standards for motor fuel grades, the license fees, and also the penalties for violations of the act. Under the bill, the Department of Agriculture would be required to conduct a review of the fee structure, and the status of the gasoline inspection and testing fund in the 2003 calendar year, and report its recommendations for any change or adjustment in the fee schedule to the House and Senate transportation committees not later than January 1, 2004. The bill would take effect January 1, 2002.

Under the current law, the director of the Department of Agriculture sets standards to ensure the purity and quality of gasoline sold in the state. In particular, the director sets standards for the amount and type of additives, and the grading of gasoline, including but not limited to the following:

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-leaded sub-regular with a minimum 87 AKI (where “AKI” or “antiknock index” is defined to mean an index number arrived at by adding the motor octane number and the research octane number, then dividing by two);

-leaded regular with a minimum 89 AKI; and,

-leaded premium with a minimum 93 AKI.

In addition, currently standards are set for:

-unleaded sub-regular with a minimum 85 AKI;

-unleaded regular with a minimum 87 AKI, and a minimum 82 MON (where “MON” or “motor octane number” means a knock characteristic of gasoline determined by use of standard procedures on a motor engine);

-unleaded mid-grade 88 with a minimum 88 AKI and a minimum 82 MON;

-unleaded mid-grade 89 with a minimum 89 AKI and a minimum 83 MON; and,

-unleaded premium with a minimum 90 AKI.

Finally, under current law the director sets grades for alcohol fuels.

House Bill 5005 would eliminate all of these categories.

In addition, the current law specifies that leaded gasoline with a 94 AKI or more, and unleaded gasoline with a 91 AKI or more, may be offered for sale labeled with the minimum AKI number, if the gasoline has been listed with and approved by the department. The leaded gasoline with 94 AKI or more must be labeled as leaded premium followed by the approved AKI number, and the unleaded gasoline with 91 AKI or more must be labeled unleaded premium followed by the approved AKI number. House Bill 5005 also would eliminate these categories.

Instead, the bill would require the director to establish standards for the grading of gasoline, including but not limited to:

-sub-regular with a minimum 85 AKI;

-regular with a minimum 87 AKI, and a minimum 82 MON (where “MON” or “motor octane number” means a knock characteristic of gasoline determined by use of standard procedures on a motor engine);

-mid-grade 88 with a minimum 88 AKI and a minimum 82 MON;

-mid-grade 89 with a minimum 89 AKI and a minimum 83 MON; and,

-premium with a minimum 90 AKI.

In addition, the director would be required to set standards for:

-premium 91 with a minimum 91 AKI;

-premium 92 with a minimum 92 AKI;

-premium 93 with a minimum 93 AKI; and,

-premium 94 with a minimum 94 AKI.

In addition, current law specifies that a storage tank at a retail outlet must be periodically tested to ensure that the tank does not have water or water-alcohol at the bottom of that tank in an amount greater than two inches. The bill would clarify that this periodic test would be undertaken by the retail dealer.

Further, current law specifies that a refiner or distributor cannot transfer, sell, dispense, or offer gasoline for sale in this state to a distributor unless the refiner or distributor indicates on each bill or invoice the name and wholesale distributor’s license number. House Bill 5005 would retain this provision but delete the requirement to list the wholesale distributor’s license number, requiring only the name.

Current law also specifies that gasoline cannot be offered for sale unless it is visibly free of undissolved water, sediments, and other suspended matter and is clear and bright at an ambient temperature of 70 degrees Fahrenheit. House Bill 5005 would retain this provision but specify an ambient temperature or 70 degrees Fahrenheit, whichever is greater.

Currently the fee for the annual license to distribute or sell fuel is set at \$15 for each year or portion of a year, and the law specifies that a license cannot be issued or renewed until the fee is paid. The law also specifies that a hearing is not required prior to the refusal to issue or review a license. The bill specifies that the fee for the license would be \$15 for each year or portion of a year through July 31, 2002, \$50 for each year or portion of a year through July 31, 2003, \$75 for each year or portion of a year through July 31, 2004, and \$100 beginning August 1, 2004 and each year or portion of a year thereafter.

Under the bill a license could not be issued or renewed until the fee and any administrative fines

issued for violations of the act had been paid. The bill also clarifies that a hearing would not be required before the refusal to issue or renew a license (rather than review a license).

Currently the law specifies that a person who individually, or by the action of an agent or employee, or as the agent or employee of another, violates the act or a rule promulgated under it is subject to an administrative fine. For a first violation, the fine is not less than \$50 or more than \$100 plus actual costs of the investigation and the amount of any economic benefit associated with the violation. The bill would increase these amounts to not less than \$100 or more than \$500 plus actual costs of the investigation and double the amount of any economic benefit associated with the violation. The law also specifies that for a second violation within two years of the first, the fine is not less than \$100 or more than \$250, plus costs of the investigation and the amount of any economic benefit. House Bill 5005 would increase these amounts to not less than \$500 or more than \$1,000 for a second violation within five years, plus actual investigation costs and double any economic benefit. Finally, the law specifies that for a third violation within two years of the first, the fine is not less than \$250 or more than \$500, plus actual costs of the investigation and the amount of any economic benefit. House Bill 5005 would increase these amounts to not less than \$1,000 or more than \$2,000 for a third violation within five years, plus actual investigation costs and double any economic benefit.

Currently the law creates different punishments for two levels of misdemeanors, and one level of felony, and then specifies particular violations in the three levels of both categories. The first misdemeanor level is punishable by imprisonment for not more than 90 days, or a fine of not less than \$1,000 or more than \$2,000, or both. House Bill 5005 would retain this penalty and the current list of violations, but extend it to apply to anyone who makes a false statement on a "label." (Currently, the penalty applies to, among other things, a false statement, representation, or certification, on an application, report, plan, or other document required under the act.) The current law also specifies two violations for which a person can be guilty of a misdemeanor punishable by imprisonment for not more than 90 days, or a fine of not less than \$2,000 or more than \$5,000, or both. The two violations would be retained under the bill (they are violating a prohibited act listed in this section within 24 months after another violation that resulted in conviction, and impersonating the director or any department inspector); however, the maximum fine portion of the

penalty would be increased under the bill to \$10,000. Further, the current law specifies two violations for which a person can be guilty of a felony punishable by imprisonment for not more than two years, or a fine of not less than \$5,000 or more than \$10,000, or both. The two felony violations would be retained under the bill (they are intentionally committing a prohibited act under this section, and violating a prohibited act within 24 months after two previous violations had resulted in convictions); however, the minimum and maximum fine portions of the penalty would be increased under the bill to \$10,000 and \$15,000, respectively.

Finally, throughout House Bill 5005, outdated references to Public Act 150 of 1927 are replaced with updated references to the Motor Fuel Tax Act, Public Act 403 of 2000. In addition and under the bill, outdated provisions would be deleted that specify the time within which dispensing facilities of different sizes were required to obtain a dispensing permit when the dispensing permit requirements were first enacted. The bill would retain the annual \$25 dispensing permit provision, a requirement that began on November 15, 1990, and also specify that the permit could not be issued or renewed until all fees and administrative fines were paid.

MCL 290.643 et al.

BACKGROUND INFORMATION:

Consumer complaints and fraud investigations by region. According to the Motor Fuels Quality Program annual report for fiscal year 2000, gasoline enters the state through tankers, barges, and pipelines, and is trucked to over 5,000 retail locations. Since the average consumer purchases over 750 gallons of gasoline each year, the retailer needs to get new deliveries every one to three days to keep pace with consumer demand. Gasoline is dangerous to regulate, a function of its inter-modal transportation distribution system, composition, additives, volatility, and flammability. Further, gasoline fraud occurs at all levels of the distribution system as the product moves from refinery to consumer.

The Motor Fuels Quality Program in the Department of Agriculture investigated 1,164 consumer complaints during fiscal year 2000. The complaints are divided into two categories: 931 gasoline dispenser complaints, and 233 gasoline quality complaints.

The regulatory program compiles its annual statistics for seven regions of the state: southeastern

Michigan; central Michigan; the Flint-Saginaw area; the Grand Rapids area; southwestern Michigan; northern Michigan; and the Upper Peninsula. During fiscal year 2000, three of the seven regions (southeastern Michigan, central Michigan, and the Flint-Saginaw area) accounted for 80 percent of the complaints about dispensers, and 88 percent of the complaints about fuel quality. The three regions accounted for 81 percent of complaints, overall.

In addition to consumer complaints, the department undertakes its own fraud investigations. Currently there are four fraud allegations under investigation in the Upper Peninsula, two in the Grand Rapids area, four in the Flint-Saginaw area, three in southwestern Michigan, five in central Michigan, and 11 in southeastern Michigan.

Statewide fraud investigations. Some of the Department of Agriculture's fraud investigations extend beyond regional boundaries. Currently there are six statewide cases under investigation for alleged fraud. Among the alleged illegal operations are the following: 1) an owner's beeper is called when an announced inspection occurs, and that beeper sends a code to the dispensers to shut off fraudulent programming at the pump during the inspection, and in the same manner, later reactivates the fraud after the inspection; 2) blend ratios are changed at the inside console program to cheat on octane, but the ratios return to normal for announced sample inspections; 3) computers are programmed to cheat on octane or measurement, but then are easily erased with a flip of a switch, or a brief power interruption; 4) an owner of several locations is suspected of credit card billing fraud and possible weights and measures fraud; 5) a computer chip is designed and installed to deliver a measure that is as much as 40 percent short; however, the chip ensures standard measurement at the customary inspection units of one-, five-, and 10-gallons while remaining short at all other readings; and 6) owners of 26 stations have been observed rigging pumps, and although the pumps were shredded when the station was sold, the Federal Bureau of Investigation suspects this fraud at other locations.

According to investigators in the department, the type and complexity of fraud investigations has escalated during the past five years, as elaborate methods have been created to avoid detection by regulatory officials. For example, nearly four years ago, the Motor Fuels Quality Program reported the following investigation. During May of 1998, the unit completed a 15-month credit card fraud investigation that involved illegal modification and use of an Allen Park station's dispensing system. The station used its

service bay to receive illegally purchased gasoline. The gasoline was pumped through a hose that ran out the back of the station, up and across the roof, and into the vent pipe to the underground storage tank, in order to avoid detection. The investigation ended successfully, and \$70,000 in fines were assessed. That same year, 150 other stations were either fined or warned.

The department's inspectors point out that detection and investigation of these types of fraud require a year or more of investigation. The nature of the fraud, the large and lucrative gains for the violators, and the length of time needed to complete an investigation all serve to increase the danger of the regulatory work. Consequently, Michigan inspectors use concealed fuel tanks and specially designed inspection equipment that can be put in any unmarked vehicle. They report that using concealed equipment during unannounced purchases expedites fraud detection, and allows enforcement officials to ascertain a station owner's operating practices.

Consumer tips. Consumers are advised to follow certain procedures when purchasing gasoline. That consumer safety and protection information is posted on the Michigan Department of Agriculture website: www.mda.state.mi.us. Click on "Consumer Protection," and then open "Consumer Tips for Buying Gasoline."

FISCAL IMPLICATIONS:

The House Fiscal Agency notes that the current price of a license to distribute or sell gasoline is \$15. This bill would increase the license fee to \$100, but phase in that \$85 fee increase over three years so that the cost of the license would be \$50 on August 1, 2002, then \$75 on August 1, 2003, and \$100 on August 1, 2004 and each year thereafter.

The following projected increases in revenue are based on a six-year average from actual revenue collected from fiscal years 1994 through 1999:

- August 1, 2002: licenses increased by \$35 (from current \$15 to proposed \$50) would increase annual revenue by \$196,000 for a total of \$278,000;
- August 1, 2003: licenses increased by \$25 (from proposed \$50 to \$75) would increase annual revenue by \$140,000 from above proposed total of \$278,000 for a new projected total of \$418,000; and,
- August 1, 2004 (and each year thereafter): licenses increased by \$25 (from proposed \$75 to \$100) would increase annual revenue by \$140,000 from above

proposed total of \$418,000 for a new projected total of \$558,000.

An additional mandate would require the Department of Agriculture to review the fee structure and report any recommended changes to the House and Senate Transportation Committees by January 1, 2004.

The bill also would increase the penalties for violations of the act by 100 percent. Collections from motor fuel quality fines average about \$232,200 annually for fiscal years 1994-1999 (from a low of \$2,846 in fiscal year 1995 to a high of \$105,650 in fiscal year 1999). Given that they would double, and assuming the average is what an annual collection would be, the revenue increase would result in \$32,200 more for a total of \$64,400 (or a projected low of \$5,692 in 1995 to a high of \$211,300 in fiscal year 1999). In addition to the proposed penalties, the act currently includes as part of the violation, actual costs of the investigation and the amount of any economic benefit associated with the violation. This bill would double the amount of any economic benefit associated with the violation (there are three levels of penalties, based on the number of violations within two years), and those investigation costs and benefits are indeterminate as each investigation and each economic benefit assigned will be judged on a case-by-case basis.

All revenues collected from the licenses, the investigation costs, and the economic benefit are sent to the state treasurer for deposit into the gasoline inspection and testing fund, and appropriated in the annual Department of Agriculture appropriations act for expenditure in the Laboratory Program. (10-24-01)

ARGUMENTS:

For:

It is important that gasoline consumers be protected from abuses in the market. The responsibility for consumer protection falls to the Department of Agriculture, since it is the agency of government that assures the quality and quantity (or standardized weights and measures) of gasoline sold to customers. Until recently the regulatory program was funded in part by money the state applied to receive under the "oil overcharge" settlement of a 1985 federal class action lawsuit, in which the judge established an escrow account of \$924,560,500 that was to be managed by the United States Department of Treasury. States like Michigan applied for grants from this account to support environmental and energy conservation programs at the state and local level. The funds in that account are now depleted. In

order to continue the regulatory program and ensure fuel quality, a new source of revenue is necessary. This legislation will provide more license fee and fine revenue to the Department of Agriculture.

For:

According to committee testimony, there has been an increase in consumer complaints about gasoline quality and price during the past three years. In addition, there are ongoing investigations to detect fraud by owners and operators of gas stations. For example, fraud investigations have revealed these and other techniques: 1) a pump's electronic system wired with a manual control to dispense the correct amount of gasoline when the inspector is known to be on the premises, but then revert to shortages when the inspector is gone; 2) computer hardware and software that re-programs gasoline pumps so they dispense correct amounts at increments of one-gallon, five-gallons, and 10-gallons (the customary inspected increments), but then reverts to short dispensing at all other amounts; and, 3) the use of illegal octane blending software installed near the cash register, so a station attendant can quickly change program modes to ensure the sample the inspector draws is the correct octane, while all others have octane shortages.

To detect and eliminate these kinds of consumer fraud, the state needs well-trained and well-equipped teams of investigators. This legislation ensures that money raised by the increases in license fees and fine revenue will be dedicated to an inspection program.

Against:

The penalties proposed in this legislation are stiffer than those currently in the law; however, they should be even more severe. For example, during the committee's deliberation, some suggested the following financial penalties for first, second, and third offenses: between \$1,000 and \$5,000 for a first offense; between \$5,000 and \$10,000 for a second offense within two years; and, loss of the license if there are three offenses within two years.

Analyst: J. Hunault

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.