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Prepared Statement of the Federal Trade Commission

**Market Forces, Competitive Dynamics, and Gasoline Prices:
FTC Initiatives to Protect Competitive Markets**

**Presented by
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Commissioner**

**Before the
Subcommittee on Oversight and Investigations
Committee on Energy and Commerce
U.S. House of Representatives**

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I. Introduction

Mr. Chairman and members of the Subcommittee, I am William E. Kovacic, a Commissioner of the Federal Trade Commission. I am pleased to appear before you to present the Commission's testimony on FTC initiatives to protect competitive markets in the production, distribution, and sale of gasoline and other petroleum products.¹

The petroleum industry plays a crucial role in our economy. Indeed, few issues are more important to American consumers and businesses than the decisions being made about current and future energy production and use. Not only do changes in gasoline prices affect consumers directly, but the price and availability of gasoline also influence many other economic sectors. No other industry's performance is more deeply felt, and no other industry is more carefully scrutinized by the FTC.

The Commission's testimony today addresses the Subcommittee's inquiries in two parts. It first reviews the basic tools that the Commission uses to promote competition in the petroleum industry: challenging potentially anticompetitive mergers, investigating potential nonmerger antitrust violations and prosecuting actions where appropriate, and monitoring industry behavior to detect possible anticompetitive conduct. This review of the Commission's petroleum industry agenda highlights the FTC's contributions to maintaining competition in the industry. The Commission places a premium on careful research, industry monitoring, and investigations to understand current petroleum industry developments and to identify obstacles to competition,

¹ This written statement represents the views of the Federal Trade Commission. My oral presentation and responses to questions are my own and do not necessarily represent the views of the Commission or any other Commissioner.

whether arising from private behavior or from public policies. The petroleum industry's performance is shaped by the interaction of extraordinarily complex, fast-changing commercial arrangements and an elaborate set of public regulatory commands. A well-informed understanding of these factors is essential if FTC actions are to benefit consumers.

The second part of this testimony reviews the Commission's additional efforts to examine and analyze issues of importance to consumers in the petroleum industry – including conferences, workshops, studies, and reports.

Recently gasoline prices have been rising. Over the past three months, retail gasoline prices have increased between 80 and 90 cents per gallon (“cpg”), depending on location. The national average price of gasoline has risen from approximately \$2.20 per gallon in early February to over \$3.05 per gallon as of May 7, 2007. Increases in crude oil prices have played a relatively minor role in this increase in retail prices.² Rather, the lion's share of the recent increase in gasoline prices appears to be attributable to three factors: refinery outages, increased demand for gasoline, and decreased gasoline imports.³

A number of refineries have experienced outages in recent months due to fires and

² For example, the price of West Texas Intermediate (“WTI”) benchmark crude oil increased from about \$1.40 per gallon for the week ending February 10 to between \$1.52 and \$1.55 per gallon in the last few weeks – a change of approximately 12-15 cpg over the same three-month period.

³ Refinery margins have grown because the gap between gasoline demand and supply has widened. For example, the weekly average refining margin on conventional gasoline – *i.e.*, the spot market price of gasoline minus the spot price of WTI crude – increased from 10-15 cpg during January and February to 70-80 cpg for the week that ended May 5, 2007. Oil Price Information Service and Department of Energy, Energy Information Administration.

equipment failures.⁴ Meanwhile, gasoline demand has been strong, and gasoline consumption since the beginning of 2007 has increased 1.8 percent over last year. Average weekly consumption since April 2007 was 1.4 percent higher than a year earlier, even though weekly prices reported by the Department of Energy's Energy Information Administration ("EIA") since the beginning of April are averaging 2.9 percent higher than the previous year. Gasoline imports, which make up 10 to 15 percent of United States gasoline supply, are down from 2006 levels – 8 percent since the beginning of April and 10 percent since the beginning of this year.⁵ This reduction in imports means that approximately 1 percent less gasoline supply is available in the United States this year compared to last year. With increased demand, lower imports, and because of recent refinery outages, U.S. inventories of gasoline fell well below normal monthly levels in April and early May of 2007. The most recent data for May 2007, however, show some re-stocking of gasoline inventories.

There is a perception that gasoline prices always increase. Gasoline prices, however, have fluctuated sharply in recent years – from the 2005 price spike after Hurricanes Katrina and Rita to the sharp decrease in prices in the months after the hurricanes; from the increase in prices

⁴ Examples of refinery outages due to fires and equipment failures include: (1) Chevron's Richmond, California refinery, which had a fire just as it was going into a turnaround for maintenance, resulting in its scheduled shutdown being extended by one month (Platt's Oilgram News, April 30, 2007); (2) BP's Whiting, Indiana refinery, which was forced to operate at half-capacity due to a hydrotreater failure (Bloomberg News, April 24, 2007); (3) Valero's McKee, Texas refinery, which was shut down for two months due to a fire and will operate at half capacity until the end of the year (Energy Intelligence Group, April 11, 2007); (4) ExxonMobil's Torrance, California refinery, in which a sulfur recovery unit failed while another such unit was being overhauled (Energy Intelligence Group, April 4, 2007); and (5) Chevron's El Segundo, California refinery, which had a fire affecting two coking units at the refinery, resulting in reduced output (Energy Assurance Daily, April 3, 2007).

⁵ Department of Energy, Energy Information Administration.

during spring 2006 to the dramatic decrease last fall and winter; and then to the dramatic price increase of the last three months. These increases naturally have caused concern and dissatisfaction among gasoline consumers. The Commission considers it an essential part of its responsibility to keep a close eye on the industry and to look for any pricing or other activity that may not reflect purely competitive decisions based on the ordinary forces of supply and demand.

II. FTC Activities to Maintain Competition in the Petroleum Industry

A. Merger Enforcement

Although the FTC does not regulate energy market sectors, the agency plays a key role in maintaining competition and protecting consumers in energy markets. The Commission has been particularly vigilant regarding mergers in the oil industry that could harm competition. It examines any merger and any course of conduct in the industry that has the potential to decrease competition and thus harm consumers of gasoline and other petroleum products. A review from January of this year of horizontal merger investigations and enforcement actions from fiscal year 1996 to fiscal year 2005 shows that the Commission has brought more merger cases at lower levels of concentration in the petroleum industry than in any other industry.⁶ Unlike in other industries, the Commission has brought enforcement actions (and in many cases, obtained

⁶ The Horizontal Merger Guidelines that serve as a guide to merger enforcement by the FTC and the Department of Justice categorize market concentration, as measured by the Herfindahl-Hirschman Index (“HHI”), into three concentration zones. (The HHI is computed by squaring each firm’s market share and summing the squares.) A market with an HHI below 1,000 is considered “unconcentrated.” A market with an HHI between 1,000 and 1,800 is “moderately concentrated,” while a market with an HHI over 1,800 is classified as “highly concentrated.” The likelihood of enforcement agency interest in a merger or acquisition generally increases as HHI levels rise, although concentration levels are only a starting point for the searching analysis of potential competitive effects that is necessary to determine how a particular transaction may affect competition and consumer welfare.

merger relief) in petroleum markets that are only moderately concentrated.⁷

Most recently, the Commission filed for a preliminary injunction in federal court and issued an administrative complaint against a petroleum industry transaction – Western Refining’s proposed acquisition of Giant Industries. On April 12, 2007, the Commission filed its complaint in the U.S. District Court for the District of New Mexico, alleging that the proposed acquisition would lead to reduced competition for the bulk supply of light petroleum products to northern New Mexico.⁸ In the complaint, as amended, we allege that Western and Giant are two of only a small number of firms capable of responding to higher prices or quantity decreases in the bulk supply of gasoline to northern New Mexico, and that Giant would have increased its supply of gasoline to that area absent its acquisition by Western.⁹ Following the district court’s April 13, 2007, issuance of a temporary restraining order against consummation of the transaction, the trial of the preliminary injunction action took place last week, and the court is expected to rule soon on the Commission’s request for an injunction. The FTC issued an administrative complaint against the merger on May 3, 2007.¹⁰

⁷ Federal Trade Commission Horizontal Merger Investigation Data, Fiscal Years 1996-2005 (Jan. 25, 2007), Table 3.1, et seq., *available at* <http://www.ftc.gov/os/2007/01/P035603horizmergerinvestigationdata1996-2005.pdf>; FTC Horizontal Merger Investigations Post-Merger HHI and Change in HHI for Oil Markets, FY 1996 through FY 2003 (May 27, 2004), *available at* <http://www.ftc.gov/opa/2004/05/040527petrolactionsHHIdeltachart.pdf>.

⁸ *Federal Trade Commission v. Paul L. Foster, Western Refining, Inc., and Giant Industries, Inc.*, Civil Action No. 07cv352 JH/ACT (D.N.M. Apr. 12, 2007), *available at* <http://www.ftc.gov/os/caselist/0610259/index.shtm>.

⁹ *See* <http://www.ftc.gov/os/caselist/0610259/070430weterngiantfirstamndcmplt.pdf>.

¹⁰ Two other recent FTC law enforcement actions also involve the energy sector, although not the petroleum industry. The Commission issued an administrative complaint on

Also, on March 14, 2007, the FTC challenged the acquisition of energy transportation, storage, and distribution firm Kinder Morgan by Kinder Morgan management and a group of investment firms, including private equity funds managed and controlled by The Carlyle Group and Riverstone Holdings. Because the proposed transaction threatened competition between Kinder Morgan and Magellan Midstream – a major competitor of Kinder Morgan in terminaling and distributing gasoline and other light petroleum products in the southeastern United States – the Commission ordered the parties in effect to turn Carlyle’s and Riverstone’s interest in Magellan Midstream into a passive investment.¹¹

In November 2006, Chevron and USA Petroleum abandoned a transaction in which Chevron would have acquired most of the retail gasoline stations owned by USA Petroleum, the

March 14, 2007, challenging Equitable Resources’ proposed acquisition of The Peoples Natural Gas Company from Dominion Resources. According to the FTC’s complaint, the acquisition would result in a monopoly in the distribution of natural gas to nonresidential customers in certain areas of Allegheny County, Pennsylvania, including Pittsburgh. See <http://www.ftc.gov/os/adjpro/d9322/0703admincmp.pdf>. Following the Pennsylvania Public Utility Commission’s approval of the merger, the FTC also filed a request in the federal district court in Pittsburgh, seeking a preliminary injunction against the transaction. On May 14, 2007, the court granted defendants’ motion to dismiss on state action grounds; the Commission has requested an injunction pending appeal.

In addition, in November 2006, the FTC challenged EPCO’s proposed \$1.1 billion acquisition of TEPPCO’s natural gas liquids storage businesses. The FTC approved a consent order that allowed the acquisition to be completed only if TEPPCO first divested its interests in the world’s largest natural gas liquids storage facility in Mont Belvieu, Texas, to an FTC-approved buyer. *EPCO, Inc., and TEPPCO Partners, L.P.*, FTC Docket No. C-4173 (Oct. 31, 2006) (consent order), available at <http://www.ftc.gov/os/caselist/0510108/0510108c4173do061103.pdf>.

¹¹ *TC Group L.L.C., et al.*, FTC Docket No. C-4183 (Mar. 14, 2007) (consent order), available at <http://www.ftc.gov/os/caselist/0610197/index.shtm>.

largest remaining chain of service stations in California not controlled by a refiner. USA Petroleum's president acknowledged that the parties abandoned the transaction because of resistance from the FTC.¹²

The Commission filed a complaint on July 27, 2005, in federal district court in Hawaii, alleging that Aloha Petroleum's proposed acquisition of Truststreet Properties' half interest in an import-capable terminal and retail gasoline assets on the island of Oahu would reduce the number of gasoline marketers from 5 to 4 and could lead to higher gasoline prices for Hawaii consumers.¹³ The case was resolved through the parties' execution of a 20-year throughput agreement that will preserve the competition that we believed was threatened by the acquisition.¹⁴

In June 2005, the FTC challenged the acquisition of Kaneb Services and Kaneb Pipe Line Partners – companies that engaged in petroleum transportation and terminaling in a number of markets – by Valero L.P., the largest petroleum terminal operator and second largest operator of liquid petroleum pipelines in the United States.¹⁵ The complaint alleged that the acquisition had the potential to increase prices in bulk gasoline and diesel markets.¹⁶ The FTC's consent order

¹² See Elizabeth Douglass, *Chevron Ends Bid to Buy Stations*, L.A. TIMES, Nov. 18, 2006, available at <http://www.latimes.com/business/la-fi-chevron18nov18,1,7256145.story?coll=la-headlines-business&ctrack=1&ccset=true>.

¹³ *Aloha Petroleum Ltd.*, FTC File No. 051 0131 (July 27, 2005) (complaint), at <http://www.ftc.gov/os/caselist/1510131/050728comp1510131.pdf>.

¹⁴ FTC Press Release, *FTC Resolves Aloha Petroleum Litigation* (Sept. 6, 2005), available at <http://www.ftc.gov/opa/2005/09/alohapetrol.htm>.

¹⁵ *Valero L.P.*, FTC Docket No. C-4141 (June 14, 2005) (complaint), at <http://www.ftc.gov/os/caselist/0510022/050615comp0510022.pdf>.

¹⁶ *Id.*

requires the parties to divest assets sufficient to maintain premerger competition, including certain Kaneb Philadelphia-area terminals, Kaneb's West pipeline system in Colorado's Front Range, and Kaneb's Martinez and Richmond terminals in Northern California.¹⁷ In addition, the order forbids Valero L.P. from discriminating in favor of or otherwise preferring its Valero Energy affiliate in bulk ethanol terminaling services, and requires Valero to maintain customer confidentiality at the Selby and Stockton terminals in Northern California. The order succeeds in maintaining import possibilities for wholesale customers in Northern California, Denver, and greater Philadelphia and precludes the merging parties from undertaking an anticompetitive price increase.

These are only the most recent actions; the FTC has challenged, or obtained modifications of, numerous other mergers and acquisitions. Indeed, statistics on FTC merger enforcement in the petroleum industry show that, from 1981 to 2007, the agency filed complaints against 21 petroleum mergers. In 13 of these cases, the FTC obtained significant divestitures.¹⁸

¹⁷ *Valero L. P.*, FTC Docket No. C-4141 (July 22, 2005) (consent order), at <http://www.ftc.gov/os/caselist/0510022/050726do0510022.pdf>.

¹⁸ See, e.g., *Chevron Corp.*, FTC Docket No. C-4023 (Jan. 2, 2002) (consent order), at <http://www.ftc.gov/os/2002/01/chevronorder.pdf>; *Valero Energy Corp.*, FTC Docket No. C-4031 (Feb. 19, 2002) (consent order), at <http://www.ftc.gov/os/2002/02/valerodo.pdf>; *Conoco Inc. and Phillips Petroleum Corp.*, FTC Docket No. C-4058 (Aug. 30, 2002) (Analysis of Proposed Consent Order to Aid Public Comment), at <http://www.ftc.gov/os/2002/08/conocophillipsan.htm>. Not all oil industry merger activity raises competitive concerns, however. In 2003, the Commission closed its investigation of Sunoco's acquisition of the Coastal Eagle Point refinery in the Philadelphia area without requiring relief. The Commission noted that the acquisition would have no anticompetitive effects and seemed likely to yield substantial efficiencies that would benefit consumers. *Sunoco Inc./Coastal Eagle Point Oil Co.*, FTC File No. 031 0139 (Dec. 29, 2003) (Statement of the Commission), at <http://www.ftc.gov/os/caselist/0310139/031229stmt0310139.pdf>. The FTC also considered the likely competitive effects of Phillips Petroleum's proposed acquisition of Tosco. After careful scrutiny, the Commission declined to challenge the acquisition. A statement issued in

Of the eight other matters, the parties in four cases abandoned the transactions altogether after agency antitrust challenges; one case resulted in a remedy requiring the acquiring firm to provide the Commission with advance notice of its intent to acquire or merge with another entity; another case (the above-mentioned Aloha/Trustreet matter) was resolved with the announcement of a throughput agreement to preserve competition;¹⁹ yet another case (the Chevron/Unocal matter, discussed below) was resolved with the parties' agreement not to enforce certain patents on CARB gasoline; and a final case (the above-mentioned Carlyle/Riverstone matter) resulted in certain ownership interests being made passive and the prohibition of exchanges of competitively sensitive information.

The Commission's merger investigations also are relevant to the detection of nonmerger antitrust violations. FTC oil and gas merger investigations during the past decade uniformly have been major undertakings that have reviewed the pertinent facets of the relevant markets. These investigations have involved the review of thousands of boxes of documents in discovery, examination of witnesses under oath, and exhaustive questioning of outside experts. All of this provides FTC staff with a greater understanding of the industry, which should assist in detecting and investigating potentially anticompetitive conduct.

B. Nonmerger Investigations into Gasoline Pricing

connection with the closing of the investigation set forth the FTC's reasoning in detail. *Phillips Petroleum Corp.*, FTC File No. 011 0095 (Sept. 17, 2001) (Statement of the Commission), at <http://www.ftc.gov/os/2001/09/philipstocostmt.htm>.

¹⁹ BUREAU OF ECONOMICS, FEDERAL TRADE COMMISSION, THE PETROLEUM INDUSTRY: MERGERS, STRUCTURAL CHANGE, AND ANTITRUST ENFORCEMENT (2004) [hereinafter PETROLEUM MERGER REPORT], available at <http://www.ftc.gov/os/2004/08/040813mergersinpetrolberpt.pdf>.

In addition to scrutinizing mergers, the Commission aggressively polices anticompetitive conduct. When it appears that higher prices might result from collusive activity or from anticompetitive unilateral activity by a firm with market power (that is, the kinds of activity that can lead to artificially higher prices), the agency investigates to determine whether unfair methods of competition have been used. If the facts warrant, the Commission challenges the anticompetitive behavior, usually by issuing an administrative complaint.

1. *Unocal*

On March 4, 2003, the Commission issued an administrative complaint against Unocal, stating that it had reason to believe that Unocal had violated Section 5 of the FTC Act.²⁰ The Commission alleged that Unocal deceived the California Air Resources Board (“CARB”) in connection with regulatory proceedings to develop the reformulated gasoline (“RFG”) standards that CARB adopted. Unocal allegedly misrepresented that certain technology was non-proprietary and in the public domain, while at the same time it pursued patents that would enable it to charge substantial royalties if CARB mandated the use of Unocal’s technology in the refining of CARB-compliant summertime RFG. The Commission alleged that, as a result of these activities, Unocal illegally acquired monopoly power in the technology market for producing the new CARB-compliant summertime RFG, thus undermining competition and harming consumers in the downstream product market for CARB-compliant summertime RFG in California. The Commission estimated that Unocal’s enforcement of its patents could potentially result in over \$500 million of additional consumer costs each year.

²⁰ *Union Oil Co. of California*, FTC Docket No. 9305 (Mar. 4, 2003) (complaint), at <http://www.ftc.gov/os/2003/03/unocalcmp.htm>.

Additional concerns arose when Chevron and Unocal proposed to merge. Although Unocal had no horizontal refining or retailing overlaps with Chevron, it had claimed the right to collect patent royalties from companies that had refining and retailing assets (including Chevron). If Chevron had unconditionally inherited these patents by acquisition, it would have been in a position to obtain sensitive information and to claim royalties from its own horizontal downstream competitors. Chevron, the Commission alleged, could have used this information and this power to facilitate coordinated interaction and detect any deviations.

The Commission resolved both the Chevron/Unocal merger investigation and the monopolization case against Unocal with consent orders requiring Chevron's agreement not to enforce the Unocal patents.²¹ The FTC's settlement of these two matters was a substantial victory for California consumers. The Commission's monopolization case against Unocal was complex and, with possible appeals, could have taken years to resolve, with Unocal receiving substantial royalties – and consumers paying higher prices – in the interim. The settlement provided the full relief sought in the monopolization case and also resolved the only competitive issue raised by the merger. With the settlement, consumers benefitted immediately from the elimination of royalty payments on the Unocal patents, and potential merger efficiencies could result in additional savings at the pump.

2. Investigation and Report on Manipulation and Post-Katrina Price Gouging

In May 2006, the Commission completed an extensive, Congressionally-mandated

²¹ *Chevron Corp.*, FTC Docket No. C-4144 (July 27, 2005) (consent order), at <http://www.ftc.gov/os/caselist/0510125/050802do0510125.pdf>; *Union Oil Co. of California*, FTC Docket No. 9305 (July 27, 2005) (consent order), at <http://www.ftc.gov/os/adjpro/d9305/050802do.pdf>.

investigation²² to determine whether gasoline prices were being affected by manipulation²³ and to determine whether “price gouging” occurred following Hurricane Katrina.²⁴ The investigation included the full-time commitment of a significant number of attorneys, economists, financial analysts, and other personnel with specialized expertise in the petroleum industry. Based on our knowledge and expertise from previous investigations and studies, and the concerns raised by knowledgeable observers and market participants about competition in this industry, the Commission and its staff focused substantially on levels of the industry and parts of the country where problematic behavior was most likely to have occurred and to have had an effect on consumers.²⁵

²² FEDERAL TRADE COMMISSION, INVESTIGATION OF GASOLINE PRICE MANIPULATION AND POST-KATRINA GASOLINE PRICE INCREASES (Spring 2006), *available at* <http://www.ftc.gov/reports/060518PublicGasolinePricesInvestigationReportFinal.pdf>.

²³ “Price manipulation” is not a defined legal or economic term. As used in the Commission’s report, the term “price manipulation” included (1) all transactions and practices that are prohibited by the antitrust laws (including the Federal Trade Commission Act) and (2) all other transactions and practices, irrespective of their legality under the antitrust laws, that tend to increase prices relative to costs and to reduce output.

²⁴ No federal statute identifies a legal violation of “price gouging,” and state laws prohibiting price gouging have not adopted a common definition or standard to describe the practice. The statute mandating the post-Katrina pricing investigation effectively defined price gouging, for purposes of the investigation, as an average price of gasoline available for sale to the public following the hurricane that exceeded its average price in the area for the month before the hurricane, unless the increase was substantially attributable to additional costs in connection with the production, transportation, delivery, and sale of gasoline in that area or to national or international market trends. Accordingly, for the report we analyzed whether specific post-Katrina price increases were attributable either to increased costs or to national or international trends.

²⁵ The FTC undertook another major nonmerger investigation during 1998-2001, examining the major oil refiners’ marketing and distribution practices in Arizona, California, Nevada, Oregon, and Washington (the “Western States” investigation). FTC Press Release, *FTC Closes Western States Gasoline Investigation* (May 7, 2001), *available at* <http://www.ftc.gov/opa/2001/05/westerngas.htm>. The agency initiated the Western States

The Commission's investigation did not uncover any evidence of manipulation to increase prices aside from limited instances of price gouging as defined by the statute mandating the post-Katrina pricing investigation.²⁶ Evidence indicated that the price of crude oil, the largest cost component of gasoline, contributed to most of the gasoline price increases that occurred from early 2002 until just before Hurricane Katrina struck the United States. Higher refining margins caused some of the remaining increase.²⁷

investigation out of concern that differences in gasoline prices in Los Angeles, San Francisco, and San Diego might be due partly to anticompetitive activities. The investigation uncovered no basis to allege an antitrust violation, and the Commission closed the investigation in May 2001.

In addition, the Commission conducted a nine-month investigation into the causes of gasoline price spikes in local markets in the Midwest in the spring and early summer of 2000. As explained in a 2001 report, the Commission found that a variety of factors contributed in different degrees to the price spikes. Midwest Gasoline Price Investigation, Final Report of the Federal Trade Commission (Mar. 29, 2001), *available at* <http://www.ftc.gov/os/2001/03/mwgasrpt.htm>; *see also* Remarks of Jeremy Bulow, Director, Bureau of Economics, Federal Trade Commission, *The Midwest Gasoline Investigation*, *available at* <http://www.ftc.gov/speeches/other/midwestgas.htm>. Primary factors included refinery production problems (*e.g.*, refinery breakdowns and unexpected difficulties in producing the new summer-grade RFG gasoline required for use in Chicago and Milwaukee), pipeline disruptions, and low inventories. Secondary factors included high crude oil prices that contributed to low inventory levels, the unavailability of substitutes for certain environmentally required gasoline formulations, increased demand for gasoline in the Midwest, and *ad valorem* taxes in certain states. The industry responded quickly to the price spike. Within three or four weeks, an increased supply of product had been delivered to the Midwest areas suffering from the supply disruption. By mid-July 2000, prices had receded to pre-spike or even lower levels.

²⁶ *But see* Concurring Statement of Commissioner Jon Leibowitz (concluding that the behavior of many market participants leaves much to be desired and that price gouging statutes, which almost invariably require a declared state of emergency or other triggering event, may serve a salutary purpose of discouraging profiteering in the aftermath of a disaster), *available at* <http://www.ftc.gov/speeches/leibowitz/060518LeibowitzStatementReGasolineInvestigation.pdf>.

²⁷ Margins in any competitive market can be expected to increase, at least in the short run, during periods of strong demand.

The Commission analyzed various aspects of refinery operations to determine whether refiners manipulated, or tried to manipulate, gasoline prices. Staff investigated whether refiners manipulate prices in the short run by operating their refineries below full productive capacity in order to restrict supply, by altering their product output to produce less gasoline, or by diverting gasoline from markets in the United States to less lucrative foreign markets. Staff also investigated allegations that companies refused to invest sufficiently in new refineries for the purpose of tightening supply and raising prices in the long run. Staff found no evidence to suggest that refiners manipulated prices through any of these means. Instead, the evidence indicated that refiners responded to market prices by trying to produce as much higher-valued products as possible, taking into account crude oil costs and physical characteristics. The evidence also indicated that refiners did not reject profitable capacity expansion opportunities in order to raise prices.

The Commission also examined the extent to which infrastructure constraints gave pipelines the ability or incentive to manipulate gasoline prices, or limited the ability of marketers to move additional supply to specific markets when an unexpected need arose. The evidence we obtained during our investigation did not suggest that pipeline companies made rate or expansion decisions to manipulate gasoline prices. Similarly, we found no evidence suggesting anticompetitive activity involving refined product terminals.

Inventory levels have declined since at least the early 1980s, covering periods when the real price of gasoline was declining and increasing. Our investigation did not produce evidence, however, that oil companies reduced inventory in order to manipulate prices or exacerbate the effects of price spikes due to supply disruptions. Maintaining inventories is costly, both in terms

of the value of assets held and in terms of the actual costs of storing the product. The decline in inventory levels reflects a trend that is not limited to the petroleum industry. As in many other major industries, lower inventory holdings likely allowed oil companies to free up capital to invest in other areas and save storage costs. Low inventories, however, provide little cushion for gasoline supplies when there is an unexpected disruption.

Hurricanes Katrina and Rita caused substantial damage to the nation's petroleum infrastructure. In the week after Hurricane Katrina – which caused the immediate loss of 27 percent of the nation's crude oil production and 13 percent of national refining capacity – the average price of gasoline increased by about 50 cents per gallon in six representative cities. About 35 cents per gallon of the post-Katrina price increase dissipated by the time Hurricane Rita hit. Rita damaged another 8 percent of crude production and, even accounting for the refineries affected by Katrina and back online, 14 percent of domestic refining capacity was lost.

In light of the amount of crude oil production and refining capacity knocked out by Katrina and Rita, the sizes of the post-hurricane price increases were approximately what would be predicted by the standard supply and demand paradigm that presumes a market is performing competitively. Thus the regions of the country that experienced the largest price increases were those that normally receive supply from areas affected by the hurricanes.

Evidence gathered during our investigation indicated that the conduct of firms in response to the supply shocks caused by the hurricanes was consistent with competition. After both hurricanes, companies with unaffected assets increased output and diverted supplies to high-priced areas. This is what we would expect in competitive markets and what the affected consumers needed. Refiners deferred scheduled maintenance in order to keep refineries

operating. Imports increased and companies drew down existing inventories to help meet the shortfall in supply.

The Commission's assessment of potential price gouging as defined in the relevant legislation revealed that the average gasoline price charged by eight of 30 refiners analyzed increased five or more cents per gallon more than the national average price trend for this period. Once geographic locations of sales and channels of distribution were taken into account, however, individual refiners' price increases appeared comparable to local market trends in almost every instance.²⁸

Based on an analysis of retail pricing data and retailer interviews, the Commission concluded that some "price gouging" by individual retailers, as defined by the relevant statute, did occur to a limited extent. Local or regional market trends, however, explained the price increases in all but one case. Exceptionally high prices on the part of individual retailers generally were very short-lived. Interviews with retailers that charged exceptionally high prices indicated that at least some were responding to station-level supply shortages and to imprecise and changing perceptions of market conditions.

The Commission's spring 2006 report to Congress, as well as testimony delivered to the full Senate Commerce Committee the day after we released the report, addressed a number of important policy issues arising from the investigation, including the important role of prices in a market-based economy and the misallocation of resources that can stem from attempts to cap or control prices. Underscoring the crucial role of the antitrust laws in ensuring that consumers are

²⁸ *But see* Concurring Statement of Commissioner Jon Leibowitz at 1-2, *available at* <http://www.ftc.gov/speeches/leibowitz/060518LeibowitzStatementReGasolineInvestigation.pdf>.

offered competitive market prices for gasoline, the report and testimony pointed out the problems that price gouging legislation can engender, including interference with the market's pricing mechanism that is likely to lead to even worse shortages and more harm to consumers. The Commission advised Congress that if it enacts a price gouging statute despite these considerations, it will be important to make the law as clear to businesses and easy to enforce as possible. In addition, the Commission urged Congress to include important mitigating factors in any price gouging statute, including allowance for market factors of supply and demand and the maintenance of incentives for firms to increase supply into a disaster-affected area.

C. Price Monitoring Project

In a program unique to the petroleum industry, the Commission actively and continuously monitors retail and wholesale prices of gasoline and diesel fuel.²⁹ FTC staff monitors gasoline and diesel prices to identify “unusual” price movements³⁰ and then examines whether any such movements might result from anticompetitive conduct that violates Section 5 of the FTC Act. FTC economists developed a statistical model for identifying such movements. The agency's economists regularly scrutinize price movements in 20 wholesale regions and approximately 360 retail areas across the country. In no other industry does the Commission so closely monitor prices.

The staff reviews daily data from the Oil Price Information Service, a private data

²⁹ See FTC, *Oil and Gas Industry Initiatives*, at <http://www.ftc.gov/ftc/oilgas/index.html>.

³⁰ An “unusual” price movement in a given area is a price that is significantly out of line with the historical relationship between the price of gasoline in that area and the gasoline prices prevailing in other areas.

collection agency, and receives information weekly from the public gasoline price hotline maintained by the U.S. Department of Energy (“DOE”). The staff monitoring team uses an econometric model to determine whether current retail and wholesale prices are anomalous in comparison to the historical price relationships among cities. When there are unusual changes in gasoline or diesel prices, the project alerts the staff to those anomalies so that we can make further inquiries into the situation.

This gasoline and diesel monitoring and investigation initiative, which focuses on the timely identification of unusual movements in prices (compared to historical trends), is one of the tools that the FTC uses to determine whether a law enforcement investigation is warranted. If the FTC staff detects unusual price movements in an area, it researches the possible causes, including, where appropriate, through consultation with the state attorneys general, state energy agencies, and the EIA. In addition to monitoring DOE’s gasoline price hotline complaints and the OPIS data, this project includes scrutiny of gasoline price complaints received by the Commission’s Consumer Response Center and of any similar information provided to the FTC by state and local officials. If the staff concludes that an unusual price movement likely results from a business-related cause (*i.e.*, a cause unrelated to anticompetitive conduct), it continues to monitor but – absent indications of potentially anticompetitive conduct – it does not investigate further.³¹ The Commission’s experience from its past investigations and from the current monitoring program indicates that unusual movements in gasoline prices typically have a business-related cause. FTC staff further investigates unusual price movements that do not

³¹ Business-related causes include movements in crude oil prices, supply outages (*e.g.*, from refinery fires or pipeline disruptions), or changes in and/or transitions to new fuel requirements imposed by air quality standards.

appear to be explained by business-related causes to determine whether anticompetitive conduct may underlie the pricing anomaly.³² Cooperation with state law enforcement officials is an important element of such investigations.

III. Additional Efforts to Examine Markets and Promote Competition

A. 2007 Energy Conference

In addition to its law enforcement investigations and its price monitoring project, the Commission spends significant resources examining and analyzing issues of importance to consumers in the petroleum industry. An important recent development in this regard was the public conference on “Energy Markets in the 21st Century: Competition Policy in Perspective” that the FTC hosted for three days last month. The conference brought together leading experts from the government, industries in the energy sector, consumer groups, and academia to exchange information and ideas about critical issues related to energy development, transportation, marketing, and use. Speakers at the conference addressed such topics as “Savvy Consumers in the Energy Marketplace,” “New Frontiers of Energy,” “The Current Implications of the World Energy Situation for United States Energy Supplies,” and “How Do Energy Markets Work Within the Framework of Government Policy Choices?” The conference website contains numerous presentations by the panelists and a number of informative background papers.³³ The Commission expects to release a written report presenting findings from the conference.

³² For example, following up on observations of anomalous pricing patterns affecting multiple cities over the past year, staff currently is examining bulk supply and demand conditions and practices for gasoline and diesel in the Pacific Northwest.

³³ See <http://www.ftc.gov/bcp/workshops/energymarkets/index.shtml>.

B. Ethanol Report

Last December, the Commission issued its second annual report on the current state of the United States ethanol industry, including measurements of market concentration using capacity and production data.³⁴ The study concluded that U.S. ethanol production currently is not highly concentrated, and that market concentration had decreased by between 21 and 35 percent since the date of the first ethanol report. The study also examined the possible effect on concentration of agreements between ethanol producers and third-party marketers. By attributing the producers' market shares to marketers when producers make such agreements, FTC staff derived alternative estimates of market concentration. The study concluded that the level of concentration in ethanol production would not justify a presumption that a single firm, or a small group of firms, could wield sufficient market power to set or coordinate price or output levels. The report noted, however, that the staff does rule out the possibility that future mergers within the industry may raise competitive concerns.

C. FTC/NAAG Workshop on Petroleum Issues

On September 21, 2006, the FTC joined with the National Association of Attorneys General to sponsor a workshop on key issues in the petroleum industry. With a substantial number of FTC staff and more than 50 representatives of state attorney general offices in attendance, the day-long program focused on such issues as mergers, consolidation, and other structural trends in the petroleum sector; petroleum product pricing and distribution practices in the aftermath of natural disasters and other severe supply interruptions; and law enforcement

³⁴ Federal Trade Commission, 2006 REPORT ON ETHANOL MARKET CONCENTRATION (Dec. 1, 2006), *available at* http://www.ftc.gov/reports/ethanol/Ethanol_Report_2006.pdf.

issues of mutual interest to the Commission and state attorneys general. The workshop, which built upon a long history of cooperation between the FTC and state officials in conducting petroleum industry investigations, afforded participants an excellent opportunity to share information and perspectives about the most fruitful ways to conduct law enforcement proceedings and studies in this sector of the economy.

D. Gasoline Price Changes Report

In July 2005, the Commission published its study explaining the competitive dynamics of gasoline pricing and price changes.³⁵ This study grew out of conferences of industry, consumer, academic, and government participants held by the Commission over the preceding four years, as well as years of research and experience, and sheds important light on how gasoline prices are set. As described in the Commission's report, in general, the price of gasoline reflects producers' costs and consumers' willingness to pay. Gasoline prices rise if it costs more to produce and supply gasoline, or if people wish to buy more gasoline at the current price – that is, when demand is greater than supply. Gasoline prices fall if it costs less to produce and supply gasoline, or if people wish to buy less gasoline at the current price – that is, when supply is greater than demand. Gasoline prices will stop rising or falling when they reach the level at which the quantity consumers demand matches the quantity that producers will supply.

How consumers respond to price changes will affect how high prices rise and how low they fall. Limited substitutes for gasoline restrict the options available to consumers to respond to price increases in the short run. Because gasoline consumers typically do not reduce their

³⁵ FEDERAL TRADE COMMISSION, GASOLINE PRICE CHANGES: THE DYNAMIC OF SUPPLY, DEMAND, AND COMPETITION (2005), *available at* <http://www.ftc.gov/reports/gasprices05/050705gaspricesrpt.pdf>.

purchases substantially in response to price increases, they are vulnerable to substantial price increases.

Furthermore, producers' responses to price changes will affect how high prices rise and how low they fall. In general, when there is not enough gasoline to meet consumers' demands at current prices, higher prices will signal a potential profit opportunity and may bring additional supply into the market. Additional supply will be available to the extent that an increase in price exceeds the producers' cost of expanding output.

E. Petroleum Merger Report

In 2004, the FTC staff published a study reviewing mergers and structural changes in the petroleum industry, as well as the antitrust enforcement actions that the agency had taken over the past 20 years with respect to petroleum industry mergers.³⁶ This study, the third in a series of reports dating back to 1982 (and covering mergers since 1971), found that mergers of private oil companies have not significantly affected worldwide concentration in crude oil, and that concentration for most levels of the petroleum industry has remained low to moderate. In addition, FTC merger investigations and enforcement have helped prevent further increases in petroleum industry concentration.

³⁶ PETROLEUM MERGER REPORT, *supra* note 19.

IV. Conclusion

High gasoline prices are a drain on consumers' budgets, particularly low-income working Americans who need cars and trucks to travel to and from their jobs. Policymakers are right to be concerned about this issue, and enforcers should – and do – vigorously pursue any evidence of market manipulation or otherwise anticompetitive conduct leading to those higher prices.

Where genuinely anticompetitive conduct is found, the Federal Trade Commission aggressively enforces the antitrust laws in the petroleum industry. The Commission has taken action whenever a merger or particular conduct has violated the law and threatened the welfare of consumers or competition in the industry. The Commission continues to search for appropriate targets of antitrust law enforcement, to monitor retail and wholesale gasoline and diesel prices closely, and to study this industry in detail.

Thank you for this opportunity to present the FTC's views on this important topic. I look forward to answering your questions.