UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Prepared Statement of the Federal Trade Commission

Petroleum Industry Consolidation

Presented by
Dr. Michael A. Salinger
Director
Bureau of Economics
Federal Trade Commission

Before the
Joint Economic Committee
United States Congress

May 23, 2007

I. Introduction

Mr. Chairman and members of the Committee, I am Michael A. Salinger, Director of the Bureau of Economics 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 through our vigilant and comprehensive merger program.[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. For example, just last month the Commission challenged a merger between Western Refining and Giant Industries because it believes the merger will lead to the reduced supply of bulk light petroleum products in Northern New Mexico.

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 released in January of this year of horizontal merger investigations and enforcement actions from

---

[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 Commissioner.

fiscal year 1996 to fiscal year 2005 shows that the Commission has brought more merger cases at lower levels of market concentration in the petroleum industry than in any other industry.[2] Unlike in other industries, the Commission has brought enforcement actions (and obtained merger relief in many cases) in petroleum markets that are only moderately concentrated.[3]

Although we analyze each petroleum merger according to numerous market facts surrounding the transaction, an overall analysis of merger policy in the petroleum industry necessarily takes a longer and broader view. Over the past 20 years, the Commission's merger policy has been consistent across administrations. Applying sound principles of law and of economics, this policy has been designed and focused to prevent the accumulation and use of market power to the detriment of consumers.

Over the past two decades, the petroleum industry has undergone a structural upheaval, punctuated by a burst of large mergers in the late 1990s. A number of other industries also saw a

---

[2] 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 understand a transaction's potential effects. U.S. Dep't of Justice and Fed. Trade Comm'n, *1992 Horizontal Merger Guidelines* (Section 4 on Efficiencies revised April 8, 1997), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,104 ("Merger Guidelines").

[3] 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.

large number of mergers in that time frame. Certain forces unique to producing and distributing petroleum products, however, have spurred the transformation of that industry. Technological, economic, and regulatory factors have led toward reliance on a smaller number of larger, more sophisticated refineries that can process different kinds of crude oil more efficiently. The development of crude oil spot and futures markets has reduced the risks of acquiring crude oil through market transactions – as opposed to owning crude oil extraction and production assets – thus contributing to a decline in vertical integration between crude oil production and refining among the major oil companies. A number of major integrated firms have restructured to concentrate on one or more segments of the industry, and a number of unintegrated refiners or retailers have entered. Domestic crude oil production has fallen, and foreign sources have supplied an increasing share of the crude oil refined in the United States, thus enhancing the importance of competition in the world market for crude oil. That competition has intensified over the last decade with the dramatic increase in crude oil demand from newly industrializing countries.

II. The FTC's Expertise in the Petroleum Industry

Since the early 1980s, the FTC has been the federal antitrust agency primarily responsible for addressing petroleum industry competition issues. The Commission has closely scrutinized prices and examined any merger and nonmerger activity in the gasoline industry that had the potential to decrease competition and thus harm consumers. The Commission and its staff have developed expertise in the industry through years of investigation and research, pursuant to our primary function as a law enforcement agency tasked with preventing "unfair methods of competition,"[4] as well as mergers or acquisitions whose effect "may be substantially to lessen competition, or tend to create a monopoly."[5] Under Section 5 of the FTC Act and Section 7 of the Clayton Act, the agency has carefully examined proposed mergers and has blocked or required revisions[6] of any that have threatened to harm consumers by reducing competition.

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.[7] Of the eight other matters, the parties in four

---

[4] Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45.

[5] Section 7 of the Clayton Act, 15 U.S.C. § 18.

[6] FTC enforcement action has played an important role in the restructuring of the petroleum industry over the past 20 years. The Commission has not challenged mergers when the overall transaction was efficient and procompetitive but has required divestitures to remedy the anticompetitive effects that might have arisen in particular relevant markets. These FTC orders permitted the merging firms to achieve the economic benefits of the transaction while curing the potential anticompetitive effects through divestiture to a third party.

[7] *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 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/phillipstoscostmt.htm.

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 (*Aloha/Trustreet*) was resolved with the announcement of a throughput agreement to preserve competition;[8] yet another case (*Chevron/Unocal*) was resolved with the parties' agreement not to enforce certain patents on California's CARB gasoline; and the order in a final case (*Carlyle/Riverstone*) required certain ownership interests to be made passive and prohibited exchanges of competitively sensitive information.

In 2004, the FTC staff also published a study reviewing the petroleum industry's mergers and structural changes as well as the antitrust enforcement actions that the agency has taken in the industry over the past 20 years.[9] This was the Commission's third such report since 1982.[10] Like its predecessors, the 2004 report had two basic goals: to inform public policy concerning competition in the petroleum industry, and to make more transparent how the Commission analyzes mergers and other competitive phenomena in this sector.

Several themes emerged from the Commission's study of changes in the petroleum industry over the past two decades:

---

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

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

[10] *See* Federal Trade Commission, *Mergers in the Petroleum Industry* (Sept. 1982), *available at* http://www.ftc.gov/os/2004/08/040813mergersinpetrol82.pdf; Staff Report of the Bureau of Economics, Federal Trade Commission, *Mergers in the U.S. Petroleum Industry 1971-1984: An Updated Comparative Analysis* (May 1989), *available at* http://www.ftc.gov/os/2004/08/040813mergersinpetrol84.pdf.

- Mergers of private oil companies have not significantly affected worldwide concentration in crude oil. This fact is important, because crude oil prices historically have been the chief determinant of gasoline prices.

- Despite some increases over time, concentration for most levels of the United States petroleum industry has remained low to moderate.

- Intensive, thorough FTC merger investigations and enforcement have helped prevent further increases in petroleum industry concentration and avoid potentially anticompetitive problems and higher prices for consumers.

- Economies of scale have become increasingly significant in shaping the petroleum industry. The United States has fewer refineries than it had 20 years ago, but the average size and efficiency of refineries have increased, along with the total output of refined products.

- Industry developments have lessened the incentive to vertically integrate throughout all or most levels of production, distribution, and marketing. Several significant refiners have no crude oil production, and integrated petroleum companies today tend to depend less on their own crude oil production. In addition, a number of independent retailers purchase refined products on the open market.

- Some significant independent refiners have built market share by acquiring refineries that were divested from integrated majors pursuant to FTC enforcement orders.[11]

III. Merger Enforcement in the Petroleum Industry

The Commission has gained much of its antitrust enforcement experience in the petroleum industry by analyzing proposed mergers and challenging transactions that likely would reduce competition, thus resulting in higher prices. For more than 20 years, the FTC has been the

[11] In 2005, the Commission issued a report on the various factors that influence the price of gasoline and other refined petroleum products. *See* Federal Trade Commission, *Gasoline Price Changes: The Dynamic of Supply, Demand, and Competition* (2005), *available at* http://www.ftc.gov/reports/gasprices05/050705gaspricesrpt.pdf. A key lesson of this report is that worldwide supply, demand, and competition for crude oil are the most important factors in the national average price of gasoline in the United States. Other important factors affecting retail gasoline prices include retail station density, new retail formats, environmental factors, state and local tax rates, and state and local regulations.

federal antitrust agency primarily responsible for reviewing conduct in the petroleum industry to assess whether it is likely to reduce competition and harm consumer welfare. In this role, the FTC has devoted substantial resources to investigating and studying the industry. For example, during the period of large oil industry mergers in the late 1990s, the Bureau of Competition spent almost one-fourth of its enforcement budget on investigations in energy industries.

The Commission investigates every substantial petroleum industry merger. Many transactions, particularly smaller ones, raised no competitive concerns and required no enforcement intervention. A case-by-case analysis is necessary to find the relevant markets in which competition might be lessened, to assess the likelihood and significance of possible competitive harm, and to fashion remedies to ensure that competition is not reduced in those relevant markets and consumers consequently are not harmed.[12] It is important to note that mergers can be, and often are, efficiency-enhancing and procompetitive.

The FTC's analysis of petroleum mergers follows the same Department of Justice/Federal Trade Commission Horizontal Merger Guidelines that the agencies use to analyze mergers in other industries. Although merger analysis begins with concentration data, the Commission analyzes qualitative factors – consistent with advances in economic learning and case law

---

[12] In May 2004, the Government Accountability Office released a report that purported to analyze how eight petroleum industry mergers or joint ventures carried out during the late 1990s affected gasoline prices. GAO, *Energy Markets: Effects of Mergers and Market Concentration in the U.S. Petroleum Industry* (May 2004). The Commission regards evaluations of past enforcement decisions as valuable elements of responsible antitrust policymaking, and is supportive of the goal of the GAO inquiry – to evaluate the consequences of past decisions by the federal antitrust agencies. The Commission believes, however, that the GAO report suffered from a number of significant deficiencies. *See* Prepared Statement of the Federal Trade Commission Before the Committee on Energy and Commerce, Subcommittee on Energy and Air Quality, U.S. House of Representatives, *Market Forces, Anticompetitive Activity and Gasoline Prices – FTC Initiatives to Protect Competitive Markets* (July 15, 2004), *available at* http://www.ftc.gov/os/2004/07/040715gaspricetestimony.pdf.

developments – that indicate whether a merger will increase the ability of the merging parties to exercise market power in one or more properly defined relevant markets[13] by curbing output unilaterally or by coordinating their behavior with rival suppliers.

Despite increases in concentration at some production levels over the last two decades, particularly since the mid-1990s, most sectors of the petroleum industry generally remain unconcentrated or moderately concentrated. In addition, the growth of independent marketers and hypermarkets has increased competition at the wholesale and retail levels in many areas.

Some mergers have led to increased concentration. An increase in concentration from a merger, however, is not by itself a sufficient basis for finding that a merger is anticompetitive. Where concentration changes raise concerns about potential competitive harm, the FTC conducts a more detailed investigation. When it has concluded that a merger is likely to reduce competition, the FTC has required divestitures or sought preliminary injunctions. Many of the mergers the FTC challenged would have lessened competition significantly if they had proceeded as originally planned. Our antitrust remedies prevented those increases: through carefully crafted divestitures and other remedial provisions, the Commission has mandated the elimination of competitively problematic overlaps between the merging parties while allowing the competitively unobjectionable – or even efficiency-enhancing – portion of a transaction to

---

[13] The correct definition of a market in merger review is a detailed, fact-intensive inquiry that involves both product and geographic components. We must ascertain for which product (or products) the transaction may harm competition, and we also must determine the geographic area over which any anticompetitive effects will be felt. In our analysis of petroleum mergers, national, state, or PADD-wide "markets" rarely correspond to properly defined geographic markets. ("PADD" stands for "Petroleum Administration for Defense District." PADD I consists of the East Coast. PADD II consists of the Midwest. PADD III includes the Gulf Coast. PADD IV consists of the Rocky Mountain region. PADD V is made up of the West Coast plus Alaska and Hawaii.)

proceed.

Collectively, mergers have raised competitive concerns at all of the various levels of the petroleum industry, but the majority of FTC actions have targeted downstream activities, *i.e.*, refining, refined products pipelines, terminals, and marketing. The competitive concern generally has been that the merger would enable the merged firm to raise prices in a market for products that it sells to the next level of the industry (*e.g.*, refined products sold to wholesalers, or wholesale products sold to retailers) through either unilateral or coordinated behavior. A key element in assessing the potential for adverse competitive effects is to determine the alternatives available to customers, including whether more distant suppliers are viable options. Some enforcement actions have been based on a potential competition theory; some on competitive problems involving market power held by a buyer or a group of buyers; and some on vertical concerns relating to the ability of a single firm or a coordinating group of firms to raise the costs of other firms in the industry, to the injury of consumers.

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.[14] 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

[14] *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.

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.[15] 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.[16]

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

---

[15] *See* http://www.ftc.gov/os/caselist/0610259/070430weterngiantfirstamndcmplt.pdf.

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

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.[17]

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 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.[18]

The Commission filed a complaint on July 27, 2005, in federal district court in Hawaii, alleging that Aloha Petroleum's proposed acquisition of Trustreet 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.[19] The case was resolved through the parties' execution of a 20-year throughput agreement that will preserve the competition that we believe was threatened by the acquisition.[20]

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

---

[17] *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.

[18] *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&cset=true.

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

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

markets – by Valero L.P., the largest petroleum terminal operator and second largest operator of liquid petroleum pipelines in the United States.[21] The complaint alleged that the acquisition had the potential to increase prices in bulk gasoline and diesel markets.[22] The FTC's consent order required 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.[23] 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.

In the past few years, the Commission has brought a number of other important merger cases. One of these challenged the merger of Chevron and Texaco,[24] which combined assets located throughout the United States. Following an investigation in which 12 states participated, the Commission issued a consent order against the merging parties requiring numerous divestitures to maintain competition in particular relevant markets, primarily in the western and

---

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

[22] *Id.*

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

[24] *Chevron Corp.*, FTC Docket No. C-4023 (Jan. 2, 2002) (consent order), *at* http://www.ftc.gov/os/2002/01/chevronorder.pdf.

southern United States.

Another petroleum industry transaction that the Commission challenged successfully was the $6 billion merger between Valero Energy Corp. ("Valero") and Ultramar Diamond Shamrock Corp. ("Ultramar").[25] Both Valero and Ultramar were leading refiners and marketers of gasoline that met the specifications of the California Air Resources Board ("CARB"), and they were the only significant suppliers to independent stations in California. The Commission's complaint alleged competitive concerns in both the refining and the bulk supply of CARB gasoline in two separate geographic markets – Northern California and the entire state of California – and the Commission contended that the merger could raise the cost to California consumers by at least $150 million annually for every one-cent-per-gallon price increase at retail.[26] To remedy the alleged violations, the consent order settling the case required Valero to divest (1) an Ultramar refinery in Avon, California; (2) all bulk gasoline supply contracts associated with that refinery; and (3) 70 Ultramar retail stations in Northern California.[27]

An additional example is the Commission's 2002 challenge to the merger of Phillips Petroleum Company and Conoco Inc., alleging that the transaction would harm competition in the Midwest and Rocky Mountain regions of the United States. To resolve that challenge, the Commission required the divestiture of (1) the Phillips refinery in Woods Cross, Utah, and all of the Phillips-related marketing assets served by that refinery; (2) Conoco's refinery in Commerce City, Colorado (near Denver), and all of the Phillips marketing assets in Eastern Colorado; and

---

[25] *Valero Energy Corp.,* FTC Docket No. C-4031 (Feb. 19, 2002) (consent order), *at* http://www.ftc.gov/os/2002/02/valerodo.pdf.

[26] *Valero Energy Corp*, FTC Docket No. C-4031 (Dec. 18, 2001) (complaint), *at* http://www.ftc.gov/os/2001/12/valerocmp.pdf.

[27] *Valero Energy Corp.*, *supra* note 25.

(3) the Phillips light petroleum products terminal in Spokane, Washington.[28] The Commission's order ensured that competition would not be lost and that gasoline prices would not increase as a result of the merger.

To sum up structural changes and merger enforcement policy in the last two decades, mergers have contributed to the restructuring of the petroleum industry but have had only a limited impact on industry concentration. The FTC has investigated all major petroleum mergers and required relief when it had reason to believe that a merger was likely to lead to competitive harm. The FTC has required divestitures in moderately concentrated markets as well as in highly concentrated markets.

IV. Other FTC Activities in the Petroleum Industry

In addition, beyond investigating mergers and acquisitions, the FTC also is very active in other antitrust enforcement work in this industry. For example, in a program unique to the

---

[28] *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. For example, 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 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/phillipstoscostmt.htm.

Acquisitions of firms operating mainly in oil or natural gas exploration and production are unlikely to raise antitrust concerns, because that segment of the industry is generally unconcentrated. Acquisitions involving firms with de minimis market shares, or with production capacity or operations that do not overlap geographically, also are unlikely to raise antitrust concerns.

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 movements[30] 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 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

---

[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.

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 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.

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

---

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.

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.

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.

In May 2006, the Commission completed an extensive, Congressionally-mandated investigation[34] to determine whether gasoline prices were being affected by manipulation[35] and to determine whether "price gouging" occurred following Hurricane Katrina.[36] The investigation included the full-time commitment of a significant number of attorneys, economists, financial

---

[33] *See* http://www.ftc.gov/bcp/workshops/energymarkets/index.shtml.

[34] 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.

[35] "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.

[36] 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.

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.[37]

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

---

[37] 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 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.

the post-Katrina pricing investigation.[38] 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.[39]

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

---

[38] *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.

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

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 obtained during that investigation did not suggest that pipeline companies made rate or expansion decisions to manipulate gasoline prices. Similarly, the Commission 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. The investigation, however, did not produce evidence 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.[40]

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

---

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

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 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 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.

V. Conclusion

The Federal Trade Commission has an aggressive program to enforce the antitrust laws in the petroleum industry. The agency has taken action whenever a merger or nonmerger 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 analyze and bring cases against any merger that is potentially anticompetitive, 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.