<u>REPORT OF THE FEDERAL TRADE COMMISSION ON ACTIVITIES IN THE OIL AND NATURAL GAS INDUSTRIES</u>

<u>REPORTING PERIOD JULY-DECEMBER 2008</u>

The Federal Trade Commission ("Commission" or "FTC") is pleased to submit this second report to the Congressional Appropriations Committees ("the Committees") in response to the Explanatory Statement that accompanied the Consolidated Appropriations Act for Fiscal Year 2008. That Explanatory Statement directed the Commission to "submit a report to the Committees on Appropriations every six months summarizing its activities relating to ongoing reviews of mergers, acquisitions and other transactions in the oil and natural gas industries, the investigation of pricing behavior or any potential anticompetitive actions in those industries, and the resources that the Commission has devoted to such reviews and investigations during that period."[1]

In the Commission's view, it bears repeating that no other sector of the economy is subject to more antitrust scrutiny by the FTC than the energy industries. The Commission continued to pay very close attention to the energy sector during the second half of 2008. During this period, the FTC and its staff continued to focus on mergers and acquisitions, possible anticompetitive conduct, and other activities involving pricing or competition in the petroleum and natural gas industries. The Commission expects its vigorous activity in this area to continue during 2009 and beyond.

During the second half of 2008, personnel from all parts of the Commission were involved in law enforcement, economic analysis, and rule- or policy-related activities in the oil and natural gas industries. The Commission's specially appointed Associate General Counsel for Energy remained involved in virtually all aspects of the agency's work in these industries. Personnel from both the Mergers III division of the Bureau of Competition (which is devoted primarily to petroleum and natural gas issues), from that Bureau's front office, and from numerous other Bureau divisions have been involved in addressing oil and natural gas issues as well.[2] In addition to the Bureau of Competition, one division of the Commission's Bureau of

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[1] Explanatory Statement for Division D, Title V, Consolidated Appropriations Act, 2008, Pub. L. No. 110-161 (House Appropriations Committee Print at 895, *available at* <u>http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_house_committee_prints&docid=f:39564d.pdf</u>). As the Commission noted in its original report, because this is a public report, it is drafted to exclude sensitive details of ongoing investigations, which the Commission is prohibited by law from revealing.

[2] Additional offices in the Bureau of Competition that have participated in oil and gas matters during the second half of 2008 include the Mergers I, Mergers II, and Mergers IV divisions, the Division of Anticompetitive Practices, the Division of Compliance, the Division of Technology and Information Management, the Office of Policy and Coordination, the Division of Operations, and the Office of Premerger Notification.

Economics also bore major responsibility for conducting competition analysis of pricing and other competitive issues in the petroleum and natural gas industries. Other staff involved in oil and natural gas matters during the second half of 2008 came from the Commission's Bureau of Consumer Protection, the Office of the General Counsel, the Office of Congressional Relations, the Commissioners' offices, and other FTC organizations.[3] All told, approximately 125 FTC staff members – attorneys, economists, paralegals, research analysts, and others – have worked on matters involving antitrust and pricing issues in the oil and natural gas sector during the relevant period, with some of these personnel (such as those in Mergers III and the economists who maintain the FTC's Gasoline and Diesel Price Monitoring Project) spending all or most of their time on these matters.

During the relevant period, the Commission actively reviewed mergers and acquisitions and maintained enforcement actions in the petroleum and natural gas industries, in order to identify anticompetitive effects and challenge transactions that threaten harm to consumers.

For example, the Commission concluded its successful involvement in the formerly proposed acquisition by Equitable Resources, Inc., of The Peoples Natural Gas Company from Dominion Resources, Inc. – a review that led to an FTC challenge in federal court and, ultimately, to the abandonment of the transaction. The FTC's investigation had revealed that the acquisition would substantially lessen competition in the distribution of natural gas to nonresidential customers in Pittsburgh and certain other areas of Allegheny County, Pennsylvania, and the agency sued to block the transaction. Although the United States district court denied the Commission's motion for a preliminary injunction, the United States Court of Appeals for the Third Circuit granted our motion for an injunction pending appeal. On January 15, 2008, while the appeal to the Third Circuit was pending, the parties abandoned the transaction. At the request of the Commission, the Court of Appeals ordered the district court to vacate its opinion as moot. The abandonment of the transaction was a substantial victory for consumers through the preservation of competition in the distribution of natural gas to nonresidential customers in the affected geographic areas. In early July 2008, the Commission closed the matter and so notified the parties.

The Commission also reviewed a number of other mergers and acquisitions involving oil and gas firms. During the second half of calendar 2008, the agency received premerger filings under the Hart-Scott-Rodino Act for eight proposed transactions in these industries. The agency reviewed each of these transactions, and also monitored the industry for other, nonreportable transactions that might raise antitrust concerns.[4]

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[3] The staff involved in the Commission's petroleum market manipulation rulemaking proceeding (discussed at page 5, *infra*) continues to come from offices spanning the entire agency.

[4] The Commission's previous report stated that the agency received 16 Hart-Scott-Rodino filings for transactions in the oil and natural gas industries during the first half of 2008. In fact, the Commission received three additional Hart-Scott-Rodino filings in these industries between

Since July 1, 2008, the Commission has conducted several new inquiries into transactions involving petroleum or natural gas, including an acquisition in the lubricating oil industry, a joint venture among natural gas pipeline companies, and an acquisition involving retail gas station operators in several western states (with a focus on Washington State). Certain investigations were closed due to a lack of competitive overlap or because the transactions being scrutinized were unlikely to lead to anticompetitive effects.

The Commission's work involving oil and natural gas also includes the examination of possibly anticompetitive conduct by firms in these industries.

For example, during the relevant period, the agency concluded a very intensive investigation of bulk supply and demand conditions and markets for gasoline and diesel fuel throughout the Pacific Northwest region, with a particular focus on price anomalies in western and eastern Washington State and supply conditions in Petroleum Administration for Defense Districts IV and V. On May 18, 2007, the Commission authorized the use of compulsory process to determine whether the observed prices resulted from unlawful anticompetitive activity. On June 21, 2007, the Commission issued numerous civil investigative demands and subpoenas *duces tecum* to dozens of companies involving refining, transportation, storage, and other aspects of supply in the Pacific Northwest. The demands for documents and data sought to identify refinery, transportation, and terminal disruptions that may have affected bulk supply of gasoline and diesel to the region during the relevant period. In addition to requests for strategic plans and competition-related documents, the staff sought evidence of communications among firms, to help determine whether illegal collusion had occurred.

In response to the subpoenas, the Commission received and staff reviewed more than six gigabytes of data and the equivalent of more than one million pages of responsive documents, in paper and electronic form. Pursuant to confidentiality waivers submitted by the subpoena recipients, the staff received the production, inventory, and sales data regularly reported by the companies to the Department of Energy's Energy Information Administration ("EIA"). The staff also analyzed approximately 327 megabytes of wholesale and retail price data purchased from the Oil Price Information Service ("OPIS"), a private price reporting service used widely by the industry. From January through March 2008, the staff conducted 14 investigational hearings with representatives of major firms. These hearings obtained company testimony relevant to key refinery outages, pipeline operations, and supply issues. The staff also conducted numerous witness interviews throughout this investigation.

The Pacific Northwest bulk supply investigation culminated in a determination that the inquiry had turned up no evidence of illegal conduct, and that the observed price anomalies most likely had stemmed from a series of unrelated events, including longer-than-expected refinery maintenance and unplanned disruptions to refinery operations. The FTC staff briefed interested

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the date on which that report was approved for submission to Congress and June 30, 2008, bringing to 19 the total number of relevant filings during the first half of 2008.

Members of Congress in mid-August concerning the findings and conclusions of the investigation, and the Commission closed the investigation later that month.

Another intensive inquiry has involved gasoline prices in North Adams and other localities in western Massachusetts. To determine whether wholesalers or retailers were pricing in ways inconsistent with competition, the Bureau of Economics staff has examined city average price data from the FTC's Gasoline and Diesel Price Monitoring Project; station-specific data for western Massachusetts; and rack price data for Springfield, Massachusetts, and Hartford, Connecticut (the two terminal areas closest to the western Massachusetts communities). The Bureau has also reviewed the trade and popular press, as well as concerns expressed by consumers to the U.S. Department of Energy Gasoline Price Hotline, for any pertinent information. The staff also has discussed this inquiry with the Massachusetts Attorney General's office. The inquiry has entailed a detailed analysis of pertinent gasoline price data for Massachusetts over the relevant period, with a particular focus on prices in the early summer of 2007 in North Adams, Pittsfield, and Springfield. The Commission expects to conclude this matter early in 2009.

The staff continues to evaluate reported differences in gasoline prices between Cape Cod and off-Cape locations. The FTC's Bureau of Economics is in the process of gathering information to analyze this situation. The Bureau staff is analyzing city average data from the FTC's Gasoline and Diesel Price Monitoring Project;[5] station-level data at various locations on and off Cape Cod; firm-level rack prices for the primary terminal for the wholesale supply of gasoline to Cape Cod.; and several other types of relevant data. Bureau staff also has examined state sales tax and employment data (to glean information about demand trends); reviewed the trade press relating to gasoline supply and brand or station control in southeastern Massachusetts; conducted background research on local zoning and environmental regulations; and sought more information on these issues from various other sources. This inquiry has involved cooperation between FTC staff and the Massachusetts Attorney General's office.[6]

Pursuant to a Congressional inquiry in the spring of 2008, the FTC's Bureau of Economics continued an intensive examination of price increases for diesel fuel and jet fuel in the second half of 2008. The staff collected relevant data from a variety of sources, including information on refinery capacity utilization, imports and exports, and refinery-level financial profits. On September 23, 2008, the Commission sent a letter detailing the results of the staff's inquiry, including an analysis of price trends for diesel fuel and jet fuel that began in 2004.

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[5] *See infra* for a more detailed discussion of the Gasoline and Diesel Price Monitoring Project.

[6] The Commission also has worked closely during this half-year with staff from a number of other state attorney general offices concerning gasoline pricing issues in certain states.

Gasoline prices in the Buffalo, New York, area have been another focus of attention since mid-October 2008. At approximately the same time as the Commission's Gasoline and Diesel Price Monitoring Project detected anomalies in Buffalo gasoline prices, the agency received a Congressional request to examine those prices. The Commission sent an interim reply to the requester, and the staff has been seeking to ascertain the reasons for higher-than-expected gasoline prices in and around Buffalo. In addition, in response to another Congressional inquiry, the staff recently has been examining unusually high prices for gasoline in northern Vermont.

In addition to the matters described above, the Commission has several other efforts underway to examine pricing behavior and to identify and, where appropriate, take action against potential law violations in these industries.

One such activity concerns market manipulation in the petroleum sector. Pursuant to Section 811 of the Energy Independence and Security Act of 2007, Pub. L. No. 110-140, the Commission is acting pursuant to the authority granted under that section regarding the use or employment of "any manipulative or deceptive device or contrivance" "in connection with the purchase or sale of crude oil gasoline or petroleum distillates at wholesale." Following intensive preparatory work by a task force composed of attorneys, economists, and other staff from throughout the agency, the Commission issued an Advance Notice of Proposed Rulemaking ("ANPR") on its website on May 2, 2008 (and in the *Federal Register* on May 7, 2008), and requested public comments by June 6 (extended to June 23) on a range of issues and questions raised in the ANPR. The Commission elicited the views of a wide spectrum of consumer groups, businesses, academic experts, and other informed sources on the issues raised in this proceeding, and received 155 public comments on the ANPR. Following analysis of those comments and additional analysis, the Commission issued a Notice of Proposed Rulemaking ("NPRM") on its website on August 13, 2008 (and in the Federal Register on August 19, 2008), setting forth the text of a proposed rule on petroleum market manipulation and inviting further public comment. In addition to evaluating 36 comments on the NPRM, the Commission held a public workshop on November 6, 2008, as part of the rulemaking proceeding. The all-day workshop – featuring more than 15 outside panelists representing diverse interests and views – considered such issues as the use of Securities and Exchange Commission Rule 10b-5 as a model for an FTC rule, the appropriate reach of an FTC market manipulation rule, and whether to include market or price effects as an element of a cause of action under an FTC rule.

During the relevant period, the FTC also continued a longstanding project that has provided valuable information in connection with the agency's efforts to police conduct in the petroleum industry. Since 2002, the Gasoline and Diesel Price Monitoring Project has involved monitoring by our Bureau of Economics of the wholesale and retail prices of gasoline in order to help detect possible anticompetitive activities and determine whether a law enforcement investigation is warranted. This project continues to track retail gasoline and diesel prices in some 360 cities across the nation and wholesale (terminal rack) prices in 20 major urban areas. The staff of the Bureau of Economics receives daily data from OPIS (except on Sundays); receives information weekly from the Department of Energy's public Gasoline Price Hotline; and reviews other relevant information that the Commission might receive directly from the public or from other federal or state government entities. The staff uses an econometric model to determine whether current retail and wholesale prices each week are anomalous in comparison with historical data. This alerts FTC staff to unusual changes in gasoline and diesel prices so that further inquiry can be undertaken expeditiously. When price increases do not appear to result from market-driven causes, the staff consults with the EIA. FTC staff also contacts the offices of the appropriate state attorneys general to discuss the anomaly and appropriate potential actions, including the opening of an investigation.

Another important FTC activity involving oil and natural gas stemmed from Hurricane Ike and its effects on the energy infrastructure of the U.S. Gulf Coast. After the hurricane made landfall, the Commission began to receive complaints and reports concerning high gasoline prices in areas affected by the storm (particularly southeastern states). The Commission quickly established a Hurricane Ike Task Force comprising staff from throughout the agency, with the mission of closely tracking gasoline price trends and supply information, and developing ways to be as responsive as possible to state authorities and to individual consumers who might need the FTC's assistance. In the first few days after the hurricane hit, Commission staff began consulting daily with the Department of Energy about complaints that the Department receives on its Gasoline Price Hotline. Moreover, we added resources to our own Gasoline and Diesel Price Monitoring Project in order to step up the level of attention that we regularly pay to prices. In addition, we contacted the offices of state attorneys general in hurricane-affected states in order to offer technical assistance in responding to consumer complaints about high gasoline prices; we continue to consult with several states on their questions regarding gasoline economics as they pursue their own pricing-related investigations. In the immediate aftermath of Hurricane Ike, we also supplemented the consumer information on the FTC's website with additional disaster-related resources and, as part of our offer of help to the state attorneys general, we invited them to appropriate any of the FTC website information for their own sites.

On November 14, 2008, the Commission released its *2008 Report on Ethanol Market Concentration*. This was the fourth such annual report issued pursuant to Section 1501(a)(2) of the Energy Policy Act of 2005 (45 U.S.C. § 7545(o)), which requires the FTC annually to perform a market concentration analysis to determine whether there is sufficient competition among ethanol industry participants "to avoid price-setting and other anticompetitive behavior." The Commission concluded its 2008 report with the observation that although "the trend of the industry to become more and more unconcentrated each year is now slowing or even slightly reversing," industry dynamics "make it extremely unlikely that a single ethanol producer or marketer, or a small group of such firms, could wield sufficient market power to be able to engage in price-setting or other anticompetitive behavior."[7]

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[7] The Commission's 2008 ethanol report is available at http://www.ftc.gov/os/2008/11/081117ethanolreport.pdf.

A number of reports prepared by the FTC or its staff that predate the period covered by the current report to Congress also demonstrate the Commission's commitment to delving deeply into key competition and consumer issues in the energy sector and sharing its expertise with Congress and the public. *See*, *e.g.*, FEDERAL TRADE COMMISSION, REPORT ON

Conclusion

Thus, the Commission has maintained its intensive antitrust scrutiny of the energy sector during the second half of 2008. In view of the fundamental importance of oil, natural gas, and other energy resources to the overall vitality of the United States and world economy, there is every reason to expect that FTC activities in the oil and natural gas industries will remain a centerpiece of our work for years to come.

SPRING/SUMMER 2006 NATIONWIDE GASOLINE PRICE INCREASES (2007), *available at* http://www.ftc.gov/reports/gasprices06/P040101Gas06increase.pdf; FEDERAL TRADE COMMISSION, REPORT ON GASOLINE PRICE MANIPULATION AND POST-KATRINA GASOLINE PRICE INCREASES (2006), *available at* http://www.ftc.gov/reports/060518PublicGasolinePricesInvestigationReportFinal.pdf; FEDERAL TRADE COMMISSION, GASOLINE PRICE CHANGES: THE DYNAMIC OF SUPPLY, DEMAND, AND COMPETITION (2005), *available at* http://www.ftc.gov/reports/gasprices05/050705gaspricesrpt.pdf; FEDERAL TRADE COMMISSION, BUREAU OF ECONOMICS, THE PETROLEUM INDUSTRY: MERGERS, STRUCTURAL CHANGE, AND ANTITRUST ENFORCEMENT (2004), *available at* http://www.ftc.gov/os/2004/08/040813mergersinpetrolberpt.pdf.