Prepared Statement of the Federal Trade Commission

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I. Introduction

Mr. Chairman and members of the Committee, I am Richard G. Parker, Director of the Federal Trade Commission's Bureau of Competition. I am pleased to appear before you today to present the Commission's testimony concerning the important topic of recent large increases in the prices of oil products, and what the various agencies of the federal and state governments can, and should, do in response. This is a national issue that calls for a coordinated response from all parties.

The FTC is a law enforcement agency whose statutory authority covers a broad spectrum of the American economy, including the companies and economic sectors that make up the energy industry and its various components. The Commission enforces, among other statutes, the FTC Act[2] and the Clayton Act,[3] sharing with the Department of Justice authority under section 7 of the Clayton Act to prohibit mergers or acquisitions that may "substantially lessen competition or tend to create a monopoly."[4] In addition, section 5 of the FTC Act prohibits "unfair methods of competition" and "unfair or deceptive acts or practices," thus giving the Commission responsibilities in both the antitrust and consumer protection areas. In antitrust cases not involving mergers, the laws enforced by the Commission generally prohibit two categories of anticompetitive activities-conspiracies in restraint of trade and exclusionary monopoly tactics. The Commission also provides advice and guidance to states and other federal regulatory agencies on competition issues.[5] Moreover, the Commission has experience in applying antitrust principles across many different industries.

Experience demonstrates that competition among market participants ordinarily will provide consumers with the benefits of low prices, desirable products, good service, and innovation. Certainly that is the case for energy products, including oil, natural gas, and electric power.

The Commission has had experience in enforcing the antitrust laws in each of these

industries. The Commission has expended a substantial part of its resources in recent years on energy matters. In fiscal years 1999 and 2000 to date, the Bureau of Competition spent 115 work years on investigations in energy industries, almost one-third of its total enforcement budget. So far in fiscal 2000, the Bureau has spent over 35 work years on energy related matters.

II. The Commission's Experience With Antitrust Enforcement in Energy Industries

Much of the Commission's experience with enforcing the antitrust laws in energy industries has been in analyzing mergers. Merger enforcement is the first line of defense in protecting a competitive marketplace, because it preserves rivalry that brings lower prices and better services to consumers. The Commission blocks those mergers that increase the likelihood that the merged firm can unilaterally, or in concert with others, increase prices or reduce output or innovation. The Commission has an extensive history of carefully investigating mergers in the energy industries, particularly petroleum, and the FTC has challenged mergers in those industries that would be likely to reduce competition, result in higher prices, and injure the economy of the nation or any of its regions.[(6)]

The Commission has been particularly active in investigating petroleum mergers due to the ongoing trend of consolidation and concentration in this industry. On February 2, 2000 the Commission voted to challenge the proposed merger of BP/Amoco and ARCO.[(7)] In recent years, the Commission has investigated the mergers of Exxon and Mobil[(8)] and BP and Amoco[(9)]-the two largest oil mergers in history-and the combination of the refining and marketing businesses of Shell, Texaco and Star Enterprises to create the largest refining and marketing company in the United States.[(10)] Other recent mergers regarding petroleum industry assets include Tosco's acquisition of Unocal's California refineries and marketing business, the acquisition by Ultramar Diamond Shamrock of Total's North American refining and marketing operations, and the combination of the refining and marketing businesses of Marathon and Ashland.

Our investigations revealed that several of these transactions threatened competition in local or regional markets. In each instance, relief was obtained to restore the competition lost as a result of the merger in a wide range of markets from refineries to distribution to retailing. In retail markets in Exxon, the Commission ordered divestiture of all Mobil stations from Virginia to New Jersey, and all Exxon stations from New York to Maine, the largest retail divestiture in history. In addition, the Commission ordered additional retail divestiture in Texas and Arizona, the divestiture of Exxon's Benicia refinery and California marketing assets, the divestiture of Mobil's Boston and Manassas, Virginia terminals, the sale of the Exxon Plantation or Mobil Colonial pipeline interest, and the divestiture of Mobil's interest in the Alaska pipeline. In BP/Amoco, the Commission ordered divestiture to preserve retail competition in 30 local gasoline markets mostly in the Midwest, and in Shell-Texaco, the Commission preserved competition through divestiture in local gasoline markets in San Diego and Hawaii, and broader refining and

pipeline markets in the Pacific Northwest, California, and the Southeast.

The Commission has also challenged anticompetitive mergers in other energy industries, including electric power, coal, and gas pipelines. The Commission recently investigated three "convergence mergers"-where an electric power company proposed to merge with a fuel supplier. The first case concerned PacifiCorp's proposed acquisition of The Energy Group PLC and its subsidiary, Peabody Coal.(11) In a second case, the Commission filed a complaint against CMS Energy Corporation's proposed acquisition of two natural gas pipelines from subsidiaries of Duke Energy.(12) In Dominion Resources, the electric utility that accounted for more than 70 percent of the electric power generation capacity in the Commonwealth of Virginia proposed to acquire Consolidated Natural Gas ("CNG"), the primary distributor of natural gas in southeastern Virginia. Working closely with Commonwealth officials, the Commission required the divestiture of Virginia Natural Gas, a subsidiary of CNG.(13)

In each energy investigation, the Commission has carefully reviewed the proposed merger, and has intervened where appropriate to prevent those mergers from significantly reducing competition in any sector of this industry that affects the United States or its citizens. The Commission's inquiry has been, and continues to be, to determine whether a merger would make it substantially likely that the remaining firms in the industry could reduce output and raise prices to the detriment of consumers anywhere in the United States. Consumer protection is the goal of antitrust enforcement across all industries; its importance is particularly clear in the energy industry, where even small price increases can have a direct and lasting impact on the entire economy.

As an analytical matter, the Commission approaches its antitrust mission by examining the areas in which merging companies compete, looking at the existing state of competition in that marketplace and the likely changes in that marketplace in the future, both from new competition entering and from existing competition exiting. We also look at the effect of recent mergers on competition in the particular marketplaces at issue, and whether the merger is a part of a trend towards concentration. The Commission has recognized the existence of such a trend toward consolidation in the petroleum industry.(14)

We also consider whether a merger will yield efficiencies that might counteract the merger's threatened anticompetitive effects. However, efficiencies must be proven-merely claiming cost savings is not enough to allow an anticompetitive merger. The cost savings must be real, they must be substantial, they cannot result from reductions in output, they cannot be practicably achievable by the companies independently of the merger, and they must counteract the merger's anticompetitive effect, not merely flow to the shareholders' bottom line.(15)

The Commission has several active investigations of matters involving energy industries, both merger and nonmerger. Commission rules prevent comment on current investigations, but it is public knowledge that the Commission has filed a complaint against the proposed merger of BP/Amoco and ARCO and is also looking at the issue of

gasoline pricing in California and other Western states.

III. The Current Economic Environment and Possible Government Action

The last year has been a volatile one for energy prices in the United States, and that volatility has only increased in the first few months of this year. Based on publicly available information, we know that crude oil prices rose from $12 per barrel in February 1999 to over $31.00 per barrel by March 1, 2000.[(16)] On top of the crude oil price increases, the prices for heating oil and diesel fuel jumped sharply in the Northeast in January 2000. Between January 17 and February 7, prices of New England residential heating oil prices rose from $1.18 to $1.96 per gallon, while New England retail diesel prices rose from $1.44 to $2.12. Just as quickly, however, prices have begun to come down. By February 21, the price for retail diesel fuel fell to $1.74 per gallon and the heating oil price also dropped.[(17)] What are the causes of high prices and substantial price volatility, and what can competition enforcement agencies do to ameliorate them?

It is no secret that the United States is dependent on foreign sources for a major portion of our petroleum consumption. That reliance is growing. In 1998, net imports of crude oil supplied approximately 52 percent of U. S. demand-the highest percentage ever. Despite the rising use of alternate fuels such as coal and natural gas, petroleum still provides 39 percent of the country's energy needs.[(18)]

Higher petroleum prices in 1999 can be traced to several factors. OPEC countries and several other non-OPEC exporting countries curtailed supply. Simultaneously, a number of Asian economies began to recover from a regional recession, causing increased demand for petroleum products. The result was that worldwide consumption exceeded production and inventories were drawn down. The price increase caused by the excess of demand over supply also reduced refinery margins, causing refiners to cut production and use inventories to meet demand.

The short term price volatility in the Northeast was probably caused by several different, or at least additional, factors, including weather and supply problems. Low inventories set the stage for price volatility as changes in demand had to be met from imports. At the beginning of January, East Coast inventories for distillates were about 8 percent below the low end of the normal range.[(19)]

The weather on the East Coast was also unusually severe in January. During the week of January 16, a cold spell hit the Northeast, dropping temperatures to nearly 20 percent lower than normal for that time of the year. The weather had a two-fold effect: at the same time that it caused the demand for heating oil to increase, the cold weather decreased supply because frozen rivers and high winds delayed product movement. Demand for electric power also increased, causing utilities to turn to distillates as a substitute for interruptible natural gas supplies. Additionally, several refinery outages in January exacerbated the supply/demand imbalances.

While cold weather and refinery malfunctions raise no obvious antitrust issues, continued antitrust oversight of these markets is important to insure that market participants do not exacerbate those conditions through anticompetitive conduct. There are a number of potential activities that would violate the laws enforced by the Commission. Price fixing, tying, or agreements on supply reductions could all be antitrust violations. For example, if producers take advantage of market-determined events to overtly or tacitly collude on price increases or output reductions, the enforcement agencies should aggressively intervene. The potential is always present for producers, refiners, or distributors to take advantage of sudden market imbalances to engage in anticompetitive conduct in the hope that their illegal activities will be lost in all the noise.

There are certain markers or evidentiary patterns that the Commission staff looks for when deciding whether or not to open an investigation. Evidence of overt collusion may point to anticompetitive activity, but it is rarely observed. Where there is evidence of overt collusion, criminal enforcement may be appropriate.(20) Where there is evidence of tacit collusion, a closer look also is warranted. Many factors may show tacit collusion, but generally we look for evidence that firms are acting contrary to what would seem to be their independent economic interests. For instance, if some or all firms in an industry are shipping from high margin markets to low margin markets, that may be some evidence of an agreement. If price and cost movement are divorced from each other, that may also be evidence that competitive forces are muted.

It is crucial to separate anticompetitive conduct from market-driven outcomes so as not to chill competitive conduct. Large price increases are not themselves inconsistent with competitive behavior. They may merely be a competitive reaction to large cost increases. Without evidence of concerted activity or exclusionary monopoly conduct, there can be no antitrust violation.

The January price spikes were principally a Northeastern phenomenon. Crude oil prices for Gulf Coast and West Texas Intermediate crude did not increase materially; Midwest heating oil prices increased only 10 cents per gallon. A number of State Attorneys General in the Northeast have opened an investigation of the increase in prices for heating oil and diesel fuel in their jurisdictions and have requested that the Federal Trade Commission assist them. Beyond stating that we are providing such assistance, I cannot comment further on this law enforcement investigation.

IV. Conclusion

The Commission thanks the Committee for holding this important hearing. The American public needs to know what forces are at work in this vital sector of the economy. Higher prices for products that are critical to our citizens' quality of life and for the efficient functioning of the national economy are a matter of serious concern. Where conduct that violates the antitrust laws is implicated in the higher prices, enforcement action must be taken.

The Northeastern Attorneys General's investigation, assisted by the Federal Trade

Commission, should enable us to determine if the reasons for recent increases in the price of heating oil warrant enforcement action.

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

2. 15 U.S.C. § § 41-58.

3. 15 U.S.C. § § 12-27.

4. 15 U.S.C. § 18.

5. In recent years, the Commission has been active in supporting the deregulation of the electric power industry. *See* Commission Letter to the Honorable Thomas E. Bliley, Chairman, Committee on Commerce, United States House of Representatives, Concerning H.R. 2944, The Electric Competition and Reliability Act (Jan. 14, 2000); Comment of the Staff of the Bureau of Economics, Federal Trade Commission, "Inquiry Concerning Commission's Merger Policy Under the Federal Power Act," Dkt. Nos. RM95-8-000 and RM94-7-001 (May 7, 1996); "Revised Filing Requirements," Dkt. No. RM98-4-000 (Sept. 11, 1998); Comment of the Staff of the Bureau of Economics of the Federal Trade Commission Before the Alabama Public Service Commission, Dkt. No. 26427, Restructuring in the Electricity Utility Industry (Jan. 8, 1999).

6. Section 7 of the Clayton Act specifically prohibits acquisitions where the anticompetitive acts affect "commerce in any section of the country." 15 U.S.C. § 18.

7. *Federal Trade Commission v. BP Amoco, p.l.c.,* Civ. No. C 000416 (SI) (N.D. Cal. Feb. 4, 2000) (complaint).

8. *Exxon Corp.,* FTC File No. 991 0077 (Nov. 30, 1999) (proposed consent order).

9. *British Petroleum Company p.l.c. ,* C-3868 (April 19, 1999) (consent order).

10. *Shell Oil Co.,* C-3803 (April 21, 1998) (consent order).

11. *PacifiCorp,* FTC File No. 971 0091 (consent order accepted for public comment Feb. 17, 1998). This order was withdrawn when the parties abandoned the transaction.

12. *CMS Energy Corp.,* C-3877 (June 2, 1997) (consent order).

13. *Dominion Resources, Inc.*, C-3901 (Dec. 9, 1999).

14. *British Petroleum Company p.l.c.,* C-3868 (April 19, 1999) (consent order), Analysis to Aid Public Comment.

15. *See* United States Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines § 4 (1992), *reprinted in* Trade Reg. Rep. (CCH) ¶ 13,104 (1992).

16. Energy Information Administration, Heating Fuels and Diesel Update, March 2, 2000, at www.eia.doe.gov. *See also* Martha M. Hamilton, "Three Major Oil Producers Consider Increasing Output,"

Washington Post (March 2, 2000) at E3.

17. Statement of John Cook, Petroleum Division Director, Energy Information Administration, Department of Energy, before the Committee on Energy and Natural Resources, United States Senate (Feb. 24, 2000).

18. *Id.*

19. The low inventories were likely a response to both high crude prices and an expectation that those prices would come down. If refineries had expected crude prices to continue to rise, it would have made sense to continue buying instead of reducing inventories.

20. The Department of Justice has brought a number of criminal enforcement proceedings against international price fixing cartels in industries such as food additives and vitamins.