Prepared Statement of the Federal Trade Commission

Midwest Gasoline Prices

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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 high gasoline prices in certain Midwest markets. Competition in the energy sector-particularly in the petroleum industry-is vital to the health of the economy of the United States. Antitrust enforcement has an important role to play in ensuring that the industry is, and remains, competitive.

Consumers in some Midwest markets, such as Chicago and Milwaukee, have experienced considerable price increases in gasoline since early spring, and prices continued to spike up in June before easing slightly this month. The national average retail price of reformulated gasoline ("RFG") increased from $1.29 to $1.67 per gallon from November, 1999 to June 12, 2000, before declining by a penny to $1.66 on July 3, 2000.[(2)] In Chicago, the average RFG price rose from $1.85 per gallon on May 30 to $2.13 on June 20, before falling to $1.82 on July 10, 2000.[(3)] From May 30 to June 20 in Milwaukee the average RFG price increased from $1.74 to $2.02, but by July 10 had fallen to $1.70.[(4)] During the week of June 19, RFG prices at some Chicago gas stations apparently rose as high as $2.50, although they have since receded.[(5)]

Conventional gasoline prices in the Midwest have also risen substantially from late 1999 levels, although they have receded slightly in recent months. National average retail prices increased from $1.25 to $1.61 per gallon for conventional gasoline between November, 1999 and June 12, 2000, and then eased to $1.60 on July 3, 2000.[(6)] Average conventional gasoline retail prices in the Midwest rose from $1.55 to $1.85 per gallon from May 29 to June 19, 2000, but had decreased to $1.67 by July 3, 2000.[(7)] Increases as dramatic as those seen in recent weeks, without any obvious complete explanation, call for scrutiny by antitrust enforcement authorities to determine whether they result from collusion or other unlawful anticompetitive conduct.

The FTC is a law enforcement agency with two related missions: to preserve competition in the marketplace for the ultimate benefit of consumers and to protect consumers from deceptive or unfair practices that may injure them more directly. Unlike agencies that focus on particular industries, the Commission's statutory authority covers a broad spectrum of sectors in the American economy, including the energy industry and its various components. The Commission's Bureau of Competition shares responsibility for antitrust enforcement with the Antitrust Division of the Department of Justice. The Commission also shares its expertise in both competition and consumer protection matters by providing advice to the States and to other federal regulatory agencies.[(8)]

Consumer welfare is the goal of antitrust enforcement across all industries. Its importance is particularly clear in the energy industry, where even small price increases can strain the budgets of many consumers, particularly those with low and fixed incomes, and of small business, and, as a result, can have a direct and lasting impact on the entire economy. In fiscal years 1999 and 2000 to date, the Bureau of Competition spent almost one-third of its total enforcement budget on investigations in energy industries.

Today, we provide an overview of our investigation into whether illegal conduct has led to gasoline price increases in Chicago, Milwaukee, and elsewhere in the Midwest.

II. Potential Causes of the Current Price Spikes

Publicly available information suggests that several factors may have contributed to the recent spikes in prices. The first factor is the reduced global supply of crude oil. In the second half of 1999, OPEC countries, joined by several non-OPEC oil exporting countries, curtailed the global supply of crude oil. During the same time period, a number of Asian economies began to recover from a regional recession, causing increased demand for petroleum products. Moreover, in recent months, many foreign economies have experienced impressive growth, while the U.S. economy has continued its record expansion. The result is that worldwide consumption of crude oil has exceeded production, and world and U.S. inventories have been drawn down. Refiners responded to the crude price increases caused by this crude shortage by cutting gasoline production and using inventories of gasoline to meet demand, in the expectation that inventories could be replenished once crude oil prices dropped, with the result that the spread between crude oil and conventional gasoline increased. All of these factors have led to tight supply situations in many countries.

In the Spring of this year, the OPEC countries agreed to increase production in an attempt to moderate the price of crude petroleum, which had increased from a low of about $12 a barrel in February 1999 to over $32 a barrel in March 2000.[(9)] The announcement of the Spring supply increase caused crude prices to dip temporarily, but they have since recovered, reaching $33 a barrel in June, in the face of continued world-wide economic expansion and summer increases in demand for gasoline. In the last month, two further production increases have been announced: on June 21, OPEC announced a further production increase of 708,000 barrels per day,[(10)] and in early July Saudi Arabia announced an increase in production of 500,000 barrels per day of crude.[(11)] It remains to be seen whether, when and to what extent OPEC's and Saudi Arabia's announcements of crude supply increases will reduce prices.

Chicago, Milwaukee, and other places, principally in the Midwest, have suffered particularly severe recent price increases that cannot be explained solely by the OPEC actions and other world market factors, which would have an impact on all regions of the United States. One factor specific to the Midwest markets that may have contributed to the price increases was the introduction of EPA Phase II regulations for summer-blend reformulated gasoline that went into effect on May 1, 2000 at the wholesale level in both Chicago and Milwaukee. The new, more-stringent regulations require that winter-blend gas be drained from storage tanks before the summer-blend supply could be added. These regulations may have led to abnormally low inventories. According to some reports, summer-blend Phase II RFG is proving more difficult to refine than anticipated, causing refinery yields to be less than expected. The ethanol-based RFG used in Chicago and Milwaukee is reportedly proving to be the most difficult of all to make. Further, St. Louis has now entered the RFG program for the first time, thus adding additional demand to an already tight Midwest RFG supply situation.[(12)] Moreover, the recent appeals court decision upholding Unocal's patent for some formulations of RFG may have caused some refineries to change RFG blends in an effort to avoid infringement, leading to production delays and decreased refinery throughput.[(13)] As with the OPEC factor, RFG-related issues seem unlikely, however, to provide a complete explanation for recent Midwestern gas price increases, given that in the Midwest as a whole, conventional gasoline prices have risen more dramatically than RFG prices since the end of May.[(14)]

Another possible factor underlying the price increases could be the break in the Explorer pipeline last March. This pipeline moves refined petroleum products from the Gulf of Mexico through St. Louis to Chicago and other parts of the Midwest.[(15)] Explorer is still not operating at full capacity.[(16)]

These supply and demand factors could explain the Midwest price increases in whole or in part. However, these price spikes are particularly large. None of these factors precludes the possibility that collusion may have occurred at some point that further contributed to higher gas prices for consumers. If non-collusive marketplace events do not explain the price spikes, that may provide circumstantial evidence that illegal activity has taken place. In addition, we may find more direct evidence. As we undertake this inquiry, we do not know what we will find.

III. The FTC's Investigation

The Commission protects competition by enforcing the antitrust laws. We do not regulate or attempt to determine the reasonableness of energy prices. Instead, we investigate whether or not specific anticompetitive and unlawful conduct has occurred that interferes with the operation of the free market. Thus, our investigation will not determine whether prices are too high or too low, but only whether there is reason to believe that the antitrust laws have been broken.

For analytical purposes, it is best to think of the Commission's antitrust enforcement authority as divided into merger and nonmerger sectors. Enforcing the law against anticompetitive mergers prevents the accumulation of unlawful market power, that is, the ability profitably to raise prices above competitive levels. The matter we are discussing today involves enforcing the nonmerger provisions of the antitrust laws. There are two principal types of nonmerger conduct that may have unlawful anticompetitive effects: (1) the illegal acquisition or maintenance of monopoly power, which typically consists of a single firm's exclusionary conduct to prevent or impede competition; and (2) collusion among two or more independent firms to increase prices, curtail output or divide markets. Our investigation will focus on whether any industry participants have engaged in collusion because it does not appear, at the outset, that any single oil company has sufficient market power to raise prices unilaterally.

The Commission has initiated a formal investigation into the causes of the recent gas price increases in the Midwest. This will be a civil investigation conducted pursuant to our authority under the Federal Trade Commission Act.[(17)] The investigation is being spearheaded by our Midwest Regional Office, located in Chicago. We are working closely with the Attorneys General of the affected States to coordinate our combined efforts.

The Commission's investigative process in a nonmerger collusive practices case involves a thorough search for evidence that the industry participants are engaging, or have engaged, in collusive behavior prohibited by the antitrust laws. Once a formal investigation is opened, staff typically requests from the Commission the authority to use compulsory process. The Commission has approved the use of compulsory process in this investigation, permitting the issuance of both subpoenas and Civil Investigative Demands, and the taking of depositions under oath.[(18)] Process will be used to take testimony and gather evidence from the various entities that refine, transport and distribute gasoline in the Midwest, as well as suppliers and customers, and other knowledgeable or affected persons. The Commission already has begun issuing subpoenas to the entities involved in the chain of gas supply to the affected region. These entities include refiners, pipeline owners and operators, terminal owners and operators, and blend plant owners and operators. Our staff also has begun conducting interviews with market participants, consumers, corporate users of gasoline, and others with potential knowledge of relevant facts. The objective is to determine who raised prices, and whether there was any illegal contact, communication or signaling among competitors before or during the time of the price increases.

The Commission must show more than parallel behavior among market participants to prove collusion. The fact that all companies raise prices at the same time is not sufficient evidence of collusion. The courts have held that some "plus factor" must be present to demonstrate that an agreement was reached. Behavior that would be unprofitable "but for" collusion may be evidence that such an agreement exists.

Beyond this general description of what the Commission is undertaking, we can make no further comment about the particulars of this on-going, non-public investigation. We must emphasize that an FTC antitrust investigation is not a quick fix. The Commission will provide an interim status report by the end of this month, but it may take significantly longer than that to complete the thorough investigation that this matter deserves and produce a final report. Our objective is to determine whether there has been any illegal conduct, and, if there has, to determine who was responsible and either bring the matter to court or initiate our own administrative proceeding. We need to develop solid documentary and testimonial evidence in order to be able to bring a case. Based on the FTC's extensive experience in conducting these kinds of investigations, we know this can be done only through a careful and fact-intensive analysis. We cannot say at this time when the investigation will be concluded.

We assure you that our investigation will be thorough, objective and as expeditious as possible. The FTC has an excellent staff of lawyers and economists with considerable experience in the oil industry who are working on this investigation, and we will pursue this matter vigorously.

Endnotes:

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. Energy Information Administration, Office of Oil and Gas Daily Price Report (June 12, 2000, July 3, 2000). In comparing average RFG prices at different times and at different places, it should be noted that RFG requirements may differ between summer and winter and also between localities.

3. EPA Data, RFG-CG Price Information, based on Oil Price Information Service data (June 14, 2000, June 23, 2000). July 10 price from OPIS Energy Group, Daily Fuel Gauge Report (July 10, 2000).

4. *Id.*

5. *See* R. Kemper & K. Mellen, "As Pressure Builds, Price of Gas Falls," *Chicago Tribune* (June 23, 2000).

6. EPA Data, RFG-CG Price Information (June 14, 2000, July 10, 2000).

7. Energy Information Administration, Motor Gasoline Watch (June 21, 2000, July 10, 2000) at 2.

8. For example, the Commission in recent years 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).

9. Energy Information Administration, Update: A Year of Volatility-Oil Markets and Gasoline, June 21, 2000 (West Texas Intermediate crude oil spot prices).

10. "OPEC Agrees to Increase Oil Production," *Wall Street Journal* (June 22, 2000) at A3.

11. "Saudi Plan to Raise Oil Output Stirs Up Debate," *Wall Street Journal* (July 5, 2000) at A2.

12. St. Louis received EPA waivers to delay implementation of Phase II RFG until early June, because of a break in the Explorer pipeline which serves the region. St. Louis uses primarily MTBE-based RFG, which many observers believe to be less costly than ethanol-based RFG. St. Louis has not so far experienced price increases as great as those in Chicago and Milwaukee.

13. *Union Oil Co. v. Atlantic Richfield Co.,* 208 F.3d 989 (Fed. Cir. March 29, 2000).

14. According to Energy Information Administration figures, average retail prices throughout PADD II (the Midwestern Petroleum Administration for Defense District) rose 18.9 cents for RFG and 29.4 cents for conventional gasoline from May 29 to June 19. *See* Energy Information Administration, Motor Gasoline Watch (June 21, 2000) at 2.

15. Environment News Service, "Gasoline Spill Threatens Dallas Water Supply" (March 13, 2000).

16. EPA/DOE briefing of results of field interviews to FTC staff, 6/14/2000 and to Midwest/Northeast Congressional Caucus, 6/16/2000.

17. 15 U.S.C. § 41 et seq. The Commission does not have criminal enforcement authority. The Antitrust Division of the Department of Justice has exclusive responsibility for criminal enforcement of the antitrust laws, pursuant to authority granted under the Sherman Act. 15 U.S.C. § 1 et seq. If we uncover evidence of criminal activity, however, such as hard-core price fixing, we can forward the matter to the Antitrust Division.

18. Subpoenas and CIDs are two methods of requiring the submission of certain information needed for an investigation. The Commission has authority to issue both. There are certain administrative and procedural advantages to each type of compulsory authority. Subpoenas are generally preferable for document discovery or in-person testimony, while CIDs may be superior for obtaining interrogatory responses or information and for service on foreign entities. Naturally, the Commission seeks evidence from witnesses on a voluntary basis where appropriate or feasible.