Prepared Statement of the Federal Trade Commission

FTC Merger Enforcement in the Gasoline Industry

Presented by Chairman Robert Pitofsky

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Subcommittee on Consumer Affairs, Foreign Commerce, and Tourism
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I. Introduction

Mr. Chairman and members of the Committee, I am Robert Pitofsky, Chairman of the Federal Trade Commission.[(1)] I am pleased to appear before you today to present the Commission's testimony concerning the important topic of competition in the gasoline industry in West Coast markets. Competition in the energy sector - particularly in the petroleum industry - is vitally important to the health of the economy of the United States, and to the various regions of the country. Our experience has taught us that gasoline markets can be much narrower than the entire country, and the West Coast markets have their own particular features that set them apart from the rest of the country. In all markets, antitrust enforcement has an important role to play in ensuring that the gasoline industry is, and remains, competitive. Merger enforcement in particular has recently been at the forefront of efforts to maintain and protect a competitive environment in various gasoline markets, and our testimony today is directed at that ongoing effort.

The FTC is a law enforcement agency with two distinct but related missions: preserve competition in the marketplace through antitrust law enforcement and protect the consumer from unfair or deceptive acts or practices. The Commission's statutory authority covers a broad spectrum of sectors in the American economy, including the companies that comprise the energy industry and its various components. Among the statutes the Commission enforces are two antitrust laws, the FTC Act[(2)] and the Clayton Act.[(3)] The Commission shares jurisdiction with the Department of Justice under section 7 of the Clayton Act, which prohibits mergers or acquisitions that may "substantially lessen competition or tend to create a monopoly."[(4)] Under section 5 of the FTC Act, the Commission prohibits "unfair methods of competition" and "unfair or deceptive acts or practices."

II. Level of Merger Activity

It is no secret that merger activity in the United States is at an all-time high. The number of mergers reported to the FTC and the Justice Department pursuant to the Hart-Scott-Rodino Act has more than tripled over the past decade, from 1,529 transactions in fiscal year 1991 to 4,926 transactions in fiscal 2000. Although filings have declined so far this year because of higher filing thresholds[(5)] and the slowing economy, the Bureau of Competition remains heavily focused on merger work. Currently, more than two-thirds of our competition resources are dedicated to merger enforcement, compared to an historical average of closer to 50 percent.

While the number of merger filings has more than tripled in the past decade, the dollar value of commerce affected by these mergers has increased an astounding eleven-fold during the same period. But mere numbers do not fully capture the complexity and the challenge of the recent merger wave. Today's merger transactions not only are larger, but often raise novel or complex competitive issues requiring more detailed analysis. In the past year alone, companies filed notifications for 288 mergers with a transaction size of one billion dollars or more, and many of these mergers involved overlaps in several products or services.

There are many reasons for the current merger wave. A large percentage of these transactions appear to be a strategic response to an increasingly global economy. Many are in response to new economic conditions produced by deregulation (*e.g.*, telecommunications, financial services, and electric utilities). Still others result from the desire to reduce overcapacity in more mature industries. The rapidly evolving world of electronic commerce has a substantial impact on the merger wave, because consolidations often quickly follow the emergence of a new marketplace. These factors indicate that the merger wave reflects a dynamic economy, which, on the whole, is a positive phenomenon. But some mergers, as well as some other forms of potentially anticompetitive conduct, may be designed to stifle competition in important sectors of this dynamic economy.

III. Merger Enforcement in the Gasoline Industry

Out of necessity, our scarce resources are directed at preserving competition in the most important areas of the economy. The Commission dedicates the bulk of its antitrust enforcement to sectors that are critical to our everyday lives, such as health care, pharmaceuticals, retailing, information and technology, and, in particular, energy.

Much of the Commission's experience with enforcing the antitrust laws in energy industries has been in analyzing mergers.[(6)] 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 or obtains relief in 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.[(7)]

In each merger investigation, the Commission will intervene if the consummated merger would significantly reduce competition in any sector of an industry that affects the United States or its citizens. The specific question the Commission must ask is whether the result of a merger "may be" - *i.e.* it would be reasonably likely - that the remaining firms in the industry could reduce output and raise prices to the detriment of consumers anywhere in the United States.

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 that limits competition.[(8)] The Commission has recognized the existence of such a trend toward consolidation in the petroleum industry.[(9)]

On the other hand, many mergers actually increase competition. So, the Commission also considers efficiencies in deciding whether to challenge an otherwise anticompetitive merger because they may counteract the merger's threatened anticompetitive effects. However, the Commission engages in a rigorous analysis of efficiencies. Merely claiming cost savings is not enough to allow an anticompetitive merger; they must be proven. The Commission demands that cost savings of the merger be real and substantial; they cannot result from reductions in output; they cannot be practicably achievable by the companies independent of the merger; and they must counteract the merger's anticompetitive effect, not merely flow to the shareholders' bottom line.[(10)]

Protecting competition and consumers is the goal of antitrust enforcement across all industries; its importance is particularly clear in the energy industry, where price increases can have a direct and lasting impact on the entire economy. Towards that end, the Commission has expended a substantial part of its resources in recent years in addressing the wave of consolidation in the petroleum and gasoline industry. In fiscal years 1999 and 2000, the Bureau of Competition spent almost one-third of its total enforcement budget on investigations in energy industries, and that level of effort has continued into 2001. Our merger review investigations revealed that several of these transactions threatened competition in local or regional markets. In those instances, the Commission allowed the merger only after demanding significant changes that would fully restore the competition lost as a result of the merger.

The Commission's investigation of the merger between Exxon and Mobil highlights many of the issues, and difficulties, in large oil company mergers. After an extensive review, the Commission required the largest retail divestiture in FTC history - the sale or assignment of 2,431 Exxon and Mobil gas stations in the Northeast and Mid-Atlantic regions, and in California, Texas and Guam.[(11)] The Commission also ordered the divestiture of Exxon's Benicia refinery in California; light petroleum terminals in Boston, Massachusetts, Manassas, Virginia, and Guam; a pipeline interest in the Southeast; Mobil's interest in the Trans-Alaska Pipeline; Exxon's jet turbine oil business; and a volume of paraffinic lubricant base oil equivalent to Mobil's production. The Commission coordinated its investigation with the Attorneys General of several states and with the European Commission (about 60% of the merged firm's assets are located outside the United States).

There are several particularly noteworthy aspects of the Exxon/Mobil settlement. First, the divestiture requirements eliminated *all* of the overlaps in areas in which the Commission had evidence of competitive concerns. Second, while several different purchasers ended up buying divested assets, each purchased a major group of assets constituting a business unit. This replicated, as nearly as possible, the scale of operations and competitive incentives that were present for each of these asset groups prior to the merger. Third, these divestitures, while extensive, represented a small part of the overall transaction. The majority of the transaction did not involve significant competitive overlaps. In sum, we were able to resolve the competitive concerns presented by this massive merger without litigation.

The Commission also required divestitures in the merger between BP and Amoco,[(12)] and in a joint venture combining the refining and marketing businesses of Shell, Texaco and Star Enterprises to create at the time the largest refining and marketing company in the United States.[(13)] BP/Amoco involved very large companies but relatively few significant competitive overlaps. There was competitive concern in a few local markets. The Commission ordered divestitures and other relief to preserve competition in the wholesaling of gasoline in 30 cities or metropolitan areas in the eastern and southeastern United States, and in the terminaling of gasoline and other light petroleum products in nine geographic markets.

The Shell/Texaco transaction raised competitive concerns in markets for gasoline and other refined petroleum products in the Pacific Northwest (Oregon and Washington), California, and Hawaii, for crude oil in California, and in the transportation of refined light petroleum products to several southeastern states. The two companies had substantial market overlaps. Both Shell and Texaco owned refineries in Puget Sound and, between them, made about 50 percent of the gasoline refined in the Puget Sound area. The Commission alleged that eliminating direct competition between those refineries could result in price increases for gasoline and jet fuel in the Pacific Northwest and California of more than $150 million per year. The Commission, in conjunction with the Attorneys General of California, Washington, Oregon, and Hawaii, required the divestiture of a refinery in Anacortes, Washington, which was a major supplier of refined products to Oregon via the Olympic pipeline; a terminal on the island of Oahu, Hawaii; retail gasoline stations in Hawaii and California; and a pipeline interest in the Southeast.

During 1999, the Commission investigated the proposed $27 billion merger of BP Amoco ("BP") and ARCO, the two largest competitors for the production, delivery, and sale of Alaska North Slope ("ANS") crude.[(14)] BP was the largest producer of ANS crude and the largest supplier to various West Coast refineries. ARCO was the second largest ANS producer.

The Commission conducted its investigation in cooperation with the Attorneys General of Oregon, Washington, and California. As part of that investigation, the Commission looked at the West Coast crude oil market to determine if the acquisition would increase the likelihood that the merged firm would be able to exercise market power, either unilaterally or in conjunction with other firms. The Commission found reason to believe that BP was *already* exercising market power in the production and sale of ANS crude oil to refineries on the West Coast, and that the merger would increase BP's ability to keep ANS prices high by eliminating the one firm with the ability and incentive to produce and sell more ANS crude oil.

The Commission's investigation revealed that BP was able to discriminate in price by charging some West Coast refineries higher prices than others, based on the ability of some refineries to substitute more easily other crude oil for ANS crude.[(15)] Economic theory teaches that the ability to practice price discrimination is limited to firms that have market power.[(16)] As crude oil is the major input into gasoline, preserving competition upstream directly affects retail competition.

The Commission and the Attorneys General filed lawsuits to block the merger in federal district court, and the case was settled with divestiture of all of ARCO's Alaska assets, including oil and gas interests, tankers, pipeline interests (in the Trans-Alaska Pipeline), real estate exploration data and selected long-term supply agreements. Those assets, now owned by Phillips, are currently the major supplier to the Puget Sound refineries, which are the primary suppliers of gasoline to the States of Oregon and Washington.

Much of BP's ANS crude oil is now used in the former ARCO refineries in Los Angeles and Puget Sound, thus eliminating BP as the dominant supplier of ANS crude to other West Coast refineries. By combining BP's ANS production with ARCO's refining capacity, the Commission's Order reduces BP's incentive to elevate the price of ANS crude. By divesting ARCO's Alaska assets to Phillips, the Order retains an independent competitive force with the incentive to find and deliver additional ANS crude oil.

IV. Conclusion

By strictly enforcing the prohibition against mergers where the effect of the merger "may be substantially to lessen competition, or to tend to create a monopoly,"[(17)] the antitrust agencies ensure that already concentrated markets do not become more so. By challenging the Shell/Texaco joint venture and BP's acquisition of ARCO, the Commission helped preserve competition in several West Coast markets, both wholesale and retail. Requiring the divestiture of Shell's Anacortes refinery preserved competition in the supply of refined products to Washington and Oregon. Requiring the divestiture of ARCO's Alaska assets to a rival company (Phillips), prevented BP from enhancing its dominant position in the market to supply ANS to West Coast refineries.

Endnotes:

1. This written statement represents the views of the Commission. My oral responses to questions are my own, and are not necessarily those of the Commission or any other Commissioner.

2. 15 U.S.C. § § 41-58.

3. 15 U.S.C. § § 12-27.

4. 15 U.S.C. § 18.

5. 16 C.F.R. Parts 801, 802, and 803, Premerger Notification: Reporting and Waiting Period Requirements for Certain Mergers and Acquisitions: Implementation of Recent Amendments to the Clayton Act (Jan. 25, 2001).

6. Under the Commission's shared jurisdiction with the Justice Department, antitrust investigations are allocated to one of the agencies under a long-established clearance procedure, based on expertise gained over the years in various industries. The Commission has expertise in oil mergers.

7. 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.

8. Industries might also consolidate for procompetitive or competitively neutral reasons, such as increasing scale efficiencies or a secular decrease in demand.

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

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

11. *Exxon Corp.,* C-3907 (Nov. 30, 1999) (consent order).

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

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

14. *Federal Trade Commission v. BP Amoco PLC,* Civ. Action No. C00 0420-SI (N.D. Cal. 2000).

15. More complex refineries are usually better able to substitute different types of crude oil in their production mix. The Puget Sound refineries that serve Oregon and Washington are less complex than others on the West Coast.

16. As Judge Posner has noted, "price discrimination implies market power, that is, the power to charge a price above cost . . . without losing so much business so fast to competitors that the price is unsustainable." *In re Brand Name Prescription Drugs Antitrust Litigation,* 186 F.3d 781, 786 (7th Cir 1999).

17. 15 U.S.C. § 18.