Before the
**FEDERAL TRADE COMMISSION**
Washington, D.C.

| In the Matter of | ) | |
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| | ) | |
| Market Manipulation Rulemaking | ) | Project No. P082900 |
| | ) | |

**COMMENTS OF FLINT HILLS RESOURCES**

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We are pleased to submit these comments on behalf of Flint Hills Resources ("FHR") in response to the Advance Notice of Proposed Rulemaking for Prohibitions on Market Manipulation and False Information in Subtitle B of the Energy Independence and Security Act of 2007.[1] We understand that summary comments are appropriate at this stage, and that more detailed support will be appropriate during the actual rulemaking process.

## I. THE INTEREST OF FLINT HILLS RESOURCES IN THIS PROCEEDING

FHR is an independent refining and chemicals company. It operates refineries in Alaska, Minnesota and Texas with a combined crude oil processing capacity of more than 800,000 barrels of crude oil per day. FHR produces a full slate of petroleum products, including gasoline, jet fuel, diesel, and heating oil, among others. FHR distributes refined petroleum products at wholesale to a variety of markets in the United States. FHR has been an active and cooperative participant in numerous prior investigations conducted by the Commission into the competitive behavior of wholesale petroleum markets. FHR fully supports the Commission's oversight of wholesale petroleum markets and commends it for continuing efforts to inform American consumers on the competitive condition of these markets.

## II. INITIAL STATEMENT AND SUMMARY OF POSITION

The Commission has requested public comment on the prospect of a new rulemaking that would involve potential Commission intervention in a list of topics that cover the pricing, production, operation and inventory decisions of wholesale petroleum market participants. The central policy question posed in the *Advance Notice* is whether the public interest would be served by new or additional Commission initiatives in these markets. The short answer is that

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[1] Federal Trade Commission, *Prohibitions On Market Manipulation and False Information in Subtitle B of the Energy Independence and Security Act of 2007*, 73 Fed. Reg. 25614 (May 7, 2008) [hereinafter *Advance Notice*].

they are not needed. As explained in the attached statement of Janusz A. Ordover and Paul E. Godek:

> We are aware of no evidence that recent increases in the world price of crude oil and the consequent increases in the price of gasoline reflect either inefficiencies or anticompetitive behavior in the U.S. oil refining industry. Regardless of the future paths of oil and gasoline prices, one would not expect the competitiveness or efficiency of those markets to be enhanced by FTC regulation of the production and distribution decisions of the industry. To the contrary, the FTC's Notice contemplates rules and regulations that are likely to be harmful to the performance of the industry and, thus, to consumers.[2]

This is not the first time that elevated prices for refined petroleum products have led to calls for government intervention. Time and again, the Commission has responded with thorough investigations that demonstrated the reality of efficient and competitive responses to supply shocks or disruptions, all of which served to the long-term interests of consumers. These lessons should not be forgotten. In the face of public insinuations that price spikes were the result of manipulative or anticompetitive behavior, and political pressures for action, the Commission has repeatedly declined to condemn firms that "reacted rationally to market conditions as they understood them."[3] The Commission should continue its sound policy of forbearance from potentially harmful intervention in well-functioning markets.

> The increasingly complicated regulatory and business environment in which these companies operate makes it inevitable that forecasting mistakes will be made, and it would ill-behoove a government agency to criticize business decisions on the basis of hindsight. Moreover, in a competitive market system, companies are entirely free to make whatever individual decisions they choose to make about the configuration of their

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[2] Ordover-Godek Statement at ¶ 46.

[3] See, for example, statement of Commissioner Orson Swindle on the Final Report on the Midwest Gasoline Price Investigation, File No. 0010174, *available at* http://www.ftc.gov/os/2001/03/mwgasrptswindle.htm. ("Some companies made more [product] . . . and some made less; and still other firms waited to see if the price spike would continue. . . . Some of these tactics were profitable . . . some turned out not to have been. The crucial point that may get lost in applying 20/20 hindsight . . . is that the industry acted quickly in response to the price spike, which was intense but relatively short-lived because of the effective workings of the market.").

plants, their rates of production or the management of their inventory, and it would be inappropriate for us to suggest otherwise.[4]

For these reasons, FHR submits that the Commission's admirable record of responsible oversight, under existing authority, is sufficient to maintain competition in the wholesale petroleum industry without resort to additional rules or regulations. As Professor Ordover and Dr. Godek observe, "The risk is that the FTC, equipped with new rules and regulations, will come under increasing pressure to intervene in the independent business decisions of refiners. . . . Such intervention can be expected to adversely affect the efficient operation of the industry to the detriment of consumers."[5]

Notwithstanding this recommendation, we recognize that the Commission must examine its responsibilities under the EISA. We offer the following comments on the potential content and interpretation of any proposed new rule in the event the Commission concludes that a new rulemaking is appropriate.

## III. FUNDAMENTAL POLICY ISSUES FOR RULEMAKING UNDER THE NEW STATUE

### A. Significance of Existing Statutory Authority and Precedents

We understand that the *Advance Notice* is designed to elicit views on the "manner in which [the Commission] should carry out its rulemaking responsibilities under Section 811" of the Energy Independence and Security Act ("EISA") of 2007.[6] Section 811 of the EISA prohibits direct or indirect use of "any manipulative or deceptive device or contrivance . . . in connection with the purchase or sale of crude oil, gasoline or petroleum distillates at wholesale" in violation of a rule or regulation prescribed by the Commission "as necessary or appropriate in

4 Statement of Commissioner Thomas B. Leary, commenting on the Final Report on the Midwest Gasoline Price Investigation, File No. 0010174, *available at* http://www.ftc.gov/os/2001/03/mwgasrptsleary.htm.

5 Ordover-Godek Statement at ¶ 5.

6 *Advance Notice* at 25614.

the public interest or for the protection of United States citizens."[7] This provision overlaps and arguably duplicates authority conferred by the Commission's own governing statute, Section 5 of the Federal Trade Commission Act, which prohibits "unfair methods of competition . . . and unfair or deceptive acts or practices."[8]

To fulfill its responsibilities under the FTC Act and the nation's other antitrust laws, the Commission has subjected the petroleum industry to a more searching level of scrutiny than any other industry or sector of the economy.[9] In addition to its repeated investigations and reports,[10] the FTC has taken enforcement action in the petroleum sector under its general Section 5 authority, which has here been applied in ways that parallel the more explicit prohibitions of the antitrust laws. It has acted against conduct that would be covered by Section 1 of the Sherman Act, which prohibits agreements in unreasonable restraint of trade;[11] Section 2 of the Sherman Act, which prohibits monopolization or attempts to monopolize;[12] and Section 7 of the Clayton Act, which prohibits mergers and acquisitions that substantially lessen competition or tend to

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7 *Advance Notice* at 25615 n.4.

8 15 U.S.C. § 45(a)(1) (1997).

9 *See Market Forces, Competitive Dynamics, and Gasoline Prices: FTC Initiatives to Protect Competitive Markets Before the Subcomm. of Energy and Air Quality of the H. Comm. on Energy and Commerce*, 108th Cong. 8 (2004) (Prepared statement of the F.T.C. given by John H. Seesel, Associate General Counsel for Energy) *available at* http://energycommerce.house.gov/reparchives/108/Hearings/09072005hearing1630/Seesel.pdf [hereinafter *FTC Initiatives*]. "These data [on all horizontal merger investigations and enforcement actions from 1996 to 2003] show that the Commission has brought more merger cases at lower levels of concentration in the petroleum industry than in other industries." *Id.*

10 *See infra* note 23.

11 15 U.S.C. § 1 (1997). In an action against American Petroleum Company, for example, the FTC alleged that American Petroleum had agreed with competing lubricating oil importers to stop importing lubricating oil. *Am. Petroleum Co., Inc.*, Docket No. C-4198, 2007 WL 2687882 (F.T.C. Aug. 21, 2007). Although the FTC brought this action under the authority of Section 5 of the FTC Act, the complaint described conduct that is *per se* illegal under Section 1 of the Sherman Act. The Order uses standard Section 1 language to prohibit American Petroleum from entering any "combination, conspiracy, or agreement" to a) "restrain, restrict, limit, or reduce the import or sale of Lubricants"; or b) boycott any potential buyer of lubricants. *Id.*

12 15 U.S.C. § 2 (1997). For example, see *Union Oil Co. of Cal.*, Docket No. 9305, 2005 WL 2003365 (F.T.C. Aug. 2, 2005). Although the FTC brought this case under Section 5 of the FTC Act, the complaint pleaded standard Sherman Act Section 2 allegations: that Unocal misrepresented the proprietary nature of technologies it advanced to a California regulatory board and thereby "wrongfully obtained monopoly power" and acted "with a specific intent to monopolize" the relevant market, "resulting, at a minimum, in a dangerous probability of monopolization." Complaint at ¶¶ 99-101, *Union Oil Co. of Cal.*, Docket No. 9305, 2003 WL 1190102 (F.T.C. Mar. 4, 2003).

create a monopoly.[13] The imposition of additional special rules by the Commission under Section 811 threatens to add redundant layers of regulation and create unnecessary compliance burdens for an industry that the Commission has consistently found functions competitively, even in the face of extreme supply shocks.[14]

### B. Definition of "Manipulative or Deceptive Device"

The most critical policy question in any formal Rulemaking would be a definition of "manipulative or deceptive device" that does not sweep so broadly as to prohibit mere attempts to profit from short-term fluctuations in market conditions. The Commission should not be asked to second guess the business decisions of petroleum product suppliers made in response to market signals.[15] The market expects – and, indeed, wants – companies to act in their self interest in order to reduce the severity and length of a disruption.[16] To avoid unintended adverse consequences, any potential rule therefore must be limited to conduct that is unambiguously deceptive. The terms "manipulative and deceptive" should cover only conduct that contains an element of fraud or dishonesty, which enables a company to profit because it has transmitted false market signals rather than because it has simply responded to signals.

The Commission's existing approach to the law of deception is entirely consistent with and sufficient to serve as the basis for any market manipulation oversight contemplated by Section 811 of the EISA. Deception involves the attempt by a seller to convey a false impression to the buyer about the value of what is being offered. Even a sophisticated business can be

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[13] 15 U.S.C. § 18 (1997); *see, e.g.*, Complaint, *Foster*, Docket No. 9323, 2007 WL 2219402 (F.T.C. May 3, 2007) (alleging Western's acquisition of Giant would violate Section 7 of the Clayton Act by lessening competition for light petroleum in northern New Mexico); *Chevron Corp.*, Docket No. C-4023, 2001 WL 1022080 (F.T.C. Dec. 18, 2001) (requiring significant divestitures in conjunction with the merger to avoid violation of Section 7 of the Clayton Act); *Exxon Corp.*, Docket No. C-3907, 2001 WL 147170 (F.T.C. Jan. 26, 2001) (same); *BP Amoco p.l.c.*, Docket No. C-3938, 2000 WL 1224962 (F.T.C. Apr. 25, 2000) (same).

[14] Ordover-Godek Statement at ¶¶ 7-8 & n.4; *see also FTC Initiatives*, *supra* note 9, at 15-23.

[15] Ordover-Godek Statement at ¶¶ 5-6.

[16] *Id.* at ¶¶ 25-26.

deceived if a seller misrepresents its future intentions about the terms it will offer or misleads other market participants about material market facts such as the availability of key inputs to a product or the existence of constraints on product distribution. It cannot be deceptive for a seller to simply tell the truth. If market participants are inhibited from disclosure of facts that they believe are accurate, consumers will lose the benefit of enormous investments made to gather and assess market information that enables market participants to reach efficient decisions.

It is imperative that the Commission resist any suggestion that "manipulation" or an "artificial price" may be defined by reference to profit. The simple fact is that a comparison of price and cost (even assuming it can be identified) cannot provide a legal definition of a manipulated or an artificial price.[17] Basic economic principles recognize that the demand side must also be considered and, beyond that, the Commission has long understood that price provides an invaluable signal that will in the long run alleviate the effects of disruptions and encourage needed investment in new facilities and infrastructure.

### C. Applicability to Market Supply Functions

It has never been – and nor should it be – unlawful for a company to unilaterally determine the quantities or mix of products that it will sell, the locations or customers it will serve, or the profits it can earn.[18] The Commission's guiding philosophy is that consumers will

[17] *See* Ordover-Godek Statement at ¶¶ 30-33.

[18] *See, e.g.*, *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 761 (1984) ("A manufacturer of course generally has a right to deal, or refuse to deal, with whomever it likes, as long as it does so independently."); *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919) ("In the absence of any purpose to create or maintain a monopoly, the act does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal . . . ."); *49er Chevrolet, Inc. v. Gen. Motors Corp.*, 803 F.2d 1463, 1468 (9th Cir. 1986) ("In addition, it is a longstanding antitrust principle that Section 1 of the Sherman Act does not preclude a party from unilaterally determining the parties with whom it will deal and the terms on which it will transact business."); *Aladdin Oil Co. v. Texaco, Inc.*, 603 F.2d 1107, 1113 (5th Cir. 1979) ("[A] seller has a unilateral right to select its customers and to refuse to sell its goods to anyone, for reasons sufficient to itself."); *Osborn v. Sinclair Refining Co.*, 286 F.2d 832, 839 (5th Cir. 1960) ("[A] trader may select his customers as he sees fit."); *Double Diamond Props., L.L.C. v. Amoco Oil Co.*, 487 F. Supp. 2d 737, 745 (E.D. Va. 2007) ("A manufacturer who acts unilaterally generally is free to deal (or not) with whoever it wishes on

be best served if suppliers are free to make these decisions independently, even when – in fact, *particularly* when – relatively stable markets are disrupted by disasters of various kinds. To avoid the distortions of additional regulation, we urge the Commission to explicitly exempt from any rule's applicability conduct and commercial practices that are vital to the efficient functioning of the wholesale petroleum supply sector. Specifically, any rule should exclude from regulatory oversight:

(a) performance of contractual obligations of suppliers to existing customers;

(b) day-to-day operational and commercial decisions of market participants including choice of a mix of products to refine;

(c) plans for and implementation of investments in facility maintenance or capacity upgrades;

(d) establishment, management, and disposition of inventory levels; and

(f) decisions by a supplier on the amount of product sold to a given customer or through a given distribution outlet at any specific time.

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whatever terms it wishes. This is a right recognized at common law.") (citation omitted); *Intervest Fin. Servs. v. S.G. Cowen Sec. Servs., Inc.*, 206 F. Supp. 2d 702, 712 (E.D. Pa. 2002) ("[A] private businessperson or entity may refuse to deal with another company."); *Sun Dun, Inc. v. Coca-Cola Co.*, 770 F. Supp. 285, 289 (D. Md. 1991) ("Failure to lower a price to meet what the customer wants to pay for the product or service is not a refusal to deal."); *Lee-Moore Oil Co. v. Union Oil Co.*, 441 F. Supp. 730, 737 (D.N.C. 1977) ("[A] manufacturer or supplier has a right to sell its goods to anyone, for any reason sufficient to itself without incurring liability under the antitrust laws.") *rev'd and remanded on other grounds*, 599 F.2d 1299, 1300 (4th Cir. 1979); *Harlem River Consumers Coop. v. Associated Grocers of Harlem, Inc.*, 371 F. Supp. 701, 709 (S.D.N.Y. 1974) ("[I]t is not necessarily a violation of the antitrust laws when a supplier allocates, or in any other way attempts to exercise control over which of its customers will receive how much of its products."); *Quigley v. Exxon Co.*, 376 F. Supp. 342, 351 (D. Pa. 1974) ("A mere refusal to deal, without more, is not a Sherman Act violation."); *Indep. Iron Works, Inc. v. U.S. Steel Corp.*, 177 F. Supp. 743, 748 (N.D. Cal. 1959) ("It is settled law, however, that each defendant, acting individually, was legally entitled to sell or not to sell to any customer or to sell him as much as he saw fit.").

## IV. ADDITIONAL COMMENTS

The following comments are organized into two separate sections. The first section suggests some important principles that we believe are appropriate for the Rulemaking, and the second section suggests an approach to various individual questions raised in the *Advance Notice*.

### A. Principles for Rulemaking

Four fundamental principles should guide the Commission in this Rulemaking process. These principles include the need to (1) avoid superfluous regulation; (2) promote competitive markets; (3) reduce duplicative jurisdiction; and (4) appreciate the differences between petroleum markets and regulated power industries.

#### 1. The Commission Should Not Engage in Superfluous Regulation

It is axiomatic that the government should not regulate where no regulation is needed. Excessive regulation unnecessarily burdens market participants and needlessly stretches limited public resources. Most important, it ultimately harms the people it is intended to protect because it inhibits normal market adjustments.[19] In this case, the Commission already has the authority to regulate deceptive behavior under its existing statutes, and as Professor Ordover and Dr. Godek observe, all credible evidence suggests that there is no need for additional oversight in the petroleum industry.[20]

As noted above, any proposed rule to govern the use of manipulative and deceptive devices in connection with the sale of petroleum products should be focused on conduct that is designed to purposely deceive the market by sending false signals that are known to be false at

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[19] Ordover-Godek Statement at ¶ 22, p. 12.

[20] *Id.* at ¶ 19, p. 10.

the time. Disingenuous business practices, however, already are covered by Section 5 of the Federal Trade Commission Act and the regulations promulgated thereunder.[21] In addition, other federal agencies – the Commodities Future Trading Commission, the Securities and Exchange Commission and the Federal Energy Regulatory Commission – possess broad authority to deal with conduct that may have a "manipulative" effect on petroleum product prices.[22] Thus, we submit any new rule that targets manipulative behavior in wholesale petroleum markets would be superfluous in light of existing law.

Moreover, as Professor Ordover and Dr. Godek note, numerous Commission studies indicate that the markets targeted here already function competitively.[23] To be clear, the FTC has *never* found evidence of the kinds of manipulative practices that would be necessary to maintain prices at supra-competitive levels at regional – let alone national – levels.[24] Instead, the

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[21] *Id.* at ¶ 7, p. 3; ¶¶ 18-19, pp. 9-10.

[22] *Id.* at ¶ 19, p. 9.

[23] *See, e.g.*, Federal Trade Commission, *Report on Spring/Summer 2006 Nationwide Gasoline Price Increases* (2007) (finding six different factors that led to increased gas prices and no evidence of unlawful conduct), *available at* http://www.ftc.gov/reports/gasprices06/P040101Gas06increase.pdf [hereinafter *Spring/Summer 2006 Report*]; Federal Trade Commission, *Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases* (2006) (same), *available at* http://www.ftc.gov/reports/060518PublicGasolinePricesInvestigationReportFinal.pdf [hereinafter *Post-Katrina Gasoline Report*]; Federal Trade Commission, *Gasoline Price Changes: The Dynamic of Supply, Demand, and Competition* (2005) (finding that worldwide supply, demand, and competition for crude oil are the most important factors in determining the average price of gasoline in the United States, and that certain retail considerations, environmental factors, and state and local tax rates and regulations also affected prices), *available at* http://www.ftc.gov/reports/gasprices05/050705gaspricesrpt.pdf; Federal Trade Commission, *Western States Gasoline Pricing Investigation* (2001) (finding no activity violating antitrust laws after a three-year investigation), *available at* http://www.ftc.gov/os/2001/03/mwgasrpt.htm; Federal Trade Commission, *Midwest Gasoline Price Investigation* (2001) (finding no credible evidence of collusion or other anticompetitive conduct by the oil industry), *available at* http://www.ftc.gov/os/2001/03/mwgasrpt.htm. Similarly, the Commission has never found that deceptive or manipulative practices caused a price spike in any investigation initiated as a result of its Monitoring Project, which tracks weekly gasoline prices in 360 retails markets and 20 wholesale markets around the country. *See, e.g.*, *Crude Oil: The Source of Higher Gas Prices? Hearing Before the Subcomm. on Antitrust, Competition Policy and Consumer Rights of the Sen. Comm. on the Judiciary*, 108th Cong. (2004) (prepared statement of the Federal Trade Commission presented by William E. Kovacic, General Counsel explaining the various factors that led to recent price spikes in Arizona, Atlanta, the Mid-Atlantic area), *available at* http://judiciary.senate.gov/testimony.cfm?id=1142&wit_id=3271.

[24] Indeed, such a result would have required a collusive reduction in capacity over a period of years – a phenomenon that would have been identified in the course of the FTC's many investigations of the industry. Had such practices been revealed, they would have been prosecutable under Section 1 of the Sherman Act.

Commission's comprehensive investigations consistently have concluded that gas prices spiked as a result of some combination of increased domestic and foreign demand, supply disruptions following natural disasters and other unplanned production outages, changing environmental regulations, and seasonal driving effects beyond the normal growth in domestic demand.[25]

We submit, therefore, the Commission lacks evidence of "manipulation" in wholesale petroleum markets that warrants the kind of extensive regulatory intervention that a proposed rule could engender.

**2. Regulations Should Promote Competitive Markets**

The Federal Trade Commission has a special responsibility and capability not only to prosecute those who engage in "unfair methods of competition . . . and unfair or deceptive acts or practices," but also to help the public and other government policy makers understand the sound economic principles that underlie these general statutory commands. Implicit in this charge is the duty to preserve the vigorous competition that exists today in our Nation's market systems.

The *Advance Notice* points out that terms like "manipulative or deceptive device or contrivance" are not familiar terms in the historic interpretation of the antitrust laws. Although those terms may not be rooted in antitrust law, existing Commission precedent does address the application of the law of deception in antitrust cases.[26] But regardless of the source of its authority, the Commission should apply the underlying concepts in a way that is consistent with sound economic principles.

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25 *See generally FTC Initiatives*, *supra* note 9. The Commission's investigations also make clear that business practices in today's petroleum market in no way resemble the notorious abuses in the securities markets of the early twentieth century that gave rise to the antimanipulation prohibitions of the Securities Exchange Act of 1934.

26 *See, e.g.*, *In the Matter of Unocal Company of Cal.,* Opinion of the Commission, Docket No. 9305 (F.T.C. July 7, 2004); *In re Rambus, Inc.*, 2006-2 Trade Cases ¶ 75,364 (F.T.C. Aug. 2, 2006), *rev'd on other grounds*, 522 F.3d 456 (D.C. Cir. 2008); *In re Dell Computer Corp.*, Docket No. C-3888, 1999 WL 701843 (F.T.C. July 28, 1999).

Any rule that would purport to define a "competitive" or a "non-artificial" price, an "excess profit," or "price gouging" would ultimately distort the market just as outright deception does. A rule of this kind would impose a form of *ad hoc* price regulation or control. The Nation's last attempt at gasoline price controls more than thirty years ago proved disastrous for consumers,[27] and there is every reason to believe that similar consequences would occur again should the Commission directly or indirectly impose similar restrictions through this Rulemaking.

In this case, congressional concerns appear to be driven by the rapid increase in prevailing gasoline prices – *not by any identified deceptive or manipulative practices*. Numerous Commission investigations have not identified any such inefficiencies, and regulatory intervention should not be a response to temporary market phenomena, *e.g.*, spikes – up or down – in the market. Nevertheless, if the Commission is compelled to regulate, it must do so in a way that avoids unintended effects, which would reduce efficiencies, disrupt supply, or otherwise limit incentives for a company to participate in the market. Any one of these factors could lead to significantly higher prices, and thereby exacerbate the "problem" Congress set out to solve.

If nothing else, the Commission must do no harm. No rule should disrupt the basic efficiencies of petroleum markets as they exist today, interfere with a company's long-term commercial obligations, or violate the central tenet of antitrust law that a company is free to unilaterally decide what to supply, how much to supply, and where to supply it. All of these elements are necessary for continued operation of a competitive market.

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[27] People should remember the gasoline lines, the "odd/even day" regulations, and inhibitions on trans-shipments from surplus to starved areas that were the dismal consequences of gasoline price controls in the 1970s. Recall also the pungent critique that was circulated at the time: "Price controls attempt to treat a fever by breaking the thermometer."

### 3. The Commission Should Avoid Duplicative Jurisdiction

There should be a presumption against enactment of any rule that simply duplicates already existing rules of another regulatory agency. Overlapping regulatory jurisdiction among multiple agencies can not only result in delays and inconsistent results but also waste public and private resources.[28] The Commission accordingly should give serious consideration to whether any new rule will provide valuable oversight in an area where regulation is currently lacking, or whether it will further burden free market activity by reducing efficiencies and subjecting participants to confusing and potentially conflicting regulations.

The Securities Exchange Commission ("SEC"), the Federal Energy Regulatory Commission ("FERC"), and the Commodity Futures Trading Commission ("CFTC") all have broad powers to police and punish market manipulation in their respective jurisdictions. FERC's regulatory authority, in particular, extends to the shipment of oil and other refined petroleum products by interstate pipeline, and the CFTC has broad oversight over conduct occurring in petroleum futures trading markets. It is unclear what conduct to be regulated by a new rule from the Commission would not already be caught in the wide antimanipulation net cast by these other agencies. Indeed, given the far-reaching authority of the SEC, FERC, and CFTC, it is highly likely that any new rule will overlap with that of another agency and potentially subject market participants to differing standards of conduct and multiple levels of liability.

Even if regulatory gaps exist between agencies, the Commission should seek comment on the costs associated with any new regulations under consideration, and it should specifically

[28] Overlapping regulatory jurisdiction may make some sense in situations where one agency has enforcement weapons that another does not have. An example might be the Commission's current practice of referring to the Department of Justice evidence of potential criminal conduct that the Commission has uncovered in the course of its own civil proceedings. Other overlaps may have historic roots that would be hard to eliminate today; that precedent, however, does not justify the creation of new ones.

consider the impact on its own resources. Expanded jurisdiction without additional appropriations will undercut existing initiatives.

**4. Petroleum Markets Are Unlike Regulated Energy Markets**

The *Advance Notice* invites comment on how the FTC's authority should be implemented in light of similar authority granted to other agencies, including the FERC.[29] Petroleum markets are not comparable to wholesale electric power markets, and the rules promulgated by FERC to avoid manipulation in those markets do not provide a model that is transferable to the petroleum industry. The antimanipulation rules promulgated by FERC are designed to govern an industry whose structural, regulatory, and physical characteristics are wholly distinct from those of the petroleum industry.[30] Without regard to the merits of the FERC market manipulation efforts, we submit that the focus of the Commission's inquiry here should be on the behavior and characteristics of wholesale petroleum product markets. It would be a mistake to transfer the complex regulatory scheme governing electric power to the wholesale oil industry.

As numerous Commission investigations have concluded, the most significant determining factor for wholesale petroleum prices is the cost of crude oil.[31] The price of crude oil, in turn, is set on a world market based on global supply and demand. The global supply of crude oil is not controlled by private companies that can be subject to regulation. Rather, the most significant players in global crude oil markets are the national oil companies of sovereign

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[29] *Advance Notice* at 25620.

[30] The wholesale electric power industry involves a product that cannot be stored, that must be delivered in real-time over an integrated transmission grid, that connects a defined set of customers in a given geographic area, and that is sold pursuant to federal, state, and regional market design rules that govern the dispatch of power to consumers and control the terms and conditions under which sellers may bid to provide power. *See* Ordover-Godek Statement at ¶ 20.

[31] *See, e.g.*, *Spring/Summer Report 2006* at 10 (noting that "[t]he largest component in producing gasoline is that of crude oil, and changes in the price of crude oil historically have been the source of a substantial fraction of changes in the price of gasoline").

oil-producing nations.[32] Many refiners' production and allocation decisions are also shaped by the availability of crude oil with the specific physical properties that a given refinery's system has been designed to refine. No new rule can change this reality; instead, a new rule simply may force market participants to make otherwise irrational business decisions simply to ensure regulatory compliance.

Most of the oil industry remains unregulated today. In this sense, the industry operates like any other manufacturing industry, with the flexibility to respond to market forces, although at times subject to relatively tight capacity constraints. As long as participants in the oil industry remain free to make fundamental business choices relating to production and supply in response to market forces, there is no reason to expect that the kind of supply disruptions that have been experienced in markets within FERC's jurisdiction would be likely to occur in petroleum markets.

### B. Suggested Approaches

The following are preliminary responses to some questions raised in the *Advance Notice*. There is some repetition in these responses because the same fundamental principles apply to multiple questions, and we wish to reduce cross-references. We will also supplement these comments in the Rulemaking proceeding itself.

#### 1. The Proposed Definition of "Manipulation"

The *Advance Notice* proposes the following definition of "manipulation":

> Market manipulation shall mean knowingly using or employing, directly or indirectly, a manipulative or deceptive device or contrivance -- in connection with the purchase or sale of crude oil, gasoline, or petroleum distillates at wholesale -- for the purpose or

[32] National oil companies account for 80% of crude oil production in the world. *See* Ordover-Godek Statement at ¶ 14

> with the effect of increasing the market price thereof relative to costs.[33]

Simply put, this definition makes no sense. All businesses seek to improve their profitability by adjusting their prices in response to market forces, and especially in response to sudden shocks. In fact, as the Commission is well aware, the overall health of the economy depends on their efforts to do so. A mere attempt to maximize profits therefore cannot constitute market manipulation, because such conduct is a necessary element of competitive and healthy market operation.

Any attempt to impose artificial rigidity on prices that firms charge is likely to open a Pandora's box of unintended consequences. Even when the Commission uncovers evidence of collusion or deception, its remedial orders generally prohibit the offensive practices directly; they almost never regulate future prices. Price regulation would distort allocation of economic resources, impede incentives to improve costs, potentially create and/or amplify shortages at the worst possible times (e.g., following a supply disruption), and offer new opportunities for manipulation.[34]

We agree with the observation in the *Advance Notice* that the "primary focus of the prohibition on manipulation appears to be on practices that are not a reaction to market forces . . . [but instead] intentionally, willfully, or recklessly cause distortions in the market."[35] It follows that the prohibition on manipulation should *not* encompass any practices that *are* a legitimate reaction to market forces. Any definition of manipulation therefore must contain an element of fraud or dishonesty that enables a company to profit from false market signals.

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[33] *Advance Notice* at 25620.

[34] Ordover-Godek Statement at ¶ 32.

[35] *Advance Notice* at 25620.

Such an interpretation is consistent with long-standing Supreme Court precedent, which has consistently read "manipulation" to connote "conduct designed to deceive or defraud"[36] and "mislead . . . by artificially affecting market activity"[37]. More important, it is also consistent with the intent of a key sponsor of Section 811 and an outspoken advocate for additional regulatory oversight of petroleum markets, Senator Maria Cantwell. In a recent letter to the Commission, Senator Cantwell made clear that the manipulation prohibitions of Section 811 are intended only to catch "conduct designed to deceive or defraud," but not "sellers who take advantage of the natural market forces of supply and demand."[38]

### 2. The Appropriate Level of Scienter

If any rules promulgated by the Commission are consistent with sound economic principles, as recommended above, it would also be appropriate to apply the same standard of intent that the Commission applies today under its existing authority to address fraud and deception. Conversely, if the Commission issues a Notice of Proposed Rulemaking that would extend more broadly than its traditional fraud and deception standards, it may be appropriate to examine a more rigorous scienter standard, but a discussion of such a standard is beyond the scope of these comments. The Commission's current approach was articulated in its 1983 Policy Statement on Deception,[39] which has been repeatedly cited as authoritative. The Statement articulates three tests for a determination of deception:

- Conduct "that is likely to mislead the consumer . . ."
- Viewed from the "perspective of a consumer acting reasonably . . ."

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[36] *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976).

[37] *Santa Fe Indus. v. Green*, 430 U.S. 462, 476 (1977).

[38] Letter from Sen. Maria Cantwell to FTC Commissioners (Apr. 8, 2008), quoting *Ernst & Ernst*, 425 U.S. at 197, *available at* http://cantwell.senate.gov/news/record.cfm?id=295769.

[39] This policy statement is available at http://www.ftc.gov/bcp/policystmt/ad-decept.htm.

– The misleading conduct must have a "material" effect on "the consumer's conduct or decision . . ."

Deception cases typically involve false statements about the attributes of a product in the context of a sales offering to an ultimate consumer, in order to create the impression that the product is worth more than it really is. However, the same principle would apply to conduct that is designed to send a *false signal* about existing market values in order to influence the price of future market transactions.

If a rule were to define deception or "manipulation" in this way,[40] it would not be necessary to explore the subjective scienter of market actors. It can be assumed that any honest person knows the difference between a false statement and an accurate one (provided accuracy is not something that can only be determined after the fact).

### 3. The "Public Interest" Standard

The term "public interest" does not appear in the laws that govern the Commission's work, but over time the Commission has established and articulated its own ideas about how it might best contribute to the public welfare. The Commission is entitled to assume that Congress expected the agency to apply its own traditional "public interest" responsibilities to the extent possible when it gave rulemaking authority to the agency.

The Commission has responsibility for so-called "competition" and "consumer protection" law. As mentioned above, consumer protection offences like deception can also have anticompetitive consequences. Unlike the monopolization offenses governed by Sherman Act, Section 2, these offences do not depend on proof of market power or specific intent. We do not believe that any Commission rules under Section 811 should necessarily conform to the

[40] This definition would be consistent with the text of Section 811 and the statements of Senator Cantwell.

standards for a violation of the Sherman Act. However, we do believe that any Commission rules should conform to the same sound economic principles that it applies in this area and others.

### 4. Comments on Specific Potential Practices

#### a) Disclosures

There is already a considerable body of learning about potentially anticompetitive effects when individual companies provide current or advance notifications of their price or capacity decisions. These notifications may be described as "facilitating practices," depending on factors like the structure of the industry, the need to inform customers, and the likelihood that required customer notifications will become public anyway. Efficient workings of a market economy require a good deal of knowledge in the hands of customers and also in the hands of producers. Hence, restrictions on disclosures that "leave customers in the dark" may be inimical to the smooth operations of the relevant markets.[41] Of course, false or deceptive reports can also raise familiar problems.

An initial question for the Commission is whether there is something special about the industries here involved that requires special rules. On the one hand, the risk of unintended downside effects may be less serious when disclosure of decisions is regulated rather than the decisions themselves. On the other hand, the benefits of special disclosure rules for the subject industries may be minimal. The Commission should refrain from imposing restrictions on accurate public announcements regarding capacity, capacity utilization, and capacity shutdowns unless it finds evidence of circumstances in which such information is used to facilitate collusion that would be condemned under Section 1 of the Sherman Act.[42]

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[41] Ordover-Godek Statement at ¶ 37.

[42] *See id.* at ¶¶ 37-40.

### b) Decisions Relating to Supply

The idea that the Commission can regulate business decisions about how much petroleum to sell, to whom to sell it, and at what price is misguided and potentially dangerous. Antitrust law has long recognized the right of a company to unilaterally decide to supply or not supply a market. And, a market economy, at its core, relies on the price system and the profit motive to allocate resources efficiently. A market participant therefore must be permitted to make production and supply determinations without fear of being second guessed by regulators after the fact.[43]

The success of long-term supply arrangements, for example, depends on the ability of suppliers to make their individual production, inventory, and allocation decisions in the face of changing demand and availability of inputs, and in consideration of their existing commitments to customers. Any new market manipulation rule should not interfere with these commercial obligations. A rule that requires a terminal owner to release inventory in response to a price spike could force the owner to decide whether to honor its commercial obligations or to comply with the regulation, and also is likely to make matters worse both in the short term and in the long term.

Inventories are essential to ensure consistent supply in the face of unexpected changes in production and demand, and to minimize the associated price fluctuations. Any proposed regulation that would interfere with business decisions on inventory management would disrupt these critical market functions with no obvious benefit. Inventories are expensive to hold, and become more expensive as prices rise. Only the reward of higher profits will motivate suppliers to build inventories in anticipation of expected supply disruptions. Mandated release of

[43] *Id.* at ¶ 25.

inventory could prolong a short-term crisis and destroy the incentive of producers to develop the most effective weapon for combating future market gyrations.[44] The inevitable result will be precisely the opposite of the intended effect.

Prices similarly serve a crucial role in an efficient market. As the Commission has repeatedly recognized, prices signal the scarcity of a product, allocate the product to its most highly valued uses, and provide incentives for the rapid supply of additional product – an especially important function during a shortage. "Artificial" prices – if they exist – can only be those rooted in deception, which send false signals to the market. A rule that suppresses or constrains price by any means absent any evidence of collusion would create a true "artificial price" that sends false signals to the market, and inevitably will exacerbate shortages, misallocate resources, and dull incentives for entry and expansion. High profits during tight market conditions provide invaluable incentives for market participants to invest in capacity and allocate supply in a way that ultimately leads to market stabilization.[45]

As a practical matter, decisions to supply or not supply a particular market or decisions about the release of inventory would also be difficult to regulate in a sensible way. Clearly, outcomes that may seem obvious *ex post* with the benefit of hindsight may not have been obvious *ex ante* when dealing with imperfect information and quickly changing market conditions as reflected in supply and demand balances.[46] It would be unreasonable for a proposed rule to condemn behavior that only *ex post* is interpreted by the regulator to have "manipulated" the market. Therefore, in the course of every investigation, the Commission's

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[44] *Id.* at ¶¶ 26-30, pp. 13-15.

[45] *Id.* at ¶ 33-34, pp. 17-18.

[46] *Id.* at ¶ 35, p. 18.



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decision would need to rely solely on the information available to the firm at the time the firm made the business decision in question.

**c) Conduct Before and After a "Disaster"**

A fundamental issue here, as elsewhere, is whether it is prudent or necessary to interfere with rational economic responses after a disaster. The effects of disasters differ in severity, in scope, and in duration. Some disasters are so severe that civil authority breaks down in the immediately affected area, and markets as we know them simply cease to function. A state of emergency may be declared, accompanied by restrictions on movement and curfews. Available food, water and shelter may be commandeered and doled out by military authorities. It is hard to imagine that any Commission Rule would be useful in these extreme circumstances.

In less extreme conditions, there may be serious shortages of certain commodities and services, with consequent sharp increases in price. Petroleum products are just a few of many that are so affected. Why should some products be singled out for regulation, but not others? As the Commission found in its post-Katrina report,[47] the gasoline market worked as it should following two major disasters in quick succession. There was "no evidence of anticompetitive behavior in . . . gasoline pricing" after the storms, "the price spikes . . . were short lived," and "suppliers responded to the higher prices with increased sales."[48] Given the size of the refining capacity disruption associated with these two hurricanes and the relative brevity of the price spikes, it is difficult to imagine a regulatory system which would yield better results for the public than the free market provided. We submit that the Commission's Rulemaking should consider whether there is any evidence to suggest that restrictions on wholesale prices of the subject products would have produced a better outcome in this situation.

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[47] *See Post-Katrina Gasoline Report*.

[48] *Id*. at 101.

### 5. Comments on Case Studies

#### a) BP Amoco/Atlantic Richfield

Most of our comments on the first scenario, which is based on the *BP Amoco/Atlantic Richfield* merger case, are largely duplicative of the points made above. In the interest of brevity, we will not repeat them here.

It is worth noting, however, that when the Commission met to approve a settlement decree negotiated by its staff, it voted 3-2 to delete a provision of the decree that would have restricted the export of crude oil extracted from Alaska's North Slope ("ANS") to Asia for the purpose of increasing the spot price for ANS crude oil on the West Coast. According to the statement released by the Commission majority, "over-regulatory" export restrictions would be "unnecessary, unenforceable and otherwise inappropriate" relief.[49] Thus, if anything, the *BP Amoco* case study illustrates the danger of a broad antimanipulation rule in the petroleum market that prohibits legitimate market responses rather than false market signals.

#### b) Enron

The Enron case study cannot inform the Commission's Rulemaking here. The conduct at issue in that case was unique to wholesale electrical power regulations. FERC has established a comprehensive set of rules governing product parameters and bidding behavior for the power industry. It was by gaming these rules that Enron engaged in a series of transactions that FERC found to be manipulative.

There are no similar rules in the wholesale petroleum market. Instead, the petroleum markets are largely unregulated, leaving participants free to react to market forces. Thus,

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[49] Statement of Commissioners Anthony, Swindle, & Leary, in *BP Amoco/ARCO*, File No. 991-0192, Doc. No. C-3938 (Apr. 14, 2000), *available at* http://www.ftc.gov/os/2000/04/bpstateasl.htm.

FERC's experience with Enron is a poor source from which to extract general principles that may be of use to the Commission in this case.

Respectfully submitted,

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**FEDERAL TRADE COMMISSION**
**16 CFR Part 317**

**Prohibitions on Market Manipulation and False Information in Subtitle B of the Energy Independence and Security Act of 2007**

**Advance notice of proposed rulemaking; request for public comment.**

# STATEMENT OF JANUSZ A. ORDOVER AND PAUL E. GODEK

**Compass Lexecon**

**June 16, 2008**

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## Exhibits

**Exhibit A: Curriculum Vitae of Janusz A. Ordover**

**Exhibit B: Curriculum Vitae of Paul E. Godek**

# STATEMENT OF JANUSZ A. ORDOVER AND PAUL E. GODEK

**Compass Lexecon**

**June 16, 2008**

## I. Qualifications, Assignment, and Summary

1. Janusz A. Ordover: I am Professor of Economics and former Director of the Masters in Economics Program at New York University, where I have taught since 1973, and a Founding Director of Competition Policy Associates, which is an economic consulting firm. During 1991-1992, I served as Deputy Assistant Attorney General for Economics at the Antitrust Division of the United States Department of Justice. As the chief economist for the Antitrust Division, I was responsible for formulating and implementing the economic aspects of antitrust policy and enforcement of the United States, including co-drafting the 1992 U.S. Department of Justice and the Federal Trade Commission *Horizontal Merger Guidelines*. I also had ultimate responsibility for all of the economic analyses conducted by the Department of Justice in connection with its antitrust investigations and litigation.

2. My areas of specialization include industrial organization, antitrust, and regulation economics. I serve on the Board of Editors of *Antitrust Report* and have served as an advisor on antitrust and regulatory issues to many organizations, including the American Bar Association, the World Bank, the Organization for Economic Cooperation and Development, the Inter-American Development Bank, and the governments of Poland, Hungary, Russia, the Czech Republic, Australia, and other countries. I have provided economic testimony in policy hearings conducted by the Department of Justice, the Federal Trade Commission, and the United States Senate. I have worked extensively on a variety of antitrust, regulatory, and public-policy issues in the energy sector, including mergers and regulatory matters involving refining, distribution, and retail sales of petroleum products. My curriculum vitae, which includes a list of my publications, is attached as Exhibit A.

3. Paul E. Godek: I am an economist and a Senior Vice President at Compass Lexecon, a private economic research and consulting firm. I received a B.A. in economics from the University of Michigan and a Ph.D. in economics from the University of Chicago. I am one of the few economists to have served at both of the federal antitrust agencies. I was the Economic Advisor to the Director of the Bureau of Competition at the Federal Trade Commission. Prior to that, I was a staff economist with the Antitrust Division of the Department of Justice. I have more than 25 years of experience in the economic analysis of issues related to antitrust, class certification, damages, and securities fraud. I have published several articles in leading economic journals on antitrust and other regulation issues. I have also worked on several antitrust matters involving the petroleum industry. My curriculum vitae, which includes a list of my publications, is attached as Exhibit B.

4. We have been retained by Flint Hills Resources, a producer and distributor of refined oil products, to examine the Federal Trade Commission's advance notice of proposed rule-making ("FTC Notice") and to offer our opinions on some of the issues raised therein. The Federal Trade Commission summarizes its request for comments as follows:

> The Federal Trade Commission is requesting comments on the manner in which it should carry out its rulemaking responsibilities under Section 811 of the Subtitle B of Title VIII of The Energy Independence and Security Act of 2007.[1]

The FTC further states:

> Section 811 prohibits "any person" from directly or indirectly (1) using or employing "any manipulative or deceptive device or contrivance," (2) "in connection with the purchase or sale of crude oil, gasoline or petroleum distillates at wholesale," (3) that violates a rule or regulation that the Federal Trade Commission "may prescribe as necessary or appropriate in the public interest or for the protection of United States citizens."[2]

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1 Federal Trade Commission, 16 CFR Part 317 "Prohibitions on Market Manipulation and False Information in Subtitle B of the Energy Independence and Security Act of 2007" ("FTC Notice"), page 1.

2 FTC Notice, page 3 and footnote 11.

5. The efficient and competitive operation of the oil refining industry is in the best interests of consumers. That said, it is not at all clear that any new FTC rules are necessary to protect the efficient and competitive operation of the oil refining industry. In particular, recent increases in the world price of crude oil and the consequent increases in the prices of gasoline and other distillates do not indicate inefficiencies or anticompetitive behavior in the oil refining industry. If anything, the risk is that the FTC, equipped with new rules and regulations, will come under increasing pressure to intervene in the independent business decisions of refiners with regard to the supply, storage, and even pricing of their products. Such intervention can be expected to adversely affect the efficient operation of the industry to the ultimate detriment of consumers.

6. In a market economy, the efficient allocation of resources depends on the unfettered decisions of competitive firms seeking to maximize their long-run value.[3] A free market is one in which each firm determines individually what to produce, how much to produce, and where and when to sell its products. Prices are determined by the independent decisions of producers and consumers interacting in the market. The FTC Notice contemplates an array of rules that would allow the FTC to investigate and to punish, after the fact, the independent production and distribution decisions of firms in the oil industry. The FTC should make no rule that either impinges on such decisions or that puts oil refiners in legal jeopardy for such decisions.

7. There should be no concern, we believe, that the two federal antitrust agencies – the FTC and the Department of Justice ("DOJ") – take lightly their responsibilities to enforce the antitrust laws with regard to the oil (or any other) industry. Given the broad powers that these and other federal agencies already have, there would seem to be no need for additional regulations specific to the oil industry. Proliferation of regulations that address various aspects of the same conduct can impose heavy burdens on industry participants, as they strive to satisfy the sometimes conflicting requirements.

3 This statement abstracts from misallocation caused by externalities such as pollution, which are not at issue in this instance. Long-run value is equivalent to the (appropriately discounted) present value of the future stream of profits.

8. The costs of the inevitable investigations and litigations that would follow from the application of such rules should also be considered. It is easy to forget that regulatory burdens add to firms' costs and thus, ultimately, lead to higher prices and lower returns on invested capital. These consequences would further harm consumers and economic efficiency. Moreover, the uncertainties generated by rules that are inherently unclear and that lead to *ex post* regulatory intervention and litigation will undermine the incentives of market participants to undertake economically desirable investments. The long-run implications of such policies for the U.S. energy sector are potentially more problematic than short-run misallocations.

## II. The Oil Industry: Past Studies and Current Rules

*Introduction*

9. In recent years, the FTC and the Energy Information Administration of the Department of Energy ("EIA-DOE") have conducted several in-depth studies of the oil industry.[4] The FTC should be commended for conducting thorough and objective analyses, and for publishing its findings in comprehensive reports.

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[4] FTC (www.ftc.gov):
–"Report on Spring/Summer 2006 Nationwide Gasoline Price Increases" 2007;
–"Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases," Spring 2006;
–"Gasoline Price Changes: The Dynamic of Supply, Demand, and Competition," 2005;
–"The Petroleum Industry: Mergers, Structural Change, and Antitrust Enforcement," August 2004;
–"Midwest Gasoline Price Investigation," March 2001.
See also the 2005-2007 annual FTC reports on ethanol market concentration and the FTC's Reply to the General Accounting Office ("GAO") report: "Effects of Mergers and Market Concentration in the U.S. Petroleum Industry," May 2004. The FTC's reply is found in the Appendices to the GAO report.
EIA-DOE (www.eia.doe.gov):
–"Reformulated Gas: Where You Live,"2007;
–"A Primer on Gasoline Prices," May 2006;
–"Hurricane Katrina's Impact on the U.S. Oil and Natural Gas Markets," 2005;
–"Analysis of Selected Transportation Fuel Issues Associated with Proposed Energy Legislation – Summary," September 2002.
Other:
–American Petroleum Institute, "The Facts About Oil Industry Mergers, Market Power and Fuel Prices: An API Primer," May 2008, available at www.api.org;
–Carol Dahl, "What Goes Down Must Come Up: A Review of the Factors behind Increasing Gasoline Prices, 1999-2006," 2007, available at www.api.org;
–Timothy J. Muris and Richard G. Parker, "A Dozen Facts You Should Know About Antitrust and the Oil Industry," June 2007, available at www.uschamber.com.

10. The FTC Notice points to one of these reports, "Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases," as a helpful guide to practices that "might be viewed as manipulative" in the context of this proposed rulemaking.[5] In that study, the FTC examined capacity utilization rates, inventory levels, and output decisions in the oil industry (in both the short and the long run). Futures market manipulation and false price-reporting to industry statistical services and government agencies were also investigated. After thoroughly examining the available evidence, the study concluded:

> Our investigation uncovered no evidence indicating that refiners make product output decisions to affect the market price of gasoline. 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 other physical characteristics. … The evidence collected in this investigation indicated that firms behaved competitively.[6]

11. The FTC has acquired a vast expertise in the structure, conduct, and performance of the oil industry. Indeed, much of what follows in the next section reflects information found in the various FTC reports. We provide here only a very brief review of certain issues that should be kept in mind when considering, from a public-policy perspective, the issues raised in the FTC Notice.

*Industry Overview*

12. It is not surprising that, on average, the price of gasoline is determined in large part by the price of crude oil. The close relationship between oil and gasoline prices is evident in the following chart. These two time series, retail gasoline prices and refinery acquisition cost of crude oil, track each other closely. Changes in gasoline prices reflect changes in the price of crude oil.

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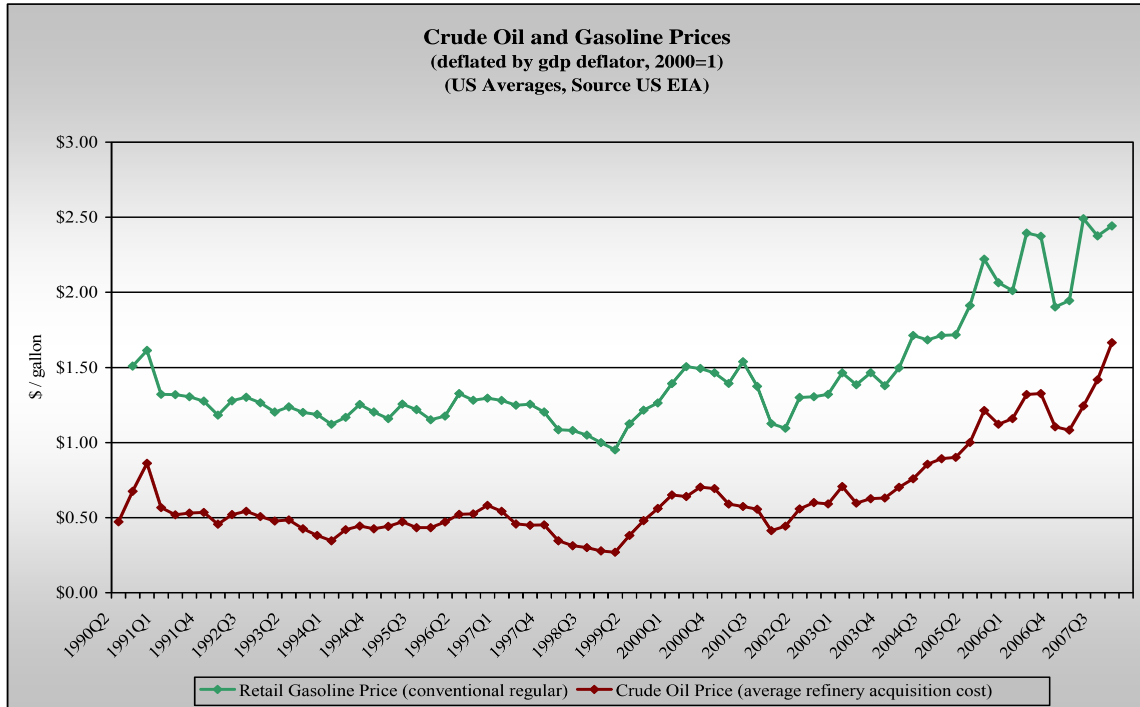
5 FTC Notice, page 22.

6 Federal Trade Commission, "Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases," Spring 2006, page vi. See also the EIA-DOE report: "Hurricane Katrina's Impact on the U.S. Oil and Natural Gas Markets."




13. Crude oil is an internationally-traded commodity and the United States currently imports approximately 2/3 of the oil it consumes.[7] The oil shipped to the U.S. comes from many sources, the most important being Canada, Mexico, Saudi Arabia, Venezuela, and Nigeria. In addition, while it is generally cheaper to refine oil in the United States, rather than to import the refined products, about 10% of the gasoline consumed in the U.S. is imported as a finished product.[8]

14. World oil markets are predominantly supplied, not by privately-owned oil refiners such as ExxonMobil, Shell, or BP, but rather by the various governments of oil-producing countries. National governments account for more than 80% of world crude oil production. The following charts show the distribution of world crude oil reserves and production.[9]

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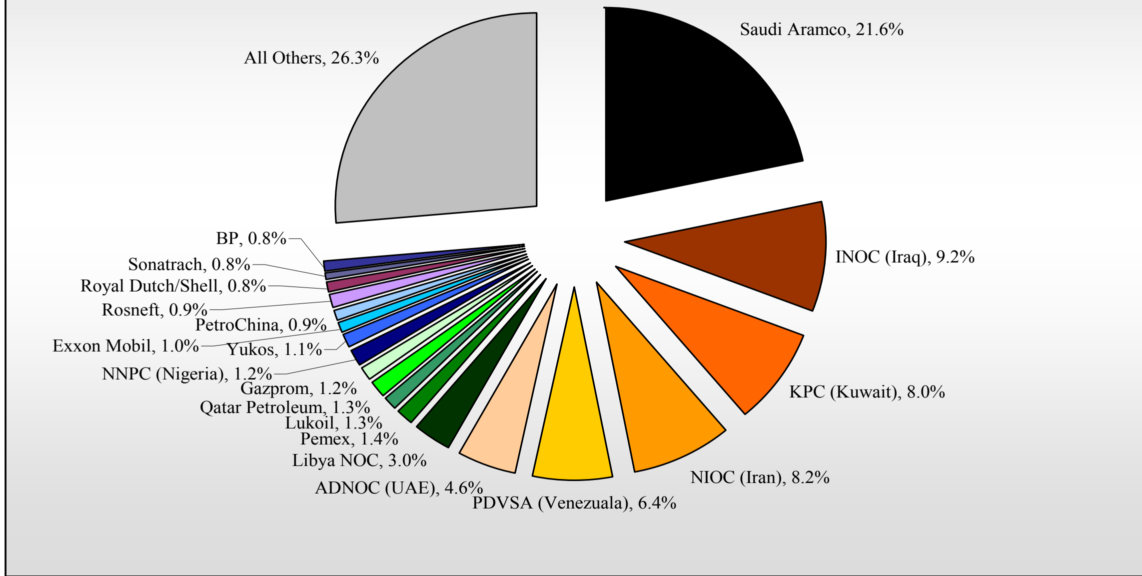
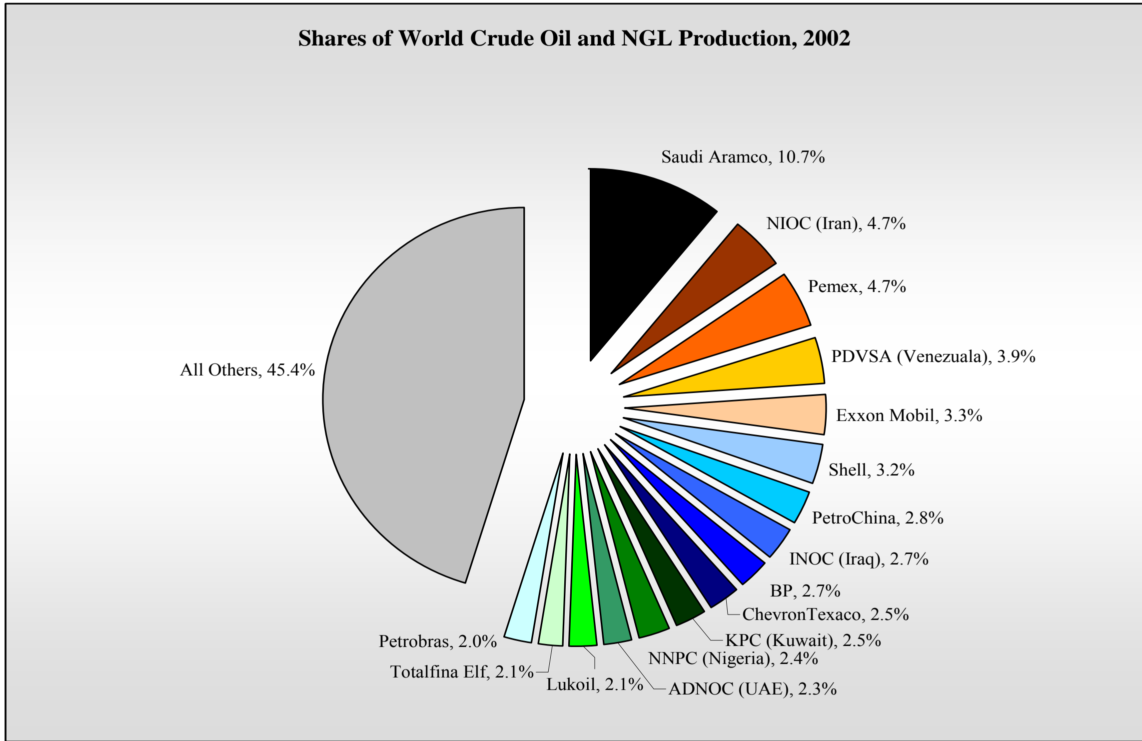
7 See the EIA-DOE *Annual Energy Review 2006*, §5 and page 130.

8 Import statistics can be found at www.eia.doe.gov.

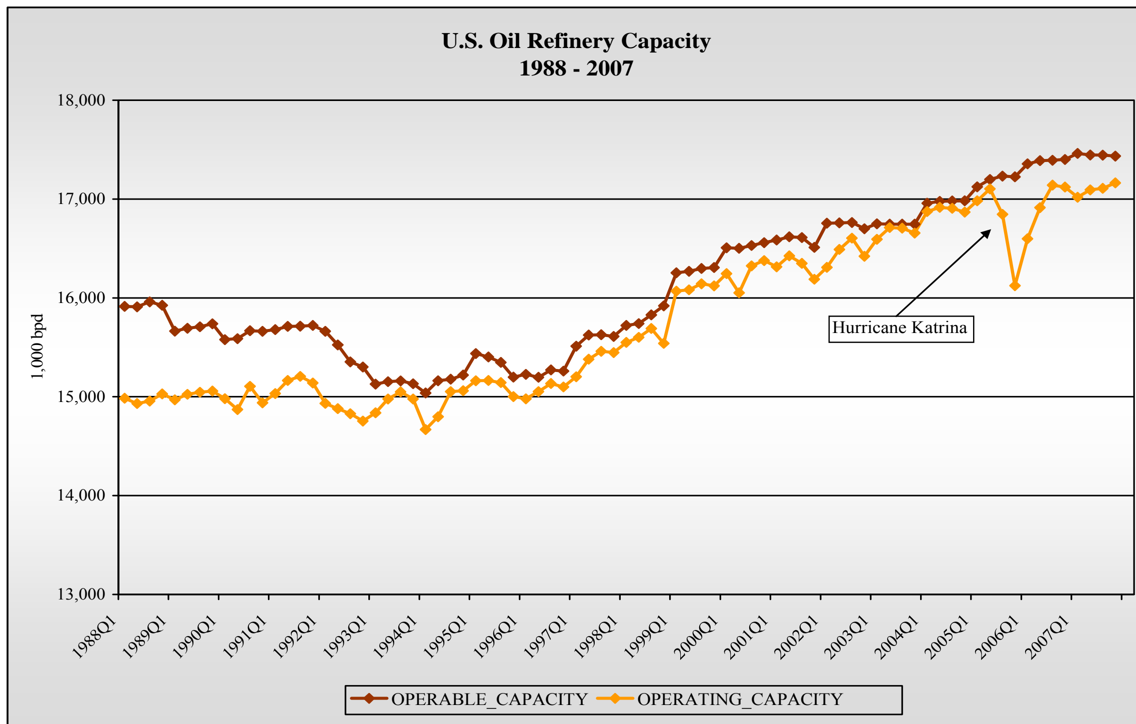
9 The sources for both charts are the FTC Report: "The Petroleum Industry: Mergers, Structural Change, and Antitrust Enforcement," August 2004. See Table 5-3 and Table 5-6. Note that the "All Other" category in the first chart contains countries or private firms each with shares less than 0.8%; the "All Other" category in the second chart contains countries or private firms each with shares less than 2.0%.


Shares of World Crude Oil Reserves, 2002
Saudi Aramco, 21.6%
INOC (Iraq), 9.2%
KPC (Kuwait), 8.0%
NIOC (Iran), 8.2%
PDVSA (Venezuala), 6.4%
ADNOC (UAE), 4.6%
Libya NOC, 3.0%
Pemex, 1.4%
Lukoil, 1.3%
Qatar Petroleum, 1.3%
Gazprom, 1.2%
NNPC (Nigeria), 1.2%
Yukos, 1.1%
Exxon Mobil, 1.0%
PetroChina, 0.9%
Rosneft, 0.9%
Royal Dutch/Shell, 0.8%
Sonatrach, 0.8%
BP, 0.8%
All Others, 26.3%


Shares of World Crude Oil and NGL Production, 2002
Saudi Aramco, 10.7%
NIOC (Iran), 4.7%
Pemex, 4.7%
PDVSA (Venezuala), 3.9%
Exxon Mobil, 3.3%
Shell, 3.2%
PetroChina, 2.8%
INOC (Iraq), 2.7%
BP, 2.7%
ChevronTexaco, 2.5%
KPC (Kuwait), 2.5%
NNPC (Nigeria), 2.4%
ADNOC (UAE), 2.3%
Lukoil, 2.1%
Totalfina Elf, 2.1%
Petrobras, 2.0%
All Others, 45.4%

15. There are other factors, of course, in addition to supply and demand in the world oil market that determine the prices of refined products in any given geographic area. Local supply and demand conditions, environmental regulations, and, notably in recent years, the weather will all affect the price of refined products in any particular area. The various FTC, EIA-DOE, and private sector reports cited above analyze such factors in detail.

16. While no new oil refineries have been built in the United States recently, in part because of environmental regulations, the industry continues to expand capacity at existing sites, in order to keep pace with increasing demand. The following chart shows the steady increase in capacity since the mid 1990s.[10] The top line, operable capacity, shows the maximum capacity that would be available if there were no shutdowns for maintenance and repairs. The bottom line, operating capacity, shows capacity actually available for production. The bottom line reveals the significant impact – and recovery from – Hurricane Katrina in the third quarter of 2005.




10 These capacity figures are from the EIA-DOE. See www.tonto.eia.doe.gov /dnav /pet /pet_pnp_unc_dcu_nus_m.htm

*Current Rules and Regulations*

17. As noted, the federal government already has powerful tools that can be used to deter and punish anticompetitive behavior in the energy sector, or any other sector for that matter. These tools are the antitrust statues which aim to regulate mergers and to deter and punish unilateral and coordinated anticompetitive conduct. The FTC investigates all refinery mergers and has sometimes required substantial divestitures before mergers were allowed to proceed. In fact, the Commission has tended to mandate divestitures at lower levels of concentration in this industry than in others.[11] In none of its merger investigations did the FTC conclude that regulatory (behavioral) relief was required, given the burdensome aspects of such relief (both on the parties and on the Commission) and given the already-existing federal powers to deter anticompetitive behavior.

18. In addition to the broad-reaching antitrust statutes, it is our understanding that the FTC also has the power to investigate fraudulent and deceptive behavior under its statutes. In addition, the Commodity Futures Trading Commission ("CFTC") and the Securities and Exchange Commission ("SEC") have expansive regulations and broad powers dealing with financial market manipulation. Finally, the Federal Energy Regulatory Commission ("FERC") regulates the shipment of oil and refined products by interstate pipelines. Given this multifarious oversight, it is not at all clear what market imperfections – that do not already fall under the purview of existing laws and regulations – are supposed to be addressed by new FTC rules.

19. It should be kept in mind that the oil industry is not a regulated utility and there is no reason to treat it as one. In particular, the oil industry is not at all like the electrical generation industry, which is heavily regulated for very specific reasons. The electric generation industry produces a commodity that cannot be stored, that must be distributed along a common grid, and that is typically delivered to the final consumer by a monopoly

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[11] On the subject of industry concentration and FTC merger analysis, see FTC, "The Petroleum Industry: Mergers, Structural Change, and Antitrust Enforcement," August 2004; American Petroleum Institute, "The Facts About Oil Industry Mergers, Market Power and Fuel Prices: An API Primer," May 2008; Timothy J. Muris and Richard G. Parker, "A Dozen Facts You Should Know About Antitrust and the Oil Industry," June 2007; Carol Dahl, "What Goes Down Must Come Up: A Review of the Factors behind Increasing Gasoline Prices, 1999-2006," 2007.

supplier: the oil industry does not share any of these features. Except for the use of common-carrier interstate pipelines for the transport of crude oil and refined products – pipelines that are already regulated by FERC – the oil industry is not fundamentally different from other manufacturing industries. Thus, the oil industry does not require additional regulation in order to avoid the substantial disruptions of the sort that occurred in recent years in some California electric markets.[12]

20. In fact, (non-weather-related) price spikes in local gasoline markets have tended to be caused by federal and state intervention in the form of environmental mandates.[13] In certain parts of the country for certain times of the year, federal environmental regulations require that only specific types of gasolines be sold. As described the EIA-DOE:

> The Clean Air Act Amendments created oxygenated gasoline and reformulated gasoline (RFG) blends, moving the system to three formulations of gasoline (conventional, oxygenated and reformulated), each of which is available in three grades, with volatility distinctions between Northern/Southern and summer/winter blends. … In parallel with the Federal gasoline changes, States have added gasoline types as well.[14]

Reformulated gas (RFG) and oxygenated gas tend to be more expensive to produce. RFG gas areas include much of California, much of the Northeast Corridor (cities along the East Coast from Washington, DC to Boston), Chicago, St. Louis, and several other cities.[15] In addition, in response to federal legislation, a common ingredient in RFG, MTBE, was phased out and replaced by ethanol.

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12 The problems in California electric markets are complex and multi-faceted and were certainly not the result of simply too little regulation. See James Sweeney, *The California Electricity Crisis*, Hoover Press, 2002; Severin Borenstein, "The Trouble With Electricity Markets: Understanding California's Restructuring Disaster," *Journal of Economic Perspectives*, Winter 2002; Paul Joskow, "California's Electricity Crisis," *Oxford Review of Economic Policy*, 2001; FTC, "Staff Report: Competition and Consumer Protection Perspectives on Electric Power Regulatory Reform," July 2000.

13 See EIA-DOE: "Analysis of Selected Transportation Fuel Issues Associated with Proposed Energy Legislation – Summary," September 2002; "Reformulated Gas: Where You Live"; "A Primer on Gasoline Prices." See also FTC, "Report on Spring/Summer 2006 Nationwide Gasoline Price Increases."

14 See EIA-DOE, "Analysis of Selected Transportation Fuel Issues Associated with Proposed Energy Legislation – Summary," September 2002.

15 See EIA-DOE, "Reformulated Gas: Where You Live."

21. Not only are these various gasolines more expensive to produce than conventional gasoline, but the seasonal switchovers to different blends and the rapid phase-out of MTBE are known to cause temporary supply bottlenecks and disruptions, with consequent effects on prices. These outcomes are well documented by the FTC and the EIA-DOE. As described by the EIA-DOE:

> [T]he general impact of an increasing number of distinct gasoline fuels with smaller demands and, in some cases, served by fewer suppliers has been to reduce the flexibility of the supply and distribution system to respond to unexpected supply/demand shifts. … When the market tightens in a distinct fuel area, which can occur from a supply disruption, a winter-to-summer transition, or unusual demand, the system has less ability to respond than when fuels were more fungible. Regions with specialized gasolines cannot borrow from their neighbors if they run short without a special waiver, and with a limited number of suppliers for a specialized fuel, supply response may take several weeks. This, in turn, has led to unintended price volatility in some areas.[16]

Several studies have concluded that price spikes and supply disruptions would be less likely and less severe if the EPA reduced the number of required gasoline types.[17] We are, of course, not arguing that environmental considerations should be ignored for the sake of reducing gasoline price volatility. We are only suggesting that when markets are already affected by regulatory requirements that, at times, lead to undesirable consequences, these consequences cannot be cured or ameliorated with other rules that, in the end, will only exacerbate the already-existing regulatory distortions.

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[16] EIA-DOE, "Analysis of Selected Transportation Fuel Issues Associated with Proposed Energy Legislation – Summary," September 2002.

Other descriptions of the effects of environmental regulations:

- FTC, "Report on Spring/Summer 2006 Nationwide Gasoline Price Increases," ("[T]he evidence indicates that about 75% of the spring and summer 2006 national average gasoline price increases stemmed from the seasonal effects of the summer driving season, increases in the price of crude oil … and increases in the price of ethanol … The evidence further indicates that the remaining 25% of the price increases stemmed from declines in the production of gasoline – due to the refiners' transition to ethanol from other widely used blending components, persistent refinery damage related to Hurricanes Katrina and Rita … and other refinery outages caused by unexpected events and required maintenance – coupled with increased demand. … Further, our targeted examination of major refinery outages revealed no evidence that refiners conspired to restrict supply or otherwise violated the antitrust laws.");
- EIA-DOE, "A Primer on Gasoline Prices," ("The rapid switch from MTBE to ethanol could have several impacts on the market that serve to increase the potential for supply disruptions and subsequent price volatility on a local basis.").

[17] See Timothy J. Muris and Richard G. Parker, "A Dozen Facts You Should Know About Antitrust and the Oil Industry," June 2007, Chapter 3 and the studies cited therein.

## III. Topics in the FTC Notice

*Overview*

22. The FTC Notice introduces a list of suggested topics with the following statement:

> The Commission requests comment on the following topic list, but encourages commenters to present any other proposals for formal rule provisions that they may wish to suggest. This list is not to be perceived as a formal proposal to address any of the practices described pursuant to Section 811; rather, it is interned to be illustrative, and to encourage further thinking.

The list of topics contains several questions and proposals that merit scrutiny and skepticism from a public policy perspective, because they suggests *ex post* micro-management of basic production and distribution decisions. Below, we address several of the issues raised, not to offer a point-by-point analysis and critique, but rather to argue that additional regulatory oversight of the oil industry is unwarranted and is likely to be counter-productive.

*Prices and Quantities*

23. It is important to state at the outset that direct government intervention – however well intentioned – in pricing, production, and inventory decisions is inimical to the operation of an efficient market. The topics discussed in the FTC Notice suggest a broad range of highly problematic interference with such decisions:

> ● Some have argued that market participants with terminal or other storage inventory should be under an affirmative obligation to release inventory during price spikes when the participant knows, or should know, that the release of the product will be profitable. The Commission seeks comment on when such an obligation should be imposed; what possible intent standard should be used as a test for liability; how one should measure profitability in such a circumstance; and, the costs and benefits to consumers of placing such an obligation on potential market suppliers.
>
> ● The Commission seeks comment on how to determine an artificial price. For example, if an entity with market power that was not obtained

by improper means, sets its prices above what would have been a competitive level, and as a result, prices in the market are higher than competitive prices, is this an artificial price? Commenters are encouraged to explain how the competitive price should be determined, including during a period in which capacity has declined unexpectedly because of a disaster. Commenters are encouraged to assess, in particular, whether setting the prices above a competitive level should be considered a manipulative device or contrivance; whether that answer would depend on other factors or circumstances, and, if so, on which ones; and what the direct and indirect, short- and long-term effects of treating this as a manipulative device or contrivance would be.

- The Commission seeks comment as to what extent or in what circumstances should the distinction between forbidden and permitted business behavior be primarily a function of the intent, purpose, or knowledge of the actor? For example, if a firm holds back inventory during a supply shortage with the intent to raise or expectation of raising immediate prices, but the effect is that the inventory is sold later, when the shortage is more severe, should that be a violation? If a firm decreases the amount of product sold in a tight market in order to grow its business elsewhere, regardless of whether prices in the tight market will rise, should that be a violation?

- The Commission encourages commenters, in addressing any of the foregoing practices, to discuss whether, and if so how, a Section 811 rule should account for the fact that the practice is used prior to, during, or in the aftermath of a natural disaster, such as an earthquake or a hurricane.

24. These paragraphs describe ideas that have the potential to do much harm. The questions posed and the suggestions offered contemplate the investigation and regulation of business decisions regarding how much to sell, to which customers, and at what price. A market economy relies on the price system and the profit motive to allocate resources. It is well understood that efficient markets depend on firms acting in their own interest and in competition with other firms. Firms should be expected to seek out the best uses of their productive assets and the best prices for their products. They do not need to be encouraged to do so; they should not be punished for doing so.

25. For example, to "second guess" independent business decisions regarding appropriate inventory levels is misguided and ill-advised. Inventories serve several business functions, one of which is to avoid losing sales in the face of both anticipated

and unanticipated fluctuations in production and demand.[18] As a general matter, then, inventory fluctuations would be expected to smooth out price variability. After all, those who hold inventory would generally prefer to buy low and sell high. To subject inventory decisions to regulation or litigation would be an unprecedented interference with the unilateral decisions of producers, with no offsetting benefit.

26. For illustration, let's assume that the FTC promulgates a rule, as stated above, creating "…an affirmative obligation to release inventory during price spikes when the participant knows, or should know, that the release of the product will be profitable." To enforce such a rule, the terms "release inventory" and "price spike" would have to be defined. How quickly and how much do prices have to rise to constitute a spike? How much inventory must be released, how quickly, and to whom? And what constitutes the relevant inventory that must be released? Does a price spike in the Midwest compel inventory be drawn down in a Gulf Coast storage terminal? These questions would have to be answered in order for the rule to be even potentially operational.

27. Even then, what does it mean to say that the participant "knows, or should know, that the release of the product will be profitable"? Profitable relative to what? Because there is an opportunity cost to holding it, releasing inventory will almost always be profitable in a short-run but economically meaningless sense. A requirement to release inventory would be impossible to prescribe, much less enforce, without harmful effects to a fundamental economic decision.

28. If such a rule pertaining to inventories were somehow made operational, would it smooth out price fluctuations? To the contrary, it could well make them worse. Any rule is likely to raise the costs and risks of holding inventory – due to the potential for forced sales and litigation. Thus, equilibrium inventory levels would be expected to decline. For illustration, if hurricanes are anticipated to impair production, it is in the best interest of consumers for suppliers to build inventories to address such possible supply disruptions. Higher inventories have higher costs, however, and there must be an incentive to bear these higher costs. Given an uncertain rule and an *ex post* assessment of their inventory

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[18] See Timothy J. Muris and Richard G. Parker, "A Dozen Facts You Should Know About Antitrust and the Oil Industry," June 2007, Chapter 1.

decisions, firms could decide to reduce the inventories held in anticipation of a disruption – causing consumers to suffer higher and prolonged price elevations.

29. In addition, in the face of such a rule, the prudent thing for a supplier to do in the event of a price spike might be to release more inventory more quickly than it otherwise would have. Whatever phenomenon caused the spike in the first instance could persist and cause an even more severe spike after inventories have been drawn down by the compelled release. If a supplier holds excess inventory beyond an initial price spike, it may be in anticipation of selling later in the event of an even higher price – as might be expected during a prolonged and severe shortage. Consumers will be better off for the inventory being held beyond the initial price spike. The FTC asks:

> For example, if a firm holds back inventory during a supply shortage with the intent to raise or expectation of raising immediate prices, but the effect is that the inventory is sold later, when the shortage is more severe, should that be a violation?

The question itself reveals the absurdity of the contemplated regulation. The inventory decision should not be a violation of any rule, regardless of expectations or outcomes.

30. It should also be kept in mind that firms don't always sell product at the highest available price at a given point in time. Again, the FTC asks a revealing question:

> If a firm decreases the amount of product sold in a tight market in order to grow its business elsewhere, regardless of whether prices in the tight market will rise, should that be a violation?

Firms enter into contracts – formal and informal, explicit and implicit – with customers. That is, firms have long-standing business relationships. A firm may choose to supply a long-term customer at a lower price rather than divert product to an area with a higher price. Again, these sorts of activities should not be second-guessed by the FTC. Allocating a firm's output is a job not suitable for the FTC or any other government agency.

31. Vague obligations to charge "fair" or "competitive" prices, or to avoid "price gouging," in the event of an emergency or natural disaster – price controls by other names – will only dull the incentives to supply product under such circumstances. Any quantity at a high price is better than no quantity at a "fair" price. High prices caused by

unanticipated disruptions in supply signal the scarcity of the product, allocate the product to its most highly valued uses, and provide incentives for the rapid supply of additional product. An arbitrary cap on prices will only cause shortages, misallocate resources, and dull incentives for entry and expansion.

32. For example, it is our understanding that, in advance of RFG specifications in the Chicago-Milwaukee areas effective in the Spring of 2000, Flint Hills Resources spent considerable effort at its Minnesota refinery to ensure that it could manufacture gasoline that would meet the new specifications. Supply disruptions and higher prices did occur when other refiners encountered difficulty in producing the new gasoline. Flint Hills Resources' advance preparations were rewarded in the market, to the benefit of consumers.

33. "Excessive" profits in the face of shortages are desirable, even if such levels of profits might be a signal of a poorly functioning market if sustained over a long period. High profits provide incentives to invest in capacity where such investments could not be fully recovered if the temporarily high profits were extinguished by regulatory fiat. Regulatory intervention, whether in response to political pressure or not, will tend to undermine the incentives that drive the investment decisions in the industry.

34. Regulators should not attempt to determine *ex post* whether a firm's decisions were "manipulative and deceptive" or whether those decisions were reasonable given the imperfect information available at the time. Indeed, it would be surprising if firms did not make "errors" under such circumstances when viewed with 20/20 hindsight – prescience should not be a requirement for passing the test for non-deceptive conduct. The information available to a regulator after the fact is not the same as the information available to firms at the time they have to make business decisions. Consequently, even if an operational definition of manipulation were available, it would be unreasonable and counterproductive to condemn such behavior based on information available after the fact.

*Information, More or Less*

35. Some of the topics involve suggestions to prohibit the dissemination of useful and accurate information. For examples:

> ● Certain refiners have made public announcements of planned reductions in the overall utilization of their refinery plant(s). The commission seeks comment on: (1) whether such practices should be viewed as manipulative; (2) the perceived harm from such actions if any; (3) whether such practices should or would manifest the intent necessary to violate Section 811; and (4) whether any business justification balance the perceived harm.
>
> ● Refiners engage in periodic scheduled maintenance and refinery downtime in order to prevent breakdowns or to change equipment. On the one hand, such maintenance and scheduled downtime are necessary for the safe and efficient operation of petroleum refineries; on the other hand, public announcements of downtime may enable competitors to collude inappropriately. The Commission therefore seeks comment on both the costs and benefits of a rule restricting public pre-announcements of such downtime.
>
> ● Regulated petroleum pipelines may not allow new shippers a share of a pipeline's capacity when historical shippers seek to transport more petroleum products than the pipeline is capable of transporting. The Commission seeks comment on whether pre-announcements that pipelines are approaching capacity constraints may be a conduit for market manipulation or deceit under Section 811, and on whether applying the rule to this behavior is likely to result in benefits that outweigh the costs.

36. The antitrust agencies are sometimes justifiably suspicious of the exchange of information among competing firms.[19] Anticompetitive information exchanges already fall under the purview of the antitrust laws. As a general matter, however, we can see no benefit in restricting *a priori* the ability of refiners or pipeline operators to make accurate public announcements regarding capacity, capacity utilization, and capacity shutdowns. Such announcements are likely to make unilateral business sense and are likely to be beneficial to suppliers and customers. Suppliers (upstream) would value such information in order to plan for reduced demand; customers (downstream) would value such

[19] For a review of the literature and a general discussion of the competitive consequences of information announcements and exchange, see Dennis W. Carlton and Jeffrey M. Perloff, *Modern Industrial Organization*, Fourth Edition, 2005, Chapters 11 and 19.

information so that other sources of supply can be sought out and temporary shutdowns or shortages can be planned for. Such announcements would tend to reduce any resulting disruption. Indeed, firms may feel that they have an obligation (either legal or ethical) to provide such information to their suppliers and customers. It would seem that banning the dissemination of accurate information can only delay the appropriate responses to that information.

37. At another point, instead of stifling the exchange of information, the FTC Notice contemplates requiring the conveyance of additional information:

> ● Wholesale petroleum market participants frequently rely on independent published data for market prices in effecting purchase and sale contracts and other supply arrangements. In the past, Commission staff have received allegations of false or misleading physical sales reports furnished to private reporting entities by market participants in thinly traded petroleum commodity markets. The Commission seeks comment on experiences with this practice, the likelihood the practice could drive false or misleading market prices, the ability of a market manipulation rule effectively to police such activities, and the potential benefits or harm to public data sources or private data compilation services.
>
> ● Accurate cost and volume data for wholesale transactions at all levels of trade, refinery or pipeline outage data, and import and inventory volumes are frequently difficult to construct or are unavailable. The Commission seeks comment on whether it possesses the authority to promulgate a rule under Section 811 requiring a covered person to maintain and submit such information to the Commission or any other government entity, and, if so, whether it should do so, and what particular data it should require.

38. It is difficult to believe that the first set of concerns discussed in the preceding paragraph, dealing with the dissemination of false information for the purpose of profiting from that false information, does not already fall under the purview of existing FTC, SEC, and CFTC regulations. There would seem to be no need, therefore, for additional regulations to address these concerns.

39. The second set of concerns, calling for additional reporting requirements, seems at odds with the previous topic on limiting the dissemination of accurate information. It is our understanding that the EIA-DOE and FERC already impose substantial reporting requirements on market participants. There are also downsides to disseminating

commercially sensitive information regarding prices and contract terms. Indeed, as discussed above, the federal antitrust agencies have in the past been concerned about the dissemination of certain types of information – such as transaction-specific information – lest it facilitate tacit collusion. It is difficult to assess in the abstract whether additional information should be collected and disseminated, but we are aware of no obvious benefits of such rules in general.

*Denial of Access*

40. Finally, with regards to common carrier pipelines and non-regulated terminals, the FTC notes:

> FERC and state regulations govern open access to common carrier pipelines. In some circumstances, prospective shippers on a given common carrier pipeline may lack the ability to access that pipeline due to an inability to place product in a terminal from which to enter the pipeline system, or because those shippers lack a terminal from which to exit the pipeline system. The Commission seeks comment on whether a denial of access to a non-regulated terminal may be an act of market manipulation subject to Section 811, and on whether applying the rule to this behavior is likely to result in benefits that outweigh the costs.

The phrase "denial of access to a non-regulated terminal" implicitly calls into question the right of a terminal owner to unilaterally deny access to its property. There are obvious perverse incentives to declaring private property accessible to all. In any case, existing antitrust laws and FERC regulations are capable of dealing with access to interstate pipelines in particular and exclusionary conduct in general.

## IV. Current Prices and Past Errors

41. The causes of recent increases of oil and, thus, gasoline prices are not mysterious and will not be alleviated by additional regulation.

● In 2005 world oil supply was 84.6 million barrels per day (mbd); in 2006 it was again 84.6 mbd; and in 2007 it was yet again 84.6 mbd.[20] There has been virtually no increase in world oil supply over the last three calendar years.

● The consensus among industry experts is that China and India have substantially increased their imports of oil in recent years. By 2006, China had become the 3rd largest net oil importer, India the 7th largest.[21] China and India together are probably now importing more oil than the United States.

● The devaluation of the dollar is also a factor to be considered. The increase in the euro price of oil since 2005 is only about half of the increase in the dollar price of oil over the last three years.[22]

In sum, the current world oil market is characterized by an inelastic supply and increasing demand. In addition, the dollar price of oil reflects the dollar's recent devaluation vis-à-vis major currencies.

42. Other, less plausible, explanations inevitably arise. In theory, everybody's favorite scapegoat, the "speculators," could be buying oil and holding it in inventory. That would increase the price, but the capacity for storage in the world is trivial relative to the market. For example, the US Strategic Petroleum reserve (the biggest inventory-holder by far) recently suspended its purchases, which amounted to 70,000 bpd, less than 1/10th of 1% of daily production. One could say that "inventory" is being held underground, but the decision on how much oil to extract is dominated by the 80% of current quantities that are supplied by national governments. Quantities supplied are also affected by environmental restrictions on developing new sources.

43. It has been made clear quite recently that "speculative bubbles" can and do occur. While formulating a precise definition of a bubble is problematic, prices can for extended

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20 EIA-DOE, *International Petroleum Monthly*, April 2008, Table 4.4.

21 See www.energy.eu/stats/energy-oil-imports-net.html.

22 See www.online.wsj.com/article/SB121150088368615927.html?mod=Letters.

periods far exceed what would be expected based on long-run market fundamentals.[23] Such bubbles tend to occur periodically in real-estate and stock markets throughout the world.[24] Several prominent economists have commented recently in the popular press on the current run-up in gasoline prices.[25] These economists generally point out that current gasoline prices reflect current oil prices, which reflect fundamental supply and demand conditions in world oil markets. They dismiss the popular notions that speculators are hording inventory and driving up the price of oil and that current prices reflect a bubble that is about to burst.

44. It should also be remembered that the U.S. has suffered once through a period of excessive regulatory zeal directed at the oil industry. Beginning with the Emergency Petroleum Allocation Act of 1973 and continuing until deregulation in 1981, the federal government expanded its role in regulating prices and allocating the output of oil refiners. The FTC Notice contemplates very similar policies. The resulting shortages, gas lines, and other misallocations should act as a cautionary factor in the contemplation of any new regulations. The FTC certainly would not want to repeat the gross policy errors of the 1970s regarding product allocation and price controls.[26]

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23 The classic reference on the subject is Charles P. Kindleberger and Robert Aliber, *Manias, Panics, and Crashes: A History of Financial Crises*, Fifth Edition, 2005. One definition is that a speculative bubble involves the purchase of a product only because of the expectation of short-run price appreciation – or the financing of purchases under conditions that will only be profitable in the event of short-run price appreciation.

24 See Kindleberger and Aliber, *Manias, Panics, and Crashes*, Chapters 1-4.

25 See Paul Krugman, *New York Times*, May 12, 2008; Martin Wolf, *Financial Times*, May 18, 2008; Thomas Sowell, *Detroit News*, May 15, 2008. The Chief Economist of the CFTC, Jeffrey Harris, also studies and dismisses the role of futures markets in increasing oil prices. See "Written Testimony of Jeffrey Harris, Chief Economist, Before the Senate Committee on Homeland Security and Governmental Affairs," May 20, 2008, available at www.cftc.gov.

26 Regarding past mis-regulation of the oil industry, see Timothy J. Muris and Richard G. Parker, "A Dozen Facts You Should Know About Antitrust and the Oil Industry," June 2007, Chapter 3; H. E. Frech and William C. Lee, "The Welfare Cost of Rationing-By-Queuing Across Markets: Theory and Estimates from the U.S. Gasoline Crises, *Quarterly Journal of Economics*, 1987; FTC, "Petroleum Product Price Regulations: Output, Efficiency, and Competitive Effects," 1981; Joseph P. Kalt, *The Economics and Politics of Oil Price Regulation*, 1981; Paul W. MacAvoy, editor, *Federal Energy Administration Regulation*, 1977. There is a vast literature on the harmful effects of price controls and other excessive regulation in various industries. A helpful survey can be found in W. Kip Viscusi, Joseph E. Harrington, and John M. Vernon, *Economics of Regulation and Antitrust*, 4th Edition, 2005, Chapters 10-18. See, for a recent example, Margaret Guerin-Calvert and Janusz Ordover, "Merchant Benefits and Public Policy towards Interchange: An Economic Assessment," *Review of Network Economics*, December 2005.

## V. Conclusion

45. We are aware of no evidence that recent increases in the world price of crude oil and the consequent increases in the price of gasoline reflect either inefficiencies or anticompetitive behavior in the U.S. oil refining industry. Regardless of the future paths of oil and gasoline prices, one would not expect the competitiveness or efficiency of those markets to be enhanced by FTC regulation of the production and distribution decisions of the industry. To the contrary, the FTC's Notice contemplates rules and regulations that are likely to be harmful to the performance of the industry and, thus, to consumers.

## Exhibit A: Curriculum Vitae of Janusz A. Ordover

COMPASS LEXECON


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## EDUCATION

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| 1968-1973 | Columbia University, New York, New York<br>Graduate Department of Economics and European Institute of the School of International Affairs<br>Doctoral Dissertation: Three Essays on Economic Theory. Ph.D. 1973. |
| 1967-1968 | McGill University, Montreal, Canada<br>Departments of Economics and Political Science |
| 1963-1966 | Warsaw University, Warsaw, Poland<br>Department of Political Economy. B.A. (equivalent), 1966. |

## HONORS

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| 1973 | Columbia University: Highest distinction for the doctoral dissertation |
| 1971-1972 | Columbia University: Honorary President's Fellow |
| 1969-1971 | Columbia University: President's Fellow |
| 1967-1968 | McGill University: Honors Student |
| 1964-1965 | Warsaw University: Award for Academic Achievement, Department of Political Economy |
| | Who's Who in the World<br>Who's Who in America<br>Who's Who in the East |

## PROFESSIONAL EXPERIENCE

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|---|---|
| June 1982-<br>present | Professor of Economics<br>Department of Economics, New York University, New York, New York |
| Sept. 1996-<br>Aug. 2001 | Director of Masters in Economics Program<br>Department of Economics, New York University, New York, New York |
| Summer 1996-<br>2000 | Lecturer<br>International Program on Privatization and Reform<br>Institute for International Development, Harvard University, Cambridge, Massachusetts |
| Aug. 1991-<br>Oct. 1992 | Deputy Assistant Attorney General for Economics<br>Antitrust Division<br>United States Department of Justice, Washington, D.C. |
| Sept. 1989-<br>July 1990 | Visiting Professor of Economics<br>School of Management, Yale University, New Haven, Connecticut<br><br>Lecturer in Law<br>Yale Law School |
| Mar. 1984-<br>June 1988 | Visiting Professor of Economics<br>Universita Commerciale "Luigi Bocconi", Milan, Italy |
| June 1982-<br>Feb. 1985 | Director of Graduate Studies<br>Department of Economics, New York University |
| Sept. 1982-<br>June 1986 | Adjunct Professor of Law (part-time)<br>Columbia University Law School, New York, New York |
| Feb. 1982-<br>June 1982 | Acting Director of Graduate Studies<br>Department of Economics, New York University |
| June 1978-<br>June 1982 | Associate Professor of Economics<br>Department of Economics, New York University |
| Sept. 1979-<br>May 1990 | Lecturer in Economics and Antitrust<br>New York University Law School |
| Sept. 1977-<br>June 1978 | Member, Technical Staff<br>Bell Laboratories, Holmdel, New Jersey<br><br>Associate Professor of Economics<br>Columbia University<br><br>Visiting Research Scholar<br>Center for Law and Economics, University of Miami, Miami, Florida |

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| Sept. 1973-<br>Aug. 1977 | Assistant Professor of Economics<br>New York University |
| Summer 1976 | Fellow, Legal Institute for Economists,<br>Center for Law and Economics, University of Miami |
| Summer 1976 | Visiting Researcher Bell Laboratories, Holmdel, New Jersey |

## OTHER PROFESSIONAL ACTIVITIES

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|---|---|
| 2006-present | Special Consultant, Compass Lexecon (formerly Compass)/FTI Company,<br>Washington, D.C. |
| 2003-2006 | Director, Competition Policy Associates, Inc. (Compass), Washington, D.C. |
| 1997-1999 | Consultant, Inter-American Development Bank, Washington, D.C. |
| 1997-present | Board of Editors, *Antitrust Report* |
| 1995-2001 | Consultant, The World Bank, Washington, D.C. |
| 1998-2004 | Senior Consultant<br>Applied Economic Solutions, Inc., San Francisco, California |
| 1995-2000 | Senior Affiliate<br>Cornerstone Research, Inc., Palo Alto, California |
| various | Testimony at Hearings of the Federal Trade Commission |
| 1994-1996 | Senior Affiliate<br>Law and Economics Consulting Group, Emoryville, California |
| 1994-2000 | Senior Affiliate<br>Consultants in Industry Economics, LLC, Princeton, New Jersey |
| 1993-1994 | Director<br>Consultants in Industry Economics, Inc., Princeton, New Jersey |
| 1992-1993 | Vice-Chair (*pro tempore*)<br>Economics Committee, American Bar Association, Chicago, Illinois |
| 1990-1991<br>1992-1995 | Senior Consultant<br>Organization for Economic Cooperation and Development, Paris, France |
| 1991 | Member<br>*Ad hoc* Working Group on Bulgaria's Draft Antitrust Law<br>The Central and East European Law Initiative<br>American Bar Association |

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|---|---|
| 1990-1991 | Advisor<br>Polish Ministry of Finance and Anti-Monopoly Office<br>Warsaw, Poland |
| 1990-1991 | Member<br>Special Committee on Antitrust<br>Section of Antitrust Law, American Bar Association |
| 1990-1991 | Director and Senior Advisor<br>Putnam, Hayes & Bartlett, Inc., Washington, D.C. |
| 1990-1996 | Member<br>Predatory Pricing Monograph Task Force<br>Section of Antitrust Law, American Bar Association |
| 1989 | Hearings on Competitive Issues in the Cable TV Industry<br>Subcommittee on Monopolies and Business Rights of the Senate Judiciary Committee, Washington, D.C. |
| 1989 | Member<br>EEC Merger Control Task Force, American Bar Association |
| 1987-1989 | Adjunct Member<br>Antitrust and Trade Regulation Committee,<br>The Association of the Bar of the City of New York |
| 1984 | Speaker, "Industrial and Intellectual Property: The Antitrust Interface"<br>National Institutes, American Bar Association, Philadelphia, Pennsylvania |
| 1983-1990 | Director<br>Consultants in Industry Economics, Inc |
| 1982 | Member<br>Organizing Committee<br>Tenth Annual Telecommunications Policy Research Conference, Annapolis, Maryland |
| 1981 | Member<br>Section 7 Clayton Act Committee, Project on Revising Merger Guidelines<br>American Bar Association |
| 1980 | Organizer<br>Invited Session on Law and Economics<br>American Economic Association Meetings, Denver, Colorado |
| 1978-1979 | Member<br>Department of Commerce Technical Advisory Board<br>Scientific and Technical Information Economics and Pricing Subgroup |
| 1978-present | Referee for numerous scholarly journals, publishers, and the National Science Foundation |

## MEMBERSHIPS IN PROFESSIONAL SOCIETIES

American Economic Association
American Bar Association

## PUBLICATIONS

### A. Journal Articles

"Coordinated Effects in Merger Analysis: An Introduction*," Columbia Bus. Law Review*, No. 2, 2007, 411-36.

"Wholesale access in multi-firm markets: When is it profitable to supply a competitor?" with Greg Shaffer, *International Journal of Industrial Organization*, vol. 25 (5), October 2007, 1026-45.

"Merchant Benefits and Public Policy towards Interchange: An Economic Assessment," with M. Guerin-Calvert, *Review of Network Economics: Special Issue*, vol. 4 (4), December 2005, 381-414.

"All-Units Discounts in Retail Contracts," with S. Kolay and G. Shaffer, *J. of Economics and Management Strategy,* vol. 13 (3), September 2004, 429-59.

"Archimedean Leveraging and the GE/Honeywell Transaction," with R. J. Reynolds, *Antitrust Law Journal*, vol. 70, no. 1, 2002, 171-98.

"Entrepreneurship, Access Policy and Economic Development: Lessons from Industrial Organizations," with M. A. Dutz and R. D. Willig, *European Economic Review,* vol. 4, no. 4-6, May 2000.

"Parity Pricing and its Critics: Necessary Condition for Efficiency in Provision of Bottleneck Services to Competitors," with W. J. Baumol and R .D. Willig, *Yale Journal on Regulation*, vol. 14, Winter 1997, 146-63.

"Competition and Trade Law and the Case for a Modest Linkage," with E. Fox, *World Competition, Law and Economics Review*, vol. 19, December 1995, 5-34.

"On the Perils of Vertical Control by a Partial Owner of Downstream Enterprise," with W.J. Baumol, *Revue D'économie industrielle*, No. 69, 3e trimestre 1994, 7-20.

"Competition Policy for Natural Monopolies in Developing Market Economy," with R.W. Pittman and P. Clyde, *Economics of Transition*, vol. 2, no. 3, September 1994, 317-343. Reprinted in B. Clay (ed.), *De-monopolization and Competition Policy in Post-Communist Economies*, Westview Press 1996, 159-193.

"The 1992 Agency Horizontal Merger Guidelines and the Department of Justice's Approach to Bank Merger Analysis," with M. Guerin-Calvert, *Antitrust Bulletin*, vol. 37, no. 3, 667-688. Reprinted in *Proceedings of the 1992 Conference on Bank Structure and Competition: Credit Markets in Transition*, Federal Reserve Bank of Chicago, 1992, 541-560.

"Entry Analysis Under the 1992 Horizontal Merger Guidelines," with Jonathan B. Baker, *Antitrust Law Journal*, vol. 61, no. 1, Summer 1992, 139-146.

"Economics and the 1992 Merger Guidelines: A Brief Survey," with Robert D. Willig, *Review of Industrial Organization*, vol. 8, 139-150, 1993. Reprinted in E. Fox and J. Halverson (eds.), *Collaborations Among Competitors: Antitrust Policy and Economics*, American Bar Association, 1992, 639-652.

"Equilibrium Vertical Foreclosure: A Reply," with G. Saloner and S.C. Salop, *American Economic Review*, vol. 82, no. 3, 1992, 698-703.

"A Patent System for Both Diffusion and Exclusion," *Journal of Economic Perspectives*, vol. 5, Winter 1991, 43-60.

"R&D Cooperation and Competition," with M. Katz, *Brookings Papers on Economic Activity: Microeconomics*, 1990, 137-203.

"Equilibrium Vertical Foreclosure," with G. Saloner and S. Salop, *American Economic Review*, vol. 80, March 1990, 127-142.

"Antitrust Policy for High-Technology Industries," with W.J. Baumol, *Oxford Review of Economic Policy*, vol. 4, Winter 1988, 13-34. Reprinted in E. Fox and J. Halverson (eds.), *Collaborations Among Competitors: Antitrust Policy and Economics*, American Bar Association, 1991, 949-984.

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"A Sequential Concession Game with Asymmetric Information," with A. Rubinstein, *Quarterly Journal of Economics,* vol. 101, no.4, November 1986, 879-888.

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"Merger Illusions and Externalities: A Note," with A. Schotter, *Eastern Economic Review*, November 1976, 19-21.

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"Linear Taxation of Wealth and Wages for Intragenerational Lifetime Justice: Some Steady-State Cases," with E.S. Phelps, *American Economic Review*, September 1975, 660-673.

**B. Books and Monographs**

*Proceedings of the Tenth Annual Telecommunications Policy Research Conference*, editor with O. Gandy and P. Espinosa, ABLEX Publishers, 1983.

*Obstacles to Trade and Competition*, with L. Goldberg, OECD, Paris, 1993.

*Predatory Pricing*, with William Green, *et al.*, American Bar Association, Section of Antitrust Law, Monograph 22, 1996.

**C. Book Chapters**

"Coordinated Effects," chap. 27, in *Issues in Competition Law and Policy* (forthcoming 2008).

"Practical Rules for Pricing Access in Telecommunications," with R. D. Willig, Chap. 6, in *Second-Generations Reforms in Infrastructure Services,* F. Besanes and R. D. Willig (eds.), Inter-American Development Bank, Washington, D.C., April 2002, 149-76.

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"The Harmonization of Competition and Trade Law," with E. Fox, Chap. 15 in L. Waverman, *et al*. (eds.), *Competition Policy in the Global Economy*, Routledge, 1997, 407-439.

"Transition to a Market Economy: Some Industrial Organization Issues," with M. Iwanek, Chap. 7 in H. Kierzkowski, *et al.* (eds.), *Stabilization and Structural Adjustment in Poland*, Routledge, 1993, 133-170.

"Competition Policies for Natural Monopolies in a Developing Market Economy," with Russell Pittman, *Butterworth's Trade and Finance in Central and Eastern Europe*, Butterworth Law Publishers Ltd., 1993, 78-88, Reprinted in *Journal for Shareholders* (published by the Russian Union of Shareholder), Moscow, January 1993, 33-36; *Versenyfelugyeleti Ertesito* (Bulletin of Competition Supervision), Budapest, vol. 3, no. 1-2, January 1993, 30-41; *Narodni Hospodarstvi* (National Economy), Prague; *ICE: Revista de Economia*, No. 736 (December 1994) (in Spanish), 69-90.

"Antitrust: Source of Dynamic and Static Inefficiencies?" with W.J. Baumol, in T. Jorde and D. Teece (eds.), *Antitrust, Innovation, and Competitiveness*, Oxford University Press, 1992, 82-97. Reprinted in "The Journal of Reprints for Antitrust Law and Economics," vol. 26, no. 1, 1996.

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"The Department of Justice 1988 Guidelines for International Operations: An Economic Assessment," with A.O. Sykes, in B. Hawk (ed.), *European/American Antitrust and Trade Laws*, Matthew Bender, 1989, 4.1-4.18.

"Predation, Monopolization, and Antitrust," with G. Saloner, in R. Schmalensee and R.D. Willig (eds.), *Handbook of Industrial Organization*, vol. 1, North Holland, 1989, 538-596.

"Supervision Technology, Firm Structure, and Employees' Welfare," in *Prices, Competition and Equilibrium*, M. Peston and R.E. Quandt (eds.), Philip Allan Publishers, Ltd., 1986, 142-163.

"Perspectives on Mergers and World Competition," with R.D. Willig, in *Antitrust and Regulation*, R. Grieson (ed.), Lexington Books, 1986, 201-218.

"Transnational Antitrust and Economics," in *Antitrust and Trade Policies in International Trade*, B. Hawk (ed.), Matthew Bender, 1985, 233-248.

"Pricing of Interexchange Access: Some Thoughts on the Third Report and Order in FCC Docket No. 78-72," in *Proceedings of the Eleventh Annual Telecommunications Policy Research Conference*, Vincent Mosco (ed.), ABLEX Publishers, 1984, 145-161.

"Non-Price Anticompetitive Behavior by Dominant Firms Toward the Producers of Complementary Products," with A.O. Sykes and R.D. Willig, in *Antitrust and Regulation: Essays in Memory of John McGowan*, F. Fisher (ed.), MIT Press, 1985, 315-330.

"Local Telephone Pricing in a Competitive Environment," with R.D. Willig, in *Regulating New Telecommunication Networks*, E. Noam (ed.), Harcourt Brace Jovanovich, 1983, 267-289.

"An Economic Definition of Predatory Product Innovation," with R.D. Willig, in *Strategy, Predation and Antitrust Analysis*, S. Salop (ed.), Federal Trade Commission, 1981, 301-396.

"Marginal Cost," in *Encyclopedia of Economics*, D. Greenwald (ed.), McGraw-Hill, 2nd ed. 1994, 627-630.

"Understanding Economic Justice: Some Recent Development in Pure and Applied Welfare Economics," in *Economic Perspectives*, M. Ballabon (ed.) Harwood Academic Publishers, vol. 1, 1979, 51-72.

"Problems of Political Equilibrium in the Soviet Proposals for a European Security Conference," in *Columbia Essays in International Affairs*, Andrew W. Cordier (ed.) Columbia University Press, New York, 1971, 1951-197

**D. Other Publications**

"Comments on Evans & Schmalensee's 'The Industrial Organization of Markets with Two-Sided Platforms', *Competition Policy International,* vol. 3(1), Spring 2007, 181-90.

"Safer Than A Known Way? A Critique of the FTC's Report on Competition and Patent Law and Policy," with I. Simmons and D. A. Applebaum, *Antitrust Magazine,* Spring 2004, 39-43.

"Predatory Pricing," in Peter Newman (ed.), *The New Palgrave Dictionary of Economics and the Law*, Grove Dictionaries, New York, 1999. Revised in *The New Palgrave Dictionary of Economics, 2nd edition,* S. Durlauf and L. Blume (eds.) (forthcoming 2007).

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"The Role of Efficiencies in Merger Assessment: The 1997 Guidelines," *Antitrust Report*, September 1997, 10-17.

"Bingaman's Antitrust Era," *Regulation*, vol. 20, No. 2, Spring 1997, 21-26.

"Competition Policy for High-Technology Industries," *International Business Lawyer*, vol. 24, No. 10, November 1996, 479-82.

"Internationalizing Competition Law to Limit Parochial State and Private Action: Moving Towards the Vision of World Welfare," with E.M. Fox, *International Business Lawyer*, vol. 24, No. 10, November 1996, 458-62.

"Economists' View: The Department of Justice Draft for the Licensing and Acquisition of Intellectual Property," *Antitrust*, vol. 9, No. 2, Spring 1995, 29-36.

"Competition Policy During Transformation to a Centrally Planned Economy: A Comment," with R.W. Pittman, in B. Hawk (ed.), *1992 Fordham Corporate Law Institute*, 533-38.

“Poland: The First 1,000 Days and Beyond,” E*conomic Times*, vol. 3, no. 9, October 1992, 6-7.

“Interview: Janusz A. Ordover: A Merger of Standards? The 1992 Merger Guidelines,” *Antitrust,* vol. 6, no. 3, Summer 1992, 12-16.

“Interview: U.S. Justice Department’s New Chief Economist: Janusz A. Ordover,” *International Merger Law*, no. 14, October 1991.

“Poland: Economy in Transition,” *Business Economics*, vol. 26, no. 1, January 1991, 25-30.

“Economic Analysis of Section 337: Protectionism versus Protection of Intellectual Property,” with R.D. Willig, in *Technology, Trade and World Competition*, JEIDA Conference Proceedings, Washington, D.C., 1990, 199-232.

“Eastern Europe Needs Antitrust Now,” with E. Fox, *New York Law Journal*, November 23, 1990, 1-4.

“Understanding Econometric Methods of Market Definition,” with D. Wall, *Antitrust*, vol. 3, no. 3, Summer 1989, 20-25.

“Proving Entry Barriers: A Practical Guide to Economics of Entry,” with D. Wall, *Antitrust*, vol. 2, no. 2, Winter 1988, 12-17.

“Proving Predation After Monfort and Matsushita: What the New ‘New Learning’ has to Offer,” with D. Wall, *Antitrust*, vol. 1, no. 3, Summer 1987, 5-11.

“The Costs of the Tort System,” with A. Schotter, Economic Policy Paper No. PP-42, New York University, March 1986. Reprinted in *Congressional Record*, U.S. Government Printing Office, Washington, D.C., 1987.

“An Economic Definition of Predation: Pricing and Product Innovation,” with R.D. Willig, Report for the Federal Trade Commission, October 1982, 131 pp.

“Market Power and Market Definition,” with R.D. Willig, Memorandum for ABA Section 7 Clayton Act Committee, Project on Revising the Merger Guidelines, May 1981.

“Herfindahl Concentration Index,” with R.D. Willig, Memorandum for ABA Section 7 Clayton Act Committee, Project on Revising the Merger Guidelines, March 1981.

“Public Interest Pricing of Scientific and Technical Information,” Report for the Department of Commerce Technical Advisory Board, September 1979.

“Economics of Property Rights as Applied to Computer Software and Databases,” with Y.M. Braunstein, D.M. Fischer, W.J. Baumol, prepared for the National Commission on New Technological Uses of Copyrighted Works, June 1977, 140 pp. Reprinted in part in *Technology and Copyright*, R.H. Dreyfuss (ed.), Lemond Publications, 1978.

Book review of O. Morgenstern and G.L. Thompson, *Economic Theory of Expanding and Contracting Economies*, reviewed in *Southern Economic Journal*, September 1978.

"Manual of Pricing and Cost Determination for Organizations Engaged in Dissemination of Knowledge," with W.J. Baumol, Y.M. Braunstein, D.M. Fischer, prepared for the Division of Science Information, NSF April 1977.

## UNPUBLISHED PAPERS

"Exclusionary Discounts," with Greg Shaffer, August 2006.

"Regulation of Credit Card Interchange Fees and Incentives for Network Investments," with Y. Wang, Competition Policy Associates WP, Washington D.C. September 2005.

"Economics, Antitrust and the Motion Picture Industry," C.V. Starr Center Policy Paper, July 1983.

"On Bargaining, Settling, and Litigating: A Problem in Multiperiod Games With Imperfect Information," with A. Rubinstein, C.V. Starr Working Paper, December 1982.

"Supervision and Social Welfare: An Expository Example," C.V. Starr Center Working Paper, January 1982.

"Should We Take Rights Seriously: Economic Analysis of the Family Education Rights Act," with M. Manove, November 1977.

"An Echo or a Choice: Product Variety Under Monopolistic Competition," with A. Weiss; presented at the Bell Laboratories Conference on Market Structures, February 1977.

## GRANTS RECEIVED

Regulation and Policy Analysis Program, National Science Foundation, Collaborative Research on Antitrust Policy, Principal Investigator, July 15, 1985-December 31, 1986.

Regulation of Economic Activity Program, National Science Foundation, Microeconomic Analysis of Antitrust Policy, Principal Investigator, April 1, 1983-March 31, 1984.

Economics Division of the National Science Foundation, "Political Economy of Taxation," Principal Investigator, Summer 1982.

Sloan Workshop in Applied Microeconomics (coordinator), with W.J. Baumol (Principal Coordinator), September 1977-August 1982.

Economics Division of the National Science Foundation, "Collaborative Research on the Theory of Optimal Taxation and Tax Reform," July 1979 to September 1980, with E.S. Phelps.

Division of Science Information of the National Science Foundation for Research on "Scale Economies and Public Goods Properties of Information," W.J. Baumol, Y.M. Braunstein, M.I. Nadiri, Fall 1974 to Fall 1977.

National Science Foundation Institutional Grant to New York University for Research on Taxation and Distribution of Income, Summer 1974.

**Exhibit B:   Curriculum Vitae of Paul E. Godek**

# Paul E. Godek

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## Personal Information

## Education

Ph.D., University of Chicago: Economics, 1983. Primary Fields: Industrial Organization and Economic Development.

M.A., University of Chicago: Economics, 1980.

B.A., University of Michigan: Economics and Political Science, 1978.

## Professional Experience

Economists Incorporated: Senior Vice President, 2004-2006; Vice President, 1996-2003; Senior Economist, 1988-1995.

U.S. Federal Trade Commission: Bureau of Competition, Economic Advisor to the Director, 1986-1988.

U.S. Department of Justice: Antitrust Division, Economic Analysis Group, Staff Economist, 1983-1986.

University of Chicago: Center for the Study of the Economy and the State, Research Assistant, 1981-1982.

University of Chicago: Department of Economics, Teaching Assistant, 1981.

Chicago Board of Trade: Economic Policy Office, Research Assistant, 1980.

**Scholarships, Awards, and Presentations**

Shadow Securities and Exchange Commission Conference on Nasdaq's Trading Structure: Invited Speaker, November 1995.

World Bank Conference on Competition Policy for Developing Countries: Invited Speaker, April 1993.

U.S. Department of Justice: Special Achievement Award, 1986.

University of Chicago: Economics Department Scholarship, Friedman Fund Scholarship, Ingersoll Fund Scholarship.

University of Michigan: State of Michigan Scholarship, University of Michigan Scholarship.

University of Michigan: B.A. with High Distinction.

**Journal Referee**

*American Economic Review,*
*Antitrust Law Journal,*
*Economic Inquiry,*
*Journal of Law & Economics,*
*Journal of Political Economy,*
*Review of International Economics.*

**Research Papers**

"A New Look at Critical Elasticity," *The Antitrust Bulletin*, Summer 2006, (with M. Baumann).

"Another Look at *Alcoa*: Raising-Rivals'-Costs Does Not Improve the View," Chapter 11 in *Famous Fables of Economics: Myths of Market Failure*, edited by D. F. Spulber, Blackwell Publishers, 2001, (with J. Lopatka). (Originally published in *Journal of Law & Economics*, October 1992.)

"A Chicago-School Approach to Antitrust for Developing Economies," *The Antitrust Bulletin*, Spring 1998.

"The Regulation of Fuel Economy and the Demand for 'Light Trucks'," *Journal of Law & Economics*, October 1997.

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"Could and Would Understood: Critical Elasticities and the Merger Guidelines," *The Antitrust Bulletin*, Winter 1995, (with M. Baumann).

"Bad Policy, Bad Law, and the Constitution: A Stiglerian View," *The Cato Journal*, Spring/Summer 1993.

"Foreign Profits and the Political Economy of Quotas," *The Cato Journal*, Spring/Summer 1991.

"The Politically Optimal Tariff: Levels of Trade Restrictions Across Developed Countries," *Economic Inquiry*, October 1986.

"Industry Structure and Redistribution Through Trade Restrictions," *Journal of Law & Economics*, October 1985.

**Other Papers**

"Stale CAFE," *Regulation*, Summer 2006.

"CAFE's Recipe for Light Trucks," *Regulation*, Fall 1997.

"One U.S. Export Eastern Europe Does Not Need," *International Merger Law,* September 1991, reprinted in *Regulation*, Winter 1992.

"Antitrust Will Stifle, Not Spur Eastern Growth," *The Wall Street Journal Europe*, July 26, 1991.

**Testimony and Attributed Reports**

Deposition testimony and report submitted in U.S. District Court for the District of Connecticut, in the matter of *Schick Manufacturing, Inc., et al.* v. *The Gillette Company*, Deposition: August 2005.

Deposition testimony and report submitted in U.S. District Court for the Central District of California, Western Division, in the matter of *Hanson Aggregates West, Inc.* v. *American Mechanical Dredge, Inc.* and *Damen Shipyards Group*, Deposition: December 2004.

Report submitted in U.S. District Court for the District of Massachusetts, in the matter of *In re Relafen Antitrust Litigation*, October 2003.

Report commissioned by the American Hospital Association, "Economic Analysis of Healthcare Cost Studies Commissioned by Blue Cross Blue Shield Association," February 2003, (with coauthors, not a primary author).

Reports submitted to the Internal Revenue Service, "Analysis of Effective Ownership of Certain Euro Disney Theme Park Assets: Reply to the Shapiro Report," January 2003, (with coauthors); "Analysis of Effective Ownership of Certain Euro Disney Theme Park Assets: Response to the IRS Reply," October 2003 (with coauthors).

Deposition testimony in the District Court of Tarrant County, Texas in the matter of *Carroll Brown, et al.* v. *Warner-Lambert Company, et al.*, Deposition: November 2002.

Declaration submitted in U.S. District Court for the Southern District of New York, in the matter of *In re Vitamin Antitrust Litigation*, April 2002.

Deposition testimony, report, and affidavit submitted in U.S. District Court for the Northeastern District of North Dakota, in the matter of *Trade 'N' Post, L.L.C.* v. *World Duty Free Americas, Inc.* and *Ammex Tax & Duty Free Shops West, Inc.,* Deposition: May 2001.

Deposition testimony, report, and affidavit submitted in U.S. District Court for the Western District of Virginia, in the matter of *Virginia Vermiculite, Ltd.* v. *W.R. Grace & Co.* and *The Historic Green Springs, Inc.,* Deposition: November 1999.

Report submitted to the U.S. Federal Communications Commission, "Further Cost of Capital Considerations Relating to Cable Cost of Service Regulation," in the matter of *Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation,* May 1996, (with coauthor).

Report submitted to the U.S. Federal Communications Commission, "The Cost of Capital for the Oncor Group," in the matter of *Operator Communications, Inc. – Investigation of Rates and Charges for Interstate Operator Services,* August 1995.

Report submitted to the U.S. Securities and Exchange Commission and the U.S. Department of Justice, "Nasdaq's Market Structure," June 1995, (with coauthors).

Deposition testimony and report submitted in U.S. District Court for the Middle District of Pennsylvania, in the matter of *Petruzzi's IGA Supermarkets, Inc.* v. *Darling-Delaware Co., Inc., et al.,* Deposition: August 1994.

Report submitted to the U.S. Federal Communications Commission, "An Event Study of AT&T's Attempted Acquisition of NCR," in the matter of *AT&T, Petition for Emergency Investigation and Special Relief*, February 1991, (with coauthor).

Report submitted to the U.S. Department of Commerce, "Economic Analysis of Brach's Application for Foreign-Trade-Zone Status," in the matter of *Foreign-Trade Zone 22; Chicago, Illinois; Application for Subzone; E.J. Brach Candy Plant*, February 1990, (with coauthors).

Testimony at the U.S. International Trade Commission, Preliminary Hearing, in the matter of *Sweaters of Man-Made Fibers from Hong Kong, the Republic of Korea, and Taiwan,* October 1989.

Trial testimony in U.S. District Court for the Northern District of Florida, in the matter of *U.S.* v. *Trawick*, January 1986.

Affidavit submitted in U.S. District Court for the District of Columbia, in the matter of *U.S.* v. *The LTV Corporation, et al.*, June 1984.