Prepared Statement of the Federal Trade Commission

Factors that May Affect Gasoline Prices

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I. Introduction

Mr. Chairman and members of the Committee, I am pleased to appear before you today at this hearing on the important topic of factors that may affect gasoline prices, and to present the testimony of the Federal Trade Commission.

The FTC is a law enforcement agency with two related missions: to preserve competition in the marketplace for the benefit of consumers, and to protect consumers from deceptive or unfair practices that may injure them. The Commission's statutory authority covers a broad spectrum of sectors in the American economy, including the energy industry and its various components.

The importance of antitrust law enforcement is particularly clear in the oil and gas industry, where fuel price increases can strain the budgets of many consumers and can have a direct and significant impact on businesses of all sizes throughout the U.S. economy. Enforcement of the antitrust laws helps ensure that the oil and gasoline industries are, and remain, competitive. In recent years, the Bureau of Competition has spent almost one-third of its total enforcement budget on investigations in energy industries, many of them merger investigations.

The Commission, however, performs more than law enforcement functions. Congress established the Commission to be an expert body that can report on important economic trends affecting the American economy. Because of the importance of the oil and gas industries to the American economy, and increased public concern about the level and volatility of gasoline prices in recent years, the Commission is studying the central factors that may affect the level and volatility of refined petroleum products prices in the United States. The Commission held a public conference on this topic in August 2001, and will hold a second one on May 8th and 9th, just two weeks from now.(2) The Commission expects to summarize and discuss its work in a public report to be issued later this year.

In addition, we are monitoring wholesale and retail prices of gasoline - by far, the largest single refinery product. Members of our staff inspect wholesale gasoline prices for 18 (soon to be 20) cities and retail gasoline prices for 360 cities throughout the United States. We will analyze this data to search for explanations of pricing anomalies.

This testimony will summarize the Commission's recent enforcement activity, review its ongoing work to increase understanding of the factors that may affect the level and volatility of refined petroleum product prices, and will discuss some of the factors that, based on our experience, we believe have an effect on the price of gasoline.

II. Merger Enforcement in the Oil and Gasoline Industries

Much of the Commission's experience with enforcing the antitrust laws in the oil and gas industries has been obtained through the analysis of proposed mergers. Merger enforcement protects a competitive marketplace, because it helps preserve rivalry that brings lower prices and better services to consumers. The Commission has an extensive history of merger investigations in the oil and gas industries, and the FTC has challenged recent proposed mergers that likely would reduce competition, result in higher prices, and injure the economy of the nation or any of its regions.(3)

Today I will briefly describe two of our most recent merger investigations in this area. One transaction involved Chevron and Texaco.(4) This transaction combined assets located throughout the United States. Twelve states participated in the FTC's investigation. The Commission entered a consent order with Chevron and Texaco requiring numerous divestitures in order to maintain competition in particular relevant markets, primarily in the western and southern United States. The consent order required Texaco to divest to Shell and/or Saudi Refining, Inc. ("SRI") all of its interests in two joint ventures - Equilon(5) and Motiva(6) - through which Texaco had been competing with Chevron in gasoline marketing in the western and southern United States; the refining, bulk supply and marketing of the environmentally mandated gasoline in California(7); the refining and bulk supply of gasoline and jet fuel in the Pacific Northwest; and the pipeline transportation of crude oil from the San Joaquin Valley, among other things.

Another important oil merger that the Commission investigated last fall was the $6 billion merger between Valero Energy Corp. ("Valero") and Ultramar Diamond Shamrock Corp. ("Ultramar").(8) Both Valero and Ultramar are leading refiners and marketers of CARB gasoline in California (gasoline which meets the specifications of the California Air Resources Board ("CARB")). CARB 2 gasoline meets the current Phase 2 specifications in effect since 1996, and is the only gasoline that can be sold to consumers in California. CARB 3 gasoline meets the proposed Phase 3 specifications scheduled to go into effect on January 1, 2003, after which it will be the only gasoline that can be sold to consumers in California. The Commission's complaint alleged competitive concerns in the refining and bulk supply of both CARB 2 and CARB 3 gasoline in California, and the Commission contended that the merger could raise the cost to California consumers by at least $150 million annually for every one cent per gallon price increase at retail.(9) To remedy the Commission's competitive concerns, the consent order settling the case required Valero to divest an Ultramar refinery in Avon, California; all bulk gasoline supply contracts associated with that refinery; and 70 Ultramar retail service stations in Northern California.(10)

III. Recent Commission Research on Factors That May Affect Prices of Refined Petroleum Products

There can be many reasons for volatile prices in any commodity, including gasoline. A sudden surge in demand, or an unexpected problem in the supply chain, can cause prices to spike almost overnight. Such price changes are disruptive to both consumers and businesses.

Price spikes for gasoline appeared in the spring and summer of 2000 and 2001, particularly for consumers in California and the Midwest, and, as you are all aware, we have been experiencing rapid price increases for gasoline this spring as well. As noted above, we are monitoring wholesale and retail gasoline prices in a number of cities throughout the United States and we will analyze this data to search for explanations of pricing anomalies.

Around this time last year, the Commission issued a report on its nine-month investigation into the causes of gasoline price spikes in local markets in the Midwest in the spring and early summer of 2000.(11) Although gasoline prices increased nationwide during that time, increases in some local markets, particularly in the Midwest, eclipsed those experienced in past years and were greater than those experienced in other U.S. markets. The Commission's extensive investigation uncovered no evidence of collusion or any other antitrust violation.

The Commission instead found a variety of factors that contributed in varying degrees to the price spikes. Primary factors included refinery production problems (e.g., refinery breakdowns and unexpected difficulties in producing the new summer-grade RFG gasoline required for use in Chicago and Milwaukee), pipeline disruptions, and low inventories. Secondary factors included high crude oil prices that contributed to low inventory levels, the unavailability of substitutes for certain environmentally required gasoline formulations, increased demand for gasoline in the Midwest, and, in certain states, ad valorem taxes. Ultimately, the industry responded to the price spike within three or four weeks with increased supply of products, and by mid-July 2000, prices had receded to pre-spike or even lower levels.

A Commission goal is to increase public awareness of competitive and other factors affecting the prices of refined petroleum products. Increased public awareness should help inform consumers and policymakers in the legislative and executive branches about potential responses to address these factors, if necessary. This past summer, the Commission commenced a series of public conferences to study in more detail the central factors that may affect the level and volatility of refined petroleum product prices throughout the United States. A one-day conference was held on August 2, 2001. Participants included representatives of the Department of Energy's Energy Information Administration ("EIA") and the State of California, as well as representatives from all segments of the industry (including exploration, refining, transportation, and marketing), consumer groups, and academia.

The wide-ranging discussion identified a number of factors that may contribute to price volatility and price spikes; we note just a few. EIA has found that, over broad time periods, the price of gasoline at the pump generally tracks crude oil prices; that is, with some time lags, gasoline pump prices generally rise and fall in response to crude oil price increases and decreases.(12) EIA reported that "OPEC cuts and high crude prices affect gasoline prices directly through the feedstock cost but also indirectly by reducing gasoline inventories."(13) Participants also commented that average inventories for refined products have declined over time,(14) contributing to price spikes as additional supply is less available quickly to meet demand.

Participants also noted the high levels of use of portions of the infrastructure necessary to refine and transport refined petroleum products to the pump. For example, current refinery capacity utilization rates in the United States are high, averaging 95 percent or higher.(15) Pipeline capacity also is stretched in some regions of the country, although various pipeline expansion projects are underway to address this situation.(16) In addition, several participants reported that a proliferation of different environmentally mandated gasoline blends has reduced the availability of substitutes to moderate any price spikes.(17) According to one expert, "[t]ight specifications for reformulated gasoline sold in [California] and limited pipeline interconnections . . . isolate the California gasoline market from gasoline markets in the rest of the country,"(18) thus contributing to higher prices in the state.

All of these comments, and many others, were presented in response to the Commission's request that participants identify areas worthy of further study. Perhaps the dominant theme of the August 2, 2001 conference was the complexity of the interrelationships among a large variety of factors and the need for further work in understanding the relative importance of different factors in particular situations. There is much left to learn and to analyze as we proceed in the weeks ahead.

As part of its work to understand better the possible role of environmentally mandated fuels in contributing to price volatility and price spikes, Commission staff provided comments to the Environmental Protection Agency ("EPA") in connection with EPA's Staff White Paper, prepared in response to the President's National Energy Report (May 2001). The President's Report directed the Administrator of EPA to "study opportunities to maintain or improve the environmental benefits of state and the local 'boutique' fuels programs while exploring ways to increase the flexibility of the fuels distribution infrastructure, improve fungibility, and provide added gasoline market liquidity."(19) FTC staff commented that the EPA might find it beneficial to use a framework similar to the one the FTC uses to analyze mergers, to determine the competitive effects likely to be associated with changes in fuel mandates in particular relevant markets.(20) We have offered suggestions to the EPA as to how they might perform such an analysis.

IV. Conclusion

The Commission has a long and continuing history with law enforcement investigations in the oil and gas industries. We have expended substantial effort and resources to maintain and study the state of competition in this industry over the years, and will continue to do so in the future.

The Commission's work in this area is ongoing. As noted above, the Commission also has scheduled a follow-up conference on refined petroleum products pricing to take place on May 8th and 9th. This conference will afford an opportunity to learn about additional research on particular issues - such as how price volatility in crude oil may affect gasoline price levels - and to probe further into the issues that have been raised so far, such as a trend toward lower levels of inventories. We do not expect to obtain definitive answers to all the questions that have been raised or to provide definitive data on how all of the factors interrelate and operate. Rather, our goal is to increase the public awareness of competitive and other factors, and to enhance our understanding of factors that may affect the level and volatility of refined petroleum product prices.

I would be pleased to answer any questions that you have.

Endnotes:

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

2. FTC to Hold Second Public Conference on the U.S. Oil and Gasoline Industry in May 2002, FTC Press Release (Dec. 21, 2001).

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

4. Chevron, Corp., C-4023 (Dec. 18, 2001) (consent order).

5. The Equilon joint venture was jointly controlled by Shell and Texaco, and its major assets included full or partial ownership in four refineries, about 65 terminals, and various pipelines. It marketed gasoline through approximately 9,700 branded gas stations nationwide.

6. Motiva, jointly controlled by Texaco, Shell, and SRI, consisted of their eastern and Gulf Coast refining and marketing businesses. Its major assets included full or partial ownership in four refineries and about 50 terminals, with the companies' products marketed through about 14,000 branded gas stations nationwide.

7. The California Air Resources Board mandates that gasoline sold in California meet certain specifications.

8. Valero Energy Corp., C-4031 (Feb. 22, 2002) (consent order).

9. The Commission also alleged competitive concerns in the refining and bulk supply of CARB 2 and CARB 3 gasoline for sale in Northern California, contending that even a price increase of one cent per gallon would increase costs to those consumers by approximately $60 million per year.

10. Also last fall, the Commission considered the likely competitive effects of Tosco's proposed acquisition of Phillips Petroleum. After careful and close scrutiny, the Commission, by a vote of 5-0, declined to challenge the acquisition. The Commission's statement closing the investigation set forth its reasoning in detail. Phillips Petroleum Corp., FTC File No. 001 0095 (Sept. 17, 2001) (Statement of the Commission).

11. Midwest Gasoline Price Investigation, Final Report of the Federal Trade Commission (Mar. 29, 2001). Also in 2001, the Commission concluded its investigation of gasoline price increases in West Coast markets. FTC Closes Western States Gasoline Investigation, FTC Press Release (May 7, 2001).

12. Cook (EIA), Aug. 2 transcript at 49-52.

13. Cook (EIA), Aug. 2 tr. at 52.

14. Greene (Cal.), Aug.2. tr. at 11 ("[i]n the 1990's, reserves and inventories [in California] have declined roughly 20-plus percent."); Rothschild (Podesta/Mattoon), Aug.2 tr. at 82 (consistently below an average of 5 days of gasoline inventory). Cooper (Cons. Fed. of Am.), written statement at 21.

15. Murphy (API), written statement, at 2.

16. Coleman (LECG), written statement at 8-9.

17. E.g., Felmy (API), Aug. 2 tr. at 26; Cooper (Assoc. of Oil Pipe Lines), Aug.2 tr. at 102.

18. Gilbert (U. Cal.Berkeley), written statement at 3-4.

19. Study of Unique Gasoline Fuel Blends ("Boutique Fuels"), Effects on Fuel Supply and Distribution and Potential Improvements, EPA Staff White Paper at 1-2.

20. The FTC's experience shows that economically relevant gasoline markets are regional for refining and transportation, and local when considering gasoline distribution or retail sales. For example, a refinery that does not, or cannot in the short run, produce the type of gasoline currently in short supply in a certain region cannot be considered to be in that market for purposes of resolving short-run price spikes. FTC Staff Comment to EPA at 4.