REPORT OF THE FEDERAL TRADE COMMISSION ON ACTIVITIES IN THE OIL AND NATURAL GAS INDUSTRIES

The Explanatory Statement accompanying the Consolidated Appropriations Act for Fiscal Year 2008 directed the Federal Trade Commission ("Commission" or "FTC") to "submit a report to the Committees on Appropriations every six months summarizing its activities relating to ongoing reviews of mergers, acquisitions and other transactions in the oil and natural gas industries, the investigation of pricing behavior or any potential anticompetitive actions in those industries, and the resources that the Commission has devoted to such reviews and investigations during that period."[1]

In response to this directive, the Commission is pleased to submit this report to the Congressional Appropriations Committees ("the Committees").[2] As we have emphasized on many occasions, no other sector of the economy is subject to more antitrust scrutiny by the FTC than the energy industries, and the first six months of 2008 have been no exception. The FTC and its staff have focused during this period on mergers and acquisitions, possible anticompetitive conduct, and other activities involving pricing or competition in the petroleum and natural gas industries. The Commission intends to continue its vigorous activity during the second half of 2008 and beyond.[3]

During the first half of 2008, personnel from all parts of the Commission were involved in law enforcement, economic analysis, and rule- or policy-related activities in the oil and natural gas industries. The Commission has appointed a special Associate General Counsel for Energy – the only industry for which the agency maintains such a position. The Mergers III division of the Bureau of Competition is devoted primarily to petroleum and natural gas issues, and personnel both from that Bureau's front office and from numerous other Bureau divisions

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[1] Explanatory Statement for Division D, Title V, Consolidated Appropriations Act, 2008, Pub. L. No. 110-161 (House Appropriations Committee Print at 895, *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_house_committee_prints&docid=f:39564d.pdf).

[2] Because this is a public report, it is drafted to exclude sensitive details of ongoing investigations, which the Commission is prohibited by law from revealing.

[3] It may be helpful in this initial report to furnish some context and additional information that will aid the Committees' understanding of the scope of activities during the first half of 2008, and therefore we include in this report some activities that occurred during the last quarter of calendar 2007. Thus, this report covers the period from the beginning of the fiscal year through June 30, 2008.

have been involved in addressing oil and natural gas issues as well.[4] In addition to the Bureau of Competition, the component of the agency most directly involved in antitrust and pricing issues in these industries has been the Bureau of Economics, one division of which has major responsibility for competition analysis in the petroleum and natural gas industries. Other staff involved in oil and natural gas matters during the first half of 2008 came from the Commission's Office of the General Counsel, the Office of the Secretary, the Office of the Executive Director, the Office of Policy Planning, the Commissioners' offices, and other FTC organizations.[5] All told, between 125 and 150 FTC staff members – attorneys, economists, paralegals, research analysts, and others – have worked on matters involving antitrust and pricing issues in the oil and natural gas sector during the relevant period, with some of these personnel (such as those in Mergers III and the economists who maintain the FTC's Gasoline and Diesel Price Monitoring Project) spending all or most of their time on these matters.

During the relevant period, the Commission actively reviewed mergers and acquisitions and maintained enforcement actions in the petroleum and natural gas industries, in order to identify anticompetitive effects and challenge transactions that threaten harm to consumers.

For example, the FTC continued its challenge to the proposed acquisition by Equitable Resources, Inc., of The Peoples Natural Gas Company from Dominion Resources, Inc. – a challenge that ultimately led to the abandonment of the transaction. The FTC's investigation had revealed that the acquisition would substantially lessen competition in the distribution of natural gas to nonresidential customers in Pittsburgh and certain other areas of Allegheny County, Pennsylvania, and the agency sued to block the transaction. Although the United States district court denied the Commission's motion for a preliminary injunction, the United States Court of Appeals for the Third Circuit granted our motion for an injunction pending appeal. On January 15, 2008, while the appeal to the Third Circuit was pending, the parties abandoned the transaction. At the request of the Commission, the Court of Appeals ordered the district court to vacate its opinion as moot. The abandonment of the transaction was a substantial victory for consumers through the preservation of competition in the distribution of natural gas to nonresidential customers in the affected geographic areas.

On October 3, 2007, following adverse decisions in federal court, the Commission dismissed its administrative complaint in the matter of Paul L. Foster, Western Refining, Inc., and Giant Industries, Inc. In the spring of 2007, the Commission had found reason to believe that Western Refining's plan to acquire competitor Giant Industries would substantially lessen

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[4] Additional offices in the Bureau of Competition that have participated in oil and gas matters during 2008 include the Mergers I and Mergers II divisions, the Division of Anticompetitive Practices, the Division of Compliance, the Office of Policy and Coordination, the Division of Operations, the Premerger Office, and the Division of Technology and Information Management.

[5] Indeed, the staff currently involved in the petroleum market manipulation proceeding (discussed at page 5, *infra*) comes from offices spanning the entire agency.

competition in the bulk supply of light petroleum products to northern New Mexico. Accordingly, the Commission had filed a complaint on April 12, 2007, in the United States District Court for the District of New Mexico, seeking a temporary restraining order and a preliminary injunction to halt consummation of the transaction pending a trial on an FTC administrative complaint (issued on May 3, 2007). The district court denied the Commission's application for injunctive relief on May 29, 2007; the United States Court of Appeals for the Tenth Circuit denied the FTC's request for an injunction pending appeal; and the parties consummated the transaction on May 31, 2007. After careful consideration of the implications of the court decisions and of the consummation of the transaction, the Commission determined to dismiss its complaint.

The Commission also reviewed a number of other mergers and acquisitions involving oil and gas firms. During the first six months of 2008, the agency received premerger filings under the Hart-Scott-Rodino Act for 16 proposed transactions in these industries. The agency reviewed each of these transactions, and also monitored the industry for other, nonreportable transactions that might raise antitrust concerns.

Thus far during Fiscal Year 2008, the Commission has opened six formal law enforcement investigations involving petroleum, including investigations of a refining joint venture and an acquisition involving retail and wholesale gasoline, diesel, and jet fuel. Investigations conducted by FTC staff also focused on sales of refining, pipeline, and terminal assets. Some investigations were closed due to lack of competitive overlap or because the transactions being scrutinized were unlikely to lead to anticompetitive effects.

One of the FTC's more substantial recent merger investigations in the oil industry involved Marathon Oil Company's proposed acquisition of CITGO Petroleum's light petroleum products terminals in a number of Ohio cities, as well as CITGO's interest in the Inland Pipeline (an intrastate products pipeline). On June 19, 2008, the Commission closed its investigation of this merger following notification by the parties that they had abandoned the transaction.

The Commission's work involving oil and natural gas also includes the examination of possibly anticompetitive conduct by firms in these industries.

During the relevant period, the agency has been conducting an intensive investigation of bulk supply and demand conditions and markets for gasoline and diesel fuel throughout the Pacific Northwest region. On May 18, 2007, the Commission authorized the use of compulsory process to determine whether the observed prices resulted from unlawful anticompetitive activity. On June 21, 2007, the Commission issued numerous civil investigative demands and subpoenas *duces tecum* to dozens of companies involving refining, transportation, storage, and other aspects of supply in the Pacific Northwest. The demands for documents and data sought to identify refinery, transportation, and terminal disruptions that may have affected bulk supply of gasoline and diesel to the region during the relevant period. In addition to requests for strategic plans and competition-related documents, the staff sought evidence of communications among firms, to help determine whether illegal collusion had occurred.

In response to the subpoenas, the Commission received and staff reviewed more than six gigabytes of data and the equivalent of more than one million pages of responsive documents, in paper and electronic form. Pursuant to confidentiality waivers submitted by the subpoena recipients, the staff received the production, inventory, and sales data regularly reported by the companies to the Department of Energy's Energy Information Administration ("EIA"). The staff also analyzed approximately 327 megabytes of wholesale and retail price data purchased from the Oil Price Information Service ("OPIS"), a private price reporting service used widely by the industry. From January through March 2008, the staff conducted 14 investigational hearings with representatives of major firms. These hearings obtained company testimony relevant to key refinery outages, pipeline operations, and supply issues. The staff also has conducted numerous witness interviews throughout this investigation.

Another substantial examination of gasoline pricing, involving the New England region, focuses on reported differences in gasoline prices between Cape Cod and off-Cape locations. The FTC's Bureau of Economics is in the process of gathering information to analyze this situation. The Bureau staff is analyzing city average data from the FTC's Gasoline and Diesel Price Monitoring Project;[6] station-level data at various locations on and off Cape Cod; firm-level rack prices for the primary terminal for the wholesale supply of gasoline to Cape Cod.; and several other types of relevant data. Bureau staff also has reviewed the trade press relating to gasoline supply in southeastern Massachusetts, conducted background research on local zoning and environmental regulations, and sought more information on these issues from various other sources.

In addition, FTC staff has begun an examination of gasoline prices in North Adams and other localities in western Massachusetts. To determine whether wholesalers or retailers were pricing in ways inconsistent with competition, the Bureau of Economics staff is examining city average price data from the FTC's Gasoline and Diesel Price Monitoring Project; station-specific data for western Massachusetts; and rack price data for Springfield, Massachusetts, and Hartford, Connecticut (the two terminal areas closest to the western Massachusetts communities). The Bureau also has reviewed the trade and popular press, as well as concerns expressed by consumers to the U.S. Department of Energy Gasoline Price Hotline, for any pertinent information. The staff has discussed this inquiry with the Massachusetts Attorney General's office, and is considering appropriate next steps.

Also, in response to concerns over recent sharp increases in the price of jet fuel, the FTC staff continues to collect relevant data from a variety of sources, including information on refinery capacity utilization, imports and exports, and refinery-level financial profits.

In addition to the discrete matters described above, the Commission has several other efforts underway to examine pricing behavior and to identify and, where appropriate, take action against potential law violations in these industries.

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[6] *See* page 5, *infra*, for a more detailed discussion of the Gasoline and Diesel Price Monitoring Project.

One such activity concerns market manipulation in the petroleum sector. Pursuant to Section 811 of the Energy Independence and Security Act of 2007 ("EISA"), Pub. L. No. 110-140, the Commission is acting to implement authority granted under that section regarding the use or employment of "any manipulative or deceptive device or contrivance" "in connection with the purchase or sale of crude oil gasoline or petroleum distillates at wholesale." Following intensive preparatory work by a task force composed of attorneys, economists, and other staff from throughout the agency, the Commission issued an Advance Notice of Proposed Rulemaking ("ANPR") on its website on May 2, 2008 (and in the *Federal Register* on May 7, 2008), and requested public comments by June 6 (extended to June 23) on a range of issues and questions raised in the ANPR. The Commission has elicited the views of a wide spectrum of consumer groups, businesses, academic experts, and other informed sources on the issues raised in this proceeding, and will take such further steps as are appropriate in light of comments received in response to the ANPR. The Commission plans to complete this process by the end of 2008.

During the relevant period, the FTC continued a longstanding project that has provided valuable information in connection with the agency's efforts to police conduct in the petroleum industry. Since 2002, the Gasoline and Diesel Price Monitoring Project has involved monitoring by our Bureau of Economics of the wholesale and retail prices of gasoline in order to help detect possible anticompetitive activities and determine whether a law enforcement investigation is warranted. Today, this project tracks retail gasoline and diesel prices in some 360 cities across the nation and wholesale (terminal rack) prices in 20 major urban areas. The staff of the Bureau of Economics receives daily data from OPIS; receives information weekly from the Department of Energy's public Gasoline Price Hotline; and reviews other relevant information that the Commission might receive directly from the public or from other federal or state government entities. The staff uses an econometric model to determine whether current retail and wholesale prices each week are anomalous in comparison with historical data. This alerts FTC staff to unusual changes in gasoline and diesel prices so that further inquiry can be undertaken expeditiously. When price increases do not appear to result from market-driven causes, the staff consults with the EIA. FTC staff also contacts the offices of the appropriate state attorneys general to discuss the anomaly and appropriate potential actions, including the opening of an investigation.

On November 30, 2007, the Commission released its *2007 Report on Ethanol Market Concentration*. This was the third such annual report issued pursuant to Section 1501(a)(2) of the Energy Policy Act of 2005 (45 U.S.C. § 7545(o)), which requires the FTC annually to perform a market concentration analysis to determine whether there is sufficient competition among ethanol industry participants "to avoid price-setting and other anticompetitive behavior." The Commission concluded its 2007 report with the observation that "[t]he ethanol production industry is not concentrated, and has become even more unconcentrated over the last year. There is a very large amount of ethanol production capacity now under construction that will further deconcentrate the industry over the next 12 to 18 months. Furthermore, the ease of entry by new firms, and the availability of ethanol imports, provide additional constraints on current market participants. These dynamics make it very unlikely that a single ethanol producer or marketer, or a small group of such firms, could wield sufficient market power to set prices or coordinate on prices or output."[7]

The Commission expects to maintain its intensive antitrust scrutiny of the energy sector. Indeed, the fundamental importance of oil, natural gas, and other energy resources to the overall vitality of the United States and world economy ensures that FTC activities in the oil and natural gas industries will remain a centerpiece of our work for years to come.

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[7] The Commission's 2007 ethanol report is available at http://www.ftc.gov/reports/ethanol/2007ethanol.pdf.

A number of reports prepared by the FTC or its staff that predate the period covered by the current report to Congress also demonstrate the Commission's commitment to delving deeply into key competition and consumer issues in the energy sector and sharing its expertise with Congress and the public. *See*, *e.g.*, FEDERAL TRADE COMMISSION, REPORT ON SPRING/SUMMER 2006 NATIONWIDE GASOLINE PRICE INCREASES (2007), *available at* http://www.ftc.gov/reports/gasprices06/P040101Gas06increase.pdf; FEDERAL TRADE COMMISSION, REPORT ON GASOLINE PRICE MANIPULATION AND POST-KATRINA GASOLINE PRICE INCREASES (2006), *available at* http://www.ftc.gov/reports/060518PublicGasolinePricesInvestigationReportFinal.pdf; FEDERAL TRADE COMMISSION, GASOLINE PRICE CHANGES: THE DYNAMIC OF SUPPLY, DEMAND, AND COMPETITION (2005), *available at* http://www.ftc.gov/reports/gasprices05/050705gaspricesrpt.pdf; FEDERAL TRADE COMMISSION, BUREAU OF ECONOMICS, THE PETROLEUM INDUSTRY: MERGERS, STRUCTURAL CHANGE, AND ANTITRUST ENFORCEMENT (2004), *available at* http://www.ftc.gov/os/2004/08/040813mergersinpetrolberpt.pdf.