

Prepared Statement of the Federal Trade Commission

Solutions to Competitive Problems in the Oil Industry

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I. Introduction

Mr. Chairman and members of the Committee, I am Richard G. Parker, Director of the Federal Trade Commission's Bureau of Competition. I am pleased to appear before you today to present the Commission's testimony concerning the important topic of competitive problems in the oil industry. Competition in the energy sector - particularly in the petroleum industry - is vitally important to the health of the economy of the United States. Antitrust enforcement has an important role to play in ensuring that the industry is, and remains, competitive. Today, we will describe the Commission's recent antitrust enforcement efforts in the oil industry. We will also provide a brief discussion of legal and other complications that would arise in an antitrust lawsuit against the Organization of Petroleum Exporting Countries ("OPEC").

Consumers have experienced considerable price increases in gasoline and home heating oil in the past year, and domestic refineries have had to bear a large increase in the price of crude oil. The price of imported crude oil rose from \$10.92 per barrel in the first quarter of 1999 to over \$31.00 in March, 2000. Gasoline prices were \$.95 per gallon and heating oil was \$.80 per gallon in the first quarter of 1999. One year later, both peaked at over \$1.70.⁽²⁾ Increases of this magnitude call for scrutiny by antitrust enforcement authorities to determine whether they result from collusion or exclusion. They also remind us that effective merger enforcement remains critical to preserving competition among domestic and foreign private oil companies.

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

Commission prohibits "unfair methods of competition" and "unfair or deceptive acts or practices." The Commission shares its expertise in competition and consumer protection matters by providing advice and guidance to states and other federal regulatory agencies.⁽⁶⁾

Consumer protection is the goal of antitrust enforcement across all industries; its importance is particularly clear in the energy industry, where even small price increases can have a direct and lasting impact on the entire economy. Towards that end, the Commission has expended a substantial part of its resources in recent years enforcing antitrust laws in energy industries. In fiscal years 1999 and 2000 to date, the Bureau of Competition spent 115 work years on investigations in energy industries, almost one-third of its total enforcement budget. So far in fiscal 2000, the Bureau has spent over 35 work years on energy related matters.

II. Causes of the Current Price Spike

The recent spike in gas and heating oil prices appears to be caused by several factors, all related to the imbalance of supply and demand. During 1998 and 1999, OPEC countries and several other non-OPEC exporting countries curtailed the supply of crude oil available to the world market. During the same time period, a number of Asian economies began to recover from a regional recession, causing increased demand for petroleum products. The result was that worldwide consumption exceeded production, and inventories were drawn down. The price increase in crude oil caused by the excess of demand over supply also reduced refiners' margins, causing them to cut production and use inventories to meet demand.

To exacerbate the situation, the weather on the East Coast was also unusually severe in January, which had a two-fold effect: it both caused the demand for heating oil to increase, and decreased supply because frozen rivers and high winds delayed product movement. Demand for electric power also increased, causing utilities to turn to distillates as a substitute for interruptible natural gas supplies. In addition, several refinery outages in January contributed further to the supply-demand imbalances.

III. Protecting Competition in the Oil Industry

The Commission's responsibility is to prevent anticompetitive mergers and collusive or abusive activities from contributing to price increases in the oil industry. The Commission does this in several different ways. For analytical purposes, it is best to think of the Commission's antitrust enforcement authority as divided into merger and nonmerger sectors. Enforcing the law against anticompetitive mergers prevents the accumulation of unlawful market power. Enforcing the nonmerger provisions of the antitrust laws prevents anticompetitive collusive activities or the acquisition or abuse of market power.

A. Merger Enforcement

Much of the Commission's experience with enforcing the antitrust laws in energy

industries has been in analyzing mergers. Merger enforcement is the first line of defense in protecting a competitive marketplace, because it preserves rivalry that brings lower prices and better services to consumers. The Commission blocks those mergers that increase the likelihood that the merged firm can unilaterally, or in concert with others, increase prices or reduce output or innovation. The Commission has an extensive history of carefully investigating mergers in the energy industries, particularly petroleum. The FTC has challenged mergers in those industries that would be likely to reduce competition, result in higher prices, and injure the economy of the nation or any of its regions.⁽⁷⁾

The Commission has been particularly active in the last two years in investigating petroleum mergers due to the ongoing trend of consolidation and concentration in this industry. For example, on February 2, 2000 the Commission voted to challenge the proposed merger of BP/Amoco and ARCO.⁽⁸⁾ In recent years, the Commission has investigated the mergers of Exxon and Mobil⁽⁹⁾ and BP and Amoco⁽¹⁰⁾-the two largest oil mergers in history-and the combination of the refining and marketing businesses of Shell, Texaco and Star Enterprises to create what was, at the time, the largest refining and marketing company in the United States.⁽¹¹⁾

Our merger review investigations revealed that these transactions threatened competition in local or regional markets. The Commission allowed these mergers to proceed only after demanding significant changes that would fully restore the competition lost as a result of the merger. For example, in the Exxon/Mobil merger review, the Commission ordered divestiture of all Mobil stations from Virginia to New Jersey, and all Exxon stations from New York to Maine, as well as additional retail divestiture in the Southwest, a refinery, and other pipeline and terminal assets. This was the largest divestiture in history.

In BP-Amoco, the Commission ordered divestiture in 30 local gasoline markets mostly in the Midwest, and in Shell-Texaco, the Commission preserved competition through divestiture in local gasoline markets and also in refining and pipeline markets.

B. Nonmerger Enforcement

Preventing anticompetitive mergers is not sufficient to protect competition in any industry. Merger enforcement must work in tandem with nonmerger enforcement against illegal monopolies and collusive practices. In the oil industry, monopoly cases are few. While there are certainly relevant antitrust markets where one firm may wield significant market power, most oil industry markets are served by multiple firms.⁽¹²⁾ Thus, the focus of nonmerger investigation in this industry has been, and likely will remain, on concerted activities that have anticompetitive effects.

(1) Fundamental Problem: OPEC Activity Leading to Higher Prices for Crude Oil

The Committee has expressed interest in whether the Commission believes that OPEC and its members could be liable under U.S. antitrust laws. The oil industry is unique

among commercially important global industries in that a large share of the reserves of the base commodity is owned and regulated by sovereign nation-states. These states regard crude oil as their primary (and perhaps only) natural resource and tightly control how that resource is exploited. This fact significantly complicates the application of competitive principles to the global oil industry. Sovereign nations typically enjoy several jurisdictional and substantive defenses to the antitrust laws that are not available to domestic or foreign private companies.⁽¹³⁾

A group of nations holding the largest oil reserves have formed OPEC for purposes of making joint output decisions. The efficiency of the cartel has varied over time. However, OPEC's members recently agreed among themselves to reduce output to a level far short of the amount that would be pumped in a freely competitive market. So far, this agreement has been maintained by those countries. The result is oil prices that substantially exceed the marginal cost of supplying oil. The same activity undertaken by a group of commercial firms would constitute a *per se* violation of the U.S. antitrust laws.

Is OPEC, because it is composed of sovereign nations, immune from liability under the U.S. antitrust laws? This question raises a number of complex issues related to international jurisdiction, sovereignty, and diplomatic relations. While the Commission does have expertise in analyzing competition in the energy sector, it does not presume to have final authority to provide definitive answers or advice to this Committee about the appropriateness of U.S. antitrust enforcement against OPEC members. That expertise and authority reside in the executive branch, including the Department of Justice and other executive agencies. We strongly recommend that this Committee also confer with those authorities about the legal issues outlined below.

The most significant attempt to enforce the antitrust laws against OPEC occurred in the 1970s in the case of *International Association of Machinists (IAM) v. OPEC*,⁽¹⁴⁾ a case in which a union brought suit against OPEC for allegedly violating section 1 of the Sherman Act⁽¹⁵⁾ by fixing the price of gasoline. In *IAM*, both a federal District Court and the Court of Appeals for the Ninth Circuit declined to apply the antitrust laws against OPEC, but for different reasons.

(a) *Foreign Sovereign Immunity*

The District Court held that OPEC was protected by the sovereign immunity doctrine, which holds that each independent sovereign is equal in sovereignty to all other states.⁽¹⁶⁾ Thus, the courts of one nation generally have no jurisdiction to entertain suits against another nation. This doctrine was codified by Congress in the Foreign Sovereign Immunities Act of 1976.⁽¹⁷⁾ That Act, however, contains an exception for an "action based upon a commercial activity."⁽¹⁸⁾ A foreign nation is deemed to have waived its immunity when it engages in "commercial activity." However, the District Court held that the OPEC agreement was not commercial activity under the statute because it related to the sovereign's choices about how the natural resources within its control are to be exploited. As the court stated, "it is clear that the nature of the activity engaged in by each of these OPEC member countries is the establishment by a sovereign state of the terms and

conditions for the removal of a prime natural resource to wit, crude oil from its territory."⁽¹⁹⁾ Other courts have agreed that a foreign nation's decisions concerning its natural resources are not subject to the jurisdiction of U.S. courts.⁽²⁰⁾

(b) Act of State Doctrine

The Court of Appeals affirmed dismissal of the action but declined to reach the sovereign immunity question. Instead, the court relied on the act of state doctrine, which "declares that a United States court will not adjudicate a politically sensitive dispute which would require the court to judge the legality of the sovereign act of a foreign state."⁽²¹⁾ This doctrine is not jurisdictional, but rather prudential -- it deems a judicial remedy inappropriate for international comity reasons and due to domestic considerations of separation of powers of co-equal branches of government.⁽²²⁾ As the court noted:

When the courts engage in piecemeal adjudication of the legality of the sovereign acts of states, they risk disruption of our country's international diplomacy. The executive may utilize protocol, economic sanction, compromise, delay, and persuasion to achieve international objectives. Ill-timed judicial decisions challenging the acts of foreign states could nullify these tools and embarrass the United States in the eyes of the world.⁽²³⁾

Thus, the Ninth Circuit declined to adjudicate the supply-restricting actions of OPEC under the antitrust laws.

In the nearly twenty years since the *IAM* case was decided, there have been no additional antitrust challenges that we know of, either to OPEC's activities or to any similar activities of foreign nations. That does not mean, of course, that the Ninth Circuit's decision is the final word on these issues. The Supreme Court has not directly addressed the issues raised by OPEC's conduct, and a number of these issues are open to dispute. Thus, any potential lawsuit against OPEC and its member nations would implicate a number of difficult legal and practical questions.

Among the complex legal questions presented would be the application of the doctrine of sovereign immunity. An important issue would be whether the conduct of OPEC and its member nations would be considered sovereign acts under the Foreign Sovereign Immunities Act, as they were in *IAM*, or commercial activities. The dividing line between "sovereign" and "commercial" activities can be elusive, particularly where, as here, a government's extraction and sale of natural resources from its own territory is concerned. Another issue would be the relevance, if any, of international law regarding sovereign immunities.

Interpreting the act of state doctrine could be equally difficult. A government challenge could well resolve the separation of powers concerns that underlie the doctrine. Any decision granting an injunction or other remedy would likely require a finding that certain decisions of OPEC member nations were invalid under U.S. law, however, which is the paradigm used for application of the doctrine.⁽²⁴⁾ Little guidance exists as to how to analyze the application of the doctrine under such circumstances.

In addition, it is possible that OPEC and its member nations might not be "persons" subject to the antitrust laws. A small number of decisions hold that a foreign state cannot be sued under the antitrust laws for actions taken in its sovereign capacity.⁽²⁵⁾ In *IAM*, the district court concluded that it was compelled to dismiss the action against the foreign sovereign members of OPEC because they could not be made defendants in an antitrust suit.

A possible enforcement action also raises practical questions as to whether jurisdiction can be obtained over OPEC and its member nations, how a factual investigation could be conducted with respect to documents and witnesses located outside the United States, and the nature and enforceability of any remedy.

Finally, and perhaps most importantly, any enforcement action would raise significant diplomatic considerations. A decision to bring an antitrust case against OPEC would involve not only, and perhaps not even primarily, competition policy, but also defense policy, energy policy, foreign policy, and natural resource issues. In particular, any action taken to weaken a sovereign nation's defenses against judicial oversight of competition lawsuits, for example, would have profound implications for the United States, which places buying and selling restrictions on myriad products. Consequently, any decision to undertake such a challenge ought to be made at the highest levels of the executive branch, based on careful consideration by the Department of Justice and other relevant agencies.

(2) Potential Collusion to Raise Prices for Refined Products

The fact that application of the U.S. antitrust laws to OPEC's decision to reduce output is problematic does not mean that there is no place for nonmerger antitrust enforcement in this industry. Continued antitrust oversight of these markets is important to ensure that private market participants do not, through anticompetitive conduct, exacerbate conditions caused by OPEC, cold weather, or other factors. For example, private firms' actions to fix prices, reduce supply, or tie products could all be antitrust violations. The potential is always present for producers, refiners, or distributors to take advantage of sudden market imbalances to engage in anticompetitive conduct in the hope that their illegal activities will be lost in all the noise.

A number of State Attorneys General in the Northeast have opened an investigation of the increase in prices for heating oil and diesel fuel in their jurisdictions and have requested that the Federal Trade Commission assist them. We are providing such assistance but I cannot comment further on this law enforcement investigation. The Commission continues to monitor gasoline price increases and competition across the U.S., looking for any indications that the antitrust laws have been violated.

IV. Conclusion

The Commission thanks the Committee for holding this important hearing. The American public needs to know what forces are at work in this vital sector of the economy. Higher prices for products that are critical to our citizens' quality of life and for the efficient

functioning of the national economy are a matter of serious concern. The Commission has devoted substantial resources to preserving competition in the oil industry during this period of consolidation through aggressive merger enforcement and nonmerger investigations. The Commission remains committed to taking all appropriate action to challenge private conduct that violates the antitrust laws. But, as we have noted above, antitrust enforcement against OPEC and its members involves considerably more complex questions than comparable actions against private companies - questions that ultimately would be resolved by other agencies in the executive branch.

Endnotes:

1. This written statement represents the views of the Federal Trade Commission. My oral presentation and response to questions are my own, and do not necessarily represent the views of the Commission or any individual Commissioner.
2. Energy Information Administration, Heating Fuels and Diesel Update, March 2, 2000, at www.eia.doe.gov See also Statement of John Cook, Petroleum Division Director, Energy Information Administration, Department of Energy, Before the Committee on Energy and Natural Resources, United States Senate (Feb. 24, 2000).
3. 15 U.S.C. § § 41-58.
4. 15 U.S.C. § § 12-27.
5. 15 U.S.C. § 18.
6. In recent years, the Commission has been active in supporting the deregulation of the electric power industry. See Commission Letter to the Honorable Thomas E. Bliley, Chairman, Committee on Commerce, United States House of Representatives, Concerning H.R. 2944, The Electric Competition and Reliability Act (Jan. 14, 2000); Comment of the Staff of the Bureau of Economics, Federal Trade Commission, "Inquiry Concerning Commission's Merger Policy Under the Federal Power Act," Dkt. Nos. RM95-8-000 and RM94-7-001 (May 7, 1996); "Revised Filing Requirements," Dkt. No. RM98-4-000 (Sept. 11, 1998); Comment of the Staff of the Bureau of Economics of the Federal Trade Commission Before the Alabama Public Service Commission, Dkt. No. 26427, Restructuring in the Electricity Utility Industry (Jan. 8, 1999).
7. Section 7 of the Clayton Act specifically prohibits acquisitions where the anticompetitive acts affect "commerce in any section of the country." 15 U.S.C. § 18.
8. *Federal Trade Commission v. BP Amoco, p.l.c.*, Civ. No. C 000416 (SI) (N.D. Cal. Feb. 4, 2000) (complaint) On March 15, 2000, the Commission and all other parties obtained an order from the Court adjourning the preliminary injunction hearing while the Commission evaluates the parties' proposal to sell all of ARCO's Alaska operations to Phillips Petroleum Co.
9. *Exxon Corp.*, FTC File No. 991 0077 (Nov. 30, 1999) (proposed consent order).
10. *British Petroleum Company p.l.c.*, C-3868 (April 19, 1999) (consent order).
11. *Shell Oil Co.*, C-3803 (April 21, 1998) (consent order).

12. *Exxon Corp., supra*, Separate Statement of Chairman Pitofsky and Commissioners Anthony and Thompson.
13. See United States Department of Justice and Federal Trade Commission, Antitrust Enforcement Guidelines for International Operations (April 5, 1995), *reprinted at* 4 Trade Reg. Rep. (CCH) ¶ 13,107, at § 3.31 (Foreign Sovereign Immunity) and § 3.33 (Acts of State).
14. 477 F. Supp. 553 (C.D. Cal. 1979), *aff'd*, 649 F.2d 1354 (9th Cir. 1981), *cert. denied*, 454 U.S. 1163 (1982).
15. 15 U.S.C. § 1.
16. The District Court also held that foreign nations were not "persons" for purposes of a Sherman Act suit, although that determination was not necessary to the outcome of the case, given the court's holding on the jurisdictional issue. The U.S. Supreme Court has held that a foreign nation may be a plaintiff in a Sherman Act case. See *Pfizer Inc. v. India*, 434 U.S. 308 (1978). The Court has not spoken on the issue of a foreign nation as a defendant in an antitrust case.
17. 28 U.S.C. § 1330 *et seq.*
18. 28 U.S.C. § 1605(2).
19. *IAM*, 477 F. Supp. at 567. See also Restatement (Third) of International Law § 443, "[a]n official pronouncement by a foreign government describing a certain act as governmental, is ordinarily conclusive evidence of its official character."
20. *MOL, Inc. v. Peoples Republic of Bangladesh*, 736 F.2d 1326, 1329 (9th Cir. 1984) (abrogating a contract to export native fauna concerned "Bangladesh's right to regulate its natural resources, . . . a uniquely sovereign function"); *Rios v. Marshall*, 530 F. Supp. 351, 372 (S.D.N.Y. 1981) ("temporary removal of manpower resources" is not a commercial activity under the FSI Act).
21. *IAM*, 649 F.2d at 1358.
22. The Supreme Court described the act of state doctrine as "a consequence of domestic separation of powers, reflecting 'the strong sense of the Judicial Branch that its engagement in the task of passing on the validity of foreign acts of state may hinder' the conduct of foreign affairs." *W.S. Kirkpatrick & Co. v. Environmental Tectonics Corp.*, 493 U.S. 400, 404 (1990), *quoting Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 423 (1964).
23. *IAM*, 649 F.2d at 1358.
24. *Kirkpatrick*, 493 U.S. at 405.
25. See, e.g., *Hunt v. Mobil Oil Corp.*, 550 F.2d 68, 78 n.14 (2d Cir. 1977); *Interamerican Refining Corporation v. Texaco Maracaibo, Inc.*, 307 F. Supp. 1291, 1298 (D. Del. 1970).