Tyson Slocum responses

Sen. Kohl

Question 1.
Should the FTC/Justice Department's merger guidelines be revised for mergers in the oil industry?

Yes. S.2557, introduced in the 109th Congress, is a great first step, as it prevents the anti-competitive practice of unilateral withholding. But additional legislation must be implemented to counter the very strong bias in recent years in the antitrust area at federal courts in favor of a "rule of reason" rather than a "per se illegal" analysis of alleged anticompetitive conduct. A perfect example of how the courts are undermining anti-trust laws is the recent Supreme Court decision *Texaco v Dagher*.[1]

Question 2
a) Does the failure of the oil industry to open new refineries suggest the presence of anti-competitive conduct?

Yes. The consolidation of downstream assets—particularly refineries—plays a big role in determining the price of a gallon of gas. Recent mergers have resulted in dangerously concentrated levels of ownership over U.S. oil refining.

In 1993, the five largest U.S. oil refining companies controlled 34.5 percent of domestic oil refinery capacity; the top ten companies controlled 55.6 percent. By 2005, the top five—ConocoPhillips, Valero, ExxonMobil, Shell and BP—controlled 55 percent and the top ten refiners controlled 81.4 percent. As a result of all of these recent mergers, the largest five oil refiners today control as much capacity as the largest 10 did a decade ago. This dramatic increase in the control of just the top five companies makes it easier for oil companies to manipulate gasoline by intentionally withholding supplies in order to drive up prices. Because most of the largest companies are also vertically integrated, they enjoy significant market share in oil drilling and retail sales.

ExxonMobil's new CEO told *The Wall Street Journal* that even though American fuel consumption will continue growing for the next decade, his company has no plans to build new refineries:

> *Exxon Mobil Corp. says it believes that, by 2030, hybrid gasoline-and-electric cars and light trucks will account for nearly 30% of new-vehicle sales in the U.S. and Canada. That surge is part of a broader shift toward fuel efficiency that Exxon thinks will cause fuel consumption by North American cars and light trucks to peak around 2020—and then start to fall. "For that reason, we*

[1] www.supremecourtus.gov/opinions/05pdf/04-805.pdf

> *wouldn't build a grassroots refinery" in the U.S., Rex Tillerson, Exxon's chairman and chief executive, said in a recent interview. Exxon has continued to expand the capacity of its existing refineries. But building a new refinery from scratch, Exxon believes, would be bad for long-term business.*[2]

ExxonMobil and other oil companies are not building new refineries because it is in their financial self interest to keep refining margins as tight as possible, as that translates into bigger profits.

Margins for U.S. oil refiners have been at record highs. In 1999, U.S. oil refiners enjoyed a 18.9 cent margin for every gallon refined from crude oil. By 2005, they posted a 48.8 cent margin for every gallon of gasoline refined, a 158 percent jump.[3] That forced *The Wall Street Journal* to conclude that "the U.S. market is especially lucrative, sometimes earning its refiners $20 or more on every barrel of crude oil they refine."[4]

b) Is there anything the antitrust enforcement agencies can do about the oil industry closing existing refineries, and failing to open new ones?

Yes, an immediate investigation—including the use of subpoena—must be initiated to determine the level of intentional actions by the oil industry to maintain tight refinery supplies.

3. Do you believe oil companies have an incentive to keep supplies off the market, or to keep supplies tight, in order to gain market power and drive up price? Does this happen – either at the time studied in the March 2001 or at other times? What can we do to prevent this?

Yes, oil companies do have an incentive to keep supplies off the market. The U.S. Federal Trade Commission found evidence of anti-competitive practices in its March 2001 *Midwest Gasoline Price Investigation*:[5]

> *An executive of [one] company made clear that he would rather sell less gasoline and earn a higher margin on each gallon sold than sell more gasoline and earn a lower margin. Another employee of this firm raised concerns about oversupplying the market and thereby reducing the high market prices. A decision to limit supply does not violate the antitrust laws, absent some agreement among firms. Firms that withheld or delayed shipping additional supply in the face of a price spike did not violate the antitrust laws. In each instance, the firms chose strategies they thought would maximize their profits.*

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[2] Jeffrey Ball, "As Gasoline Prices Soar, Americans Resist Major Cuts in Consumption," May 1, 2006.
[3] *Refiner Sales Prices and Refiner Margins for Selected Petroleum Products, 1989-2005*, www.eia.doe.gov/emeu/aer/pdf/pages/sec5_53.pdf
[4] Steve LeVine and Patrick Barta, "Giant New Oil Refinery in India Shows Forces Roiling Industry," August 29, 2006.
[5] www.ftc.gov/os/2001/03/mwgasrpt.htm

Although federal investigators found ample evidence of oil companies intentionally withholding supplies from the market in the summer of 2000, the government has not taken any action to prevent recurrence.

A congressional investigation uncovered internal memos written by major oil companies operating in the U.S. discussing their successful strategies to maximize profits by forcing independent refineries out of business, resulting in tighter refinery capacity. From 1995-2004, 97 percent of the more than 929,000 barrels of oil per day of capacity that has been shut down were owned by smaller, independent refiners.[6] Were this capacity to be in operation today, refiners could use it to better meet today's reformulated gasoline blend needs.

Question 4.

Because of the rise in the worldwide price of crude oil, our oil companies must pay higher and higher prices to obtain the crude oil they refine into gasoline, heating oil and other petroleum products. Yet as the price they pay for this raw material rises, their profits also rise. In your view, how can this be? How can the industry's profits rise as the price for the raw material it uses to make its products rise?

First, vertically-integrated companies like ExxonMobil are large producers of oil, and they are often transferring oil to their own domestic refineries. Second, the refining profit margins I cited in response to question 2a show that the companies have been able to counter the rise in crude oil by making up the difference with huge profits at the refining level.

Question 5.

Does the exporting of refined products—such as gasoline, diesel and home heating oil—drive up price?

Since our current level of exports—425 million barrels in 2005[7]—is relatively small, I don't think exports currently are causing high prices. However, there is potential for this to be a problem, particularly in the exporting of refined products, and therefore I think prudent policy would dictate a limit or a ban on future exports.

SENATOR SPECTOR QUESTIONS

Question 1.

Does the concentration of power in the energy industry, in and of itself, increase prices? If so, why?

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[6] Energy Information Administration Form EIA-820, *Annual Refinery Report*.

[7] http://tonto.eia.doe.gov/dnav/pet/pet_move_expc_a_EP00_EEX_mbbl_a.htm

Yes. oil companies are also exploiting their huge market control and lax regulatory oversight to price-gouge Americans. For example, in June 2006, the U.S. Commodity Futures Trading Commission (CFTC) brought charges against BP for manipulating the entire U.S. propane market, and CFTC staff "notified BP on November 21, 2006 that they intend to recommend to the CFTC that a civil enforcement action be brought against BP…alleging violations…of the Commodity Exchange Act in connection with its trading of unleaded gasoline futures…The U.S. Attorney for the Northern District of Illinois is also conducting an investigation into BP's gasoline trading… [and the CFTC] is currently investigating various aspects of BP's crude oil trading and storage activities in the US since 2003."[8] Investigations are expanding into manipulation of crude oil and gasoline futures markets, and "many trading firms had received CFTC demands for information, suggesting that the investigation went beyond BP."[9]

Oil companies, financial firms and other energy traders are increasingly exploiting their control over infrastructure assets, parlaying the knowledge of the movements of energy through the systems they control to make big bets on the futures exchanges. Glenn Dubin, co-founder of the hedge fund Highbridge Capital (that is financially backed by JP Morgan) explained when buying a big stack in Louis Dreyfus: "Owning physical assets such as pipelines and storage facilities is crucial to investing in the energy business," said Dubin. "That gives you a very important information advantage. You're not just screen-trading financial products."[10]

In just the last few years, mergers between giant oil companies—such as Exxon and Mobil, Chevron and Texaco, Conoco and Phillips—have resulted in just a few companies controlling a significant amount of America's gasoline, squelching competition. In 1993, the largest five oil refiners controlled one-third of the American market, while the largest 10 had 55.6 percent. By 2005, as a result of all the mergers, the largest five now control 55 percent of the market, and the largest 10 dominate 81.4 percent. This concentration has led to skyrocketing profit margins.

Question 2.
Would legislation be appropriate, and what kind of legislation would you suggest?

We should strengthen antitrust laws by empowering the Federal Trade Commission to crack down on unilateral withholding and other anti-competitive actions by oil companies; re-regulate energy trading exchanges to restore transparency and impose firewalls to stop energy traders from speculating on information gleaned from the companies' affiliates; and establish a Strategic Refining Reserve to be financed by a windfall profits tax on oil companies that would complement America's Strategic Petroleum Reserve.

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[8] www.sec.gov/Archives/edgar/data/313807/000102123106000617/b843546-6k.htm

[9] John R. Wilke, Ann Davis and Chip Cummins, "BP Woes Deepen With New Probe," *The Wall Street Journal*, August 29, 2006

[10] Saijel Kishan and Jenny Strasburg, January 8, www.bloomberg.com/apps/news?pid=20601014&sid=aBnQy1botdFo

Question 3.
To what extent do you think increased profits for energy companies will find their way into exploration?

Bigger profits will indeed increase the amount of capital that the oil industry allocates for exploration and production. But the companies are also spending record amounts of their capital on other things that are not useful for consumers or America's energy supply. For example, since January 2005, the largest five oil companies in America—ExxonMobil, ChevronTexaco, ConocoPhillips, BP and Shell—have spent $145 *billion* buying back their stock and paying dividends.

Question 4.
If the seven big companies had their profits cut in half in any given year, what impact would that have on the price of gasoline to a consumer over a year's time?

The results would be dramatic. As I mentioned earlier, margins for U.S. oil refiners have been at record highs. In 1999, U.S. oil refiners enjoyed a 18.9 cent margin for every gallon refined from crude oil. By 2005, they posted a 48.8 cent margin for every gallon of gasoline refined, a 158 percent jump.[11] That forced *The Wall Street Journal* to conclude that "the U.S. market is especially lucrative, sometimes earning its refiners $20 or more on every barrel of crude oil they refine." Clearly, if their refining profit margins drop, the price of a gallon of gas should drop, too.

Question 5.
How would you change zone pricing to bring about the best effect for the consumer?

Zonal pricing should be made illegal. Connecticut Attorney General Richard Blumenthal recommended that Congress adopt the following language to outlaw zonal pricing:

"No person engaged in the business of furnishing gasoline to retail distributors of gasoline may use a pricing system under which the wholesale price paid for gasoline by any such retail distributor is determined based on the location of the retail distributor in any geographic zone…a person engaged in the business of furnishing gasoline to retail distributors of gasoline shall sell gasoline to all retail distributors of gasoline at the same base price minus any bona fide volume discount and plus any actual transportation cost. The invoice for the sale of such gasoline shall indicate the base price and any discounts or transportation costs. Such base price shall not be adjusted more than once in any 24-hour period and shall be the rack price as posted in the oil price information service."

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[11] *Refiner Sales Prices and Refiner Margins for Selected Petroleum Products, 1989-2005*, www.eia.doe.gov/emeu/aer/pdf/pages/sec5_53.pdf

Finally, Congress should amend the Petroleum Marketing Practices Act, 15 USC § 2801 et seq., to prohibit major oil companies from dictating the source of supply of the brand name gasoline.