Testimony of

Mr. Tim Hamilton

February 1, 2006

Testimony of Timothy A Hamilton,
Senate Judiciary Committee
Washington, DC February 1, 2006

Mr. Chairman, Honorable Members of the Committee, for the record my name is Tim Hamilton. I am the Executive Director of AUTO, a non-profit trade association of independent gasoline wholesalers and retailers that operate approximately 400 gasoline service stations and convenience stores in Washington State. I also serve as a consultant in the industry advising small businesses, trade groups, state government, and consumer groups such as the Foundation for Taxpayer and Consumer Rights (FTCR) based in Santa Monica, CA.

My career in the industry began when I bought my first Exxon gasoline station in 1974 in McCleary, Washington. When I tried to order my first load of gasoline Exxon refused to deliver and our little town experienced the gas lines of the Arab Oil Embargo era previously only seen on television. I subsequently operated a Shell station near Aberdeen where I experienced the reappearance of gas lines a second time in 1980. The last station I operated was a Union 76 station in our state capitol of Olympia.

I appreciate the invitation to testify before the committee. At least in my industry, I believe it extremely important that public policy makers recognize that the federal antitrust laws no longer provide the protections anticipated by its drafters.

Decades of consolidation, regulatory lobbying and legal maneuvering by the industry following federal decontrol in 1981 has resulted in formation of international corporations that dwarf the Standard Oil Trust and other monopolies that gave birth to the antitrust concept. One can hardly criticize the drafters for failing to anticipate the evolution of PC computers, internet communications and other modern technology that currently allows the industry to legally use tacit collusion that nearly mirrors the monopolistic powers of the Standard Oil Trust. The same applies to envisioning that the industry would use environmental initiatives to meet, divide up markets, and create barriers to entry and other anti-competitive institutions.

My career in governmental affairs and public policy began in 1984 when I formed AUTO and lobbied passage of the Washington Gasoline Dealers Bill of Rights (RCW 19.120). Since then I have experienced near continuous interaction in industry litigations, antitrust regulatory actions, and responded to requests for assistance from federal, state, and local elected officials in WA, OR, HI, CA, AZ, NV, MT, MI, and the Provincial Governments in Quebec and Nova Scotia. I sat on the California Attorney General's Task Force on Gasoline Prices and provided expertise to the California Energy Commission.

During regulatory reviews of mergers and acquisitions in the industry, I often interacted with the Merger and Acquisition Division of the FTC. The experience was disturbing as antitrust theories of the FTC often lacked common sense. As an example, one FTC counsel explained to me that if one company controlled every gas station in WA, OR, and CA the FTC would not object and further more, they wouldn't want to even know about it.

The mergers and acquisitions occurring within the petroleum industry has greatly reduced competition between oil companies. The first region to fully feel the effects was the West. The competitive decline created an oligopoly, which is defined as "A market condition in which sellers are so few that the actions of any one of them will materially affect price and have a measurable impact on competitors."

The oil companies themselves provided insight into the dangers presented by oligopolies. In opening arguments in the antitrust suit filed by the state of Hawaii against the companies in 1998, the attorney leading off for the companies explained high pump prices with "Once you decide it's an oligopoly, you've got an explanation for the phenomenon of the high prices, the high margins, the high profits, the lack of vigorous price competition. That explains it all."

The failure of federal antitrust law to fully consider all the impacts of a worldwide merger has been troubling as well. The review process concentrates on the combined market share created by a consolidation of assets of the two companies in a particular region. If the consolidation exceeds a certain level, divestitures are required to bring the number in line with antitrust review levels adopted in the 80's. Seeming missing from this exercise was recognition that these mergers could create economic incentives for oil companies to create artificial shortages that resulted in regional price spikes that inflated company profits.

Using BP's acquisition of Amoco and ARCO as an example, prior to the merger if ARCO or other refiners in the West failed to provide enough gasoline or diesel the price would rise. The increase in price created a financial incentive for those not doing business in the region to ship in gasoline. AMOCO could ship in supplies from the Midwest and BP could bring it from refineries in the Far East. The same example applies to ConocoPhillips, which were Conoco, Phillips 66, and Union 76 prior to their mergers.

Following the mergers, BP lost the financial incentive to ship in gasoline from its previously acquired Amoco refineries in the Midwest during a price spike in the West. Such an action would undermine the higher price the company was receiving for gasoline made in its newly acquired Arco refineries in LA and Puget Sound. The same would occur for the managers at ConocoPhillips who be reluctant to ship in gasoline in amounts adequate to lower the prices as it would be enjoying increase margins at the former Union 76 refineries it acquired in LA and San Francisco.

The same problem exists when antitrust reviews fail to consider the international effects. The oil companies haven't built a new refinery in the U.S. in 30 years even though consumption has increased by 33 percent. The industry is quick to point out difficulties complying with environmental standards. Yet, the companies fail to mention new refineries that could supply the needs of the Americas were not built in Canada, Latin America, or South America.

As an example, Shell sold half its Deerpark refinery in Houston, Texas to the government of Mexico. Instead of a new Mexican refinery supplying gas and diesel to the U.S. market, over a million gallons of unleaded fuel per day flowed out of Houston to eastern ports in Mexico before and after Katrina. Out West where farmers, loggers, and truckers were painfully paying over $3 per gallon for diesel, cargoes from refineries in WA, CA, and HI cruised south to unload in Mexican ports on the Pacific side.

The key to higher pump prices and increased profits for the companies lies buried in the "supply and demand" scenario. Simply put, if demand exceeds supply, prices go up. Unfortunately, this creates a conflict of interest between American consumers and the oil companies. The industry has a tremendous financial incentive to take steps that insure the supply does not exceed the supply.

A key ingredient for success was the removal of the refinery surplus existing in the U.S. at the time of decontrol. An internal Chevron memo publicly released by Senator Ron Wyden acknowledged the industry goals with "A senior energy analyst at the recent API convention warned that if the US petroleum industry doesn't reduce its refining capacity it will never see any substantial increase in refinery margins." Similar memos from Texaco and Mobil discussed how the larger companies were closing down their refineries. The combined weight of the large companies was utilized to lobby for technical language in environmental rules that would discourage smaller competitors from operating refineries reduce supply by limiting competition from alternative fuels.

It is hard to believe drafters of antitrust laws envisioned an environmental regulatory process where a handful of companies could knowingly and legally sit down together in a "smoke-free room" to discuss limiting supply and competition. I am convinced that while unsuspecting regulatory staff acted as meeting facilitators, the industry used the opportunity to reached understandings on refinery retrofits that limited local refinery production and created barriers to entry for competitors.

Today, the industry acts in unison to limit supply as a means to drive up price. A key component is the large shared storage tank located near a refinery, pipeline, or seaport terminal where the companies commingle their gasoline or diesel. The companies use a complicated formula of contracts or exchange agreements to divide up the supplies produced locally or imported into the area. Computers at each company track the fuel supply of not only their inventory, but also the inventory of competitors throughout the entire region. Shipping and pipeline schedules are tracked to show when and where fuel will be exported or imported, the volumes involved, the impact on local inventories and the identification of the industry participant.

One company on its own or in concert with others can export, delay or divert scheduled imports, or cut back production at a local refinery. This independent actions draws down their portion of the supply in the shared tank. All the competitors are aware of the shortfalls (often even before event occurs). The initiating company then starts raising prices directly or indirectly to its gasoline stations. Utilizing third party reporting services and internet technology, the other companies immediately recognize a price spike is underway and counter with increases of wholesale prices to their stations operators. Sometimes gasoline marketers will receive up to four changes in price in a single 24-hour period.

As the companies monitor each price increase from competitors on their computer screens, consumers see pump prices skyrocket across the region and complain bitterly of price fixing. Elected officials turn to the Federal Trade Commission (FTC) asking for investigations. The FTC typically issues a study report stating no illegal behavior was found and the oil companies kick out press releases proclaiming how "we didn't do anything wrong!"

Prior to Katrina, one of the best examples outside of the West occurred in the Midwest in 2000. A study I conducted with FTCR looked into the price run up in the Midwest following the introduction of an ethanol blend of cleaner burning fuel. The study concluded the companies profited by the price spike, which could have been avoided, if the companies had not taken measures to "short the market". While the American Petroleum Institute issued a press release severely criticizing my conclusions, a short time later the Wall Street Journal, a Senate Investigation, and a reluctant sounding FTC independently seemed to confirm my observations of the following:

? the companies lowered historical gasoline production in the area following meetings and negotiations with the regulatory community on retrofitting refineries;
? the companies dramatically reduced local inventories in the shared tanks which triggered a price spike to slow consumption down to meet available supply; and
? at least one company admitted it intentionally withheld supplies available at its refinery outside the region to avoid undermining the high prices it was receiving at its Great Lakes region refinery.

Price spikes have become nearly annual events out West. The spike typically begin each year following a rash of exporting that empties those large shared storage tanks just in front of the increased demand that comes with the spring plant and kids getting out of school. Especially with diesel, the exporting shows how a loss of a very small percentage of supply can create a remarkable increase at the pump.

Our trade group first raised public attention to the exporting when it published an article titled "The parade of ships" in 1997. The article documented how the companies loaded ships with gasoline and nearly before the ships cleared the harbors in Seattle, San Francisco, and Los Angeles the price spiked at the pump across the West. Chevron and others placed distributors on allocation and limited deliveries to gas stations. I provided all the information to the FTC including the names of the ships and the jumps in price in a letter dated 9/19/97 and received the expected thank you followed by no further response.

In 2004, the Orange County Register did a similar story as the companies admitted gasoline that could have been sold in the West found its way across the Pacific right before the spring drive. Not to be outdone, the LA Times reported how cargoes of ultra low sulfur diesel was exported out of CA to Chile in June of 2005 when diesel prices in the West were setting all time records.

It is important to note that very little trade secrets exist in the production and distribution of motor fuel. Rest assured, all of the oil companies can track their competitors exports, monitor refinery production levels, recognize the diversion of import cargoes to other locations and all the other factors that effect availability of supply and the price at the pump. The primary motivation for the companies claiming a need for confidentiality is to insure that the public is kept in the dark.

A CLASSIC EXAMPLE of frustration with antitrust law is the recent attempt by Shell Oil to close its highly profitable refinery in Bakersfield, California. Already short on fuel and home to some of the highest prices for diesel and gasoline, Shell attempted to bulldoze the refinery rather than sell it. During initial open meetings with effected employees, the Shell spokesman claimed the company would never sell the plant. The bulldozing was desired to prevent a new competitor from entering the market. The company claimed the decrease in production at Bakersfield was expected to increase profits for Shell at its remaining refineries in Puget Sound, Los Angeles, and San Francisco.

Shell's intentions alarmed the entire West. Elected officials pushed Shell to sell the refinery rather than close it and some asked the FTC to investigate. The company claimed it was losing money in Bakersfield and its wells in nearby California fields were running dry. The FTC agreed to investigate and announced its report would be completed sometime after Shell was scheduled to send the bulldozers through the refinery.

Shell's public comments and letters to Senator Boxer and others contained statements that were totally contradictory to prior statements reported by the effected employees. Further, internal Shell documents smuggled out by employees and posted by the FTCR at www.consumerwatchdog.org showed Bakersfield was receiving awards for its efficiency and earning profits in excess of those typically posted by its other refineries in the U.S. The gross discrepancy between Shell's written communications to elected officials and its own internal documents cast is a prime example of the reliability of industry statements.

The company was obviously "disappointed" that its employees disclosed the internal documents. After watching television broadcasts throughout California featuring interviews with employees sitting behind dark curtains explaining the companies intentions, Shell eventually sold the refinery to Flying J.

Ironically, the FTC subsequently issued an investigation report that seems to state that federal antitrust laws do not apply when a company decides to close a production facility. Fortunately, the report was not released until after the efforts spearheaded by California Attorney General resulted in a sale to a new operator. The FTC report encourage others to attempt to close refineries in the U.S. and if such occurs, undoubtedly cast a large shadow on any attempts by state AGs to protect regional supplies of gasoline or diesel.

As major participant in the debate, I personally feel that if the FTC had completed its efforts before Shell inked a deal with Flying J, the state of California could have found its legal position undermined by the FTC report. Ironically, my reading of the FTC report on Bakersfield finds it went beyond just explaining the limitations of existing laws in such matters. The report seems to attempt to provide Shell a public relations defense for its actions, which if correct is a disturbing testament to its orientation.

Often I am asked "How high will the prices go". My first response is to return a question with "Well, how much will you pay to get to work when the gas gauge is on empty?" I then add "Can't tell for sure, but one thing for certain is the oil companies are going to take this country on one heck of a ride over the next 5-10 years."