Senator Kohl's Follow-up Questions for Oil Consolidation Hearing

FOR JOSEPH ALIOTO:

QUESTION:

1. Oil companies must pay higher and higher prices from the world market to obtain the crude oil they refine into gasoline, heating oil and other petroleum products. Yet as the price the pay for this raw material rises, their profits also rise. How can this be?

RESPONSE BY JOSEPH M. ALIOTO:

All of the major integrated oil companies cooperate with each other in the exploration and production of crude oil. All of them make exploration and production a separate profit center as well as refining and marketing as separate profit centers. Therefore they make extraordinary amounts on the exploration and production (crude oil sales) as well as profits from refining and marketing. Because they are integrated they can manipulate the margins from the various levels.

QUESTION: How can the industry's profits rise as the price for the raw material it uses to make its products rises? Does this suggest to you any anti-competitive market conditions?

RESPONSE BY JOSEPH M. ALIOTO:

There is no question that major anticompetitive market conditions exist in integrated oil companies.

The industry's profits rise as the price for crude oil rises because industry players "sell" the crude oil to themselves, and to their competitors. Each oil company uses these "sales" to artificially bolster the upstream oil-production profits. In addition, when raw material prices go up, prices (but not profits) are also expected to rise.

However, profits accompanied by raw-material cost increases is indicative of collusion and an artificially manipulated market. Finally, because all of the major oil companies are fully integrated (unlike any other industry), they can manipulate their profits and allocate them to any level they want. Because they can do this, they are constantly exchanging and verifying price information by exchanging crude oil and refined products among and between themselves at so-called "transfer prices" and verifying price changes at retail whether the prices are going up or down in order to control any independent who attempts to start a price war.

In the Shell-Texaco joint venture approved by the FTC, Shell and Texaco first raised the price of Texaco to the same price as Shell, and then increased prices across the board throughout the United States some 50% to 70%, even though the crude oil prices were at the lowest since the Depression, their costs were supposedly substantially reduced by the joint venture, and there was

substantial over-capacity. Supply and demand played no part in this increase, nor does it play any part today, because of the few fully integrated oil companies

High prices and obscene profits will continue in the oil industry until competition is restored. That can only happen if the oil companies are prohibited from being fully-integrated.

QUESTION:

2. Much of the crude oil the U.S. oil companies refine into gasoline and other petroleum products comes from their own oil fields. For example, according to its annual report, in 2005 ExxonMobil produced 477,000 barrels of oil per day in the United States, more than 26% of their domestic refining capacity. Overall, the U.S. produces about 40% of the crude oil it consumes. The cost to produce this oil domestically should not be affected in any way by the rising worldwide price of crude oil, a price largely determined by the OPEC oil nations. So why should the rising price of crude oil on the international markets lead to higher prices with respect to petroleum products refined from the oil companies' own domestically produced oil? In your view, are the oil companies just profiteering with respect to the oil that comes from the oil fields they own?

RESPONSE BY JOSEPH M. ALIOTO:

See response above.

QUESTION:

3. In the last 15 years there has been a tremendous amount of consolidation in the oil industry – the GAO counts 2600 mergers and acquisitions in this industry since the 1990s alone. During this time, the FTC has approved almost all of the oil industry mergers it has reviewed, including the gigantic ones like Exxon/Mobil, Chevron/Texaco and Conoco/Phillips. While each one of these mergers may not have seemed problematic when reviewed, taken as a whole these mergers have greatly increased concentration in the industry.

Many wonder whether new rules or merger guidelines are necessary because of the special circumstances in the oil industry. For example, it is not easy to increase capacity to meet growing demand because of environmental and other restrictions to building new refineries. In addition, consumers cannot respond to higher prices by buying substitute products – people must buy gas to drive to work, and must buy heating oil or natural gas to heat their homes in the winter.

(a) In your view, should the FTC's merger guidelines be revised for mergers in the oil industry because of these special conditions? If so, do you have any suggestions as to how the Guidelines should be revised?

RESPONSE BY JOSEPH M. ALIOTO:

The FTC guidelines are given a prestige they do not deserve. They were not written by legislators. They were not written by judges. In fact, no one knows who wrote them. Nevertheless, they have been given more importance than the law itself. The law with regard to mergers is well established. As Judge Posner wrote in *Hospital Corp. of America v. Federal Trade Commission*, 807 F.2d 1381 (7th Cir. 1986):

> The Commission may have made its task harder (and opinion longer) than strictly necessary, however, by studiously avoiding reliance on any of the Supreme Court's Section 7 decisions from the 1960's, except *United States v. Philadelphia Nat'l Bank*, which took an explicitly economic approach to the interpretation of the statute. The other decisions in that decade – in particular *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962); *United States v. Aluminum Co. of America*, 377 U.S. 271 (1964); *United States v. Von's Grocery Co.*, 384 U.S. 270 (1966); and *United States v. Pabst Brewing Co.*, 384 U.S. 546 (1966) – seemed, taken as a group, to establish the illegality of any nontrivial acquisition of a competitor, whether or not the acquisition was likely to bring about or shore up collusive or oligopoly pricing. The elimination of a significant rival was thought by itself to infringe the complex of social and economic values conceived by a majority of the court to inform the statutory words "may … substantially … lessen competition." None of these decisions has been overruled.

Congress should make certain that any person threatened by a merger should have a right to sue, whether the threatened injury is direct or indirect, or whether the persons is a purchaser, seller, or competitor.

Congress should specifically prohibit the introduction into evidence in a private antitrust case any "non-objections" or "approvals" by the FTC with regard to any mergers or other claimed violations of the antitrust laws. Private parties ought not be encumbered by the claim by antitrust defendants that their conduct was in any way approved or sanctioned or not objected to by the government.

QUESTION:

(b) Section 7 of the Clayton Act currently states that mergers and acquisitions are illegal if the effect such an acquisition "may be substantially to lessen competition." Do you believe that standard should be modified for mergers in the oil and gas industry to lower the showing of competitive injury necessary to make a merger illegal?

RESPONSE BY JOSEPH M. ALIOTO:

Section 7 of the Clayton Act should require that the burden of proof should be placed on the defendants who seek the elimination of competition by a merger to prove that their merger (or acquisition) does not substantially lessen competition.

QUESTION:

(c) Would you support shifting the burden of proof in merger cases under the antitrust laws, so that the burden would rest on the parties to the transaction to prove that their transaction does not substantially injure competition, rather than having the burden rest on the government or other party challenging the merger?

RESPONSE BY JOSEPH M. ALIOTO:

Yes.

QUESTION:

4. Do you believe antitrust regulators should seek to require expansion of refining capacity as a condition of approving mergers in the oil industry? Or should conditions be placed that prevent closures of existing refineries?

RESPONSE BY JOSEPH M. ALIOTO:

No. Refining capacity would be increased and refinery enclosures would not take place so long as the oil companies are required to compete. The natural consequence of mergers of major companies like the integrated oil companies result in social and political harms as well as economic ones. The uncertainty caused by competition requires that a competitor attempt to anticipate the conduct of another competitor.

QUESTION:

5. The antitrust case David Boies has filed in Alaska is based on allegations that ExxonMobil and BP have refused to sell natural gas to a pipeline his clients seek to build in Alaska. His complaint alleges that they have done so in order to keep natural gas supplies tight to raise the price of natural gas.

Do you believe the antitrust laws as currently written are adequate to deal with a situation in which an oil company deliberately withholds supply in order to gain market power to raise the price? Do you support the legislation Senator Specter and I have drafted to make it unlawful for a supplier to refuse to sell petroleum products with the intention of raising price?

RESPONSE BY JOSEPH M. ALIOTO:

Already answered above with the following: The antitrust laws as presently written are adequate to deal with an oil company that deliberately withholds supply in order to raise prices. However, that law is not enforced. For example, as the CEO of Chevron testified, Chevron and Texaco had an agreement not to supply the United States with crude oil from their joint venture in Asia. This is a plain violation of the antitrust laws. However, no one seeks to enforce it. It is not a question of new laws, but a question of enforcement of existing laws. In this regard, the best guarantee, is to allow the private litigant the authority to file any cases in which the private litigant is injured directly or indirectly by a violation of the antitrust laws. Therefore, all that is needed is that Section 4 include the words "directly or indirectly" after the phrase "anyone injured in his business or property …"

Certainly we would support the bill by Chairman Specter and by Senator Kohl. However Section 2(2)(a) line 6 "primary" should be eliminated. The conduct should be unlawful if one of the reasons is to create a shortage and not simply the primary reason.

Also, a new section should be added to Section 8 giving authority to private parties injured directly or indirectly by the conduct to sue.

QUESTION:

6. In most competitive industries, when there are high prices, high profits to be made, and soaring consumer demand, we would expect to see an expansion of capacity to meet this demand. Yet in the oil industry this has not happened. Instead of opening new refineries, the industry has closed more than half of all that existed 25 years ago. In 1981, there were 324 refineries operating in the United States – today there are 149. Overall national refining capacity declined by more than 9% from 1981 to 2004, while demand for gasoline rose 38% during that same period. Oil industry critics suggest that this decline in refining capacity is no accident – oil companies actually prefer to keep supplies tight in order to be able to gain market power to raise price. What's your view? Does the failure of the oil industry to open new refineries suggest anti-competitive conduct?

RESPONSE BY JOSEPH M. ALIOTO:

Yes.