"The Cost of Filling Up: Did the FTC Approve Too Many Energy Mergers?"

Remarks of

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before

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Section of Antitrust Law
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Good morning, and thank you for inviting us. We're very pleased to have this opportunity to participate in a discussion of merger policy and energy prices – subjects of great interest to the consuming public. As is almost always the case with presentations by Federal Trade Commission staffers, our remarks today convey only our own views and do not necessarily represent the views of the Commission or of any individual Commissioner.

The Fuel and Energy Committee has selected a topic for this morning's program that we expect will generate a discussion as lively as the debate over energy merger policy that has lately y pe."

[1] Interpreting an agency decision not to challenge a transaction at the pre-consummation stage as "approval" may create a sense of false comfort. Recent developments in FTC administrative litigation show that the Commission decides on occasion to challenge a merger years after consummation, once evidence has accumulated supplying a reason to believe that the deal was anticompetitive.

released last August.[2] That report, which built upon prior learning set forth in reports issued in 1982 and 1989, studied in great detail the merger and acquisition activity in the petroleum industry over two decades and devoted individual chapters to structural changes in discrete levels of the industry – crude oil production and reserves, bulk transport of crude oil, refining, bulk transport of refined products, and the terminaling and marketing of refined products. The report included in its scope the petroleum mergers of the last half-dozen years whose so-called "approval" by the FTC has fomented a great deal of discussion and debate (as well as the title of this morning's program).

The BE Report described in detail the very substantial divestitures, restructurings, and other remedies prescribed in such cases as *Shell/Texaco*,[3] *British Petroleum/Amoco*,[4] *BP Amoco/ARCO*,[5] *Exxon/Mobil*,[6] *Chevron/Texaco*,[7] *Valero/Ultramar Diamond Shamrock*,[8] *Conoco/Phillips*,[9] and others in recent years that have been carefully designed to prevent the creation or growth of market power. Any assertion that the Commission has exercised less than maximum vigilance in the petroleum sector is belied by studies that show exactly the opposite – that FTC merger enforcement has been more likely in the oil industry than in virtually any other industry.[10] Although relief has been achieved primarily through the issuance of consent orders in

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[2] Bureau of Economics, Federal Trade Commission, The Petroleum Industry: Mergers, Structural Change, and Antitrust Enforcement (Aug. 2004), *available at* http://www.ftc.gov/os/2004/08/040813mergersinpetrolberpt.pdf ("BE Report").

[3] *Shell Oil Co., et al.*, 125 F.T.C. 769 (1998).

[4] *The British Petroleum Company p.l.c., et al.*, 127 F.T.C. 515 (1999).

[5] *BP Amoco p.l.c., et al.*, FTC Docket No. C-3938 (consent order issued Aug. 25, 2000), *available at* http://www.ftc.gov/os/2000/08/bparco.do.pdf.

[6] *Exxon Corp., et al.*, FTC Docket No. C-3907 (consent order issued Jan. 26, 2001), *available at* http://www.ftc.gov/os/2001/01/exxondo.pdf.

[7] *Chevron Corp., et al.*, FTC Docket No. C-4023 (consent order issued Jan. 2, 2002), *available at* http://www.ftc.gov/os/2002/01/chevronorder.pdf.

[8] *Valero Energy Corp., et al.*, FTC Docket No. C-4031 (consent order issued Feb. 19, 2002), *available at* http://www.ftc.gov/os/2002/02/valerodo.pdf.

[9] *Conoco Inc., et al.*, FTC Docket No. C-4058 (consent order issued Feb. 7, 2003), *available at* http://www.ftc.gov/os/2003/02/conocophillipsdo.htm.

[10] *See, e.g.*, Bureau of Economics, Federal Trade Commission, Transparency at the Federal Trade Commission: The Horizontal Merger Review Process, 1996-2003, at 27 (Feb. 2005), *available at* http://www.ftc.gov/os/2005/02/0502economicissues.pdf; *see also* The

Petroleum Industry: Mergers, Structural Change, and Antitrust Enforcement, *supra* n.2, at 13 ("The FTC has taken a strict approach in reviewing petroleum-related mergers and has obtained relief in markets at lower concentration levels than it has in other industries."), 27 ("A comparison of Table 2-6 [of the report] with the information that the FTC has published about its merger enforcement in other industries shows that, in mergers involving petroleum markets, the Commission has obtained relief at lower levels of concentration."); Prepared Statement of the Federal Trade Commission, *Market Forces, Anticompetitive Activity, and Gasoline Prices: FTC Initiatives to Protect Competitive Markets*, before the Subcommittee on Energy and Air Quality, Committee on Energy and Commerce, United States House of Representatives (July 15, 2004), at 4-5 ("These data [concerning FTC horizontal merger enforcement from 1996 to 2003] show that the Commission has brought more merger cases at lower levels of concentration in the petroleum industry than in other industries. Unlike in other industries, the Commission has obtained merger relief in moderately concentrated petroleum markets."), *available at* http://www.ftc.gov/os/2004/07/040715gaspricetestimony.pdf; Federal Trade Commission Horizontal Merger Investigation Data, Fiscal Years 1996-2003 (Feb. 2, 2004; revised, Aug. 31, 2004), *available at* http://www.ftc.gov/os/2004/08/040831horizmergersdata96-03.pdf; FTC

[12] *Supra* n.3.

[13] *Supra* n.6.

[14] *Supra* n.7.

[15] *Supra* n.8.

[16]

leniency at the Commission point to instances in which individual petroleum firms took or contemplated unilateral actions that had (or might have had) an impact on market prices. But there is at best a tenuous connection between such anecdotes and any diminution of competition attributable to mergers. For example, much has been made of an episode in the Midwest gasoline crisis during the spring of 2000, in which some critics characterized a particular firm as

petroleum mergers.

that may have changed over time. We know that demand for gasoline has risen, both in the U.S. and abroad. As refiners reached capacity limits, prices rose – something that would have happened independently of the mergers. Supply disruptions, such as the 2000 Midwest gasoline crisis, also contribute to temporarily higher prices. Second, refiners invested billions of dollars to meet new environmental specifications, including the production of cleaner gasoline. By one estimate, the industry incurred about $98 billion of environmental expenditures between 1993 and 2001.[20] These investments do not show up in the margin calculation, but they are real costs to refiners that must be recouped over time to prevent assets from exiting the market. Third, it

[20] BE Report, *supra* n.2, at 69.

[21] *See* Energy Information Administration, Financial Reporting System Public Data, Petroleum Operations Statement of Income, *available at* http://www.eia.doe.gov/emeu/finance/frsdata.html, spreadsheet S5210.xls.

[22] GAO, Energy Markets: Effects of Mergers and Market Concentration in the U.S. Petroleum Industry (GAO-04-96), *available at* http://www.gao.gov/new.items/d0496.pdf ("GAO Report").

[23] Christopher T. Taylor and Daniel S. Hosken, Bureau of Economics, Federal Trade Commission, The Economic Effects of the Marathon-Ashland Joint Venture: The Importance of Industry Supply Shocks and Vertical Market Structure (last revised May 7, 2004), *available at* http://www.ftc.gov/be/workpapers/wp270.pdf.

methodologies to approach the problem of identifying the competitive effects of mergers.[24] The two reports reached somewhat different conclusions about the Marathon-Ashland transaction. The GAO Report concluded that the transaction resulted in a positive and significant wholesale price increase for both conventional and reformulated gasolines. The BE analysis found that a positive, significant increase occurred in wholesale prices for reformulated gasoline about 15 months after the joint venture was consummated, but concluded that a change in fuel formulation requirements in an area not affected by the transaction was responsible for the observed price increase. The BE analysis found no increase in wholesale prices for conventional gasoline, and no increase in the retail prices of conventional or reformulated gasoline, following the transaction.[25]

The expert economists at the January program made a number of important points. First, the panelists were in agreement that it is very difficult to correctly estimate the competitive effects of mergers, and that it is particularly challenging to isolate any such effects from other factors affecting gasoline prices. Among othe

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[24] The GAO approach relied primarily on specific control variables to account for supply and demand factors affecting gasoline prices, while the BE approach relied primarily on a "difference in difference" approach that used prices in other geographic areas not affected by a merger to account for other factors influencing gasoline prices.

[25] The GAO Report did not analyze the potential competitive effects of mergers upon retail gasoline prices.

conclusions regarding the estimated competitive effects of the Marathon-Ashland joint venture. And while the GAO Report generally found that mergers were associated with price increases, a more detailed look reveals those findings to be quite mixed. Specifically, the GAO Report

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[26] Moreover, a Bureau of Economics technical report presented to the panelists in preparation for the January conference showed that if GAO's merger regressions for reformulated and CARB gasoline were re-estimated by means of a methodology similar to that followed by the Bureau in its study of the Marathon-Ashland joint venture, results very different from those reached in the GAO Report would follow, with many of the GAO Report's significant merger effects disappearing. (This technical report did not re-estimate GAO's regressions for conventional gasoline.) FTC Staff Technical Report (Dec. 21, 2004), *available at* http://www.ftc.gov/ftc/workshops/oilmergers/ftcstafftechnicalreport122104.pdf.

[27] January 14, 2005 conference.

years and has maintained a policy of vigorously enforcing the antitrust laws. The remedies that the Commission has prescribed have been carefully crafted to address the competitive issue at hand. By the same token, however, the FTC does not seek relief when none is necessary and does not pursue remedies that are likely to interfere with substantial merger-related efficiencies.

We remain confident that the Commission has not "approved" too many energy transactions. FTC petroleum merger investigations – as well as nonmerger investigations such as the Midwest gasoline matter – typically involve the close scrutiny of many thousands of pages of internal company documents, numerous investigational hearings or interviews with company executives and other market participants, and a painstaking assessment of relevant quantitative data. Investigations of some transactions involve revisiting markets previously studied, which affords the Commission an in-depth historical perspective on how markets are evolving.

The question posed by the title of today's program implies that the proof of the pudding is evident ex post in the FTC's track record – in other words, that despite the Commission's best efforts ex ante, from time to time the agency has been off the mark in dealing with mergers in the petroleum industry. Although the current learning from econometric retrospectives leaves many questions unanswered, the evidence produced in each FTC oil merger investigation amply supported the agency's decision to take (or not to take) law enforcement action – as well as the remedy prescribed in each instance – and those unanswered questions do not sustain a conclusion that enforcement policy should be changed. Of course, we always welcome additional research on the relevant issues, and the FTC itself will continue to conduct research in order to test our theoretical assumptions and to refine the analytical techniques that we employ both in ex ante investigations and in ex post evaluations of energy mergers. But we have no doubt that the Commission will continue its record of aggressively enforcing the law in this industry.

Thank you, and we look forward to the rest of this morning's discussion.