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TESTIMONY OF
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BEFORE THE ANTITRUST TASK FORCE OF THE
HOUSE COMMITTEE ON THE JUDICIARY
MAY 16, 2007

I appreciate the opportunity to speak on the issue of the impact of mergers on gasoline prices

The Federal government's lax and lackluster enforcement of antitrust laws has led to an explosion of mergers in the oil industry -- more than 2,500 in the past 15 years, or more than 150 mergers and acquisitions every year -- many of them profoundly anti-competitive and anti-consumer. More and more market power is concentrated in fewer and fewer hands.

Consumers need and deserve swift Congressional action to halt oil company mergers, break up oil companies who misuse market power to engage in predatory practices against competitors and consumers and allow antitrust lawsuits against OPEC.

The record is replete with instances of oil company misuse of market power to crush competition. We need mandatory break up of oil companies that engage in predatory, anti-competitive acts. Further, antitrust law should be amended to specifically authorize lawsuits against foreign governments who engage in the same anti-competitive practices in the oil industry that are illegal for private companies under current law.

Mega-companies arising from this merger mania have aggressively used their ever-growing market clout to subject consumers to increasing prices and unnerving market volatility Big Oil has created a market on the brink, manipulating inventories and refinery capacity to the point that the slightest supply disruption sends prices -- and company profits -- skyrocketing. There is sufficient supply, but these newly created industry giants use their huge market power to keep a stranglehold on the spigot

While consumers struggle to pay record heating oil and gasoline prices, the industry is drowning in cash. Witness the staggering level of oil industry profits in the wake of a horrible natural disaster -- Hurricane Katrina: Three companies reported quarterly profits exceeding $16 billion. More recently, Exxon Mobil took advantage of refinery shutdowns to raise its refiner margins by 50%, recording $9.28 billion in profits for the quarter. Astronomical profits at the expense of American consumers have been the rule, not the exception, again and again.

Government tolerance of anti-competitive mergers and oil industry practices has enabled, even encouraged, the recent sharp rise in gasoline prices. Congress needs to take aggressive action easing sky-high gasoline prices that hit hardest people of low and moderate means, who can reduce only so much their consumption of such a vital commodity.

I strongly believe in free markets. Congress needs to restore the free market in oil products by breaking excessive market concentration that stifles competition and constricts supply.

I am here today to reiterate and reinforce with increasing urgency my plea that Congress:

(1) order an aggressive, comprehensive federal investigation, in partnership with the states to determine whether and how oil companies have misused monopolistic power -- much as federal and state antitrust enforcers combined and cooperated in the Microsoft investigation;

(2) enact a one-year moratorium on oil industry mergers;

(3) prohibit any oil company merger in a highly concentrated market unless the Federal Trade Commission (FTC) specifically finds consumers benefit from the merger;

(4) mandate breakup of any oil company that misuses market power to crush competition and increase gasoline prices;

(5) authorize antitrust lawsuits against OPEC for its monopolistic manipulation of oil supplies to raise prices;

(6) ban zone pricing and other mechanisms that prevent gasoline retailers from obtaining gasoline at the best price;

(7) expand refinery capacity and mandate minimum oil product inventory levels; and

(8) lessen our dependency on gasoline through conservation and alternative fuels.

The effect of anticompetitive oil markets on gasoline prices is well-documented.

In 2000 and again in 2002, I and other state attorneys general criticized the federal government's failure to aggressively stop harmful mergers in the oil industry. We have not been alone.

In 2002, the Senate Permanent Committee on Investigations concluded that market consolidation had concentrated too much market power in two few companies, harming consumers.

In 2004, studies by Public Citizen and others found that the gasoline market was uncompetitive, resulting in artificially high prices and unconscionable profits.

In 2004, the United States General Accounting Office (GAO) conducted an econometric study of 8 major mergers in the oil industry and concluded 6 caused higher prices for consumers.

In 2005, the Foundation for Taxpayer and Consumer Rights agreed with the GAO's conclusion and cited an industry expert who concluded that the Federal Trade Commission (FTC) has been "ineffective" and a "negotiator for the oil companies."

In 2005, the Congressional Research Service noted the highest profits in the gasoline industry occur in the refining and marketing sectors, finding that these profits were not simply the result of higher crude oil prices. Clearly, such profiteering contributes to higher prices at the pump.

In 2006, the GAO again reviewed the gasoline industry and determined that limited refinery capacity, deliberate industry reductions in inventory on hand and concentrated market power -- among other criteria -- increased gasoline prices.

In 2007, a research paper by Hayley Chouinard and Jeffrey Perloff in the B.E. Journal of Economic Analysis and Policy cited the impact of mergers on gasoline prices in various markets and cited numerous other expert analysis to conclude mergers and increased market power concentration have led to higher gasoline prices.

Rampant mergers have significantly concentrated market power at every level of the gasoline industry. For example:

- Five companies control 61% of the 175,000 gasoline stations in the nation, compared to 27% in 1991;
- The five largest companies control 50% of the refinery capacity, as opposed to 1/3 of capacity ten years ago;
- The five largest oil companies have doubled their control of oil production in the past ten years;

In its 2002 study, Senate Permanent Subcommittee on Investigations (the Subcommittee Report) found that refining and supply was highly concentrated in 9 states and moderately concentrated in 28 states. Today, these markets are even more concentrated

By 2004, the GAO concluded that lax FTC enforcement allowed mergers that dramatically increased market concentration in refining and marketing, especially on the East and West Coasts.

Connecticut, along with its sister states in the Northeast and Mid-Atlantic, have suffered most severely from this wave of mergers. According to the GAO, the Herfindahl-Hirschman Index (HHI), a renowned method of measuring market concentration for antitrust purposes, for the Northeast and Mid-Atlantic region increased by 683 points to 1819 points. At this level, economists conclude that the market is "highly concentrated."

This change did not occur in a vacuum. Rather, in 1990, the HHI for our region was 1136 points, leading economists to conclude that the refining and marketing sectors were "moderately concentrated" At this level, each and every merger should have been critically scrutinized. Many proposed acquisitions should have been flatly rejected by the FTC

Lax antitrust enforcement has real life consequences

In one example affecting Connecticut, the proposed Mobil-Exxon merger would have resulted in the top four gasoline companies controlling 73% of the retail market in half the metropolitan areas in the Northeast and Mid-Atlantic region. I strongly opposed this merger in comments to the FTC. While the FTC ordered divestiture of some assets, such divestiture did not prevent the market from becoming highly concentrated with its anti-consumer impact.

In the retail area, the merger trend has enhanced the power of industry players to use zone pricing. The FTC describes this practice as "oligopolistic." This term could easily apply to the entire industry

So too, oil company decisions to close 50 refineries and merge with competitors have led to significant market concentration in the refinery and production segments of the oil industry. The Wall Street Journal recently reported that the six largest refiners control 59% of the refining market, a 50% increase in the concentration level of that market in 12 years. The FTC has reviewed and approved refiner company mergers with conditions and divestments supposedly designed to reduce the impact of the proposed mergers Again, these conditions and divestments have failed to slow, let alone stop, the anti-competitive consequences of increasingly concentrated market power.

In its review of the California market, the Subcommittee Report found that the federal government allowed the refining market to become an oligopoly with the top four refiners owning nearly 80% of the market. Six refiners also owned 85% of the retail outlets, selling 90% of the gasoline in the state

The Subcommittee Report also found that two thirds of the gasoline supplied to Michigan comes from 4 large refiners. Three of those four refiners also combine to own two thirds of the Wolverine Pipeline, one of the key suppliers of gasoline into the state. The refiners also have substantial interests in terminals Vertical integration of this type allows a small number of firms to control the refiner sector of the oil industry and maintain critical supply and market power.

In the refining and production area, the merger trend has produced a herd mentality, with innovative, rebel companies less likely to buck the industry. Refiners and producers can reduce refining and production levels causing widespread supply shortages and higher prices, with little risk that another company will present any significant competitive threat. The Subcommittee Report found that refiners are as averse to gaining market share through aggressive pricing as they are to losing market share. The companies' pricing is designed simply to maintain market niches and market share.

In another example of market consolidation leading to anti-consumer practices, the FTC examined a gasoline price spike in several Midwestern states during 2000 and found that the three refiners of summer-grade reformulated gasoline (not jointly according to the FTC) limited refinery upgrades to comply with stricter EPA standards so as to produce only enough gasoline to supply their branded gas stations and other existing contractual obligations. Even if such decisions were made independently, the decisions clearly recognized that the other participants would not be risk increasing their summer grade production to increase market share There is clearly a problem with this market, replicated in many markets nationwide

Through increased market concentration, domestic refining capacity has diminished, even as demand has increased steadily. The predictable result has been extraordinarily tight supplies, barely meeting demand, leading to very volatile prices at the pump Inadequate inventories, disruption in delivery systems and other factors make the market even more vulnerable.

When oil is in short supply, the consumer is a sure loser, and rightly a sore loser.

1. Break up predatory oil companies

Congress should define certain predatory, anticompetitive acts that would require break-up of an oil company engaging in such conduct These acts should include threatening to take regulatory or legislative action to harm a competitor if the competitor is seeking to bring more oil or gasoline or competition into a market.

As an example, the Subcommittee Report recounted Shell's threat to seek enactment by the California legislature of a tax on imported gasoline if Texaco pursued its plan to import California CARB gasoline to relieve a shortfall in refinery output in that state This story was cited as only one example of major oil company efforts to squeeze supplies and raise prices.

In addition, predatory acts should include the deliberate and unilateral withholding of oil or gasoline supplies from a market for the sole purpose of increasing price and profits During the Midwestern price spike of 2000, one company deliberately withheld some gasoline, keeping prices and profits artificially high

Breaking up a monopolistic company is not unprecedented. AT&T was the subject of such action more than twenty years ago. More recently, Microsoft faced a potential divestment order in a federal antitrust lawsuit brought by state attorneys general

A mandatory break-up remedy would serve as a powerful deterrent to predatory practices that have stifled competition and raised consumer prices.

2. Antitrust lawsuit against OPEC

The Organization of Petroleum Exporting Countries (OPEC) -- Algeria, Angola, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, United Arab Emirates and Venezuela -- jointly decide how much oil to produce with a stated goal of keeping oil prices within a preferred price range. This policy clearly and decisively violates United States antitrust laws. Yet, private citizens and governmental agencies are powerless to bring antitrust actions because federal law has been interpreted to not apply to OPEC's actions

A federal district court, in a case brought by the Machinists union against OPEC, held that the Foreign Sovereign Immunities Act of 1976, (the "Act") 28 *USC 1330 et seq.*, prohibited lawsuits against OPEC for deliberately conspiring to limit oil production. The court found that although the Act had created an exception from immunity for governmental actions that are commercial in nature, OPEC's actions were not commercial but rather decisions involving the use of the member nations' natural resources *IAM v OPEC*, 477 F Supp. 553 (C.D. Cal 1979), aff'd 649 F 2d 1354 (9th Cir. 1981).

On appeal, the Ninth Circuit declined to extend federal court jurisdiction over the matter citing the prudential 'act of state' doctrine that states the courts will not judge the legality a sovereign act of a foreign state. *IAM v. OPEC*, 644 F 2d. 1354 (9th Cir 1981).

Both of these barriers to an antitrust lawsuit against OPEC can be addressed through legislation such as HR 2264, the No Oil Producing and Exporting Cartels Act of 2007. This legislation would hold OPEC accountable under the Sherman Antitrust Act for its concerted actions to increase the price of oil and gasoline

3. Federal/state investigation into the oil industry

The record is clear: the oil industry is not competitive, yields billions of dollars in profits while it constricts supply and drives up prices.

A joint federal-state investigation into the oil industry can determine whether some companies are using their market power to constrain competition in violation of federal and state antitrust laws. The investigation's report should also provide specific recommendations for strengthening federal and state supervision of mergers and acquisitions in the industry and, perhaps, divestment of certain acquisitions to spur competition.

This investigation should also analyze the role of the futures market in gasoline supply and price manipulation. While the major oil companies and suppliers are well-known to consumers, the futures market has a silent, stealth impact on gasoline prices. For example, a significant portion of gasoline wholesale supply in Connecticut is owned by private investors or investment houses. The investigation should determine whether investor-focused decisions exacerbate supply shortages or price spikes.

4. Moratorium on oil industry mergers

I urge Congress to enact a one year moratorium on any merger or acquisition of an oil industry company -- including cross-sector mergers and acquisition -- while Congress, FTC and the states work together to investigate this industry and improve current consumer protection statutes

5. Oil company mergers in highly concentrated markets

New federal law should create a presumption that any merger in the oil industry in a moderately or highly concentrated market -- as defined by the HHI -- violates antitrust law unless the Federal Trade Commission finds clear and convincing evidence that consumers will benefit, and that tangible, specific steps will be taken to assure consumers see lower prices and better services

The FTC should take a tough approach to both horizontal as well as vertical integration mergers, recognizing that some mergers may tighten market control downstream. Mergers should also be critically examined to ensure that the merged company cannot pose significant barriers to entry by independents

6. Prohibit zone pricing

Heightened scrutiny of oil industry mergers will take time to bring relief to consumers through increased competition but some immediate steps may be available. One immediate step could bring some reduction in gasoline prices: banning zone pricing and refiner and distributor control of gasoline sales to retailers

Zone pricing is used in almost every state: the major oil companies create artificial geographic areas and charge dealers different gasoline prices in each zone. Mobil has 46 zones in a small state like Connecticut.

The power of the major oil companies to charge inflated, excessive, arbitrary prices derives from gasoline dealer franchise agreements requiring gasoline dealers to purchase products from a single supplier As a result of such sole source provisions, gasoline dealers are powerless to seek or shop for a cheaper supply.

Zone pricing is invisible and insidious. It distorts the free market It is possible only because of restrictive contracts that include sole source provisions It benefits only the oil industry, to the detriment of consumers Perhaps the industry's own consultant, MPSI, states it best in its promotional brochures quoted in the Subcommittee Report: "To **maximize profits**, you need to establish a large number of price zones... **You will be able to charge more** in areas that can support higher prices...."

I urge this committee to consider legislation to specifically ban the practice of zone pricing either as a separate law, an amendment to the antitrust price discrimination statute (Robinson-Patman Act) or an amendment to the Petroleum Marketing Practices Act The committee should consider the following language:

"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."

Congress should also consider an amendment to the Petroleum Marketing Practices Act (PMPA), 15 U.S.C. 2801, et seq., prohibiting major oil companies from dictating the source of supply of the brand name gasoline.

The PMPA was enacted in 1978 to provide national standards for gasoline franchise agreements regarding the termination and nonrenewal of such franchise agreements

Unfortunately, while Congress, in approving the PMPA, recognized that gasoline dealers are in a weak bargaining position with the major oil companies over terms of the franchise agreement, the PMPA does not provide specific protection against unfairly burdensome franchise provisions foisted upon gasoline dealers by the major oil companies.

The power to impose zone pricing is solely based on the power of the major oil companies to control purchases by the gasoline dealers If the wholesale supply of gasoline were truly competitive, and a Mobil gasoline dealer could purchase Mobil gasoline from any Mobil gasoline wholesaler, the major oil companies could not dictate the price of wholesale gasoline based on location. The dealer could simply choose another vendor of the same brand of gasoline at a more competitive price

Thus, the PMPA could be amended to prohibit the anti-competitive provisions in gasoline dealer franchise agreements that dictate the wholesale source of gasoline I suggest that the committee consider the following language: "No franchise, as defined in subdivision (1) of 15 USC 2801, shall limit the source of acquisition of gasoline by a retail distributor except that the franchisor may require that such gasoline is the same brand as the franchisor."

<u>7. Expand refinery capacity/enact minimum inventory levels</u>

Recent dramatic spikes in gasoline and heating oil have been due in large part to industry decisions that result in reduced inventory. This industry practice may lead to shortfall if something unexpected occurs such as sudden drop in temperatures or a refinery fire.

The Energy Information Administration has recognized the clear connection between price volatility and refiner inventory practices, finding that wholesale gasoline prices are bid up by more than the underlying cost increases when inventories are low. The Subcommittee Report also provides excellent examples of how industry profits from low inventories.

Present inventory practices increase profits while subjecting consumers to wide swings in gasoline prices and preventing quick industry adjustments to unexpected supply shortages or increased demand.

In the 1980's, refiner capacity averaged 77.6% which allowed for easy increases in production to address shortages. In the 1990's, as the industry closed refineries and adopted just-in-time inventory practices, refinery capacity rose to 91.4%, leaving little room for expansion to cover supply shortfalls.

These practices hardly inured to the benefit of consumers as refinery profits soared during the 1990's. During the 1980's, refiner margins averaged approximately 19 cents per gallon. In the 1990's the average refiner margin rose 23% to 23.4 cents per gallon. Mergers, refinery shut-downs and inventory practices resulted in an increased bottom line for oil companies and price volatility and uncertain supplies for consumers.

I urge Congress to carefully review these inventory practices and refinery closings and take steps that encourage or mandate increased inventory and refinery capacity. Although returning competition to these markets would result in additional inventory and less price volatility, the current market requires some form of governmental oversight. Congress should consider ways to encourage competitors to expand into the refinery and distribution, lowering barriers to entry into the market.

8. Windfall profits tax to fund conservation

In addition to making the oil industry more competitive and pro-consumer, Congress should aggressively pursue policies designed to lessen American consumer exposure to decisions made by members of OPEC and other foreign producers of oil.

A windfall profits tax on oil company earnings could produce billions of dollars directed toward significant conservation measures. In Connecticut, our Energy Conservation and Load Management Fund has saved millions of kilowatts of electricity through targeted investments in conservation measures. Similarly, oil company profits should be used to reduce our dependence on oil.

We are becoming more, not less, dependent on oil. Consumption rose 2.6% last year, with additional increases predicted for the foreseeable future. Many solutions to this dependence also will result in cleaner air. We should pursue these goals with more vigor than ever.

First, mass transportation should be encouraged. Safe, clean and convenient mass transportation would be used by many citizens.

Second, cars need to be more fuel-efficient. Congress needs to continue pressuring automobile manufacturers to increase the average miles per gallon of their fleets. In the 1970's, automobile manufacturers complained that they couldn't make their 12 mile-per-gallon vehicles more efficient. Today, cars average 27 miles per gallon. Increasing that average to 45 miles per gallon would save 237 billion gallons of gasoline over a 5 years

Finally, we must increase our commitment of resources to develop alternative fuels and energy efficient technologies, such as fuel cells.