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**Testimony of Tyson Slocum, Research Director
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Regulatory Affairs of the U.S. House of Representatives' Committee on
Government Reform**

“Easing Pain at the Gasoline Pump: Finding Solutions for Western Woes”

Thank you, Mr. Chairman and members of the House Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs for the opportunity to testify on the issue of gasoline prices. My name is Tyson Slocum and I am Research Director of Public Citizen's Energy Program. Public Citizen is a 30-year old public interest organization with over 160,000 members nationwide. We represent consumer interests through research, public education and grassroots organizing.

We were the first national consumer group to show that the California electricity crisis of 2000-01 was the fault of market manipulation by a handful of companies, and that state and federal environmental regulations had nothing to do with the crisis.

More recently, we released *Mergers, Manipulation and Mirages: How Oil Companies Keep Gasoline Prices High, and Why the Energy Bill Doesn't Help* which documents, among other things, how recent mergers in the domestic oil refining industry have consolidated control over gasoline, making it easier for a handful of companies to price-gouge consumers. This price-gouging has not only been officially documented, but it is also evident in the record profits enjoyed by large oil companies. Since 2001, the five largest oil companies operating in America have recorded \$125 billion in after-tax profits. It is uncompetitive practices—not OPEC or environmental laws—that are to blame for high gasoline prices.

Congress can remedy this price-gouging by taking two broad actions. First would limit the financial incentives oil companies have to keep gasoline supplies artificially tight by mandating minimum storage of gasoline, reevaluating recent mergers, investigating anti-competitive practices, and re-regulating oil trading. Second would be to increase domestic oil supplies by improving fuel economy standards and to temporarily cease filling the Strategic Petroleum Reserve.

Gas prices in the Western U.S. are currently more than 10% higher than the national average. Consumers are paying more in the west than elsewhere because oil companies are exploiting the inelastic supply created by RFG blends to engage in anti-competitive behavior. Is the solution, then, to rid the market of the clean-burning fuel requirements, or to rid the market of manipulation practices? Public Citizen believes that we must begin by doing all we can to hold oil companies accountable and stop them from engaging in anti-competitive behavior.

Recent Mergers Create Uncompetitive Markets

Over the past few years, mergers between giant oil companies—Exxon and Mobil, Chevron and Texaco, Conoco and Phillips, just to name a few—have resulted in just a few companies controlling a significant amount of America's gasoline, squelching competition. A number of independent refineries have been closed, some due to uncompetitive actions by larger oil companies, further restricting capacity. As a result, consumers are paying more at the pump *than they would if they had access to competitive markets* and five oil companies are reaping some of the largest profits in history.

Although the U.S. is the third largest oil producing nation in the world, we consume 25% of the world's oil every day, forcing us to import oil. Domestic sources of oil (nearly 30% of our domestic oil is produced in Alaska and California, and three-quarters of our domestic oil comes from Alaska, California, Texas and the Gulf of Mexico) provide 37% of our daily crude oil needs. Middle Eastern OPEC nations supply only 15% of our total crude oil needs, and non-OPEC nations—such as Canada, Mexico, Norway and England—provide 34% of our daily oil.

All of the large oil companies, such as ExxonMobil and ChevronTexaco, have financial dealings with Middle East OPEC nations. ExxonMobil obtains more than a quarter of its oil from Middle East OPEC nations; ChevronTexaco more than 40%.

While our reliance on imported oil overall has increased, from 43% in 1989 to 63% in 2003, the consolidation of downstream assets—particularly refineries—play a bigger role in determining the price of a gallon of gas. Recent mergers joined vertically integrated companies owning significant market shares of exploration, production, refining, and marketing of oil and gas. As a result, just five companies now control 48% of domestic crude oil production, 50.3% of domestic refining capacity, and 61.8% of the domestic retail gasoline market. These mega-companies are major international producers, controlling 14.2% of global oil production.

In 1993, the five largest oil companies operating in the U.S. controlled one third (34.5%) of domestic oil refinery capacity; the top ten companies controlled 55.6%.

In just ten years, because of mergers, the largest five oil companies now control half (50.3%) of domestic oil refinery capacity, while the top ten control 78.5%. This dramatic increase in the control of just the top five companies—from one third of capacity in 1993 to one half of

capacity in 2003—makes it easier for oil companies to manipulate gasoline by intentionally withholding supplies in order to drive up prices. Because the largest companies are vertically integrated, in addition to their control over refining capacity, they enjoy significant market share in oil drilling and retail sales.

The proof is in the numbers. The domestic gasoline spread—the price of a gallon of gas, minus the cost of crude oil and taxes—has increased by 30% from the mid-1990s to 2004. The domestic spread measures the share of a gallon of gas charged by refiners and marketers. In the mid-to late-1990s, the domestic spread averaged 39 cents per gallon. But during the post-merger period from 2000-04, the average domestic spread has been 51 cents. This translates to an increase in U.S. gasoline prices of \$55 billion, the amount by which U.S. consumers have been price-gouged. It is no coincidence that oil corporation profits—including refining—are enjoying record highs.

Consumer advocates like Public Citizen aren't the only ones saying this. In March 2001, the U.S. Federal Trade Commission concluded in its *Midwest Gasoline Price Investigation*:

*The completed [FTC] investigation uncovered no evidence of collusion or any other antitrust violation. In fact, the varying responses of industry participants to the [gasoline] price spike suggests that the firms were engaged in individual, not coordinated, conduct. Prices rose both because of factors beyond the industry's immediate control and because of conscious (but independent) choices by industry participants...each industry participant acted unilaterally and followed individual profit-maximization strategies...It is not the purpose of this report - with the benefit of hindsight - to criticize the choices made by the industry participants. Nonetheless, a significant part of the supply reduction was caused by the investment decisions of three firms...One firm increased its summer-grade RFG [reformulated gasoline] production substantially and, as a result, had excess supplies of RFG available and had additional capacity to produce more RFG at the time of the price spike. This firm did sell off some inventoried RFG, but it limited its response because selling extra supply would have pushed down prices and thereby reduced the profitability of its existing RFG sales. **An executive of this 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.***

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. Since the report's release, two additional mergers, ChevronTexaco and ConocoPhillips, have been approved.

Requiring oil companies to increase the size of their storage capacities, mandating them to hold significant amounts of product in that storage, and reserving the right to order these companies to release this stored oil and gas would significantly limit the ability of oil companies to intentionally withhold gasoline to raise prices.

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-

2002, 97% of the more than 920,000 barrels of oil per day of capacity that has been shut down were owned by smaller, independent refiners. Were this capacity to be in operation today, refiners could use it to better meet today's reformulated gasoline blend needs.

In California, independently-owned refinery capacity of 100,000 barrels of oil per day has been shut down since 1995, even though they were relatively new. The Coastal Corporation's 50,000 barrels of oil per day Pacific refinery 25 miles north of San Francisco was shut down in 1997, despite the fact it was only 29 years old. Castle Energy's 46,500 barrels of oil per day Powerine refinery 12 miles southeast of Los Angeles was shut down in 1995, although it was less than a decade old. Castle Energy's CEO at the time, Joseph Sparano, told *The San Francisco Examiner* in June 1995 that "operating as a small, independent refinery in California has been very difficult because of the competition and poor refining economics."

An internal Mobil document helps explain why independent refineries like Powerine had such a tough time. The Mobil document highlights the connection between an independent refiner producing CARB (cleaner burning California Air Resources Board) gasoline, the lower price of gasoline that would result from the refinery being in operation, and the need to prevent the independent refiner from operating:

If Powerine re-starts and gets the small refiner exemption, I believe the CARB market premium will be impacted. Could be as much as 2-3 cpg (cents per gallon)... The re-start of Powerine, which results in 20-25 TBD (thousand barrels per day) of gasoline supply... could... effectively set the CARB premium a couple of cpg lower... Needless to say, we would all like to see Powerine stay down. Full court press is warranted in this case.

As a result of uncompetitive practices, made easier by the wave of mergers, three-quarters of the refinery capacity in California-Arizona-Nevada is controlled by the five largest oil companies operating in the United States (ExxonMobil, ChevronTexaco, ConocoPhillips, BP and Shell). When the 20% share controlled by the large independents Valero and Tesoro is included, only seven percent of the refinery capacity is owned by "true" independent, smaller refineries.

Precedent exists for oil companies manipulating energy supplies in order to price-gouge consumers. In July 2003, a subsidiary of oil giant BP agreed to pay \$3 million to settle allegations brought by the Federal Energy Regulatory Commission that the company "manipulated electricity prices" in California. In March 2004, a subsidiary of Royal Dutch/Shell agreed to a preliminary payment of \$7.8 million to FERC to settle allegations the company manipulated supplies and prices of power in California.

FTC Not Adequately Protecting Consumers

At the same time that the FTC concludes that refining markets are uncompetitive, the agency consistently allows refining capacity to be controlled by fewer hands, allowing companies to keep most of their refining assets when they merge, as a recent overview of FTC-approved mergers demonstrates.

The major condition demanded by the FTC for approval of the August 2002 ConocoPhillips merger was that the company had to sell two of its refineries—representing less than 4% of its domestic refining capacity. Phillips was required only to sell a Utah refinery, and Conoco had to sell a Colorado refinery. But even with this forced sale, ConocoPhillips remains by far the largest domestic refiner, controlling refineries with capacity exceeding 2.2 million barrels of oil per day—or more than 13% of America's entire capacity.

The major condition the FTC set when approving the October 2001 ChevronTexaco merger was that Texaco had to sell its shares in two of its joint refining and marketing enterprises (Equilon and Motiva). Prior to the merger, Texaco had a 44% stake in Equilon, with Shell owning the rest; Texaco owned 31% of Motiva, with the national oil company of Saudi Arabia (Saudi Aramco) also owning 31%, and Royal Dutch Shell owning the remaining 38%. The FTC allowed Shell to purchase 100% of Equilon, and Shell and Saudi Aramco bought out Texaco's share of Motiva, leaving Motiva a 50-50 venture between Shell and Saudi Aramco.

Prior to the merger, Texaco's share of Equilon and Motiva refinery capacity equaled more than 500,000 barrels of oil per day—which was simply scooped up by another member of the elite top five companies, Shell. Had the FTC forced Texaco to sell its share to a smaller, independent company, the stranglehold by the nation's largest oil companies could have been weakened.

As a condition of the 1999 merger creating ExxonMobil, Exxon had to sell some of its gas retail stations in the Northeast U.S. and a single oil refinery in California. Valero Energy, the nation's fifth largest owner of oil refineries, purchased these assets. So, just as with the ChevronTexaco merger, the inadequacy of the forced divestiture mandated by the FTC was compounded by the fact that the assets were simply transferred to another large oil company, ensuring that the consolidation of the largest companies remained high.

The sale of the Golden Eagle refinery was ordered by the FTC as a condition of Valero's purchase of Ultramar Diamond Shamrock in 2001. Just as with ExxonMobil and ChevronTexaco, Valero sold the refinery, along with 70 retail gas stations, to another large company, Tesoro. But while the FTC forced Valero to sell one of its four California refineries, the agency allowed the company to purchase Orion Refining's only refinery in July 2003. This acquisition of Orion's Louisiana refinery defeats the original intent of the FTC's order for Valero to divest one of its California refineries.

Over-the-Counter Energy Disclosure is Underegulated

Contracts representing hundreds of millions of barrels of oil are traded every day on the London and New York trading exchanges. An increasing share of this trading, however, has been moving off regulated exchanges such as the New York Mercantile Exchange (NYMEX) and into unregulated Over-the-Counter (OTC) exchanges. Traders operating on exchanges like NYMEX are required to disclose significant detail of their trades to federal regulators. But traders in OTC exchanges are not required to disclose such information

allowing companies like Enron, ExxonMobil, and Goldman Sachs to escape federal oversight and more easily engage in manipulation strategies.

A recent congressional investigation concluded that “crude oil prices are affected by trading not only on regulated exchanges like the NYMEX, but also on unregulated OTC markets that have become major trading centers for energy contracts and derivatives. The lack of information on prices and large positions in OTC markets makes it difficult in many instances, if not impossible in practice, to determine whether traders have manipulated crude oil prices.”

Public Citizen has supported efforts to re-regulate energy trading by subjecting OTC markets to tougher oversight. But the latest such effort, an amendment to the energy bill, was rejected by the Senate by a vote of 55-44 in June 2003.

Raise Fuel Economy Standards to Lower Our Oil Consumption

Due to increasing numbers of gas-guzzling SUVs on America's roads and the absence of meaningful increases in government-set fuel economy standards, America's fuel economy standards are lower today than a decade ago.

In April, the Environmental Protection Agency found that the average fuel economy of 2004 vehicles is 20.8 miles per gallon (mpg), compared to 22.1 mpg in 1987—a six percent decline. This decline is attributable to the fact that fuel economy standards haven't been meaningfully increased since the 1980s. And sales of fuel inefficient SUVs and pickups have exploded: in 1987, 28% of new vehicles sold were light trucks, compared to 48% in 2004.

Billions of gallons of oil could be saved if significant fuel economy increases were mandated. Improving fuel economy standards for passenger vehicles from 27.5 to 40 mpg, and for light trucks (including SUVs and vans) from 20.7 to 27.5 mpg by 2015 would reduce our gasoline consumption by one-third.

Dramatic reductions in consumption will not only reduce strain on America's refinery output, but also on Americans' pocketbooks. Comparing two Americans with identical driving habits, one driving an SUV and one a regular passenger car, reveals that the person driving the passenger car saves \$510 a year due to the superior fuel economy of passenger cars compared to light trucks.

Increase Domestic Supply Through Proper Management of the Strategic Petroleum Reserve

The purpose of the SPR is to “store petroleum to reduce the adverse economic impact of a major petroleum supply interruption to the United States.” Federal law further states that

the reserves can be tapped if the “President has found drawdown and sale are required by a severe energy supply interruption.” A “severe energy supply interruption shall be deemed to exist if the President determines that an emergency situation exists and there is a significant reduction in supply which is of significant scope and duration; a severe increase in the price of petroleum products has resulted from such emergency situation; and such price increase is likely to cause a major adverse impact on the national economy.” Previous presidents, such as Bill Clinton, have interpreted domestic price spikes like the ones the U.S. is now experiencing as satisfying the criteria to release reserves. In September 2000, President Clinton authorized the release of 30 million barrels of oil, which resulted in gasoline prices dropping 10% in six months.

At the same time that industry consolidation is limiting competition in the domestic production and refining sectors, the Bush administration has exacerbated domestic supply shortages through its mismanagement of the SPR. After September 11, 2001, the administration set a priority of filling the 700 million SPR to capacity. While the goal is laudable, the administration has aggressively purchased oil from the market for delivery into the SPR regardless of the market price. To reach the goal, President Bush has been removing more than 100,000 barrels of oil every day from the domestic market, increasing the amount stored from 541 million barrels at the end of Clinton's term (77% capacity) to 650 million barrels today (more than 92% capacity). While previous administrations have typically filled the SPR only at times when oil prices were low and domestic supplies in surplus, President Bush has been filling it at times when prices are above \$30/barrel and domestic supplies are tight. Moving so much oil out of an expensive, tight market has made oil even more expensive here at home—a boon for oil company profits but a bust for consumers. As a result, Bush's policy is actually undermining the goals of the SPR.

If all Middle Eastern members of OPEC were to cease exports to the U.S., we could rely on the SPR, at current levels, to supply enough oil to the U.S. market for nearly 300 days. This is more than enough of a buffer to protect national security in the event of an oil embargo by nations most likely to carry out such an action.

Public Citizen agrees with Texas Republican Joe Barton, chairman of the House Energy and Commerce Committee, who earlier this month supported our position that President Bush should cease filling the SPR.

When the Senate passed a non-binding resolution by a vote of 52-43 buried as an amendment to unrelated legislation on March 11, 2004, mandating that President Bush merely stop filling the SPR, Wall Street speculators immediately drove down the price of crude oil 1.6%.

Federal Energy Bill Does Nothing to Address Overconcentration or Conservation

Contrary to recent statements by congressional leaders and Executive Branch officials, the stalled energy bill will do nothing to reduce high prices of gasoline because it fails to either improve regulations of an oil industry that is over-concentrated or rein in demand by

adopting tougher fuel economy standards. Instead, the legislation proposes just what the industry wants—giving billions of the taxpayers' dollars to large oil companies in the form of subsidies and tax breaks with no real conservation requirement.

The Bush administration's own analysis (*Summary Impacts of Modeled Provisions of the 2003 Conference Energy Bill*) concludes that the legislation's billions of dollars in incentives will have only a negligible success reducing our reliance on foreign sources of oil. The Bush administration report concludes that implementation of the energy bill would reduce net petroleum imports only by 100,000 barrels of oil per day by 2010—a reduction equal to the amount of oil the Bush Administration removes from the market each day to place in the SPR.

Further, the energy bill would actually lead to increased concentration in the U.S. energy industry by repealing the Public Utility Holding Company Act (PUHCA). PUHCA prevents large, non-utility companies from controlling utilities without first divesting their nonutility businesses. If PUHCA is repealed, oil companies could also acquire electric and natural gas utilities, further consolidating economic control over the domestic energy industry.

Conclusion

The most effective way to protect consumers is to restore competitive markets is for Congress to adopt the following five proposals:

- Require oil companies to increase the size of their storage capacities, mandate them to hold significant amounts of product in that storage, and reserve the right to order these companies to release this stored oil and gas in order to address supply and demand fluctuations.
- Document how recent mergers have made it easier for large oil companies to engage in uncompetitive practices, and take concrete steps—including forced divestiture of assets to independent companies - to remedy the problem of too few companies controlling too much of the market.
- Restore transparency to energy futures markets by re-regulating Over-the-Counter exchanges.
- Cease filling the SPR until oil prices fall below \$30 per barrel.
- Reduce America's oil consumption by improving fuel economy standards.