S. HRG. 107–1022

WEST COAST GASOLINE PRICES

HEARING

BEFORE THE

SUBCOMMITTEE ON CONSUMER AFFAIRS,
FOREIGN COMMERCE AND TOURISM

OF THE

COMMITTEE ON COMMERCE,
SCIENCE, AND TRANSPORTATION
UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

APRIL 25, 2001

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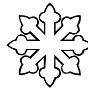

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ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

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WEST COAST GASOLINE PRICES

WEDNESDAY, APRIL 25, 2001

U.S. SENATE,
SUBCOMMITTEE ON CONSUMER AFFAIRS,
FOREIGN COMMERCE AND TOURISM,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:36 p.m., in room SR–253, Russell Senate Office Building, Hon. Gordon Smith, presiding.

OPENING STATEMENT OF HON. GORDON SMITH, U.S. SENATOR FROM OREGON

Senator SMITH. Welcome, Senator Murkowski. You are first in the dock and we thank you, sir, for coming.

Good afternoon, ladies and gentlemen. I have convened this hearing of the Senate Subcommittee on Consumer Affairs, Foreign Commerce, and Tourism to investigate high gasoline prices on the West Coast. I want to thank our Chairman, Senator McCain, who is present at this hearing, also Senator Fitzgerald, who is the Chairman of this Subcommittee, for allowing us this hearing today.

I want to extend also a warm welcome to Chuck Mau from Portland, Oregon, who will be testifying on our third panel.

Finally, I want to thank Senator Murkowski for being here to testify as well.

In the last 2 years, the impacts of high gas prices have been felt by most every American. This week the national average for gas prices jumped nearly 13 cents per gallon, or 8.4 cents, and the West Coast continues to pay more than any other region in the United States.

For the constituents I represent, Oregonians all, the sting of high gasoline prices is particularly blistering. For those with limited means or those who drive long distances for their livelihoods, even a small increase in gas prices can be disastrous. My constituents have already been slapped once on the cheek with inflated electricity prices and are now being asked to turn another cheek for record high gas prices.

It is important to remember that there are a number of factors affecting consumer fuel prices, particularly on the West Coast. I believe that all of our witnesses today will converge upon this point. The cost of delivering gasoline in the West Coast, the lack of crude refining capacity, and the specialized fuel requirements for California make the entire West Coast region susceptible to supply disruption and severe price spikes.

Yesterday's refinery fire in California reminds us how fragile our infrastructure is and may reverberate into this summer's gas prices, yet to be announced. They are already projected to be higher than they have ever been before.

There are also State-specific factors that affect gas prices. In California, which currently faces the highest gas prices in our Nation, the cost of refining clean-burning fuel has driven up costs to consumers. In my State of Oregon, several inherent factors affect prices. In response to my request to an investigation, the General Accounting Office identified these factors: there are no refineries in Oregon, the cost of getting fuel to rural areas is high, and Oregon State taxes at 24 cents a gallon are some of the highest in the country.

But this hearing is not just about Oregon. Our goal here today is to shed some light on a difficult problem that affects everyone in Oregon and elsewhere. As we have seen in other energy and fuel issues, there is no silver bullet. Just as electricity does not come from a flicking a light switch, gasoline does not come from a filling station. It must be drilled for and then shipped and piped thousands of miles, refined to meet our environmental standards, and distributed to customers in cities and in rural locations as well.

I also want to note that this cannot be a partisan matter. I am glad to be here today with my colleague Ron Wyden. We are united in this effort to find out the truth.

Ron and I have worked hard to bring together clarity and balance to this issue on behalf of Oregonians and we hope for the broader constituency of the American people.

Having said these things, I want to make it very clear the seriousness of the charge that brings us to this hearing this day. I would say to all the public in all our constituencies, this above-the-fold headline in our largest paper in Oregon, *The Oregonian*: "Experts: BP Rigged Prices," and today apparently a memo detailing this. My constituents are prepared to pay the prices that are legitimate costs, but they are not willing to pay the price of market manipulation. That is the charge. There is no conviction, but we are due some answers.

Senator Wyden.

Senator WYDEN. Thank you, Mr. Chairman.

I note the Chairman of the Full Committee is here. He has been very gracious in terms of letting us have this hearing and I am sure his schedule is short. Mr. Chairman, if you would rather go ahead and I will go after you.

STATEMENT OF HON. JOHN McCAIN, U.S. SENATOR FROM ARIZONA

Chairman MCCAIN. I want to thank Senator Smith and Senator Wyden for being involved in this issue. This hearing is important. I also want to applaud them for being two of the most valued Members of our Committee.

This hearing is about the reasons why West Coast gasoline prices are higher than in any other part of the country. I think Americans around the country have been watching with dismay as the signs posting prices at their corner gas stations are changed daily and changed upwards. It has been reported that gasoline prices in the

U.S., not adjusted for inflation, have risen more in the past 2 weeks than in any other 2-week period in the past 50 years, meaning that this is an incredibly appropriate time for this hearing.

The real hikes may be yet to come. Energy industry analysts and some of the witnesses who will appear today say that prices could go higher as we head into the summer months. Combine this with the news yesterday that one oil company's profits are up 44 percent over last year, and analysts being reported as saying that the company's biggest problem will be what to do with all the cash flowing into its coffers, and you have some perplexed drivers with lots of questions they want answered.

While there may be no relationship between the high worldwide oil company profits and skyrocketing gasoline prices in the U.S., I would like to know more about the profitability of the refining sector. I understand the witnesses here today all agree that we have a major capacity problem in our refining sector and that this problem is going to get worse as U.S. demand for gas and oil products increases.

Does the lack of refining capacity mean that every time there is a refinery outage prices skyrocket along with oil company profits? I hope this topic is covered at this hearing as it has implications not just for the West Coast, but for the entire country.

I also hope that our distinguished Chairman will examine whether the balkanization of gasoline, with States adopting their own peculiar gasoline reformulations for laudable environmental purposes, is contributing to higher prices because we no longer have a common product that can be shipped for use to combat shortages.

Again, I am very pleased Senator Smith and Senator Wyden are holding this hearing. I hope the information today helps to answer questions on people's minds throughout the country, not just those on the West Coast. I thank my colleagues.

Senator SMITH. Senator Wyden.

STATEMENT OF HON. RON WYDEN, U.S. SENATOR FROM OREGON

Senator WYDEN. Thank you, Mr. Chairman.

Before Chairman McCain leaves, I do want to express my appreciation to him for giving us a chance to work together on a bipartisan basis with the Committee and the staff. This hearing could not go forward without your leadership, Mr. Chairman and I appreciate it.

I also want to begin by thanking my friend and colleague from Oregon, Senator Smith. He and I have worked together on a whole host of issues that have been important, but especially on this one today. I am very grateful. We have teamed up consistently on this issue and I just want the record to show that I am particularly grateful for your willingness to join me in the effort to try to get access to those 1400 boxes of records involved in the BP-ARCO acquisition case that experts have stated contain numerous smoking gun documents showing how consumers in western States are being gouged.

Mr. Chairman and colleagues, there is substantial evidence that the juices of competition are being sucked out of West Coast gasoline markets and that it is no accident that Oregonians have lost

more than 600 gas stations, typically pay gas prices far higher than the national average, and have 70 percent of our gas distributed by four oil companies. The evidence indicates that communities up and down the West Coast are being red-lined by the major oil companies. Red-lining is about as anti-free enterprise as it gets. With red-lining, oil companies restrict who independent gas wholesalers can sell to, and red-lining breaks down the marketplace forces that are so critical because it denies choice to whole segments of communities on the West Coast.

There is evidence that communities up and down the West Coast are being victimized by zone pricing. With this form of discriminatory pricing, one oil company sells the same gas to its own brand service stations at different prices. The cost of the gas to the company is the same, but the price the stations pay is not. Eventually the station that pays the higher price cannot remain competitive and yet another community in the West has monopoly pricing.

Recently, as Chairman Smith has noted, *The Oregonian* newspaper published a story documenting secret oil company records revealing that BP-Amoco exported Alaskan North Slope crude oil to keep West Coast prices higher. These documents show that BP exported oil to Asia at a lower price than what it sold the same oil for on the West Coast as a part of a strategy to make even higher profits on the West Coast sales.

Since the newspaper story that Chairman Smith has highlighted, I have obtained documentation that before BP bought ARCO, ARCO exported gasoline—that is refined oil—out of the West Coast market in order to drive up West Coast prices. In fact, this documentation shows that ARCO had a business strategy to "export to keep the market tight." Chairman Smith, I would ask unanimous consent that this document be made a part of the record.

Senator SMITH. Without objection.

[The material referred to follows:]

HIGHLY CONFIDENTIAL

APC WILL ALSO NEED TO BE AN AGGRESSIVE MARKET PLAYER AT THE MICRO-MARKET LEVEL

- Focus barrels in strategic micro-markets
  - Retail
  - Commercial
- Manage local supply/demand balance on an integrated basis to maximize APC profitability
  - Channel selection
  - Price/volume trade-offs for region
  - Optimal product slate to fit strategic market view
- Create/capture opportunities across markets
  - Move product between markets to capture or maintain uplift
  - Move product between refineries to manufacture uplift
- Exchange and trade selectively to preserve market discipline

ARC 000014116

ARCO PRODUCTS COMPANY — BOOZ·ALLEN & HAMILTON INC.

Senator WYDEN. Mr. Chairman and colleagues, this ARCO document cannot be shrugged off as inconsequential. It was prepared for the senior management of the company as a snapshot picture of what ARCO's business strategy was at that time. The president of ARCO Products Company described it as a "study of our manufacturing and wholesale marketing efforts of the purpose of looking at strategies that were in place." Now, this ARCO document is relevant because recently BP has made the argument that they are no longer exporting and have no plans to resume such exports. BP argues that any oil they produce in Alaska is less than what the company needs to supply its West Coast refineries and therefore they have no interest in exporting.

I believe that the new ARCO document knocks the legs out from under BP by revealing that ARCO was exporting under circumstances exactly like BP is in now. ARCO then owned and BP now owns the very same refineries and both companies produce less Alaskan oil than needed to supply those refineries.

What is troubling with this evidence is that BP exported oil when they could have sold it for more on the West Coast and ARCO exported gas to tighten the West Coast market and consumers ended up virtually defenseless in the West.

Here is my bottom line concern. Despite the evidence that Chairman Smith has highlighted, despite the further documentation from ARCO's files, our government now simply has to take BP-ARCO's word that they are going to act in the public interest in the future. This is hard to do, given the fact that BP-ARCO lawyers have pulled out all the stops to conceal more than 1400 boxes of records involved in the BP-ARCO acquisition case that several experts have stated contain numerous smoking gun documents showing how consumers in western States are getting gouged.

I would like to conclude by referring to one other newly obtained document which raises additional questions about the nature of competition among oil companies on the West Coast.

ARCO Products Company in 1996 stated that it was their plan to "exchange and trade gasoline selectively to preserve market discipline." The significance of this document is that it raises serious questions about whether ARCO was competing against or cooperating with the other major West Coast oil companies.

Chairman Smith, I would ask unanimous consent that this document be included in the record as well.

Senator SMITH. Without objection.

[The material referred to follows:]

HIGHLY CONFIDENTIAL

GOING FORWARD, PRODUCT SUPPLY HAS A ROLE TO PLAY IN MONITORING AND MAINTAINING BALANCE IN THE WEST COAST

MONITOR SUPPLY / DEMAND	TRACK COMPETITOR ACTIVITY / BEHAVIOR	TAKE ACTION
• Track pricing trends and movements • Understand competitors market position (i.e., who is long / short in specific products) and strategies • Forecast changes in market supply and demand	• Monitor export activity • Understand trading behavior	• Export to keep the market tight • Execute appropriate spot sales if APC is long in tight market

ARC 000014120

ARCO PRODUCTS COMPANY BOOZ·ALLEN & HAMILTON INC.

Senator WYDEN. The question therefore is whether the West Coast is being victimized and by what amounts to a West Coast-wide system where a handful of companies pretend to compete while quietly making certain that they profit at the consumer's expense. It is going to be important for the Subcommittee to examine this issue and I am happy that we have this opportunity.

This Subcommittee's hearing is important because it gives us a chance to examine key anti-competitive practices that are distorting West Coast gas markets. But more needs to be done, and it is especially important to West Coast consumers that the cloak of secrecy shrouding the BP-ARCO case be lifted so that all the evidence can be examined. This Subcommittee has the power to exam-

ine the documents now sealed in Federal court in San Francisco and I believe that this action is critical to Congress learning why West Coast gas prices are so high.

Mr. Chairman, I want to wrap up by joining you in welcoming Chuck Mau from our home State to this hearing, and also take note of the fact that Senator Boxer has had a great interest in this issue over a number of years and has worked closely with the western delegation on a bipartisan basis as well.

Senator SMITH. Thank you, Senator Wyden.

Senator Boxer, do you have a statement?

STATEMENT OF HON. BARBARA BOXER, U.S. SENATOR FROM CALIFORNIA

Senator BOXER. Yes, Mr. Chairman, I do. First I want to commend you, Senator Smith, and you, Senator Wyden, for your work here. I have to say we started working on this together a long time ago.

What I would like to do is ask unanimous consent to place into the record all the various things that my office has been involved in since 1996 on this issue.

Senator SMITH. Without objection.

[The material referred to follows:]

SENATOR BARBARA BOXER'S RECORD ON HIGH GASOLINE PRICES AND MERGERS BY OIL COMPANIES

- In Spring 1996, I wrote to then-Energy Secretary Hazel O'Leary asking her to investigate possible price gouging in California.
- In June 1997, I wrote to FTC Chairman Robert Pitofsky, asking him to block the proposed joint venture between Shell and Texaco. The FTC agreed with my concerns and required the divestment of gas stations in the San Diego area before allowing the joint venture to proceed.
- In August 1997, I wrote to then-Energy Secretary Federico Peña and then-Attorney General Reno to take the necessary steps to ensure fair gasoline prices for California drivers.
- I opposed the Shell Oil and Texaco joint venture. I wrote to the FTC to urge them to block it.
- In March 1998, I wrote to the FTC to launch an investigation of anti-competitive oil company prices throughout California.
- In August 1998, I and several gas station operators asked Pitofsky to open a formal investigation of anti-competitive practices in the California oil industry. He responded to me that he agreed that charges "warrant further inquiry." He directed the Commission's Bureau of Competition to investigate gasoline pricing practices in California.
- I provided the FTC with information about possible harassment of gas station operators by major oil companies (May 1998), over a hundred pages of data on California gasoline pricing practices, and petitions containing the signatures of 50,000 California motorists concerned about high gas prices.
- I opposed the BP/Amoco and the Exxon/Mobil mergers by asking the FTC to oppose both mergers that the defy antitrust laws restricting the consolidation and abuse of market power.
- I wrote to the FTC to call on them to require oil companies, as a condition of allowing mergers to proceed, to guarantee access to oil and gasoline for independent refiners and nonbranded gas stations. This would promote competition to keep prices in check.
- In the 106th Congress, I introduced S. 1137 the Integrated Oil Company Antitrust Act, which amends the Clayton Act to give the Attorney General additional authority to prevent certain anticompetitive mergers and acquisitions in the oil industry. Mergers of major oil companies are banned unless:
- The Attorney General finds that the merger or acquisition will promote competition.

- The FTC has approved an agreement by the merging or acquiring company to guarantee adequate supplies of crude oil and petroleum products to independent refiners and marketers.
- I supported a "Gas Out" as a day for consumers to protest higher prices.
- I wrote to the FTC, in May 1999, to expand the gas price investigation to examine whether anti-competitive activities were to blame for slower than anticipated gas price reductions.
- In the last Congress and this Congress, I have introduced legislation to ban the exportation of oil from Alaska's North Slope. Currently, the companies are doing this on a voluntary basis.

Senator BOXER. Thank you, and I will summarize it.

In 1996, I wrote to Hazel O'Leary asking her as the Energy Secretary to investigate price-gouging in California. In 1997, I wrote to FTC Chairman Pitofsky, whom we will be hearing from today, asking him to block the proposed joint venture between Shell and Texaco. The FTC did not block it, but they did agree with my concerns and required the divestment of gas stations in the San Diego area before allowing the joint venture to proceed.

In August 1997, I wrote to Secretary Peña and Attorney General Reno asking them to take necessary steps to ensure fair gasoline prices for our drivers. I then outright opposed the Shell Oil and Texaco joint venture and I asked the FTC to block it.

In 1998, I asked the FTC to launch an investigation on California prices. I am very distressed to tell you that I still have not gotten that report. I am very disturbed about it, and it is not for lack of trying. I have met with them often. I have presented them with many documents, including hundreds of pages of data on pricing policies, petitions, the fact that we proved that there was harassment going on by big oil companies to the independent gas station owners and the independent dealers. We got them together. They came out there and they talked to them. But, we still do not have an answer.

We know that competition has gone down. You know, if anyone tells you it is supply and demand I would tell you this. If the supply is manipulated, as Senators Wyden and Smith have indicated may well be the case, there is no real supply and demand at work. When supply is manipulated, that is not a fair picture. That is what has been going on.

I have introduced legislation with Senator Wyden dealing with the exports from Alaska's North Slope, and there are other things I will not go into. I want to make a couple of points.

This is what gas prices look like in San Francisco. This was yesterday. Today who knows if it is higher? If you are lucky enough to take the lowest grade of gasoline, it is $2.19. This is on Franklin Street in San Francisco yesterday. It is higher elsewhere. If you have to take the special super-duper kind, it is $2.39.

This is an outrage. People do not have a choice, especially right before the summer driving season.

Senator McCain already talked about the record profits that we are seeing from big oil. Exxon Mobil, up 44 percent from a year ago. In 2000 they had record earnings of $17.7 billion, so record earnings in 2000 and now on top of that a 44 percent increase. Conoco, 59 percent increase over the quarter last year.

So all you have to do is follow the money and talk to consumers in my State and talk to the independent dealers to find out how they have been discriminated against. I have a copy of a letter

where Chevron threatened to double rents on independent gas station owners if they continued the support gas price reform legislation in California. They were being retaliated against because they said: It is outrageous; we do not want to charge these prices; we do not think we should have to.

I have other letters that I will put in the record later from independent gas station owners about the questionable business practices of these oil companies. Oil companies came in to do an investigation of their dealers and if there was a light out in the bathroom and everything else was perfect, they said: That is a warning; we are going to take over your station. We have all that documented, and consumers are getting killed at the pump.

I am all for people making a good dollar. I think it is important to succeed. But I have to tell you, when I read that Exxon Mobil's chair—and this may be the most wonderful human being; I do not know him and he may even be here—earned a $13.9 million bonus in 2000 and a $17.4 million—a $13 million bonus in 1999 and a $17 million bonus in 2000, while consumers are struggling to pay at the pump.

Where is the FTC? I do not know. Where is corporate responsibility? I do not know. I am waiting and I am hopeful, because we are getting the report supposedly in June now, just a few years after we asked for it. So maybe we are going to get some—you know, the FTC does have the power to disgorge profits that have been unfair. So we hope that they will maybe come down with that kind of a report.

We have the highest gasoline prices in the country. Three years ago, I asked for this report. Yet the problem is getting worse.

Oh, you will hear it is the environmentalists. Well, we just took our latest check. Eight cents a gallon absolutely for cleaner air, that is what we pay. I think the vast majority of Californians are happy to pay 8 cents a gallon for clean air. But you cannot explain anything because the same law has been in effect for a decade. So it is not clean air requirements that are causing the problem.

In closing, let me say there are a number of things I am going to be working on. First, I am going to be pressing the FTC and hoping we get some redress. I am going to be appealing to the oil companies, although I know I have tried that before, but I will keep appealing to them, that they are going to bring down this economy. We are already entering a period of weakness here. This is a terrible situation, and it is not just California's problem. You hear it is the West Coast's problem. California, we are the sixth largest economy in the world and when we get a cold everybody sneezes. So we have to pay attention to what happens here.

But there are things we can do. We can start driving hybrid vehicles. You do not make any sacrifice. You fill up your car with gas and you get 50 miles to the gallon. I drive one myself. Comfortable, wonderful, no culture shock. You do not have to plug it in. It is real simple. We ought to do that.

We ought to give more incentives for that. We ought to have Senator Wyden's and my bill on the floor to reinstitute the ban on exports of Alaskan North Slope oil. We know that the companies are doing it voluntarily, but it could change.

SUVs, there is no reason why they cannot get the same fuel mileage as an average car. If we did that, that is equal to one ANWR every 6 years, a million barrels of oil a day.

So yes, there are things we can do. But Mr. Chairman, I cannot thank you enough, both you, Senator Wyden, Senator McCain. It is just a few of us who have been talking about this for a long time. I know Senator Murkowski is very interested in this consumer issue as well. I thank you very much.

Senator SMITH. Thank you, Senator Boxer.

Chairman Murkowski, we welcome you, and thank you for taking the time to be with the Commerce Committee today in your capacity as Chairman of the Energy Committee.

STATEMENT OF HON. FRANK H. MURKOWSKI, U.S. SENATOR FROM ALASKA

Senator MURKOWSKI. Thank you very much, Mr. Chairman, and I appreciate the opportunity to spend a few minutes with you. I think you have got a balanced agenda, a list of witnesses, and I hope that you proceed to dwell into the areas that you brought up in your opening statements and get some specific answers to your legitimate concerns.

I am here for one purpose and that is to set the record straight on Alaska oil and where it goes. I think it is fair to say that the industry can comment on the allegations that have been made collectively by your Members here today.

I am going to refer over here to this chart, and I will speak loudly, so hopefully, the court reporter can hear me. As you know, Alaska's proximity to the West Coast is very real, and as a consequence where our oil goes today, the million barrels that we produce: 60,000 barrels are consumed within our State. However, California is the second largest consumer with 395,000 barrels a day; Washington State at 495,000 barrels a day and Hawaii at 50,000 barrels a day. That is where Alaska oil goes.

There is an assumption that somehow the connections between Alaska's oil production and the issue of oil exports has something to do with the price. There has not been a barrel of oil exported from Alaska since last June. The record will note that. So I would ask you to consider the reality that, while there may have been exports up to about 60,000 barrels a day prior to a year ago, that does not occur as a consequence of the change in the market.

I will explain that change very briefly in the realization that the West Coast consumes somewhere in the area of 2.5 to 3 million barrels a day. A million barrels roughly comes, as I have indicated, from Alaska. A million barrels is roughly produced in California. Approximately 700,000 barrels a day comes in from the Mideast. So as you can see, as Alaska's production declined, the decline in Prudhoe Bay, that has been displaced with oil coming in from the Mideast.

I will refer to my written comments here, because I know what you want to get at is the bottom line, an explanation of why prices are higher on the West Coast, and hopefully I can shed some light on that. As you know, as Chairman of the Energy and Natural Resources Committee, this matter and matters of rising energy costs in general are of great concern, because they affect the economy,

they affect the national security of our country, and as a consequence they need explanations.

But to a large degree, as I have indicated, you have a supply and demand problem. The West Coast is consuming more oil than is produced on the West Coast and the difference is being exported in.

I would like to point out a couple of other differences. All the oil that moves from Alaska without exception moves in U.S.-flag vessels built in U.S. shipyards with U.S. crews. That is the Cabotage Law. It does not suggest that you could bring it in cheaper if you could bring it in in foreign vessels. It mandates that the carriage of goods between two American ports be carried in a U.S.-built vessel. That also occurs in the passenger service as well. It is one of our laws that occasionally we overlook, but recognize in the interest of protectionism of our American merchant marine it is necessary. Otherwise we would not have any U.S.-flag vessels. We mandate this.

The cost of a vessel built in a U.S. yard—and we have built—currently we have got about six under construction, three in San Diego and another five in Louisiana—about twice as much to build as you could build that ship in a foreign yard. Those ships in the U.S. cost about $200 million. You can build them in Korea for $100 million.

So you have got to recognize the reality that this is passed on to the consumer. I am not arguing the merits of the Jones Act, but I am simply explaining one reason why it costs more to move Alaskan oil down to the West Coast than it would if you were able to move that oil down in a foreign vessel.

So, those facts being out there, I think it is important to recognize the recent increase in the cost of gasoline focuses again on our problems at the pump because States along the Pacific have traditionally had the highest gasoline prices in the country, averaging somewhere in the area of $1.70 per gallon. As the Senator from California indicated, they are going up. They may well reach $3 a gallon.

But as I think all of you recognize, the price of oil is primarily set by the major producers. The major producers are OPEC. As you have observed OPEC and the discipline that has come about as a consequence of OPEC getting together, they have effectively put a floor and a ceiling on the price of crude oil. They have been able to reduce production, and since they are the key supplier they have got the leverage and will continue to have it, and will continue to frustrate those of us on the West Coast, and particularly my State of Alaska, where we have the capability of producing more domestic oil and clearly we can do it safely.

Now, do you really care, California, Washington, Oregon, where your oil comes from? There does not seem to be much interest in where it comes from as long as you get it and that you get it at the lowest price. I can understand that, but there is no concern over the scorched earth policies of developing oil in the Mideast or the national security of our Nation as we become more dependent on importing oil from Saddam Hussein, 700,000 barrels a day.

Is it not rather ironic that our foreign policy is so inconsistent, that on the one hand we would enforce a no-fly zone, we bomb him

often, we cut out his radar sites, but we are importing his oil? We put it in our airplanes to go fly over, enforce a no-fly zone, bomb Iraq, with his oil. Now, what kind of a foreign policy is that? A bit inconsistent.

What does he do with our money? He pays his Republican Guards, keep them alive certainly. He develops a missile competition, an energy competition with biological technology. Who does he aim it at? He aims it at our ally Israel. This is the cost of depending on foreign sources of oil.

I am not going to give you my usual pitch about the merits of producing it from Alaska, but recognize where your oil comes from now and as we decline where it is coming from and what care and concern you have as long as you can get it.

You indicated, Senator Smith, the cost associated with Oregon. Oregon has no refineries. That is a choice of their own to some degree. On the other hand, your taxes and your gasoline costs are higher than 33 other States. A portion of that is due to your tax rate. You set your own tax rate, 18 cents a gallon Federal and, what is it, 24 States, for 42 cents a gallon. Again, that is higher than 33 other States.

California requires reformulated gasoline and it is necessary in that State, and I understand that. But what we have seen as a consequence of the previous administration opening up, if you will, the salt caverns in Louisiana by making that 30 million barrels available from SPRO, we did not have the refining capacity to refine it. So what did we do? We offset what we import by taking the oil out of SPRO. Was there any net increase in refined product? Clearly there was not, because we also have a problem of refining capacity in this country, have not built a new refinery in 25 years.

If it is so profitable for the oil companies to build refineries or to make money in refined product, why are they not building more refineries? It is clear the reason they are not. The permitting time is of a consequence that they do not feel they can generate a return.

But they should respond to those questions, which I agree are certainly legitimate.

I am sensitive about calls for reimposing an export ban on Alaskan oil, which continually comes up even though since last June there has not been a drop of oil that has been exported from Alaska. There is an assumption out there that somehow we bear a responsibility for your high prices or that we are exporting oil out of Alaska and therefore that is the consequence of your high prices. We are not and I think the record should recognize that and once and for all put behind us the issue of exporting Alaskan oil as being part of your solution.

We are tired of being a scapegoat for the failures and excesses of local and State actions that impact prices at the pump. We have all heard about “not in my back yard”; I do not want a refinery in my back yard, I do not want to be exposed to developing oil and gas off the shores of California or Washington or Oregon. But that is the case, and I respect your opinions. If you do not want it, you should not have it. But somebody has got to produce it because you have got to have it.

Only Alaska has ever suffered an export ban. No other State in the Union was precluded from exporting its oil or petroleum products—not California, not Oregon, not Washington. There have been no attempts to ban such exports. Why should we be treated differently? A legitimate question. If you are going to ban exports, let us ban them from everybody, let us ban exports from California, let us ban exports of refined product. Do not look at my State of Alaska. We are not exporting any oil. We are not your problem.

Should there be a ban on exporting Boeing airplanes or Starbucks coffee or a ban on food products from Oregon? How about California wines? Hollywood films? That would be a good idea.

[Laughter.]

There is another thing I think you have overlooked, and that is the GAO Report, which we requested in my committee. I think some history is in order. When Congress passed, with the Clinton Administration's support, a law to give the President the authority to lift the ban in 1995, it required the GAO to conduct a study about the impacts. That study was done in 1999. The results were very simple:

One, lifting the ban increased—increased—total West Coast crude oil production from where it would have been, simply because it spurred development of some of the marginal wells. This happened because the price of crude oil on the West Coast was raised at that time from 89 cents to $1.30 a barrel. We all know that strippers cannot operate at a figure below their recovery costs.

The third reason, consumers were not impacted. Instead, refineries who were profiting from a flood of Alaskan crude oil lowered their profit margins. Now, I hope the record will note that, but that is what the GAO said. This is not Frank Murkowski talking.

A review of the GAO Report tells us what really happened, and what really happened was that Alaskan oil stopped being shipped through the Panama Canal and around the Horn to refineries in the Gulf Coast and the Virgin Islands. That was terminated because the market changed. If there is anyone who believes that reducing Alaska crude shipments to the Virgin Islands somehow affected gasoline prices in the Pacific Northwest, I would urge him or her to speak up, because obviously, the Virgin Islands, part of it is in the United States in the sense of the territorial status.

What have we done that has been so terrible in Alaska in this issue of oil export? Well now, the GAO study—and this is not Frank Murkowski—told us that exports were averaging about 60,000 barrels per day, 60,000 barrels, ladies and gentlemen, out of 1.2 million, which is what we were producing. Hardly a point of leverage. About 5 percent of Alaska's North Slope production, obviously a very small percentage.

Since that time, Alaska's production has fallen about 200,000 barrels a day. In fact, in the past decade, Alaska production has fallen by 1 million barrels. Now, that is the reality.

If we are so concerned about 60,000 barrels of Alaskan oil that was being exported each day to the Pacific Rim, are we not just a little bit concerned today about the million barrels of extra Alaskan oil that was produced in 1990 but is not being produced today because Prudhoe Bay is in decline? We have the capability of pro-

ducing more oil to replace that deficit if given the opportunity, which only Congress can address. Well, I think you should be concerned where you get your oil.

Furthermore, as a result of the recent FTC-approved merger between ARCO and BP, BP now has a domestic home for virtually all of its Alaska crude to be refined on the West Coast because they acquired, if you will, ARCO's refineries.

Finally, I urge the Members of the Commerce Committee to look closely at what is happening to our Nation's energy and stop kidding ourselves. We have a supply and demand problem. The demand is increasing and the supply is coming from overseas. We have different fuel standards in many parts of the country for different places at different times of the year. The refiners have to batch that. They have to ship it separately, they have to store it separately. That costs money.

Some adjacent counties are required to use different fuels. Congress and the Federal Government first tells the refiners to add, what, MTBE to fuel to make it burn cleaner, and later they outlaw it. OK, those are the irregularities that occur in any free market.

Well, we need to do better. As a consequence, tomorrow my Energy Committee is holding a hearing about the realities of the fuel situation across the country, and our goal is to shed some new light on the real costs of balkanization of our gasoline standards. I think it is time to stop scapegoating and blaming the symptoms. It is time to get on with the hard job of fixing the problem so the symptoms stop hurting so many American people, whether they be in Washington, Oregon, or California.

I hope you will join the Energy Committee—I know two of you are on that Committee—in a bipartisan way to come up with some real solutions to real problems, because the American people certainly deserve no less. But I hope my statements here today underline the realities associated with where Alaskan oil goes and the realization that as Alaska oil's contribution declines to its natural markets on the West Coast you are simply going to depend on oil coming in from someplace else, and you do not seem to care where or how.

I would be happy to respond to any questions.

Senator SMITH. Thank you, Senator Murkowski. As a Northwesterner as well, I want you to know that I have no ax to grind with Alaska. Yours is a great State. As I indicated in my opening statement, my real beef here is the allegation—and I emphasize, allegation—of market manipulation. Oregonians will not pay for it. We will pay market prices and that is fair. The other is not.

I have no questions of our Energy Chairman.

Senator Boxer.

Senator BOXER. Yes. I have a couple of comments.

I do care where my oil comes from. I want it to come from Alaska, not from Saddam.

Senator MURKOWSKI. Well, we both share that.

Senator BOXER. Good, good. That is why it was difficult before this voluntary move when we saw that oil leaving for Asia. I am happy to look at oil produced anywhere in America when we are in such a shortage situation to keep it in America. That is a patriotic thing to do. So I agree, it should not be discriminatory. I think

we ought to look at it. I do not know if anyone else is exporting it. I do not think so.

Senator MURKOWSKI. California exports a little bit.

Senator BOXER. We should definitely look at that, because I do not think that is right. I think we ought to, certainly in California where we are short—and you make that point.

I also so much agree with you that we need an energy policy in this country. We have needed it since the 1970s. I suspect where we probably differ a little bit is where to stress. I mean, I think we need a balance of supply and demand. I tend to look at ways in which we can curb usage—we are the biggest energy user in the world. We are fifth in population. There are really ways we can conserve and do very well at it and not change our lifestyle.

I pointed out one way. If we could drive more fuel efficient vehicles, if we chose to do so, we would almost be out of our problem. We would be very much close to being out of our problem, because if you look at the gasoline use in automobiles, that is a huge part of the problem in transportation.

Last, I will defend some movies. I think it would be a good thing for the world to see "Schindler's List" and a good thing for the world to see the movie "Traffic," Orrin Hatch was in.

Senator SMITH. And Barbara Boxer starred as well.

Senator BOXER. Well, I was being very humble. And Don Nickles was in it. It was a good movie and made a good point. And a good thing for the world to see "Erin Brockovich," and it would be a bad thing for anyone to see "Sun Mothers"—examples good and bad. But I just do that to defend my State.

But I do feel that we do have agreement that we need an energy policy. It would be really a wonderful thing if we could come to some common ground on what that ought to be. But I think that the issues raised by Senator Wyden on the oil companies' pricing strategies, I think you agree we should ask them about it. It is very discouraging.

My sense in dealing all these years with it is these are multinational companies—and I used to think as a kid growing up when I saw those oil signs, these were our people and they cared about us. I've got to say, when I see these prices, I do not think these people care, because I honestly believe, when you look at the facts, when they are merging as they are, when they are driving independent dealers, I am deeply concerned. We have had the same environmental laws for the last 10 years. We have the same taxing structure. Yet, you see the profits and you see these bonuses and you've got to wonder.

In California we are very upset. But I do thank you, Mr. Chairman for your presence here. I hope we do find some common ground.

Senator MURKOWSKI. Well, I hope, Senator Boxer, that at some point in a time in the not too distant future you do not raise that up and we see $3-a-gallon, because if we do I think many Members will have to revisit the merits of whether or not we should look to Alaska and the opening up of that small segment of ANWR for relief, because many, many of our constituents are going to be asking why we did not support opening up a domestic supply that is believed to be of the magnitude of Prudhoe Bay that we have been

relying on for the last 27 years for 20 percent of our crude oil, as opposed to the environmental constituency out there that says we cannot open it up safely.

Clearly, we have the American engineering technology, the can-do spirit. I do not know about you, but I have always believed that charity begins at home. We have done a good job of providing the United States, particularly the West Coast, with its oil needs and we can do so in the future, only we can do a better job in the future.

As you know, oil is where you find it, and when you have taken individually the action to prohibit the exploration off the shores of the West Coast of the United States and duplicated that by taking the offshore areas off limits from the East Coast, you have left very little area left other than the Gulf of Mexico and the Overthrust Belt, where there has been a difficulty in opening that area up, and my State of Alaska, who I think has been responsible in the manner in which we have allowed the development of our resources.

So with that, I would suggest that you look for oil where you are most apt to find it, because if you do not you probably will not find it.

Thank you.

Senator BOXER. Mr. Chairman, you know, the Chairman and I go at this all the time, and usually it is when I am in his Committee and he gets the last word. Since I am on this Subcommittee——

Senator MURKOWSKI. Fair enough.

Senator BOXER. I think it is fair, it is fair.

I think we have our very strong differences on ANWR, as does Senator Stevens.

Senator MURKOWSKI. Why do you not come up there, take a look.

Senator BOXER. Well, as you well know, I am going to do that, and I have sent my chief person——

Senator MURKOWSKI. Give me a date and we will set it up.

Senator BOXER. Well, the last date you picked, it was so frozen I probably never would have come back, and I think that was the plan.

Senator MURKOWSKI. That is the way it is 7 months of the year, you know. That is the way it is.

[Laughter.]

Senator BOXER. That was the plan. You invited me up there when I probably would be freezing and could never get home.

Senator MURKOWSKI. You got the last word.

Senator BOXER. No, I did not get the last word. I am going to get the last word, maybe, at least in this setting.

Senator MURKOWSKI. I will concede the last word.

Senator BOXER. Thank you.

We have a huge difference on the ANWR issue and that is so fair, and I am not going to get into it. I did not raise it in my opening because to my view when you deal with this particular issue many other issues come behind it, namely how much is there, when will it be there for us, what does it do to the wildlife. We are one Nation under God. I consider all the States to be a responsibility of all of us. I want you to care as much about California as I care about Alaska.

But on the issue of taking California off the table in terms of a lot of our offshore tracts, I want to tell you this is the most bipartisan decision that has ever been made in history, from Pete Wilson to everybody else, to Gray Davis to all of us. You know why? It is not just an environmental issue, although it certainly is that, but it is a tourism issue. Since this is the Subcommittee that deals with it, our tourism is based around our magnificent coast, and this is a decision that we have made.

I know that you have made the decision to drill in Alaska. I just look at all of our States as God's gift. It is just an issue that we have to deal with. But we need an energy policy.

Senator SMITH. If I may as the Subcommittee Chair, just as a reminder, our focus is on the allegation of market manipulation, not the well-being of the caribou today.

Senator MURKOWSKI. I am going to leave my closing statement to Senator Stevens.

Senator BOXER. You are in good shape. You are in good hands.

Senator SMITH. We are pleased to be joined by Senator Stevens, probably the most senior Member of the Commerce Committee. Senator, if you have an opening statement or a comment.

Senator STEVENS. No, I shall listen.

Senator SMITH. All right. Thank you.

The first panel after Senator Murkowski is the Honorable Robert Pitofsky, Chairman, Federal Trade Commission. We welcome you, sir, and the mike is yours.

STATEMENT OF HON. ROBERT PITOFSKY, CHAIRMAN, FEDERAL TRADE COMMISSION

Mr. PITOFSKY. Thank you very much, Mr. Chairman. As always, it is a great pleasure and honor for me to appear before this Subcommittee and its Members, who have supported in my years at the FTC so constantly the work that we have been engaged in.

The subject today is the level of gasoline prices on the West Coast, which, as several speakers have noted, have been for the most part the highest gasoline prices in the United States for quite a while. As background, let me say that I can not isolate any one or two reasons why the West Coast prices are so high. I do think blaming it on OPEC—I am no defender of OPEC—but blaming high West Coast prices on OPEC does not make any sense. OPEC prices are high in New York, they are high in Louisiana, they are high on the West Coast.

As to why the West Coast prices are so high, it is true, as I will discuss in a moment, the level of concentration on the West Coast is higher than in other sections of the U.S. There are fewer players. There are regulations, like the CARB regulations in California, designed to protect the environment, that are very special and probably add a few cents to the cost of a gallon of gasoline. There is no self-service in Oregon, which may be a factor there.

I do not want to let pass, however, the opportunity to talk about something that Senator McCain mentioned, and also Senator Murkowski, and that is this business of refinery capacity in the United States. Let me put some numbers on this. In the U.S. generally, capacity utilization is 82 percent. Generally, in the United States,

month-in and month-out, the oil industry operates at 95 percent of capacity. That is higher than any other sector that I am aware of.

But that does not even tell the story, because when you roll around to April, May and June that percentage kicks up to 97 and 98 percent. In different sectors of the country it is even higher. I would not be at all surprised to find that refinery utilization right now in California is 100 percent.

The consequence of that is when anything happens, when there is a pipeline rupture, as there was in the Midwest last summer, when there is an explosion at a refinery in California, as there was two summers ago, prices skyrocket. Until this country addresses the question of refinery capacity, I think we are in danger of seeing this kind of behavior almost every summer. The unpredictable is predictable, and price spikes are going to happen.

Specifically, I would like to address three questions: merger activity, exports out of the West Coast, and distribution practices. Let me say that much of this is not in the testimony of the Commission. These are my own views this afternoon.

On mergers, we all know there has been an almost unparalleled merger wave in this country over the last 7 or 8 or 9 years—3 times as many mergers, 11 times as many assets scooped up in mergers, than was true 9 or 10 years ago. That has been especially true in the oil industry. Indeed, of our resources, the FTC probably spends more reviewing energy mergers than any other single sector of the economy.

But I do want to put this in context. I am very troubled about the wave of mergers in the oil industry, and I will come back to that. But let us recognize that even after all these mergers there are still ten oil companies in the United States competing and they have less than 70 percent of the market.

It is more concentrated on the West Coast because there the top seven have something between 90 and 95 percent. But I do suggest that if there are reasons for these higher prices I do not think it is the merger activity of the last decade. First of all, there has not been a major merger that we reviewed and we did not require restructuring.

Senator Boxer referred to Shell-Texaco. Exxon-Mobil was the largest restructuring in the history of antitrust. In BP-ARCO, we challenged that deal in court until the parties agreed, or when they agreed, because we were comfortable with the settlement, that they would bring Phillips in as a replacement for the competition that was lost by the acquisition of ARCO. If there were seven players on the West Coast before the merger, there were seven players after the merger.

By the way, in the Midwest, where we had a price spike last summer, there were no significant mergers that affected competition in that area.

Let me turn next to exports. Let me emphasize that we did take a position on exports in the BP-ARCO case, but it was a very, very narrow point. The FTC has no stake whatsoever in the question of whether there is a ban across the board on exports. That is a question for Congress. Congress decided it. We take the world as a given.

In BP-ARCO, however, there was what I would describe as an unusual allegation. We alleged and we were prepared to prove in court that BP systematically had sold in Asia at a lower price, a lower netback, a lower profit to BP, than they could have sold on the West Coast, for the purpose of keeping West Coast prices high or raising West Coast prices.

That was not speculation. That was discussed in the documents that we had in that matter. We were prepared to prove it. We alleged it in our briefs. The case was settled to my satisfaction, with one exception. The case was settled and therefore we were never put to our proof. But I think the documents were there.

I would have preferred that our order include a provision that said that BP, and Phillips for that matter, could not and would not export in the future. My colleagues did not think that was necessary. Their position was that these companies had promised not to export anyway. Incidentally, as far as I know, there have been no exports away from the West Coast by these two companies anywhere since that case was settled.

Since they were going to do it anyway, I would have liked to have seen that in the order. Circumstances change. Who knows what the world will be like next year. But the fact of the matter is that there have not been exports since the case was settled.

I also would say that we were never called upon to quantify how much of a difference to West Coast motorists this export program to the Far East made. We could probably come up with some very rough estimates, and I know two witnesses later will have some views on that. But I emphasize, we alleged and we were prepared to prove that these exports did occur.

Finally on distribution. This has to do with our ongoing investigation of red-lining and zone pricing. It is an ongoing investigation and therefore I cannot discuss the documents we have and I will not have anything to say about particular companies.

Let me say that, Senator Boxer, we have been doing this for 2½ years and I am not comfortable here defending a 2½ year investigation. It should have been completed more promptly. I will say that you and Senator Wyden supplied us with witnesses and documents and we have followed up every one of those. We have attained enormous numbers of documents from the companies.

I will predict today—we are at the end of this investigation and I will predict today that the Commission will come to its conclusion within 30 days. I cannot justify taking this long, except that it is a complicated question and the law that we would have to deal with is not hospitable to plaintiffs challenging this kind of behavior. So we have been cautious, we have been careful, we have run down every lead.

What we are looking at is red-lining and zone pricing. I do not want to get into it too deeply, but red-lining is a practice in which the refineries say to the jobbers—and incidentally, the jobbers usually buy at a lower price than anybody else—you can have this low price, but we are telling you, or we are agreeing with you that you may not sell in certain parts of your market. It is usually large center cities, like San Francisco. You may not sell there without our permission. I think the jobbers are so convinced they will never get permission they do not ask in the first place.

Site-specific red-lining, which is a different sort of red-lining, is one in which the refiners agree with the jobbers to control the price at which they sell in cities like San Francisco and San Diego.

Zone pricing, of course, has been described. It is a technique for setting up pricing in particular areas of a city or particular rural areas depending on what the refiners think is the level of competition in those areas.

All I can say is we will come to a conclusion in this matter and I am confident that it will be within 30 days or so. Let me bring this to a conclusion by summarizing. One, as I say, we will finish our investigation. Two, we have and will continue to pay special attention to merger activity in this industry. In general, I would describe the oil industry as having gone from deconcentrated to moderately concentrated. But I say again, there are still nationally 10 oil companies that are competing for business. That is not a level of concentration that ordinarily concerns antitrust enforcement people, but the oil industry is made up of enormously large companies and there is some history of disregard for antitrust in that industry.

Finally, I can only say again I think that Congress needs to address this question of energy policy and particularly refining capacity. There is plenty of oil in the world. There is a lot of oil in the world, but there does appear to be a bottleneck with respect to refineries in this country.

Thank you very much and, of course, I would be delighted to answer questions.

[The prepared statement of Chairman Pitofsky follows:]

PREPARED STATEMENT OF HON. ROBERT PITOFSKY, CHAIRMAN, FEDERAL TRADE COMMISSION.

Mr. Chairman and Members of the Subcommittee, I am Robert Pitofsky, Chairman of the Federal Trade Commission.[1] I am pleased to appear before you today to present the Commission's testimony concerning the important topic of competition in the gasoline industry in West Coast markets. Competition in the energy sector—particularly in the petroleum industry—is vitally important to the health of the economy of the United States, and to the various regions of the country. Our experience has taught us that gasoline markets can be much narrower than the entire country, and the West Coast markets have their own particular features that set them apart from the rest of the country. In all markets, antitrust enforcement has an important role to play in ensuring that the gasoline industry is, and remains, competitive. Merger enforcement in particular has recently been at the forefront of efforts to maintain and protect a competitive environment in various gasoline markets, and our testimony today is directed at that ongoing effort.

The FTC is a law enforcement agency with two distinct but related missions: preserve competition in the marketplace through antitrust law enforcement and protect the consumer from unfair or deceptive acts or practices. The Commission's statutory authority covers a broad spectrum of sectors in the American economy, including the companies that comprise the energy industry and its various components. Among the statutes the Commission enforces are two antitrust laws, the FTC Act[2] and the Clayton Act."[3] Under section 5 of the FTC Act, the Commission prohibits "unfair methods of competition" and "unfair or deceptive acts or practices." The Commission shares jurisdiction with the Department of Justice under section 7 of the Clayton

[1] This written statement represents the views of the Commission. My oral responses to questions are my own, and are not necessarily those of the Commission or any other Commissioner.
[2] 15 U.S.C. §§ 41-58.
[3] 15 U.S.C. §§ 12–27.

Act, which prohibits mergers or acquisitions that may "substantially lessen competition or tend to create a monopoly.[4]

II. LEVEL OF MERGER ACTIVITY

It is no secret that merger activity in the United States is at an all-time high. The number of mergers reported to the FTC and the Justice Department pursuant to the Hart-Scott-Rodino Act has more than tripled over the past decade, from 1,529 transactions in fiscal year 1991 to 4,926 transactions in fiscal 2000. Although filings have declined so far this year because of higher filing thresholds[5] and the slowing economy, the Bureau of Competition remains heavily focused on merger work. Currently, more than two-thirds of our competition resources are dedicated to merger enforcement, compared to an historical average of closer to 50 percent.

While the number of merger filings has more than tripled in the past decade, the dollar value of commerce affected by these mergers has increased an astounding elevenfold during the same period. But mere numbers do not fully capture the complexity and the challenge of the recent merger wave. Today's merger transactions not only are larger, but often raise novel or complex competitive issues requiring more detailed analysis. In the past year alone, companies filed notifications for 288 mergers with a transaction size of one billion dollars or more, and many of these mergers involved overlaps in several products or services.

There are many reasons for the current merger wave. A large percentage of these transactions appear to be a strategic response to an increasingly global economy. Many are in response to new economic conditions produced by deregulation (*e.g*., telecommunications, financial services, and electric utilities). Still others result from the desire to reduce overcapacity in more mature industries. The rapidly evolving world of electronic commerce has a substantial impact on the merger wave, because consolidations often quickly follow the emergence of a new marketplace. These factors indicate that the merger wave reflects a dynamic economy, which, on the whole, is a positive phenomenon. But some mergers, as well as some other forms of potentially anticompetitive conduct, may be designed to stifle competition in important sectors of this dynamic economy.

III. MERGER ENFORCEMENT IN THE GASOLINE INDUSTRY

Out of necessity, our scarce resources are directed at preserving competition in the most important areas of the economy. The Commission dedicates the bulk of its antitrust enforcement to sectors that are critical to our everyday lives, such as health care, pharmaceuticals, retailing, information and technology, and, in particular, energy.

Much of the Commission's experience with enforcing the antitrust laws in energy industries has been in analyzing mergers.[6] Merger enforcement is the first line of defense in protecting a competitive marketplace, because it preserves rivalry that brings lower prices and better services to consumers. The Commission blocks or obtains relief in those mergers that increase the likelihood that the merged firm can unilaterally, or in concert with others, increase prices or reduce output or innovation. The Commission has an extensive history of carefully investigating mergers in the energy industries, particularly petroleum, and the FTC has challenged mergers in those industries that would be likely to reduce competition, result in higher prices, and injure the economy of the Nation or any of its regions.[7]

In each merger investigation, the Commission will intervene if the consummated merger would significantly reduce competition in any sector of an industry that affects the United States or its citizens. The specific question the Commission must ask is whether the result of a merger "may be"— *i.e.* it would be reasonably likely— that the remaining firms in the industry could reduce output and raise prices to the detriment of consumers anywhere in the United States.

The Commission approaches its antitrust mission by examining the areas in which merging companies compete, looking at the existing State of competition in that marketplace and the likely changes in that marketplace in the future, both

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[4] 15 U.S.C. § 18.

[5] 16 C.F.R. Parts 801, 802, and 803, Premerger Notification: Reporting and Waiting Period Requirements for Certain Mergers and Acquisitions: Implementation of Recent Amendments to the Clayton Act (Jan. 25, 2001).

[6] Under the Commission's shared jurisdiction with the Justice Department, antitrust investigations are allocated to one of the agencies under a long-established clearance procedure, based on expertise gained over the years in various industries. The Commission has expertise in oil mergers.

[7] Section 7 of the Clayton Act specifically prohibits acquisitions where the anticompetitive acts affect "commerce in any section of the country." 15 U.S.C. § 18.

from new competition entering and from existing competition exiting. We also look at the effect of recent mergers on competition in the particular marketplaces at issue, and whether the merger is a part of a trend toward concentration that limits competition.[8] The Commission has recognized the existence of such a trend toward consolidation in the petroleum industry.[9]

On the other hand, many mergers actually increase competition. So, the Commission also considers efficiencies in deciding whether to challenge an otherwise anticompetitive merger because they may counteract the merger's threatened anticompetitive effects. However, the Commission engages in a rigorous analysis of efficiencies. Merely claiming cost savings is not enough to allow an anticompetitive merger; they must be proven. The Commission demands that cost savings of the merger be real and substantial; they cannot result from reductions in output; they cannot be practicably achievable by the companies independent of the merger; and they must counteract the merger's anticompetitive effect, not merely flow to the shareholders' bottom line.[10]

Protecting competition and consumers is the goal of antitrust enforcement across all industries; its importance is particularly clear in the energy industry, where price increases can have a direct and lasting impact on the entire economy. Toward that end, the Commission has expended a substantial part of its resources in recent years in addressing the wave of consolidation in the petroleum and gasoline industry. In fiscal years 1999 and 2000, the Bureau of Competition spent almost one-third of its total enforcement budget on investigations in energy industries, and that level of effort has continued into 2001. Our merger review investigations revealed that several of these transactions threatened competition in local or regional markets. In those instances, the Commission allowed the merger only after demanding significant changes that would fully restore the competition lost as a result of the merger.

The Commission's investigation of the merger between Exxon and Mobil highlights many of the issues, and difficulties, in large oil company mergers. After an extensive review, the Commission required the largest retail divestiture in FTC history—the sale or assignment of 2,431 Exxon and Mobil gas stations in the Northeast and Mid-Atlantic regions, and in California, Texas and Guam.[11] The Commission also ordered the divestiture of Exxon's Benicia refinery in California; light petroleum terminals in Boston, Massachusetts, Manassas, Virginia, and Guam; a pipeline interest in the Southeast; Mobil's interest in the Trans-Alaska Pipeline; Exxon's jet turbine oil business; and a volume of paraffinic lubricant base oil equivalent to Mobil's production. The Commission coordinated its investigation with the Attorneys General of several states and with the European Commission (about 60 percent of the merged firm's assets are located outside the United States).

There are several particularly noteworthy aspects of the Exxon/Mobil settlement. First, the divestiture requirements eliminated *all* of the overlaps in areas in which the Commission had evidence of competitive concerns. Second, while several different purchasers ended up buying divested assets, each purchased a major group of assets constituting a business unit. This replicated, as nearly as possible, the scale of operations and competitive incentives that were present for each of these asset groups prior to the merger. Third, these divestitures, while extensive, represented a small part of the overall transaction. The majority of the transaction did not involve significant competitive overlaps. In sum, we were able to resolve the competitive concerns presented by this massive merger without litigation.

The Commission also required divestitures in the merger between BP and Amoco,[12] and in a joint venture combining the refining and marketing businesses of Shell, Texaco and Star Enterprises to create at the time the largest refining and marketing company in the United States.[13] BP/Amoco involved very large companies but relatively few significant competitive overlaps. There was competitive concern in a few local markets. The Commission ordered divestitures and other relief to preserve competition in the wholesaling of gasoline in 30 cities or metropolitan areas in the eastern and southeastern United States, and in the terminaling of gasoline and other light petroleum products in nine geographic markets.

The Shell/Texaco transaction raised competitive concerns in markets for gasoline and other refined petroleum products in the Pacific Northwest (Oregon and Wash-

[8] Industries might also consolidate for procompetitive or competitively neutral reasons, such as increasing scale efficiencies or a secular decrease in demand.

[9] *British Petroleum Company p.l.c.,* C-3868 (April 19, 1999) (consent order), Analysis to Aid Public Comment.

[10] *See* United States Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines § 4 (1992), *reprinted in* Trade Reg. Rep. (CCH) § 13,104 (1992).

[11] *Exxon Corp.,* C-3907 (Nov. 30, 1999) (consent order).

[12] *British Petroleum Company p.l.c.,* C-3868 (April 19, 1999) (consent order).

[13] *Shell Oil Co.,* C-3803 (April 21, 1998) (consent order).

ington), California, and Hawaii, for crude oil in California, and in the transportation of refined light petroleum products to several southeastern states. The two companies had substantial market overlaps. Both Shell and Texaco owned refineries in Puget Sound and, between them, made about 50 percent of the gasoline refined in the Puget Sound area. The Commission alleged that eliminating direct competition between those refineries could result in price increases for gasoline and jet fuel in the Pacific Northwest and California of more than $150 million per year. The Commission, in conjunction with the Attorneys General of California, Washington, Oregon, and Hawaii, required the divestiture of a refinery in Anacortes, Washington, which was a major supplier of refined products to Oregon via the Olympic pipeline; a terminal on the island of Oahu, Hawaii; retail gasoline stations in Hawaii and California; and a pipeline interest in the Southeast.

During 1999, the Commission investigated the proposed $27 billion merger of BP Amoco ("BP") and ARCO, the two largest competitors for the production, delivery, and sale of Alaska North Slope ("ANS") crude.[14] BP was the largest producer of ANS crude and the largest supplier to various West Coast refineries. ARCO was the second largest ANS producer.

The Commission conducted its investigation in cooperation with the Attorneys General of Oregon, Washington, and California. As part of that investigation, the Commission looked at the West Coast crude oil market to determine if the acquisition would increase the likelihood that the merged firm would be able to exercise market power, either unilaterally or in conjunction with other firms. The Commission found reason to believe that BP was *already* exercising market power in the production and sale of ANS crude oil to refineries on the West Coast, and that the merger would increase BP's ability to keep ANS prices high by eliminating the one firm with the ability and incentive to produce and sell more ANS crude oil.

The Commission's investigation revealed that BP was able to discriminate in price by charging some West Coast refineries higher prices than others, based on the ability of some refineries to substitute more easily other crude oil for ANS crude.[15] Economic theory teaches that the ability to practice price discrimination is limited to firms that have market power.[16] As crude oil is the major input into gasoline, preserving competition upstream directly affects retail competition.

The Commission and the Attorneys General filed lawsuits to block the merger in Federal district court, and the case was settled with divestiture of all of ARCO's Alaska assets, including oil and gas interests, tankers, pipeline interests (in the Trans-Alaska Pipeline), real estate exploration data and selected long-term supply agreements. Those assets, now owned by Phillips, are currently the major supplier to the Puget Sound refineries, which are the primary suppliers of gasoline to the States of Oregon and Washington.

Much of BP's ANS crude oil is now used in the former ARCO refineries in Los Angeles and Puget Sound, thus eliminating BP as the dominant supplier of ANS crude to other West Coast refineries. By combining BP's ANS production with ARCO's refining capacity, the Commission's Order reduces BP's incentive to elevate the price of ANS crude. By divesting ARCO's Alaska assets to Phillips, the Order retains an independent competitive force with the incentive to find and deliver additional ANS crude oil.

IV. CONCLUSION

By strictly enforcing the prohibition against mergers where the effect of the merger "may be substantially to lessen competition, or to tend to create a monopoly,"[17] the antitrust agencies ensure that already concentrated markets do not become more so. By challenging the Shell/Texaco joint venture and BP's acquisition of ARCO, the Commission helped preserve competition in several West Coast markets, both wholesale and retail. Requiring the divestiture of Shell's Anacortes refinery preserved competition in the supply of refined products to Washington and Oregon. Requiring the divestiture of ARCO's Alaska assets to a rival company (Phillips), pre-

[14] *Federal Trade Commission* v. *BP Amoco PLC,* Civ. Action No. C00 0420-SI (N.D. Cal. 2000).

[15] More complex refineries are usually better able to substitute different types of crude oil in their production mix. The Puget Sound refineries that serve Oregon and Washington are less complex than others on the West Coast.

[16] As Judge Posner has noted, "price discrimination implies market power, that is, the power to charge a price above cost . . . without losing so much business so fast to competitors that the price is unsustainable." *In re Brand Name Prescription Drugs Antitrust Litigation,* 186 F.3d 781, 786 (7 th Cir 1999).

[17] 15 U.S.C. § 18.

vented BP from enhancing its dominant position in the market to supply ANS to West Coast refineries.

Senator SMITH. Mr. Pitofsky, I have one fundamental question for you as the Chairman of the FTC. Did your Commission protect Oregon consumers from monopolistic pricing practices?

Mr. PITOFSKY. Well, we certainly—yes, I think we did.

Senator SMITH. I am troubled by that answer, frankly, because I think you said that you were aware of the memos Senator Wyden has referenced, *The Oregonian* has reported on, that suggest that there was manipulation involved. You must have concluded that it was manipulation, and that was not illegal. Was that what you found?

Mr. PITOFSKY. Senator, I hope I did not say that. Until this morning I did not know about the memos that Senator Wyden called to my attention. When I was talking about memos and witnesses, it had to do on zone pricing and red-lining.

Senator SMITH. So you did not know of any of the factors that led *The Oregonian* to report allegations of manipulation?

Mr. PITOFSKY. Let me break this down. We of course knew about the documents that describe BP's policy of exporting oil to the Far East. That was a part of our case. As far as we knew at that time, there was no evidence that that was other than single firm behavior. We relied on that heavily in challenging the BP-ARCO deal.

On this more recent set of documents dealing with ARCO's behavior, I was not aware of that and the Commission was not aware of it.

Senator SMITH. Had you been aware of it, would that have affected your vote to approve the merger?

Mr. PITOFSKY. Senator, I want to be cautious here. I have not seen the document. I do not know what ARCO would say about it.

Senator SMITH. That is fair.

Mr. PITOFSKY. But it is certainly something that one would look at if you had a document like that. But I have not seen it. You would have to ask the companies what they have to say about it.

Senator SMITH. We intend to ask.

Mr. Pitofsky, I believe you and Commissioner Thompson commented separately that you thought the Commission should have explicitly prohibited BP and Phillips from exporting ANS crude to Asia. Do you still think this condition should be imposed?

Mr. PITOFSKY. I do, but can I elaborate on that?

Senator SMITH. Yes, please.

Mr. PITOFSKY. We were concerned about exporting it for the purpose of raising prices on the West Coast. If they want to export to Asia to make a profit in Japan they cannot make in California, I do not have any problem with that. Of course they would do that.

This is different. This was an allegation that they were selling in Japan at a price that was lower than they could have received on the West Coast, in order to raise prices on the West Coast.

I thought that should have been covered by the order, as did my colleague.

Senator SMITH. What can be done to ensure adequate competition in the West going forward, on the West Coast for gasoline? What can we do specifically. Got to have more refining, more mar-

keting sectors; those are the recommendations you have had, would have today to this Subcommittee?

Mr. PITOFSKY. Well, certainly I would underscore this refining problem. I understand there was a fire in a major refinery in California just a day or 2 ago. Our initial reaction—we have not had a chance to really study it and the company says it is not going to affect prices. But if that refinery is put out of commission for a substantial period of time, history indicates that will affect prices in California.

We certainly will take the most careful look at any proposed mergers that affect the marketplace in California, as we have in the past and as we will in the future.

Senator SMITH. One more time on this earlier issue. You said that your concerns, except for one, were addressed in the conditioning of the merger. What was your other concern?

Mr. PITOFSKY. It is the point you made, Senator, about exports. I thought the order should have covered that. Now, I know the companies said they would not export. They made that announcement publicly and as far as I know they have not exported since it went through. But I thought we ought to get that down in writing, because who knows who will be running those companies and what the circumstances will be next year and the year after.

Senator SMITH. Thank you.

Senator Wyden.

Senator WYDEN. Thank you, Mr. Chairman.

Chairman Pitofsky, I thank you for coming and for your service. I think your service is going to be marked by a standard of fairness. I have watched the Federal Trade Commission, how often decisions are not even close, that the Commissioners can come together on even some of the most difficult issues, and I commend you for your service to the government.

Mr. PITOFSKY. Thank you, and I agree that the Commission can come together.

Senator WYDEN. Let me start with this question of red-lining to begin with. In my view, red-lining is about as anti-free enterprise as you can possibly get. On the basis of my inquiries, there is substantial evidence that this is going on up and down the West Coast, and that this is, in fact, sucking the competitive juices out of our West Coast gasoline markets, because with red-lining there is a restriction with respect to choice and who one can sell to.

My question to begin with for you is, in your opinion is there substantial evidence that red-lining of gasoline markets on the West Coast is taking place?

Mr. PITOFSKY. Yes.

Senator WYDEN. I understand that you cannot get into all of the details on this matter. I have essentially the same question with respect to zone pricing, because I again think that there is substantial evidence that West Coast gasoline markets are being priced by zone and that this is anti-competitive as well.

Do you believe in your opinion that that is the case as well?

Mr. PITOFSKY. Let me break it down. There is no question that it is going on. The companies do not make any apologies for that. They say they are engaged in these practices, what we call red-lining—I am not sure they would call it that—and zone pricing.

As to whether it is anti-competitive, I wonder if I could reserve on that. It is a matter of concern. We would not have spent 2½ years investigating in this area if it was not a matter of concern. I would like to reserve on balance whether or not there are justifications for that behavior.

Senator WYDEN. Can an oil company practice be legal and anti-competitive?

Mr. PITOFSKY. Can it be legal and anti-competitive? Well, not ordinarily, not ordinarily. If it is anti-competitive, under our statute that would make it illegal as an antitrust matter.

Senator WYDEN. Beside the e-mail exchange reported in *The Oregonian* between BP trading managers where they talk about shorting the West Coast market to leverage up the price, did you find other evidence from company files that BP was exporting at a lower price to Asia to manipulate West Coast prices?

Mr. PITOFSKY. I have asked about that in the past and the answer is yes. We were not a party to the effort by *The Oregonian* to obtain these documents and the assignment of that matter to a special master. But I understand that the special master did not turn over all the documents that were sought and there are other documents of the kind that you describe.

Senator WYDEN. *The Oregonian* also reported that BP used a computer model to manipulate West Coast prices by setting non-competitive discriminatory prices for many years. Are there other company documents that have not been made public that show BP engaged in discriminatory pricing practices?

Mr. PITOFSKY. This is BP's so-called optimizer model. I believe there are other documents. I am not as sure of that as I am about the earlier question. But I am fairly sure there are other documents not yet made public, placed under seal by the judge, that discuss that issue.

Senator WYDEN. Now, recognizing that it is hard to quantify, is it likely that I, my staff, and other Oregon consumers paid higher prices at the pump because of BP's exports of Alaskan oil to Asia and discriminatory pricing practices?

Mr. PITOFSKY. Yes. Our allegation was that the reason the company engaged in this practice of exporting oil was to raise prices on the West Coast. That was their goal. Now, I do not know that they achieved their goal, but that was what they were trying to do.

Senator WYDEN. Mr. Chairman, that is essentially the reason why we need to get access to these other boxes of documents. What the Chairman has just said is there is substantial evidence in his opinion that red-lining is taking place on the West Coast and he has found evidence of zone pricing. Besides the e-mail exchange reported in *The Oregonian* with respect to shorting the West Coast market, the Chairman has indicated that there was additional evidence in documents that have not been made public with respect to BP's export practices. The Chairman has indicated that there is evidence that BP used a computer model to manipulate West Coast prices. Finally, you, I, and other Oregonians, there is a likelihood that we paid higher prices at the pump because of BP's exports of Alaskan oil and discriminatory pricing practices.

So I am of the view that the Chairman has just spelled out why it is so critically important that this Subcommittee use its power

to work with the Federal Trade Commission so as to see these documents, because with the answers that the Chairman just gave to my questions, which by the way did not even go into this matter of the ARCO strategy on gas prices, which I did not ask about because you had not seen, what you have painted is a very troublesome picture.

What concerns me is that a company can go out and begin exporting in the middle of this hearing if they choose to do so. We can debate who did it and when they did it and the like. The fact of the matter is under current law they can begin to export at any time. The position of the government for West Coast consumers and others is we just have to trust them. Given the answers you have just given to my questions plus the memo that I did not even ask about today, I think we ought to get to the bottom of this and on a bipartisan basis look at those boxes to find out what is really taking place here.

I thank you for the chance to begin this hearing and Chairman Pitofsky for his answers.

Senator SMITH. Senator Stevens.

STATEMENT OF HON. TED STEVENS, U.S. SENATOR FROM ALASKA

Senator STEVENS. Thank you.

Mr. Pitofsky, I assume you are familiar with the fact that Oregon does not allow self-service in their service stations?

Mr. PITOFSKY. Yes, I am.

Senator STEVENS. They pay 5 cents more than anywhere else in the country just because of that, do they not?

Mr. PITOFSKY. I do not know exactly the number.

Senator STEVENS. That is my information.

On September 26th the FTC wrote to Senator Wyden, and I am quoting from our committee memorandum here. It wrote that:

> "The practices of red-lining and zone pricing raise serious questions about the effects on competition in gasoline markets." It went on to state how you define red-lining and zone pricing. It says 'Oil companies in Oregon and elsewhere,' the Commission noted, 'use red-lining. Though not all companies use red-lining on the West Coast, Chevron does, but BP does not."

As to its legality, the Commission wrote that

> "Arrangements by which independent business people are prevented by agreement from competing in the marketplace raise serious questions under antitrust laws. Whether they are legal or not depends on additional factors, such as market share and possible justifications."

Are you changing that statement now?

Mr. PITOFSKY. No, it sounds right to me.

Senator STEVENS. You just answered the question of whether it was legal or not without regard to the additional factors.

Mr. PITOFSKY. Oh, I want to be clear about this. Two points. One is, as your comment makes clear, red-lining and zone pricing is not limited to the West Coast. It goes on in other parts of the United States.

Senator STEVENS. It is not illegal per se?

Mr. PITOFSKY. It is certainly not—it is neither legal nor illegal per se.

Senator STEVENS. Right.

Mr. PITOFSKY. You have to find out the context and that is what we have been about for a long time now.

Senator STEVENS. That is the subject of another inquiry of yours, right?

Mr. PITOFSKY. It is.

Senator STEVENS. Now, my colleagues seem to believe that somehow or other you should have the power to limit where Alaskan oil can be marketed. To my knowledge, the only reason it was limited in the first place was that it was a condition required on the right-of-way permit for the Alaska oil pipeline, which was modified by Congress when we finally proved to Congress that it was unconstitutional.

I know of no other commodity that is limited in terms of where it can be marketed. If it is being marketed for another ulterior motive, which is the process that you are going through, that might be a different matter.

Do you disagree with what I have just said?

Mr. PITOFSKY. Not at all, Senator. That is exactly the point.

Senator STEVENS. I want to encourage my friends here from California and Oregon, the West Coast, to understand that so long as I am in the Senate we are not going back to the unconstitutional practice of limiting where Alaska products can be sold. Let us just make sure we have that basically understood.

We had this fight in Maryland once, by the way, over an amendment to a treaty that we had to have defeated on the floor of the Senate because of a similar limitation on where products from Alaska could be marketed.

Now, I do believe that there are a lot of problems involved in this matter today. For instance, it worries me considerably that between 1982 and 1999 the number of refineries on the West Coast decreased from 42 to 23. Yet somehow the decision to sell oil elsewhere—now, you may have some other facts that I do not have at my command. But the decision to sell elsewhere than the West Coast by the producers of Alaskan North Slope oil is, I think, partially reflected on the markets, is it not, down there? Their markets are limited because of the number of refineries.

In addition to that, California has some specific restrictions on the type of oil that can be refined in specific locations. So that the markets down there are not free markets. They are limited by California law. They are limited by Oregon law, too, as I understand it.

You understand those conditions?

Mr. PITOFSKY. That is why I opened my discussion by saying there is no one reason, this is a complicated area, and there were many factors. I do not disagree with the factors that you are now calling our attention to.

Senator STEVENS. Now, in the heyday of the Alaska pipeline when we were exporting 2.1 million barrels a day from Alaska, all of it going down to the West Coast from the North Slope, that was not purchased in Washington and in Oregon and in northern California. It got into southern California and the producers then faced the question of, shall we send that oil down and send it through the Panama Canal and send it back up into the East Coast or shall we just dump it in southern California?

I think the case can be made that for years the producers dumped oil in California rather than pay the costs of that shipping because their net-net was higher because of the cost of transportation and the fees of going through the pipeline or through the Panama Canal pipeline.

Since this, since the reduction in our throughput, we are down now to about 1.2, 1.3 million barrels a day, almost a million barrels a day less. There is not the supply. There is some competition now for Alaskan oil. I wonder about that in terms of your inquiries and to what extent that has been taken into account, or is that proper for me to ask?

Mr. PITOFSKY. On past cases, absolutely proper. That is certainly an issue. I do not know as much about the history going back to 1982, but your description of the decline in the supply of North Slope oil is exactly right, and we took that into account in our review of cases that affected West Coast prices.

Senator STEVENS. You and I had a disagreement before. We patched that up a little bit.

Mr. PITOFSKY. I hope so.

Senator STEVENS. I do, too. But as a practical matter, one of our differences of opinion was that you had described the West Coast market as a separate market from the global market. Do you still maintain that position?

Mr. PITOFSKY. Yes, I do. Well, no, I am sorry. Senator what we, what the Commission described, was a product market that was limited to Alaskan North Slope crude which was separate from the world market. It was not that the West Coast geographically was different. It was that those two types of oil competed in separate markets.

Senator STEVENS. Well, perhaps we will have some time again to discuss that. I personally believe we have made a historical mistake in not establishing a posted price for oil in Alaska. We are the only market in the world that does not have a posted price in the place of production. As such, we are destination priced. As such, that affects this competition for Alaskan oil because of the net-net to the producer. The further you go, the less your net is.

In many respects it is closer to Japan than it is to Los Angeles. I hope people keep that in mind in this hearing.

Senator SMITH. Thank you, Senator Stevens.

Senator Boxer.

Senator BOXER. Thank you.

First of all, Chairman Pitofsky, thank you for saying that you are going to have this study on California high prices completed in 30 days. I am very grateful for that. It has been a source of tremendous frustration for me because, as you point out, it is a complicated area, but our constituencies expect us to get something done for them and they do not understand, and they keep asking me all the time, where is that? You promised us the FTC was going to do this. Where is it?

So now I am going to tell them, and I've got you on the record and I am happy. May 25th I look forward to getting the report.

These prices are hurting us in California and anyone can put any spin they want on it. But to me there are a lot of things that I see that are not right. It is not right to red-line. It is not right to have

the zone pricing. It is not right to drive people out of independent stations. I ask unanimous consent that this letter be placed in the record from Gary and Deborah Ray, whose family owned a station for 39 years and were run out of town on a rail. I would like to include that. There are so many more of those.

Senator SMITH. Without objection.

[The material referred to follows:]

DECEMBER 14, 1999

Hon. BARBARA BOXER,

DEAR MR. HAGEN: I spoke with you a few days ago regarding our Chevron station at 2007 Redwood Rd. Napa, CA. This is a three party station. My father-in-law opened the station 39 years ago, when he passed away 7 years ago, we purchased it from the estate for $300,000. My husband, Gary, has worked there since he was 15, he is now 45. Every 2 years Chevron gives us a hard time on our lease renewal. Our station pumps over 230,000 gallons a month and makes a good living for us, even though Chevron charges us a rent of $14,000-$16,000 a month, depending on what we pump.

In June, Larry Oliver had a meeting with my husband and me stating that they would not renew with us because they wanted all the profits and that if it was not a company-owned station it would not be there. Furthermore they would not be buying us out. Which means they are probably going to slide in after the lease ends. The land owner told us that be has to wait until they decline, stating that they have first right of refusal, otherwise we could go ahead and do a deal with him. So we have to wait until the eve of December 31, 1999, when our lease is out. If we leave at that time, they can say that we abandoned it. Also, for some unknown reason our in-house credit card accounts have been denied.

My husband has become a Shell dealer hoping to put a Shell Station there, since Chevron says that they are leaving the site. We along with our Shell Rep find this all very hard to believe. All we request from Chevron is a letter that they are not renewing the lease with the land owner after we leave, but they refuse to comply.

Please help us out if you can. If this had to go to court, we would go broke because we all know that we cannot afford to fight the corporations. The person to contact concerning the letter that states Chevron is leaving that site is Greg Wankent at (925) 842-9551. We would appreciate future contact with you on this matter. Thank you for your time.

Sincerely, Gary & Debra Ray

Senator BOXER. Then you put all of these little pieces together and you have to be just born into the world yesterday not to see a pattern of disturbing things. Red-lining, oh, it is not illegal. Zone pricing, well, it is not technically illegal. Mergers, well, we do not know that they are responsible for the problems.

But yet if you take a graph and you show the number of mergers that have been approved and then you show the price of gas, there is a correlation with the number of mergers and price increases. So somebody could say, fine, it is not illegal, it is not a problem. Meanwhile, my people are paying $2.16 for the lowest grade of gasoline today. That was yesterday. I do not have a later picture. I do not know where it is headed. It is not right.

I see a pattern that is very disturbing to me. Then I see Ron Wyden's work here along with *The Oregonian*, and I just want to read what he said, the little jump quote here: “When you look at the ARCO report, it is clear that their very business model, the essence of their business, was to take advantage of the lifting of the export ban to manipulate supply and stick it to the people on the West Coast.”

That is a strong statement. But guess what? It is backed up when you read the document, which you have not had a chance to examine.

Senator STEVENS. Are those documents here, Senator?

Senator BOXER. I do not know.

Senator WYDEN. Would the Chairman yield to me? These documents are not confidential. They are public documents. They come from the California lawsuit. I am happy to make them available to the Chairman. These are not the confidential documents.

I appreciate the Chairman's question because I want to draw the distinction. I think it is extremely important on a bipartisan basis for this Subcommittee to have access to those sealed documents involving the BP-ARCO acquisition matter. I think that that will shed a great deal of light on this. I am interested in working with you, Mr. Chairman, figuring out a way to do this in a fair process.

But the memo that Senator Boxer is talking about is one that, I have obtained it already. It is a public document involving the California lawsuit. I am happy to make it available to you.

Senator STEVENS. Well, I do not want to interfere with Senator Boxer's comments, but I take the position that there are documents that the Federal Government requires to review a proposed business transaction which are by law confidential. If you want to make them not confidential, then pass a law to break the confidentiality. They were acquired in the process of a confidential disclosure to determine whether or not the merger was in the public interest, and I oppose and shall oppose the breaking of that confidentiality by our Committee without really advice from the Justice Department and others about what that is going to do to future disclosure by companies that are under review for antitrust, concerns of the government over antitrust. But it is a merger, a private series of documents that are disclosed in order to justify their case.

Senator BOXER. This document has nothing to do with the merger, Senator Stevens, and that is what I think Senator Wyden was saying.

Senator STEVENS. These are documents that were filed in connection with the merger, are they not?

Senator WYDEN. No.

Senator BOXER. No, this is a lawsuit because of the pricing.

Senator STEVENS. Are they confidential?

Senator WYDEN. No.

Senator BOXER. No.

Senator WYDEN. There are two sets of documents in question: the one involving the merger, which I think those 1400 boxes which have been sealed, this Subcommittee should work out a way to look at. That is sealed and is confidential.

But as Senator Boxer and I have both said, this memo does not involve merger activity. It is not sealed. It is not confidential. It is a public document.

Senator STEVENS. I will withhold until we get to the subject of the ones in the boxes, because those were given, as I understand it, under a process that confidentiality was assured in terms of complete disclosure, and it will harm the antitrust situation in my opinion if we put a mar on that by saying if we give them to the FTC or the Justice Department under a confidentiality restriction the Congress can come on later and wash it off.

Senator WYDEN. Mr. Chairman, would you just yield further on that, because you are making a very important point. I am not interested in breaking that confidentiality through a public process.

What I am interested in is seeing that this Subcommittee, through a process that protects the confidentiality, can examine those documents, because I think the Subcommittee needs to see those documents in order to address these important issues.

Senator STEVENS. If they are confidential, how did they get into *The Oregonian*?

Senator WYDEN. Mr. Chairman, again this story does not deal with those documents involving the 1400 boxes, nor does the previous story.

Senator BOXER. If I might say, these are documents that were gotten during discovery process by the consumer attorneys who were trying to make the case that there was price collusion. If I could just continue my point, I agree with Senator Wyden's conclusion here in which he says when you look at this, again you would have to be pretty naive not to think there was manipulation of the supply.

I am all for supply and demand, but it is not real, it does not work, when the supply is manipulated. In this discovery—and again, I am reading. I have not seen the actual documents, although Senator Wyden, I assume has seen them—it describes—there is a memo there that describes ARCO's action plan "to export to keep the market tight" as part of "maintaining balance on the West Coast." Then e-mails that say—records obtained included e-mail exchanges in which BP trading managers discussed the benefits of "shorting the West Coast market to leverage up prices."

Well, maybe if you are from a State where people are not hurting this sort of goes over your head. But when you are hurting like we are in our State, this makes us get angry. I am sorry about it.

I also feel very differently on the confidentiality. I have a different view. It is not before us now, but I believe taxpayers pay good money for the FTC to operate and it is a government agency. It does not run at the behest of oil companies, multinational oil companies. It is supposed to protect consumers right here in America. So I view the issue a little differently.

I would like to work out some kind of compromise. I think I have been talking to the FTC Chairman for a long time about getting a look at some documents. He said absolutely not, cannot even look at them, cannot even see them, cannot even get a hold of them, you cannot know what I know. I mean, he defended the confidentiality, as he should, under the law. I want you to know that.

But I feel at a great disadvantage. The people elected us to do a job. If I do not know what is going on and I have got to piece it together—red-lining here, zone pricing there, exporting to Asia when we needed the oil on our West Coast here, 60 percent increase in profits there, $17 million bonus to a CEO on top of a $13 million bonus to an oil company, and I am adding it all up and I am saying on behalf of my constituents I am concerned.

Mergers, you follow the mergers and you follow the prices. It is not that hard. I have got it in Los Angeles. I held a press conference at a corner where there were four different gas stations. All had the same price. One was a Shell, one was a Chevron, one was something, something, and they all had this. It is in the zone.

It is frustrating. So today I am so relieved that we are having this hearing. I am relieved to hear we are going to have a report

soon. I am very concerned. I know Senator Stevens probably has the votes on the export issue. I said that I am willing to even look if California companies are exporting out of the country at a time when—you know, this is not a piece of candy or something—this is a necessity for our economy, to keep our engine going.

Anyway, I am quite concerned. Again, I just want to thank our two co-chairs today.

Senator SMITH. Thank you, Senator Boxer.

We have been joined by the Subcommittee Chairman, Mr. Fitzgerald.

STATEMENT OF HON. PETER FITZGERALD, U.S. SENATOR FROM ILLINOIS

Senator FITZGERALD. Well, thank you, Mr. Chairman, I guess I should call on you, for the day anyway.

Senator SMITH. Only in your stead.

Senator FITZGERALD. Thank you very much. I would like to have an opportunity just to ask Mr. Pitofsky about the situation we had in Chicago—I remember it was a little over a year ago—when our gas prices in the Chicago metropolitan area were going up much faster than in the rest of the country. There were a lot of calls for investigations at that time of the oil companies, but ultimately the FTC did a study to see whether there had been any collusion amongst refiners.

Mr. Pitofsky, if I am correct your study ultimately concluded that you did not find any collusion amongst oil company executives in the Chicago area; is that correct?

Mr. PITOFSKY. That is correct.

Senator FITZGERALD. There were allegations or suggestions or innuendo that there had been something amiss amongst the oil marketers in the Chicago area. There was a lot of suspicion. People did not know why prices were going up. But it turned out as I recall that your report suggested that actually two pipelines bursting, the taking effect of new Clean Air Act requirements in the Chicago area, a variety of factors caused the supply to be very low and the demand to be very high, and the prices went up.

I just wonder. My experience has led me to believe that we ought to be kind of careful before going out and potentially ruining the reputation of good people by alleging criminal conspiracies before we have any facts. The allegation of collusion is very serious. There are criminal penalties in the law, are there not, Mr. Pitofsky, for collusion by oil companies or others?

Mr. PITOFSKY. Price-fixing can be treated criminally.

Senator FITZGERALD. And you can be thrown in jail for that.

Mr. PITOFSKY. Yes.

Senator FITZGERALD. So I think, while it is fine to have these investigations, we ought to wait until we have some evidence before we start throwing out those allegations, because they are very serious allegations and I think there can be good explanations for why prices go up.

Do you have a copy of the report? Would your staff have a copy of the report that you ultimately issued on Midwest gasoline?

Mr. PITOFSKY. Absolutely. We will get it to you promptly.

Senator FITZGERALD. Mr. Chairman, I would ask for unanimous consent that, if we get a copy of that report on the investigation that was done of Midwest oil prices a year ago, that we enter that into the record. After a lengthy investigation, they found that there had been no collusion and that, in fact, supply was tight and demand was high and that is why prices went up so dramatically in Chicago. After it was up for a while, actually demand died down and product was rushed to the market and prices fell again.

Senator SMITH. Without objection, we will include that.

[The report is available on *www.FTC.gov* and in Committee files.]

Senator FITZGERALD. Thank you very much, Mr. Chairman.

Senator SMITH. If the Chairman will yield, the point you are making is a good one, but what we are concerned with is the ARCO memo from 1996 and the internal BP-Amoco memo was from 1995. I guess the question is when it comes to an allegation of market manipulation, you approved a merger between this. Did you, Mr. Pitofsky, the FTC, essentially ratify a price-rigging scheme?

Mr. PITOFSKY. In BP-ARCO?

Senator SMITH. Yes.

Mr. PITOFSKY. Absolutely not.

Can I just clarify one point, Senator? You are absolutely right. The report speaks for itself on the Midwest gas prices. You are right, after a careful investigation we found no collusion. We also found that for the most part the reasons prices spiked up in Chicago as they did were reasons that were beyond the control of the oil companies, like a rupture in a pipeline and many other reasons.

However, we also found that at least one and maybe more companies engaged in strategic behavior to make sure that prices did not come down. That is the sort of thing we are talking about here in terms of exporting oil to the Far East to make sure prices do not come down. But there was no collusion and I think that is in the report.

Senator FITZGERALD. There is nothing illegal about that, though, is there? I mean, companies try every day to keep their prices as high as the market will bear, do they not?

Mr. PITOFSKY. Single firm behavior taking advantage of that situation is not illegal. But we were asked by Congress, not just whether there was a violation of the antitrust laws, but whether there was profiteering of some sort, and we addressed that question. But it is not illegal, you are right.

Senator FITZGERALD. It becomes illegal when they collude to try and fix the prices, and that was not found in the Chicago situation. But you did find, sure, companies were trying to on their own, hoping that the demand would stay high and the low supply could give them the opportunity to sell their product at a high cost.

Mr. PITOFSKY. They were taking advantage of that situation, in some cases to the maximum extent possible. One case, a company kept oil that it had off the market to make sure the prices did not come down during that price spike.

Senator FITZGERALD. Is there anything illegal about that?

Mr. PITOFSKY. No.

Senator FITZGERALD. No.

Senator BOXER. Mr. Chairman, would you yield to me?

There is a lot that is not illegal in life. You could walk up to the line of being unethical and not be illegal. I would hope that what we are about—and I agree with you, we should not throw around criminal terminology. That is not appropriate, to do that. But I would really hope that we would not sit by and be silent.

If people were manipulating the supply, even if it is legal, and if it hits our people in such a way that it is disadvantageous; you must see this as an ugly thing. Look at this ugly thing. This is San Francisco gas prices yesterday. I would hope that we would work with the corporate community for some sense of responsibility here. Maybe that is impossible. Maybe the attitude is you walk up to the line; it is not illegal, so sue me.

Senator FITZGERALD. But you would agree that we have a low supply of crude oil in this country, would you not, Senator?

Senator BOXER. I think in this case, when you export some of it out to another country, yes. If you manipulate the supply, yes.

You know, we are facing this in California, and maybe it is not illegal, but gee, it is amazing how many plants are shut down for repair all at the same time. It is amazing. It is a great concern to me that the consumer does not seem to have—well, I will not go there.

I would just say that we are waiting for a report that we asked for 2½ years ago.

Senator FITZGERALD. Will the Senator yield for a question?

Senator BOXER. Yes. I will just finish my point.

If I might just tell my friend that in 30 days we are going to have a report on California pricing. I will also want to enter it into the record here. I do not know if it will show illegality or immorality or something in between or something or neither. But we are going to show something there, because it has taken 2½ years to get it done. I think there is something there. But I will share that with you.

Senator FITZGERALD. If the Senator would yield, you would agree that the oil companies are doing very well right now? They are making a lot of money in this current climate, where they can resell gasoline at very high prices.

Senator BOXER. Yes, some of them are up 60 percent in their profits. Conoco is up 59 percent.

Senator FITZGERALD. Now, a couple years ago when oil was close to $10 a barrel, a lot of oil companies were not doing as well. That is when they started doing the mergers. Their stock prices were low. They were not as profitable as they are today. Would you not think they would be more likely to collude or to have criminal behavior when they were desperate and they are not making money and jobs are on the line and those executives you talk about are not getting the bonus?

It almost does not make sense to me that at the moment their companies are most profitable they would resort to illegal collusion. I know it is a good sound bite because a lot of politicians in Illinois were running up and down the State saying: We cannot explain these high oil prices; there has got to be criminal collusion on the part of the executives. But I thought, boy, that is a serious charge, and to think that some of those oil company executives are sitting in a back room engaging in a criminal conspiracy for which they

could have time in a Federal penitentiary—I think we have got to be careful about going out and hurling those kind of charges.

Ultimately in Chicago, after a lot of people were implying there was criminal allegations or criminal conduct on the part of a lot of oil company executives, they found nothing criminal after an investigation by Mr. Pitofsky's agency.

So I just wanted to share that experience with you that we had in Chicago. It may well be that there are very good reasons that the prices have gone up on the West Coast as they have gone back everywhere else in this country now.

Senator BOXER. Well, Senator, let me just say the record will show I have not used the word "collusion" since I sat down here. What I have said is there is a lot of things going on that when you put it into a pattern it raises concern to me.

No, I do not expect that corporate executives who are ethical would ever collude or would ever break the law, and I expect that they would never do that. I would hope that, in addition to never doing that, I hope that they would not take advantage of a situation. Again, I think asking the question, is it illegal, is a good one. It is a very good one, particularly in a court of law. But around this place I would hope we are concerned about the way consumers are treated, whether supply is manipulated, whether it is legal or not.

I think it is a concern for consumers and it could impact this economy in a very heavy way.

Senator FITZGERALD. Can I offer one note of encouragement to the West Coast?

Senator BOXER. Yes.

Senator FITZGERALD. After our prices were the highest in the country in the Midwest for a sustained period of time, for several weeks, they started rushing supply to the Midwest because you could make more reselling your oil in the Midwest than anywhere else in the country, and by the end of last summer the Chicago area had amongst the lowest gas prices in the country.

Senator SMITH. We look forward to that this summer. I do not expect it, though.

Senator FITZGERALD. That is reassurance for those who believe in the free market system, because I think we see this same cycle in agriculture. When the price of cattle is really high, people rush to production and then it plummets. I think that we are seeing a cycle that is old as the ages of supply and demand here. That was my impression after going through this last year in the Chicago area.

I think we need to increase supplies of fuel oil and decrease demand the best we can.

Senator SMITH. Thank you, Senator.

Mr. Pitofsky, we are not quite done with you. Just a few more questions. So if anyone has a second round, we will proceed with that.

You have heard the charge and my question to you is this. If the FTC's allegations are true and BP kept oil prices on the West Coast higher by exporting Alaskan North Slope crude to Asia, is this a violation of Federal law?

Mr. PITOFSKY. Is that behavior in and of itself a violation?

Senator SMITH. A violation.

Mr. PITOFSKY. No, it is not.

Senator SMITH. If not, why not? We have not done anything about it.

Mr. PITOFSKY. Even if I were on the Supreme Court, I do not think I—it is single firm behavior. Our antitrust laws are very generous to single firm. We are tough as can be on collusion, but on single firms behavior—proving an attempt to monopolize, which is what that is all about, is enormously difficult and there is no precedent for challenging that kind of behavior.

Senator SMITH. The expert that you hired during the FTC's review of the BP-ARCO merger and who we will hear from later today says that BP's Asian exports increased West Coast gasoline prices by at most a quarter-of-a-cent per gallon. Do you agree with that figure?

Mr. PITOFSKY. I do not know. We were not required to quantify. We did not quantify. At the time we went into court all we said is they had the power to do it and they did it. What the consequences were we were never called upon to address.

Senator SMITH. Finally, without commenting too much on the investigation and the report that you are about to submit, are you finding any other reasons for the loss of over 600 gasoline stations since 1990?

Mr. PITOFSKY. In Oregon? We have not looked at that question.

Senator SMITH. Thank you.

Senator Wyden had a question.

Senator WYDEN. I just want to draw again the distinction between collusion, which is obviously illegal, and these anti-consumer practices. As you know, Mr. Chairman, I asked your opinion today because you have an ongoing inquiry. So I just ask you your opinion. I did not ask you if there was substantial evidence of collusion. I asked you if there was substantial evidence in your opinion of, in effect, supply manipulation. You indicated to me that there was. You said that with respect to red-lining and also laid out your views with respect to zone pricing as well.

Is it not correct to say that supply manipulation can be anti-consumer?

Mr. PITOFSKY. It can be. On the other hand, I want to be clear about this. In this area of the law what the courts do is they look at the competitive effect, but then they look at the business justifications. Generally speaking, when you are talking about where jobbers or distributors can sell, location, the law is very generous to the manufacturer or the refiner.

I think I said to you, I once checked, and of the first 20 cases, the defendants won 19. That is one of the reasons that we are so careful about examining this situation. Yes, there can be anti-competitive effects. But unlike price-fixing, they can be outweighed by good business justifications.

Senator WYDEN. One additional question with respect to the effect of the BP merger on the consumer at the pump. *The Oregonian* recently quoted the economist that you hired, one of the two economists that you hired to analyze the merger, R. Preston McAfee, a Professor at the University of Texas at Austin, who said in his opinion that the merger translated to 1 to 3 cents a gallon extra cost at the gas pump.

Now, if you were to take the millions of gallons of gas sold on the West Coast and Mr. McAfee was right that it was 1- to 3-cents-a-gallon, we would be talking about a very substantial sum of money to BP, is that not correct?

Mr. PITOFSKY. Yes, although I do want to signal that——

Senator WYDEN. You have not quantified it.

Mr. PITOFSKY [continuing]. testimony later will be that that 1 to 3 cents is a little on the high side. But we have not quantified it, but obviously, it would be a very big number.

Senator WYDEN. Would it not be fair to say if you are talking about millions of gallons, even if it was 1 cent a gallon, you would be talking about a pretty big number in terms of the company's bottom line, would you not?

Mr. PITOFSKY. We did a rough estimate some time ago based on government statistics and I believe 1 cent per gallon would translate into about $200 million.

Senator WYDEN. A year?

Mr. PITOFSKY. A year.

Senator WYDEN. Thank you, Mr. Chairman.

Senator SMITH. Senator Stevens.

Senator STEVENS. I have one last question or comment.

Mr. Pitofsky, ARCO is gone. This is 1995-96 we are talking about. We have had oil and gas prices drop down to $9 to $10 a barrel. We have had other mergers. We have had other investigations. We have had situations where the industry tried to build up markets in Asia as the markets were becoming flooded with foreign oil in California.

Have you had any reason to investigate as the FTC the pricing situation as far as the North Slope oil in terms of the Asian markets in general?

Mr. PITOFSKY. We have not.

Senator STEVENS. Have there been any complaints filed with you about unfair practices, of people being denied oil in California because oil was being shipped to Japan or Asia by our North Slope producers?

Mr. PITOFSKY. I am not certain. I can find out the answer to that. Offhand, I do not recall. Well, there may have been. There may have been complaints, Senator. Let me get the answer for that question.

Senator STEVENS. I would like to see that, because when I look at the situation here I understand that gasoline prices are up pretty high in California right now, but I also know that in the period of $9 to $10 a barrel oil, my State lost billions of dollars. We had producer after producer fold and leave Alaska. We are a very high-priced area.

It seems to me very strange that we are going back to 1995 and 1996 allegations concerning a company that is dead and now bringing all that and putting it on the one surviving major that is there in terms of this West Coast production. I would like to see if you have had allegations to that effect.

Mr. PITOFSKY. We will look for that, Senator.

Senator BOXER. If I might, Mr. Chairman. I would just say in this article that we have been quoting extensively from——

Senator STEVENS. Ma'am, I have got to tell you I did not come here to debate with you. I came to listen to witnesses.

Senator BOXER. I wanted to give you the answer to your question, Senator.

Senator STEVENS. I did not ask you a question, Senator.

Senator BOXER. Well then, I will take my own time. That is fine. Mr. Chairman, may I have a minute, please?

Senator SMITH. Yes, we are on the third round and it is your turn.

Senator BOXER. Thank you very much.

If anyone is interested as to whether there has ever been a question from California consumers about the export of Alaska oil, I would ask them that they should read this article and they should go to this particular case, which is *Aguilar* vs. *ARCO*. In fact, that is where these documents come from, and they are from 1997.

So yes, there have been, if anyone is concerned—any Senator or any person in the audience—as to whether California consumers have complained, there is a class action suit filed by a number of California consumers dealing with this. It is actually *Aguilar* vs. *Atlantic Richfield et al.*, a 1997 consumer class action that accused ARCO and other California refiners of price-fixing. It goes to all of these issues.

So we have had these complaints and that is where these documents are now being made public.

Thank you very much. Thank you again; I am looking forward to your report.

Senator SMITH. Mr. Pitofsky, I think that concludes our questioning and we thank you for your appearance today.

Mr. PITOFSKY. Thank you all.

Senator SMITH. We will now call forward our next panel, which is: Mr. Jim Wells, the Director of the Natural Resources and Environment of the General Accounting Office; and also Mr. John Cook, the Director of the Petroleum Division of the Energy Information Administration.

STATEMENT OF JIM WELLS, DIRECTOR FOR NATURAL RESOURCES AND ENVIRONMENT, U.S. GENERAL ACCOUNTING OFFICE; ACCOMPANIED BY FRANK RUSCO, SENIOR ECONOMIST, RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION, GAO

Mr. WELLS. Thank you, Mr. Chairman and Members of the Subcommittee. Accompanying me today is Frank Rusco, a fellow team member who worked on our gasoline work.

As you know, gasoline prices in the West Coast States are frequently among the highest in the Nation. The West Coast States also tend to experience longer periods of high prices compared to other areas in the United States. It is sort of a legacy of the West Coast. High prices have caused public concern and can be a hardship to consumers, especially with low-income families and those that depend on driving for their livelihoods.

GAO has done a body of work over a number of years that sheds some light on some of the root causes for West Coast high gasoline prices, which I will summarize today. But before I do, I want to begin with four points that will help put the discussion in context.

As you, Mr. Chairman, mentioned in your opening statement about clarity and balance, what I want to do is talk about four comments here to put some balance on what is going on in the marketplace right now, and then we will talk about the West Coast prices.

Gasoline prices differ from other commodities in that prices are very visible to the public. Prices are publicly displayed virtually at every station on every street and consumers are making frequent purchases. When prices rise quickly, as they have numerous times in the past, not only do the consumers immediately observe it, but they also feel it in their wallets. I doubt that consumers can tell you the same about milk or bread price behavior.

Gasoline and oil prices typically fluctuate widely from season to season and even year to year. For example, in 1998, GAO was called upon to explain why crude oil prices were so low that some domestic producers were actually closing their wells and going out of business. One year later, GAO was called in again to explain how refinery outages in California led to high gasoline prices and price spikes. Again, high fluctuation as a commodity.

While rising prices are alarming to consumers, it is important to put gasoline prices in real dollar terms to understand their actual economic impact. For example, the 30 cent per gallon gasoline of the 1960s would be equivalent to a price roughly today of $1.75 in today's dollar, while the $1.25 gasoline of the 1980s would be equivalent to roughly $2.50 per gallon today. So to place that in context, the national average today, although not on the street corner of the photograph in San Francisco, of $1.65 per gallon is not a historically high figure.

I want to pause just a second to point out that nevertheless, in terms of real dollars, these recent increases in prices and the potential for higher prices this summer is a very valid legal concern—legitimate concern, as expressed so ably by Senator Boxer and others.

The fourth factor I want to talk about is a consideration of the large and growing demand for this commodity, gasoline. While fuel economy efficiency for automobiles almost doubled from 1973 to 1985, there has been very little improvement occurring today. This is partially explained by the increase in popularity of the SUVs and light duty trucks, both of which are subject to lower fuel efficiency standards.

My point is, the fact today, Americans are consuming over 130 billion gallons of gasoline per year, which equates to about 1 gallon of gasoline out of every 9 consumed worldwide.

So with that context in mind, I just want to briefly turn to the work that GAO has done in the past 3 years and talk to some of the root causes, not all causes, for high gasoline prices on the West Coast. The West Coast market, which you have heard, is clearly characterized by a tight balance between supply and demand, and the West Coast is, in effect, isolated a little bit from the U.S. gasoline markets elsewhere. For example, in order to meet consumer demand in the West Coast, the refineries in California are operating flat out.

Another important factor in determining prices in the short run is this level of gasoline inventory figure that can be documented. A disruption in production causes an immediate response to turn

to inventories to meet the demand. Classic economics say that if the inventories are insufficient, demand will quickly push that price up. In recent years that is typically what has been happening in the West Coast. There has been low inventories of gasoline. There is no storage place to turn to meet that demand, and this has added to the tendency for prices to soar quickly.

Our comparison of gasoline prices in the cities throughout California, Oregon, and the State of Washington, in the three States, confirmed to us that essentially the entire three States are part of a single market for gasoline. What that means is what happens in one State, whether it is California or Oregon, has some impact on all three.

I can also say that there are individual States that have attributes that do also tend to increase the gasoline prices. For example, California uses the boutique gasoline designed to reduce harmful exhaust emissions that causes smog. This is a good thing, not to have smog. Oregon, on the other hand, depends completely on out-of-State supplies for its gasoline. It has no refinery capacity, but most of it must come from a single pipeline in the State of Washington. If something happens to that pipeline, Oregon pays the price.

In conclusion, Mr. Chairman, our work has shown that prices have been volatile in the past and we have every reason to believe that this is going to continue in the foreseeable future. It is not going to change overnight. Unexpected events will continue to cause price spikes. While the timing of these events is unpredictable, clearly they will occur.

For example, the unexpected refinery outages and pipeline disruptions cause prices to rise. More recently, there have been unexpected refinery outages in the U.K., Aruba and just last Monday, as mentioned in Carson, California. Looking toward this summer, there are also potential concerns: potential electricity blackouts in California and the West. Some would say the word "potential" is not the right word, but clearly this has the potential to affect refinery production and distribution on the West Coast. If they occur, gasoline prices, high gasoline prices this summer are a sure bet.

I want to end here not so much on a sour note. If there is any kind of a silver lining in the current situation, to the current cloud of high gasoline prices, it is that historically we have observed that if you have high gasoline prices, as Chairman Fitzgerald was alluding to earlier, it has always had a tendency to encourage eventually a supply response that could perhaps bring down prices. So I want to end with: Perhaps there is hope this summer for gasoline prices.

Thank you, Mr. Chairman, and when the panel concludes we will be glad to answer questions.

[The prepared statement of Mr. Wells follows:]

PREPARED STATEMENT OF JIM WELLS, DIRECTOR, NATURAL RESOURCES AND ENVIRONMENT, U.S. GENERAL ACCOUNTING OFFICE

Mr. Chairman and Members of the Subcommittee: I am pleased to participate in the Subcommittee's hearing on the causes of high retail gasoline prices in California, Oregon, and Washington. As you know, prices in West Coast states are frequently among the highest in the Nation and these states tend to experience longer periods of high prices compared with other areas in the United States. As of March 27, 2001, the retail prices of gasoline in West Coast states were higher than the national average—the average national price for a gallon of unleaded regular gaso-

line was $1.43, compared with $1.72 in California, $1.57 in Oregon, and $1.56 in Washington. Furthermore, according to the Energy Information Administration, gasoline prices are expected to rise this summer and price volatility remains a concern.

Over the last 3 years, GAO has issued several reports on gasoline prices and gasoline price behavior in two West Coast states—California and Oregon.[1] Our analyses focused on observable factors that affect gasoline prices and did not address issues concerning the competitiveness of gasoline markets, which may also affect prices in these states. In addition, we issued a report in response to a mandate in Public Law 104-58 to determine the effects of lifting the ban on Alaskan crude oil exports on crude oil prices and production, refiners, consumers, and the oil shipping industry on the U.S. West Coast.[2] My testimony, which is based on these reports and related work, specifically discusses factors affecting gasoline prices in California, Oregon, and, more generally, the West Coast. In summary, I will make the following points:

- The West Coast gasoline market is characterized by a tight balance between supply and demand, and is isolated from other U.S. gasoline markets. For example, in order to meet consumer demand, refineries in California operated at about 97 percent of capacity in 1999 compared with about 93 percent nationally. In addition to the overall tight balance between supply and demand, the West Coast market is isolated from out-of-state sources of gasoline so that supply shortages cannot easily be replaced. Both these situations cause rapid price increases in reaction to supply disruptions.
- Our comparisons of gasoline prices in cities in California, Oregon, and Washington found that individual markets in the three states are closely linked and are essentially part of a single market for gasoline on the West Coast. Gasoline prices for cities in these states, while differing at any given moment in time, generally followed similar patterns with respect to price increases and decreases. As a result, any event that caused a significant price change in one State could affect the gasoline prices in other West Coast states.
- While California, Oregon, and Washington are essentially part of the same West Coast market, each State has attributes that tend to increase its respective gasoline prices. For example, California uses a "boutique" gasoline designed to reduce the harmful exhaust emissions that cause smog. In contrast, Oregon depends completely on out-of-state supplies for its gasoline, much of which comes through a single pipeline from the State of Washington. These attributes, among others, lead to higher gasoline prices in these states. Moreover, within any given state, local market conditions may cause prices to vary considerably.
- Our analysis found that lifting the export ban on Alaska North Slope (ANS) crude oil caused the West Coast price of this oil to rise but it did not significantly affect the price of gasoline.

WEST COAST MARKET IS TIGHT AND ISOLATED

The West Coast gasoline market is characterized by an especially tight balance between supply and demand, and is isolated from other U.S. gasoline markets. In general, California's gasoline demand dominates the West Coast market. Based on 1997 data, the last year data on international gasoline consumption were available to us, California is the third largest gasoline consumer in the world—behind only the rest of the United States and Japan—and its consumption is being met almost entirely by supply from refinery production within the state. In addition to making California's boutique CARB gasoline, some of California's refineries produce conventional and other reformulated gasoline to supply to western markets, such as Oregon, Arizona, and Nevada.[3] To meet this high demand for gasoline, California's refineries produce at almost full capacity. For example, in 1999, California's refineries operated at about 97 percent of capacity compared with a national average of about 93 percent. Because the existing refineries in California have virtually no spare capacity, unanticipated refinery outages, such as those caused by mechanical problems, can cause supply disruptions and rapid price increases not only within the State but also in other western states that it supplies. California refineries experienced unanticipated outages every year from 1995 through 1999.

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[1] Motor Fuels: Gasoline Prices in Oregon (*GAO-01-33R, February 23, 2001*), *Motor Fuels: Gasoline Price Spikes in Oregon in 1999* (GAO/RCED-00-100R, Feb. 23, 2000) and *Motor Fuels: California Gasoline Price Behavior* (GAO/RCED-00-121, Apr. 28, 2000).

[2] *Alaskan North Slope Oil: Limited Effects of Lifting Export Ban on Oil and Shipping Industries and Consumers* (GAO/RCED-99-191, Jul. 1, 1999).

[3] CARB stands for California Air Resources Board, the State agency that administers California's emissions-reducing gasoline program. CARB gasoline is designed to reduce harmful exhaust emissions that cause smog.

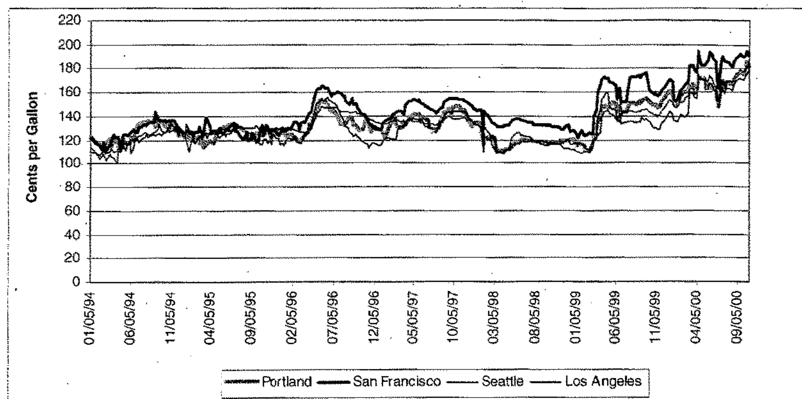
When unanticipated refinery outages occur, other out-of market sources have to supply gasoline to make up for the lost production. However, the West Coast market is isolated from other major refining centers because it has few, if any, pipelines that can bring gasoline to the West Coast states. Therefore, tankers and other means must be used. The process is slow and costly compared with pipelines. Gasoline shipped into California (and other West Coast states) by tanker from such places as the U.S. Gulf Coast, the U.S. Virgin Islands, Europe, and Asia, can take between 11 and 40 days and add 3 to 12 cents per gallon to the retail price. In addition, the uniqueness of California's CARB gasoline further isolates the state's gasoline market, because only a few refineries outside California can produce CARB gasoline. Moreover, these few refineries are not designed to make CARB gasoline routinely and the refining operations have to be reconfigured to produce it. This reconfiguration process, some oil industry officials told us, can take up to a week and adds to the cost of production.

WEST COAST STATES ARE ESSENTIALLY PART OF A SINGLE MARKET

Our comparisons of gasoline prices in cities in California, Oregon, and Washington found that individual markets in the three states are closely linked and that they are essentially part of a single gasoline market on the West Coast. When we compared gasoline prices in Portland, with prices in Los Angeles, San Francisco, and Seattle, we found that although average prices in the four cities differed, they generally moved in the same direction simultaneously and hence, the price differences remained fairly stable over time. Variations in price levels could be attributed in part to differences in transportation costs, taxes, and other local regulations and conditions.

Figure 1 shows a comparison between retail prices of regular unleaded gasoline in Portland and those in Los Angeles, San Francisco, and Seattle for January 5, 1994, through October 18, 2000.[4]

Figure 1: Retail Gasoline Prices in Selected West Coast Cities



Source: GAO's analysis of *Oil & Gas Journal* data.

Gasoline prices in the four cities, while differing at any given moment in time, generally followed similar price fluctuation patterns. For the entire period, retail regular gasoline prices in Portland averaged about 4 cents higher than in Los Angeles, about 1.4 cents higher than in Seattle, and about 10 cents lower than in San Francisco.

Despite these average price differences, the gasoline markets in all four cities responded similarly to rapid price fluctuations caused by supply disruptions or other factors. In addition to examining price trends, we conducted a statistical analysis of retail gasoline prices in the four cities and found that an increase in price in one

[4] The data come from survey results published weekly in the *Oil & Gas Journal.* We chose this timeframe in order to cover sufficient periods of time before and after the Olympic pipeline disruption of June 10, 1999.

city was quickly followed by price increases in the other cities. We found that prices fully adjust to the change within about 5 to 6 weeks.[5]

STATE-SPECIFIC ATTRIBUTES AFFECT GASOLINE PRICES

While California, Oregon, and Washington are essentially part of the same West Coast market, each State has specific attributes that tend to increase its respective gasoline prices. Moreover, within any given state, local market conditions may cause prices to vary considerably, as illustrated by our analyses of California and Oregon markets.

For California, we identified the following specific attribute:

- *CARB gasoline requirements.* In 1996, California introduced reformulated gasoline standards that were more stringent than the Federal standards and different from those of any other state. The additional refining cost for CARB gasoline has contributed to the higher retail price of gasoline in California relative to the rest of the United States. Also, California's gasoline market has become more sensitive to supply disruptions because, as mentioned above, outside sources of CARB gasoline are not readily available to make up for disrupted supplies in a timely and cost-effective manner.

For Oregon, we identified the following specific attributes:

- *Higher transportation costs for gasoline.* Oregon depends completely on out-of-state supplies for its gasoline because it has no refineries and, thus, must acquire gasoline via pipeline from refineries located in northern Washington, and—to a lesser extent—in California via tanker and/or truck. As a result, transportation costs tend to be higher in Oregon than in areas closer to the refining centers of northern California, southern California, or northern Washington. Furthermore, of the West Coast states, Oregon has the highest proportion of miles driven in rural areas—about 53 percent—compared with 19 percent for California and 32 percent for Washington. To meet rural demand in areas that are generally not served by pipelines, gasoline must be trucked in from the nearest pipeline, increasing transportation costs further.[6]
- *A gasoline tax higher than the national average.* At 24 cents per gallon, in 2000, Oregon had the highest State gasoline tax among the West Coast states and the eighth highest in the country.[7] The average State tax on gasoline at the retail level in the United States is about 20 cents per gallon.
- *No self-service lanes at gasoline stations.* According to industry sources, Oregon's prohibition on self-service gasoline stations may add as much as 5 cents to the cost of a gallon of gasoline.

Finally, local supply and demand conditions affect both California's and Oregon's gasoline prices. For example, our analysis of California gasoline prices showed that when CARB gasoline was introduced in 1996, the difference in gasoline prices between San Francisco and Los Angeles changed. Both wholesale and retail gasoline prices increased more in San Francisco than in Los Angeles—wholesale prices increased by about 2 cents a gallon and retail prices increased about 11 cents. There was no consensus among experts and industry officials as to why prices increased more in San Francisco. One explanation offered was that higher refining costs are easier to pass on to consumers in San Francisco because of its local supply and demand conditions. Another was that the new fuel requirements might have tightened the gasoline supply and demand balance more in the northern part of the State than in the southern part.

Similarly, local conditions have affected Oregon gasoline prices. For example, in June 1999, an explosion in the pipeline connecting Washington refineries with Oregon consumers caused an immediate reduction in the supply of gasoline to Portland and Eugene. To compensate for this shortfall, additional gasoline had to be shipped in by barge or tanker from Washington and California or by truck from other locations. As a result, transportation costs for gasoline coming to Portland increased and prices rose compared with Seattle and Los Angeles. This supply disruption coincided with a period of unanticipated refinery outages in northern California, which exacerbated the region's supply shortfall, making it more costly for Oregon to replace the gasoline supply lost by the damaged pipeline.

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[5] A similar process of supply adjustments would occur for an initial drop in price.

[6] Of the three principal means of shipping gasoline—pipeline, tanker or barge, and trucking—per gallon costs are typically lowest for pipelines and highest for trucking.

[7] While not included above, State excise taxes and/or other local charges may apply and these would also be expected to have an upward impact on gasoline prices. For example, in addition to California's State gasoline tax of 18 cents per gallon, the state's sales tax of 7.25 percent would, at current gasoline prices, also add about 12 cents to the price of a gallon of gasoline.

LIFTING EXPORT BAN INCREASED CRUDE OIL PRICES, BUT HAD NO OBSERVABLE EFFECT ON GASOLINE PRICES

We found that lifting the export ban on ANS crude oil in 1995 increased the price of crude oil on the West Coast.[8] However, our analysis found no evidence that lifting the export ban caused increases in the prices of three petroleum products used by consumers—gasoline, diesel, and jet fuel.

Lifting the export ban raised the relative prices of Alaskan North Slope (ANS) and comparable California crude oils between $0.98 and $1.30 higher per barrel than they would have been had the ban not been lifted. The higher ANS price provided North Slope producers an incentive to produce more oil and therefore should lead to greater total oil production in Alaska than would have occurred had the export ban remained in place. Lifting the ban also increased the efficiency of the West Coast crude oil market by lowering the total shipping costs associated with transporting ANS to its final destination. The magnitude of reduced shipping costs was at least $65 million in the first 2½ years after the removal of the export ban. These impacts measured by GAO were consistent with predictions of prior studies by the Department of Energy and private sector analysts.[9]

Aside from higher crude oil costs for refiners buying ANS oil, we observed no increases in consumer prices on the West Coast during the period that we analyzed. According to GAO's statistical and economic analyses, the prices of gasoline, diesel, and jet fuel on the West Coast did not significantly change as a result of lifting the export ban. Moreover, the consumer groups and industry experts GAO contacted were unaware of any adverse effects on consumers from lifting the ban. GAO's findings were consistent with the expectations of some industry analysts. Several industry analysts believed that consumer prices would be unaffected because these prices were determined by the costs of foreign imported crude oil and final products and imported products were already selling at their world prices on the West Coast, rather than the artificially low ANS price.

Mr. Chairman, this concludes my prepared remarks. We would be pleased to answer any questions you or any Member of the Subcommittee may have.

Senator SMITH. Thank you, Mr. Wells. That is the best word we have heard yet.

Mr. Cook.

STATEMENT OF JOHN COOK, DIRECTOR, PETROLEUM DIVISION, ENERGY INFORMATION ADMINISTRATION

Mr. COOK. Thank you, Mr. Chairman and Members of the Subcommittee, for the opportunity to testify.

As we have heard repetitively today, gasoline prices have risen sharply over the last few weeks, with regular grades now up over 20 cents a gallon and additional increases likely to follow. While the largest increases have occurred in the Midwest and Gulf Coast regions as well, average prices remain on the West Coast somewhat higher than elsewhere, with an average of about $1.70 in our latest survey.

Higher still is regular grade reformulated gasoline, RFG, in California, currently averaging about $1.83 statewide. We saw that there are some locations already reporting over $2-a-gallon prices in the San Francisco area, and premium grades are over $2 throughout the State.

Clearly, when gasoline prices reach these levels consumers demand to know the underlying causes. My testimony summarizes some of these factors, beginning with the drivers behind the West Coast elevated prices. Gasoline prices on the West Coast are usually the highest in the Nation, largely due to several factors.

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[8] See *Alaskan Crude Oil Exports* (GAO/T-RCED-90-59, Apr. 5, 1990).

[9] *Exporting Alaskan North Slope Crude Oil: Benefits and Costs, U.S. Department of Energy (June 1994),* and Samuel Van Vactor, "Time to End the Alaskan Oil Export Ban," *Policy Analysis* 227 (May 18, 1995).

First, the West Coast is geographically isolated. That is, usually gasoline demand is almost entirely supplied from West Coast refineries. When supplies get tight, it can take several weeks for added supply to arrive from outside the region. To satisfy consumption, West Coast refineries normally operate at relatively high levels, especially during the peak summer season.

When refinery or other distribution problems occur, West Coast markets tighten quickly, causing prices to rise behind them. Since the entire West Coast market is highly interconnected, price pressures in one area often affect the whole region.

The second reason for high West Coast prices is that California comprises, of course, the dominant share of the market and uses a unique type of reformulated gasoline. California RFG must conform to more stringent requirements than federally-mandated RFG, making it more expensive to produce. More importantly, with no short-term complying supply readily available, significant shifts in market conditions can cause large price changes.

Still another but often unrecognized factor is that not only does California consume more gasoline than any other State, but in recent years demand has grown at a pace roughly 2 to 4 times capacity growth. These factors combine to put pressure on refineries to produce at near-maximum rates. Thus, with the balance between supply and demand so fragile, any problems with infrastructure can be expected to cause substantial price increases.

I think the April 2000 GAO Report has already been noted. The point I want to underscore here is that it showed that California has not experienced more price spikes, but that when they do experience these fluctuations they tend to be higher and last longer. This finding is exactly consistent with a system operating with a finely tuned balance between supply and demand, with little or no room for error.

Although California strongly influences gasoline market conditions on the entire West Coast, it can also have impacts on other regions of the country, especially this year. A problem in California can result in extra supplies of gasoline being purchased on the Gulf Coast for delivery to the West Coast. These marginal barrels add price pressure to the Gulf market, which also serves the East Coast and Midwest.

With gasoline balances very tight in these other regions, especially the Midwest, additional product demand from California can increase prices throughout areas east of the Rockies.

For the remainder of my testimony I want to focus then briefly on the remainder of the country. As stated earlier, prices are increasing dramatically across all regions of the country, for a number of reasons. First, as we have heard earlier, crude prices remain relatively high, nearly triple what they were in early 1999. This change in crude oil prices since then alone explains 35 to 45 cents of that increase.

Perhaps more importantly, gasoline inventories are currently very low in virtually every region of the country and especially in the Midwest. Our preliminary estimate show stocks at the lowest end March level since EIA began compiling these data in 1963. The situation has not improved in recent weeks. Mid-April levels are

significantly less than the past 5-year average and especially again in the Midwest.

When inventories are this low, supplies immediately available to cover unexpected imbalances in supply and demand are minimal. This raises the risk sharply of price increases.

Since U.S. refineries operate at high utilization rates during the summer, absent adequate inventories, added supplies have to come from other parts of the country or even from foreign sources. As such, even the perception of tightening conditions, such as a rumored refinery problem—witness the Tosco situation the other day; it turned out not to be a serious gasoline impact—even rumored refinery problems can precipitate price pressure through "precautionary buying." In fact, gasoline production has generally exceeded year ago levels since the beginning of this year. Despite that, extensive refinery maintenance this spring has begun to limit these production levels, even resulting in a brief dip below year ago levels in the second half of last month.

On the other hand, with demand resuming growth rates so far this year more typical of the late 1990s, despite an apparent slowdown in the U.S. economy, this exceedingly tight balance has emerged, resulting in low stocks and rapidly rising wholesale prices. With spot prices now rising 25 to 30 cents a gallon or more in almost all regions since mid-March, retail prices have begun to respond accordingly, and further increases should be expected over the next several weeks.

In particular, the Midwest is especially tight again this year. Retail prices for conventional gasoline have already risen 20 cents a gallon in the last 4 weeks and reformulated gasoline is up over 40 cents a gallon, in part due to the pull on the Gulf Coast clean products by California. Like California, parts of the Midwest also use a unique reformulated gasoline, one blended with ethanol rather than MTBE. This unique nature of gasoline consumed in the Chicago and Milwaukee areas is one of the reasons Midwest gasoline prices temporarily rose above West Coast prices last summer.

While not geographically isolated per se, the Chicago-Milwaukee market is partially depending on distant Gulf Coast production. This combination effectively makes the Chicago-Milwaukee area an RFG island and can result in very high prices. This is because significant distances are involved in acquiring this unique blend of RFG not produced by many refineries outside the Chicago market.

Like my colleague, to conclude on a brighter note, retail prices may be nearing an early seasonal peak barring further significant operating problems. Preliminary EIA data show that currently high prices have sparked the expected sharp increase in refinery production and imports over the last 2 weeks. For illustration, refinery production is up maybe a million barrels a day in the last 2 weeks, fairly close to flat out, and we have not even gotten into the summer season.

If these continued high supplies occur, we may yet see inventories stabilize and prices weaken as we go forward into the summer.

This concludes my testimony.

[The prepared statement of Mr. Cook follows:]

PREPARED STATEMENT OF JOHN COOK, DIRECTOR, PETROLEUM DIVISION, ENERGY INFORMATION ADMINISTRATION

Thank you, Mr. Chairman. I would like to thank the Committee for the opportunity to testify on behalf of the Energy Information Administration (EIA).

As you know, gasoline prices have increased substantially in recent weeks. Prices for regular grade gasoline have risen over 20 cents per gallon across the country over the past 4 weeks, with additional increases likely to follow. While the largest increases in gasoline prices over this period have occurred in the Midwest and Gulf Coast regions of our country, average prices along the West Coast are still the highest in the country at over $1.70 per gallon (Figure 1). Regular grade Reformulated Gasoline (RFG) prices along the West Coast are currently averaging nearly $1.83 per gallon, with premium grade RFG averaging over $2.02 per gallon. When gasoline prices reach these levels, consumers, industry, and policymakers alike demand to know the underlying causes. In my testimony before you today, I will attempt to describe these factors.

WHY WEST COAST GASOLINE IS OFTEN THE MOST EXPENSIVE IN THE NATION

Typically, gasoline prices on the West Coast, are the highest in the nation. This is largely due to two factors. First, the West Coast is geographically isolated from the rest of the country; petroleum markets in this region are mostly self-contained (i.e., supplied by West Coast refineries). Thus, if supplies get tight, it can take weeks for resupply to arrive from outside the region. To satisfy demand, West Coast refineries operate at relatively high utilization rates, especially during the peak summer season. If there is a problem with a refinery or the distribution of supplies, or demand increases dramatically, markets along the West Coast can tighten very quickly, thus causing prices to rise quickly. Since the entire West Coast market is interconnected, price pressures in one area often affect the whole region.

The second reason gasoline prices are typically higher along the West Coast is that California, which represents a dominant share of the West Coast market, uses a unique type of reformulated gasoline. California RFG has more stringent requirements that federally mandated RFG. Not only is California RFG more expensive to produce, but when supplies get tight, there is not a ready source of gasoline available immediately outside the region. By having a "boutique" blend of gasoline (i.e., a type only used in a limited area) changes in market conditions may cause larger price changes than might otherwise occur.

Parts of the Midwest have their own "boutique" blend of RFG, one that is blended with ethanol, rather than MTBE, which is used by most of the rest of the country as a blend stock for the federally mandated RFG. The unique nature of gasoline in the Chicago and Milwaukee areas was one of the reasons why Midwest gasoline prices temporarily rose above West Coast prices last summer when supplies were initially unable to meet demand at the start of the summer season. While not geographically isolated per se, the Chicago/Milwaukee market is partially dependent on distant Gulf Coast production. This combination, which effectively makes the Chicago/Milwaukee area an "RFG island", can result in very high prices, because significant distances are involved in acquiring a blend of RFG not produced by many refineries outside their market.

GASOLINE PRICES ARE HIGH ACROSS THE COUNTRY

As I stated earlier, prices are increasing dramatically across all regions of the country. There are a number of reasons for this.

First, crude oil prices remain high, nearly triple what they were as recently as early 1999. The change in crude oil prices alone would explain about 35-45 cents per gallon of the increase in gasoline prices since that time.

As importantly, gasoline inventories are currently very low throughout most of the country. EIA's preliminary estimate has total gasoline inventories at the lowest end-March level since 1963, which is as far back as EIA has compiled data. The situation has not improved in recent weeks, with mid-April gasoline inventories significantly less than has been averaged over the previous 5 years (Figure 2). For example, as of April 13, gasoline inventories in the East Coast (PADD I) and the Midwest (PADD II) are 10-15 percent less than the 5-year average for this time of year and even about 10 percent less than last year's low levels. When inventories are low, supplies immediately available to cover any imbalances in supply and demand are reduced and prices can become more volatile. Since U.S. refineries operate at very high utilization rates throughout the gasoline season, without inventories on hand, additional supplies must come from farther away, either from other parts of the country, or even foreign sources. As such, even the perception of tightening con-

ditions, such as rumored refinery problems, can precipitate price pressure through "precautionary buying". In fact, while gasoline production has generally exceeded year-ago levels since the beginning of the year, extensive refinery maintenance this Spring has somewhat limited recent operations, resulting in a brief dip below year-ago levels in the second half of March. With demand resuming growth rates so far this year typical of the late 1990s, despite an apparent slowdown in the U.S. economy, an exceedingly tight gasoline balance has emerged, resulting in very low stocks and rapidly rising wholesale prices. With spot prices rising 25 to 30 cents per gallon since mid-March in almost all regional markets, retail prices have begun to respond accordingly. Of course, high gasoline prices would encourage additional supply, both through increased production and imports. Thus, barring a sudden reversal in current patterns, further retail increases should be expected over the next few weeks, but prices could fall some thereafter if increased gasoline supplies enter the market.

While gasoline inventories are much lower than is normal for this time of year, crude oil inventories remain below typical levels as well, despite a dramatic increase in recent weeks. Nationally, crude oil inventories have improved considerably in the last few weeks, rising by over 35 million barrels to 313 million barrels, with the Gulf Coast region (PADD III) finally returning to 5-year average levels this past week. But, the situation is much worse in the West Coast (PADD V), where crude oil inventories are over 17 percent less than the 5-year average and more than 6 percent less than last year's low levels. With the West Coast a largely self-contained region, low crude oil inventories could contribute added pressure to already high product prices in the near future.

CALIFORNIA AND OREGON GASOLINE MARKETS

As I mentioned earlier, the West Coast gasoline market is an interconnected one, where price pressures in one area can affect other areas in the West Coast. However, there are a few unique characteristics about both the California and Oregon gasoline markets that I would like to take a moment to address now.

Certainly, the use of California RFG is the most unique factor affecting California gasoline markets. But an often, unnoticed factor is that California consumes more gasoline than any other state, nearly 39 million gallons daily in 1999, and whose demand is growing at 2 to 4 times the rate of California's gasoline production growth in recent years. These two factors combine to put pressure on refineries to produce at near maximum rates. With the balance between supply and demand so fragile, any problems with infrastructure, whether refining or distribution, could cause prices to increase substantially. An April 2000 General Accounting Office (GAO) report noted that while California had not experienced a greater number of price "spikes" than other regions of the United States, the increases experienced were larger. This finding is consistent with a system that has a finely tuned balance between supply and demand, with little or no room for error.

A new concern for California this summer is the possibility of rolling blackouts. California has already experienced rolling blackouts this Spring and hot summer weather suggests more are likely this summer. Without sufficient backup capability offline from the California grid, a rolling blackout could cause an entire refinery to have to shut down, which besides meaning less product being made available, would also disrupt pipeline flows. Typically, refineries are not built to shut down abruptly or to begin smooth operations immediately following a "cold start". With the delicate system that I have already described, many analysts are concerned rolling blackouts could further affect gasoline prices this summer. We are in communication with the California Energy Commission, as well as industry groups regarding this issue and will be closely monitoring the situation this summer.

Although California strongly influences gasoline market conditions for the entire West Coast, there are a few unique factors unique to Oregon that I would like to address.

Oregon's gasoline prices are usually about 15 cents per gallon higher than the national average, although currently they are about 10 cents below the national average, since prices have been increasing more elsewhere in the country than in Oregon recently. Oregon is one of only two states (the other being New Jersey) which has a ban on self-service gasoline stations. A GAO memo on Oregon gasoline prices released in March 2001 cited "industry experts" estimating that the self-service ban could add as much as 5 cents per gallon to the final retail price. In addition, Oregon's lack of refinery capacity makes it dependent on product shipments from outside the state, primarily California and Washington, thus increasing the transportation costs to get gasoline into the state. Then once in the state, transportation costs to get the gasoline to the retail station is generally higher than in other states since a large proportion of Oregon's gasoline is in rural areas. A tight supply and

demand balance, a lack of excess refining capacity, stringent standards on California reformulated gasoline all impact the West Coast conventional gasoline market by effectively reducing the capacity available to make other products, including the conventional gasoline used in Oregon.

CONCLUSION

U.S. retail gasoline prices have risen substantially in the last three to 4 weeks, with further increases likely since even greater jumps have occurred at the spot level. This situation has come about as a result of low gasoline inventories across the country, a tight supply and demand balance, little excess refining capacity, and low crude oil inventories, particularly in the West Coast. With California requiring some of the cleanest gasoline in the world and the geographic isolation of West Coast markets from other regions, West Coast gasoline prices are typically the highest in the country, as they are now. The specter of rolling blackouts this summer adds uncertainty to a typically delicate balance between supply and demand. The potential exists for a substantial price "spike" to occur on the West Coast this summer, even from already high levels, if problems are experienced at refineries or in the delivery system. Although it may take weeks to arrive, if gasoline prices get high enough, supply into the West Coast system would be encouraged, thus reducing prices eventually. But of course, no one really knows what will happen this summer. I can assure you that EIA will be actively monitoring the summer season and will provide as timely analyses as possible throughout the summer months.

This concludes my testimony, and I would be pleased to answer any questions the Committee may have.

Figure 1.

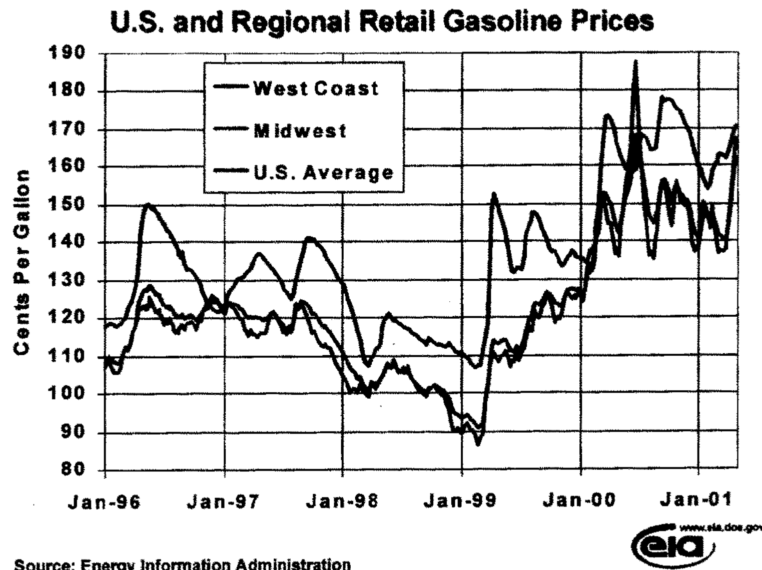
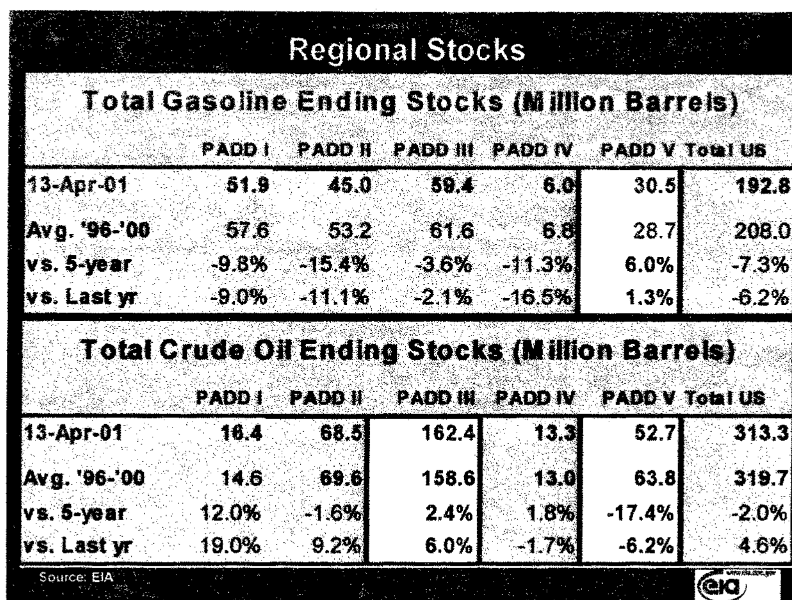


Figure 2.



Regional Stocks

Total Gasoline Ending Stocks (Million Barrels)

	PADD I	PADD II	PADD III	PADD IV	PADD V	Total US
13-Apr-01	51.9	45.0	59.4	6.0	30.5	192.8
Avg. '96-'00	57.6	53.2	61.6	6.8	28.7	208.0
vs. 5-year	-9.8%	-15.4%	-3.6%	-11.3%	6.0%	-7.3%
vs. Last yr	-9.0%	-11.1%	-2.1%	-16.5%	1.3%	-6.2%

Total Crude Oil Ending Stocks (Million Barrels)

	PADD I	PADD II	PADD III	PADD IV	PADD V	Total US
13-Apr-01	16.4	68.5	162.4	13.3	52.7	313.3
Avg. '96-'00	14.6	69.6	158.6	13.0	63.8	319.7
vs. 5-year	12.0%	-1.6%	2.4%	1.8%	-17.4%	-2.0%
vs. Last yr	19.0%	9.2%	6.0%	-1.7%	-6.2%	4.6%

Source: EIA

Senator STEVENS. Could you repeat that, Mr. Cook? Up from what? You said a million barrels up from what?

Mr. COOK. Would you like the number?

Senator STEVENS. I mean, for what date.

Mr. COOK. Oh, just over the last 2 weeks. As the maintenance has wound down, these fellows have cranked up from already fairly high levels to fairly close to peak levels, levels like we saw last summer. If this continues and the high level of imports that we have seen in the last few weeks continues—well, it is not a surprise stocks have built a little bit in the last couple of weeks.

Senator SMITH. Do you anticipate that the fire in California at the refinery, will that have an impact on the fragile supply and demand existing on the West Coast?

Mr. COOK. Well, it is too early to say one way or another, really. It will have an impact, but it is currently expected to be a minimal impact. This is because the fire occurred in a unit that does not produce a lot of gasoline.

On the other hand, that balance is so tight that any loss for any period of time of gasoline can have some effect on prices.

Senator SMITH. Have you concluded your statement, then?

Mr. COOK. Yes.

Senator SMITH. I thought so. My first question was about that refinery and the balance. But I am wondering. We have talked a lot about supply and demand here and we have all mentioned how long it has been since a refinery has been built. If it is so profitable in the oil business right now, what is holding back new refinery construction?

Mr. COOK. Well, I think someone alluded to the fact that it has not always been that way. Even as recent as a little over a year ago, refinery margins, well, throughout 1999, refinery margins were almost nonexistent. Profits were almost nonexistent. Obviously, not an environment to attract capital. In fact, if you look over the last 20 years or so, on average the U.S. refining sector has done rather poorly.

Senator SMITH. Has that not changed? It seems to me enough have gone out of business, and they are running at 98 percent capacity. That is an extraordinary use of assets. I wonder if there is not some incentive there for somebody to build another refinery.

Mr. COOK. Well, that only occurs in the summertime.

They do not run at anywhere near that rate during the wintertime. Although you did not ask, they would run at higher rates during the wintertime barring non-discretionary maintenance that has to be performed if the economics of crude are attractive. But as long as crude prices are relatively high, the law of demand says refiners are going to buy less, stock less, produce less product over time in the face of continuing rising gasoline demand, diesel demand, and what have you. Therefore, product stocks will erode to the point where you have this fragile situation.

Senator SMITH. Thank you.

Senator Wyden, do you have a question?

Senator WYDEN. Just a couple, Mr. Chairman.

With respect to GAO's report on Alaskan oil exports, did GAO have access to the various issues raised by *The Oregonian*, the e-mail exchange between BP trading managers where they talk about shorting the West Coast market to leverage up the price, the question of BP selling oil to Asia at lower net prices than they could get on the West Coast? You did not have access to any of that information that was in *The Oregonian* article, did you?

Mr. WELLS. That is correct, we did not see those documents. Our work started in 1998, completed in early 1999. Our audit teams did, in fact, talk to the FTC. We talked to the oil companies during the work. But we did not see those documents, no, sir.

Senator WYDEN. You did not have any access to the documents that are under seal in Federal court in San Francisco, either?

Mr. WELLS. Did not.

Senator WYDEN. Is that right?

Mr. WELLS. Yes.

Senator WYDEN. One other question for the GAO folks. BP asserts that your July 1999 report on the effects of lifting the ban on exporting Alaskan North Slope oil shows there was no increase in prices. But my understanding is on page 6 of your report you state that that is not the case. Could you describe what the ramifications are with respect to lifting the ban as it relates to prices?

Mr. WELLS. We have page 6 here. I will be glad to let Mr. Frank Rusco answer this question.

Mr. RUSCO. Yes, Senator. What we found was that the price of Alaskan North Slope crude oil did rise on the West Coast, somewhere in the neighborhood of $1 per barrel. But we found that that was not passed on to consumer prices. There are a number of explanations for why that might not have been the case.

For one, the amount of Alaskan North Slope oil that was sold in third party transactions on the West Coast was relatively small compared to the total amount of Alaskan North Slope oil. On the West Coast there was ARCO and Exxon that produced Alaskan North Slope oil and largely refined their own product. So that oil never saw a third party transaction or a market price.

Senator WYDEN. What were you saying, then, at page 31 of the report, where you said: "West Coast refiners we contacted did not reveal the extent to which they passed on increased acquisition costs for crude oil to consumers?"

Mr. RUSCO. Yes. No refiner told us that they had passed on any of the increased crude oil costs. We did not have access to proprietary information to determine that ourselves. We did our own analysis of what happened to prices at the time that the export ban was lifted and found an effect on crude oil prices, but not on consumer prices, consumer product prices, I should say.

Senator WYDEN. I will tell you, I question that finding. I think it is late in the day and I am not going to belabor this, but you say at page 6 "Lifting the ban caused the relative prices of Alaskan North Slope and California oils with comparable characteristics to be between 98 cents and $1.30 higher per barrel than they would have been had the ban not been removed."

Then of course you all were not able—and I understand it—to look at the sealed documents and the e-mail exchange that talks about shorting the West Coast market. So I want to be clear that at least this Member of the U.S. Senate feels that you worked with the information you had, but it was very, very limited. At least from my standpoint, I want the record to show that.

I thank you, Mr. Chairman.

Senator SMITH. Thanks, Senator Wyden.

Senator Stevens, do you have a question for these witnesses?

Senator STEVENS. No, I have no question for these witnesses.

Senator SMITH. Senator Boxer.

Senator BOXER. Thank you.

Mr. Cook, what did you say the average price of gasoline was in California when you opened up your remarks?

Mr. COOK. The average price as of our Monday survey was $1.83.

Senator BOXER. I just wanted to point out that the AAA said it is $2.03. So I don't know.

Mr. COOK. Well, you showed a sign of a Shell price of $2.02 in San Francisco and our survey is consistent with that. It does show San Francisco——

Senator BOXER. I am not talking about San Francisco. I represent the whole State.

Mr. COOK. I know.

Senator BOXER. I am just suggesting to you that AAA has a different price, average price. I would like us to get together and figure out exactly why there is this difference.

Mr. COOK. Well, we may be comparing apples and oranges. I am not sure, because I have not seen that survey. But usually our surveys are within a penny or two of theirs.

Senator BOXER. Yes, that is why—well, we will get that to you, because my understanding is—I showed you one gas station that is higher than lots of others for the regular gas. But I wanted to

show it to you, because if you are more than a penny or two off, then I think that is a problem.

Mr. COOK. Right. I think that survey—they tend to do city pricing, so maybe the survey that you are thinking of was for San Francisco at over $2, and we show that in our survey also.

Senator BOXER. Laurie Saroff, what did you tell me that the AAA said was the average price of gasoline?

Ms. SAROFF. $2.03.

Senator BOXER. For gasoline across the whole State?

Ms. SAROFF. San Francisco.

Senator BOXER. You are right. She said San Francisco.

I mean the whole State. What do they show for the whole State?

Ms. SAROFF. I do not have that.

Senator BOXER. Let us get that number.

Then you are right. I stand corrected.

I would like to say that two Commissioners, FTC Commissioners, did believe that the shipping of the Alaska oil to Asia had a direct impact on California prices. I do not know whether or not you saw—and one of them happened to be Chairman Pitofsky. They tried to make it a part of that last merger, BP merger, a condition in the merger that they will not be able to export it. He lost on the vote. I believe it was a 3-2 vote.

So did you not have access to that information that he had access to? This gentleman, I am not sure your name, sir.

Mr. RUSCO. Thank you, Senator. No, we did not have access to any FTC documents related to the merger, and our report came out about the time that the merger was getting underway as well as the investigation.

Senator BOXER. I disagree with Senator Wyden. I just do not think that there is a question there, because you have to realize we are not talking about the whole country. We get our oil essentially from Alaska and California and the rest of it is elsewhere. We get a third from Alaska, a third of our oil. So if they short us, if a third of our supply that we count on is somehow shorted—and I do not know about Oregon. I do not know what the sources of your oil. But you probably depend, maybe even more, on Alaska.

It just does not add up that you could possibly say that there is no proof that it had any impact. So I would like you to go back and, since you did not have the benefit of the FTC's information, I would like you to take a look at that because I think it is pretty relevant.

Mr. RUSCO. May I respond? The work that we did was based on a statistical model of prices. The increase in crude oil prices that we found was precisely the same model that we employed for product prices. So we looked for an effect in the prices themselves. The documents I think that you are referring to would not have changed the statistical results of the model.

Senator BOXER. Let me just talk common sense. You get a third of your supply from a place that now decides to export it. That is a problem. If you are counting on a certain supply and it is shorted and then the market is shorted, if we are a capitalistic society, which we are, why would it not have an impact if less supply is going there?

Mr. RUSCO. Yes, Senator, it does have an impact on the price of crude oil. The question is whether that price is then passed on to

consumer products. That I think is where the disconnect is. What many analysts said going into the lifting of the export ban was that prior to the lifting of the export ban, refiners were earning high margins as a result of getting what they said were artificially low Alaskan North Slope oil prices prior to the lifting of the ban.

After the ban was lifted, the price of Alaska oil rose in the West Coast to closer to world levels and the refining margins shrank, but that was not passed on to consumers, just as the low oil prices prior to the ban being lifted were not passed on to consumers in the form of low consumer prices for all those years prior to the ban being lifted.

Senator BOXER. Yes, we know that. I do not know. I have a problem with the logic of it all. I was an economics major, but that was a long time ago. It seemed to me you have a cost; the bottom line price is going to be reflective of that. As I say, two of the FTC Commissioners did not agree.

Well, we are going to have this debate about this export question, but it seems to me just common sense, but maybe common sense does not apply in this case, which would not be the first time. But thank you very much.

Senator SMITH. Gentlemen, thank you for your testimony, and Frank as well. We did not announce you, but we are glad you are here. Thank you for your contribution.

We will now call on our third panel. We invite Professor Preston McAfee, Visiting Professor of Economics and Strategy of the University of Chicago; Professor Carl Shapiro, Transamerica Professor of Business Strategy at the Haas School of Business, University of California at Berkeley; Mr. Robert Malone, the Regional President, Western United States, of BP; Mr. Chuck Mau, Oregon gasoline dealer from Portland, Oregon.

Senator Stevens has asked that we proceed in the order that they were announced, because he is hoping to return and ask some questions as well. So, Professor McAfee, we thank you for being here and the microphone is yours.

STATEMENT OF R. PRESTON McAFEE, VISITING PROFESSOR OF ECONOMICS AND STRATEGY, UNIVERSITY OF CHICAGO

Dr. McAFEE. Mr. Chairman and Members of the Subcommittee: My name is Preston McAfee. I am a Professor at the University of Texas and I am currently visiting the University of Chicago. I assisted the Federal Trade Commission in its analysis of the Exxon-Mobil mergers and the BP-ARCO merger, and I am pleased to have the opportunity to address this Subcommittee and have provided a report which makes the following points.

First, the West Coast gasoline market is integrated. Supply and demand events in California, Oregon, or Washington affect all three States. Generally, Nevada and Arizona are part of this market area as well.

West Coast gasoline refining is concentrated in the hands of a relatively small number of firms and the fact that the same firms control terminaling, refining, and retail exacerbates antitrust issues. So that is to say it does not necessarily imply uncompetitive behavior, but it would raise flags in the event for merger analysis.

Third, inelastic demand for gasoline implies that modest supply disruptions have very large impacts on prices. Inelastic demand also exacerbates antitrust concerns.

The divestitures that were obtained in the Exxon-Mobil merger ensured that the competition by refineries and retailers was maintained. So that is, the level of competition that existed prior to the merger persisted after the merger.

Absent the divestitures in the BP-ARCO merger, there would have been a reduction in competition for bidding, exploration, and development of oil resources in Alaska. However, the divestitures of ARCO's Alaskan assets to Phillips has preserved competition for the oil bidding, exploration and development and ensured an increased flow of oil.

BP in the past has exercised some monopoly power in the sale of oil to refineries, and that is evidenced by price discrimination. Price discrimination is very common. In fact, whenever you see a store advertise "Buy one, get a second at half price," that is the same phenomenon. That is price discrimination. It is very common.

BP's attempts to increase West Coast oil prices had a very, very small impact on West Coast gasoline prices, and the manipulation of oil prices certainly does not account for the extent to which West Coast residents pay higher prices for gasoline than are paid in other parts of the country.

The divestiture of ARCO's Alaska assets has eliminated BP's profits from increasing West Coast oil prices. So now as a major buyer of oil on the West Coast their incentive to increase prices has vanished.

Let me also say that to my knowledge—and I have read a very large number of BP documents—to my knowledge, BP has never engaged in rigging prices. Now, I understand "rigging" to imply collusion. I have tried to find out where this got into the newspaper record and as far as I can tell it was a reporter paraphrasing the term "manipulation." Manipulation can be done by a single firm. "Rigging" as I understand it, implies two firms or more, and I know of no event, no instance of BP rigging prices on the West Coast. I have not seen Senator Wyden's new documents concerning ARCO.

Let me finally say that the major factors that have increased the West Coast prices include the increased world oil prices that have increased the price for gasoline all Americans pay, increased West Coast demand, the CARB requirements over the last decade have decreased West Coast supply, there have been no new refineries and limited expansion of refineries and, in fact, mothballing of some. Also, the West Coast market is isolated, say, from the Gulf Coast and that increases its sensitivity to refinery outages.

Thank you.

[The prepared statement of Professor McAfee follows:]

PREPARED STATEMENT OF R. PRESTON MCAFEE, VISITING PROFESSOR OF ECONOMICS AND STRATEGY, UNIVERSITY OF CHICAGO

Mr. Chairman and members of the Committee, my name is R. Preston McAfee. I am Murray S. Johnson Professor of Economics and former Chair of the Department of Economics at the University of Texas at Austin, and Visiting Professor of

Strategy at the University of Chicago Graduate School of Business.[1] In 1999 and 2000, I was retained by the Federal Trade Commission ("FTC") to provide expert economic analysis and potential testimony in connection with the FTC's investigations of the mergers of Exxon Corporation (Exxon) and Mobil Corporation (Mobil) and of British Petroleum PLC (BP) and the Atlantic Richfield Company (ARCO). In addition, I provided assistance to the FTC in its investigation of last summer's price increase in the Midwest. I am pleased to be here today to discuss the economic issues that I researched, as they pertain to your examination of West Coast gasoline prices in general and Oregon in particular.[2]

As part of my studies of the two mergers, I had access to and studied a substantial amount of information, including the documents that the FTC had gathered in the course of its investigations. I am advised that much of this information was provided to the FTC under statutory authority that generally requires the FTC to keep the information submitted to it confidential,[3] and, except to the extent that information has independently been made public, I am not at liberty to disclose today information submitted to the FTC pursuant to confidentiality restrictions.

However, as the Committee is aware, the U.S. District Court for the Northern District of California has ordered the release of some of the documents filed under seal in *FTC* v. *BP Amoco*, and I understand that I am at liberty to discuss those documents. In addition, some of the information I examined as part of my analysis was obtained from public sources.

EXXON MOBIL

One of the major focuses of my Exxon Mobil investigation was the West Coast refining and retailing markets, where Exxon and Mobil had been the fifth and sixth largest firms. Six firms, including Chevron, ARCO, Equilon, and Tosco refined over 90 percent of all California Air Resources Board (CARB) gasoline. There has not been a new refinery built on the West Coast, or anywhere else in the United States for that matter, for decades, and there was no prospect of new entry into the market in the foreseeable horizon. Older refineries that have been mothballed, such as the Powerine refinery in Southern California, could theoretically be returned to the market to produce conventional gasoline, but they would face extraordinary and probably prohibitive costs in upgrading to produce a significant quantity of CARB.

Furthermore, it is very expensive to ship refined products to the West Coast from the nearest major refining center,[4] the Gulf Coast, in part because of the Jones Act requirements that such shipments be made on U.S. built, owned, and crewed vessels, but also because of size restrictions in the Panama Canal as well as its costs, and the lack of a gasoline pipeline alternative. Moreover, even provided a company succeeded in bringing CARB gasoline from the Gulf Coast or the Caribbean, it is not trivial to get the gasoline to consumers. In particular, transporting gasoline to consumers requires terminaling facilities and retailing facilities, which are in large part controlled by incumbent refiners. Thus, it is unlikely that imports of CARB gasoline will enhance West Coast supply at current, or even moderately higher, prices.

Demand for gasoline is highly inelastic, meaning that small reductions in supply that are not offset by other increases can lead to significant price increases. Thus, even quite modest levels of market power may translate into significant producer margins. Inelastic demand exacerbates concerns about any enhancement of market power.

For these reasons, it is my opinion that the FTC was right to be concerned about the increase in market concentration that the Exxon Mobil merger would have caused on the West Coast. I believe that the Commission was right to require the divestiture of the Exxon refinery in Benecia, California as a condition for approval of the merger.

BP-ARCO

The combination of BP and ARCO would have meant that a single company would have dominated oil exploration and production in Alaska. This domination would

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[1] I attach a copy of my curriculum vita for the Committee's reference. (Maintained in the Committee's files.)

[2] I have not made any study of gasoline prices in Oregon beyond what I have done in preparing for this testimony and my knowledge of the subject is necessarily limited.

[3] I was authorized to receive FTC confidential information as a consultant to the FTC, and I gave the FTC written assurances that I would not disclose confidential information that I received from the FTC.

[4] It is estimated to cost 8 to 12 cents, *Oxy Fuel News*, September 6, 1999. The Jones Act accounts for about four cents per gallon in added shipping costs.

likely have given the combined company a great deal of monopsony power in the purchase and development of oil leases on the North Slope of Alaska. (Monopsony power is power for buyers corresponding to monopoly power for sellers.) This power covers negotiations with Federal and State authorities as well as other producers that depend on BP and ARCO infrastructure.

BP and ARCO were the two largest firms in bidding for exploration leases in Alaska, in exploring for oil in Alaska, in producing oil in Alaska, in transporting oil from the North Slope of Alaska to the port of Valdez via the Trans-Alaska Pipeline, and in shipping Alaskan oil to refineries on the West Coast. From 1989 to 1999, ARCO and BP were first and second respectively in dollar value of bids made and bids won for Northern Lease Area auctions held by Alaska and the Federal Government. During that 10-year period, the two firms submitted 85 percent of the winning bids, won 70 percent of all leases sold, drilled 90 percent of the wells, ran 10 of 11 operatorships, and produced 74 percent of the crude oil.[5] BP and ARCO owned 72 percent of the Trans- Alaska Pipeline and 70 percent of the tankers in the Alaska trade.

Absent the divestiture ordered by the FTC, the merger would have eliminated the competition BP faced from ARCO to find and produce ANS crude oil. This reduction in competition would have reduced revenues on the oil, and might have led to a reduction in exploration and development in Alaska. Economic theory makes a strong presumption that a monopsonist would have been likely to eliminate some investments in oil production that likely would be made in a more competitive environment.[6] Primarily for this reason, I believe the FTC was justified in imposing a requirement that BP divest itself of most or all of ARCO's Alaskan properties as a precondition for the merger. The sale of all the stock in the ARCO Alaska company to Phillips Petroleum gave me great confidence that the merger would not harm competition on the North Slope.

A second issue that arose in the BP ARCO merger was BP's efforts to raise price on the West Coast through price discrimination, including most prominently the sale of some oil in the Far East, but also differences in prices charged to refiners on the basis of their willingness to pay.[7] While this issue has received a great deal of publicity, and was important to the evaluation of the merger, it was a very minor factor in determining West Coast gasoline prices: at the most a penny per gallon and probably less than half that.[8] FTC Commissioners Anthony, Swindle, and Leary have also stated that they believe that half a cent is the upper bound.[9] The desire of BP to export even with net earnings on exports (the "netback") lower than those prevailing on sales to the West Coast was important for the analysis of the proposed merger, even if it ultimately had little to do with West Coast gasoline prices. BP's

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[5] Exxon, the next largest producer in Alaska, had essentially dropped out of bidding and exploring. While Exxon had made 276 bids (winning 123) from 1959 to 1982, it made only 13 bids from 1989 to 1999, winning 2. It appears that Exxon has taken a "harvest" strategy with respect to Alaska.

[6] The risk of this happening was much greater at the time the merger was announced than it would be now, because of the large increase in world crude oil prices.

[7] BP described the means by which it sets the prices as follows: "By building computer models of each major WC refinery and our knowledge of product and import crude prices, we can approximate the required ANS price to displace the foreign imports for each refinery. Integrating the individual refinery models together along with transportation costs into a single ANS model, allows determination of the optimum ANS price and geographic disposition that maximizes BP's overall ANS revenues. As exports are allowed, Far East sales will replace Gulf Coast, Virgin Island and Mid-continent placements. The model will be modified to take into account the Far East refineries." [PX 425, BPA-ORG 003830]

[8] This estimate comes from BP's optimizer model, which was used by its traders as a tool for making export decisions. This model indicated in some months that for every 10 thousand barrels per day the company exported, it would be able to raise the price of Alaska North Slope crude oil (ANS) by perhaps a tenth of a cent per gallon, or 4 cents per barrel. Because sales to Asia would raise the spot price on the West Coast, and therefore BP's price to all consumers who had contracts tied to that spot price, BP was willing to export oil to Asia even when the profit margins on such sales were smaller than what could have been earned on the West Coast. While BP's exports are not a matter of public record, total exports from the region have averaged 50 to 60 thousand barrels per day since 1996 and 74 mbd in 1999. Therefore a rough estimate would be that BP's exports raised the price of ANS by about half a cent per gallon at the refinery level. Prior to 1996 there was a ban on exports abroad, although oil was shipped to the Gulf. Not all of BP's exports were at net prices below what could have been earned on the West Coast. At times when West Coast supply was high relative to demand, for example when a refinery was shut down, there were no buyers in California willing to pay as much as the export price (less a transport discount). Public data source: Petroleum Supply Annual, Table 13; Petroleum Supply Monthly, Table 25.

[9] "Statement of Commissioners Anthony, Swindle, and Leary in BP Amoco/ARCO, File No. 991-0192, Docket No. C-3938", footnote 3: "We have reason to believe that the upward price effects of these sporadic sales amounted to no more than one-half cent per gallon at the pump."

price discrimination demonstrates that BP's marginal value of ANS was lower than ARCO's, because ARCO's marginal value was typically determined by transactions at or near the spot price. Thus, the merged entity could inherit BP's lower value for oil, which would lead to reduced efforts to explore and develop ANS. BP's perception that it faced a downward sloping demand exacerbates concerns about the increased concentration in Alaska.

ANS represents less than half of all the crude used in West Coast refineries, so a reasonable estimate is that the typical refinery might have experienced one quarter of a cent price per gallon increase because of the exports. Some of that price increase may have been absorbed by firms rather than passed on to consumers, so the impact of the exports on consumer prices was probably even lower.[10] I do not know if BP was able to earn the margins suggested in their theoretical Optimizer model.

That the maximum amount that BP could leverage prices in the US West Coast is small is also guaranteed from the existence of substitutes. There are good substitutes for ANS available, although at somewhat higher transportation and logistics costs. These substitutes insure that the maximum possible price variations that could be sustained are modest. In addition, BP's ability to export is constrained by the availability of shipping. Few ships meet Valdez requirements and existing ships are being retired. It is implausible that new ships would be built for the purpose of exports, and thus BP's ability to restrict sales to the West Coast was diminishing even absent the merger. Exports to the Far East essentially ended in May, 2000.

Exports serve a potentially useful role in promoting exploration. A very large discovery or a sequence of medium discoveries in Alaska could produce more than the West Coast can absorb at world prices; in this happy circumstance basic economic theory suggests that our Nation is better off selling oil at high prices rather than consuming at artificially low prices. BP's modest attempt at increasing West Coast oil prices in the recent past does not economically justify a return to the export ban. The Nation prospers by exporting resources and other goods and services for high market prices, not consuming internally at lower prices, and the primary effect of the export ban was to reduce the value of Alaskan exploration and production, by reducing the options available to explorers.

BP also discriminated among targeted West Coast refineries, charging what BP estimated the refinery was willing to pay. This discrimination presumably was done to raise BP's profits, but it is unclear whether the effect on consumer prices was to increase them or lower them.[11] In any event the overall effect on gasoline prices of BP's discrimination was probably very small, and might have even contributed to lowering the prices.[12] It would be important for the refineries themselves, of course.

The divestiture of ARCO's Alaska assets to Phillips has preserved existing competition in Alaska—Phillips should become a strong competitor to BP in the same way that ARCO was. Moreover, the incentive of BP to export in order to increase West Coast prices is mitigated or eliminated by the terms of the merger. The acquisition of ARCO's West Coast refining assets substantially reduces the value of increased West Coast oil prices to the combined entity. Overall, the divestitures required by the FTC have definitely preserved and likely enhanced competition to supply Alaskan oil to the West Coast.

OTHER FACTORS INFLUENCING CURRENT WEST COAST PRICES

If not exports, then, what does account for the higher prices in places like California and Oregon? As noted above, exports account for only a small portion of the higher West Coast prices. I claim no special expertise relative to many other econo-

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[10] GAO, "Alaska North Slope Oil: Limited Effects of Lifting Export Ban on Oil and Shipping Industries and Consumers," Report No. RCED-99-191 (July 1999). The GAO report states: "Despite higher crude costs for some refiners, no observed increases occurred in West Coast consumer prices as a result of lifting the export ban." Id. at 8. However, this issue is complicated by the fact that increased ANS prices might increase prices of California crudes.

[11] Price discrimination can either increase or decrease total output—that is, the effect of price discrimination to the West Coast may have been to increase the total sales of oil, which would have reduced gasoline prices overall. BP had an incentive to keep inefficient refineries in business as consumers of oil, and thus may have offered lower prices to refineries that would otherwise shut down. However, BP's pricing could discourage refinery investment. The main importance of price discrimination for the merger is its evidence of market power, and thus an increased concern in bidding, exploration and production, rather than its direct impact on gasoline consumers.

[12] Price discrimination involves reducing prices to some refineries while increasing prices to others, so the average price increase even at the refinery level would be much less than the difference between the average and lowest prices charged.

mists in answering this question: I have not performed the sort of detailed analysis required for the Exxon-Mobil and BP-ARCO mergers. However, there are a number of causes, besides OPEC, that are uncontroversial among economists. The California Energy Commission breaks down prices every week. For the 52 weeks ended April 16, 2001 the prices for branded gasoline broke down in the following way: [13]

Gasoline Cost Breakdown

Dealer Cost and Profit Margin: $.07
Crude Oil Cost: .66
Other Refining Costs and Profit Margin: .48
State and Local Taxes: [14] .31
Federal Taxes: .24
Total Retail Price: $1.76

Increases in crude oil costs, which averaged about 30 cents a gallon in 1998 when crude prices were $12-13 per barrel, is the single largest contributor to the recent price increases. I will focus my comments on the Refiner Cost and Profit margin, which usually though not always is higher on the West Coast than it is elsewhere in the country.[15]

First, CARB gasoline costs refiners an additional 3-4 cents per gallon in marginal production costs to manufacture, after producers have incurred the fixed expense of upgrading their refineries to make them capable of producing reformulated gasoline.[16]

Second, in addition to the higher marginal costs West Coast refiners incurred around $3 billion in fixed costs to be able to produce CARB. These expenses would not be incurred unless higher retail prices justify the expenditures, and consequently we should expect these costs to be reflected in the average price of CARB gasoline. The cost of upgrading was enough to cause some smaller refiners to shut down, thereby reducing California refining capacity.[17] Furthermore, because CARB gasoline gets 1 to 3 percent less miles per gallon than conventional gasoline, the switch to CARB likely caused California consumers to demand more gasoline just to go the same distance.[18] The combination of higher demand and lower supply would be expected to lead to higher prices as a matter of basic economics. These higher prices in part compensate the suppliers for large expenditures in refinery upgrades.

As there are no refineries in Oregon, Oregonians must compete for the gasoline from the same refineries that supply California and Washington. That is why a

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[13] See California Energy Commission, "Estimated 2000 Gasoline Price Breakdown and Margin Details" and "Estimated 2001 Gasoline Price Breakdown and Margin Details", available at *www.energy.ca.gov*. Dealer Cost and Profit Margin includes all costs associated with the distribution and retailing of motor fuel, including but not limited to: franchise fees, and/or rents, wages, utilities, supplies, equipment maintenance, environmental fees, licenses, permitting fees, credit card fees, insurance, depreciation, advertising and profit. Dealer Margin normally lags changes in the wholesale price of gasoline. Refinery Cost and Profit Margin must cover all costs associated with production, distribution, and acquisition of gasoline. The Refinery Margin covers all costs associated with refining and terminal operation, crude oil processing, oxygenate additives, product shipment and storage, oil spill fees, depreciation, brand advertising, purchases of gasoline to cover refinery shortages and profits. The CEC acknowledges that the refiner margin estimates may not equal actual margins.

[14] State excise taxes in Oregon are 24 cents, to which must be added 1.5 to 3 cents per gallon for local taxes (3 cents in Portland). Steve Sou, "Taxes help State prices float near top of nation", The Oregonian, February 24, 1999.

[15] In Oregon, for example, refiner sales of conventional gasoline for resale were at prices that were about 9 cents above the national average in December 2000 and 4 cents below the national average in January 2001, the last 2 months for which data is available. (Petroleum Marketing Monthly, April 2001, table 35.)

[16] A 1999 Energy Information Administration (EIA) report on Phase II reformulated gasoline (RFG) regulations estimated that the Phase II RFG standard would increase costs by approximately 3.5 to 4 cents per gallon over the cost of conventional gasoline. (California's CARB standard is even more stringent than Phase II RFG.) Although that report did not directly estimate the cost of the CARB standard, the EIA observed that the actual wholesale price difference between CARB and conventional gasoline was 4.2 cents per gallon between January 1997 and December 1998. See Tancred Lidderdale and Aileen Bohn, EIA, "Demand and Price Outlook for Phase 2 Reformulated Gasoline, 2000" (Aug. 6,1999), *www.eia.doe.gov/emeu/steo/pub/special/rfg4.html*

[17] During the 1990s, four smaller refineries in California shut down: Golden West and Fletcher in 1992 and Pacific Refining and Powerine in 1995. In addition, Paramount Refining continues to produce conventional gasoline, but has not upgraded to produce CARB. See Leffler, Keith and Barry Pulliam. "Preliminary Report to the Attorney General Regarding California Gasoline Prices," November 22, 1999, p.8.

[18] See California Air Resources Board press release, "Fuel-Economy Reduction From Cleaner-Burning Gas Within Expected Range, According To Statistics", October 10, 1996.

shortage of CARB gasoline that leads to a price increase in California should lead to a similar price increase in Oregon, even though Oregonians usually consume conventional gasoline.[19] The wholesale price of conventional gasoline in Oregon, which was, on average, about eight cents higher than in the rest of the country[20] in 2000, reflects the shortage of refining capacity on the West Coast.

The most significant gasoline problem facing the West Coast is the lack of new refineries. The West Coast market, which largely operates separately from the rest of the country in terms of gasoline production, has a relatively small number of large firms. The fact that the industry is so stable, with no entry and the small number of firms, creates an oligopoly rather than a perfectly competitive market. This oligopoly is reinforced by concentration by the same firms at the terminaling and retail stages of production. Concentration of production facilities was a key reason for requiring a divestiture of a refinery in the Exxon and Mobil mergers.[21] Oligopolies may charge prices above competitive levels without explicitly coordinating or colluding, by following their individual interests.[22]

Fourth, it is expensive to ship refined products to the West Coast. While there are serious logistical problems associated with bringing gasoline to the West Coast, the threat of imports exerts some pressure on West Coast gasoline prices. These costs are increased by the Jones Act, which increases transportation costs by around four cents per gallon.

The tight supply situation on the West Coast, combined with the expense of shipping into the region, means that supply disruptions are likely to lead to price increases. A fifth major factor in the high prices that Oregonians paid in 2000 was the rupture of the Olympic pipeline, which is normally the main source of gasoline in Oregon.[23] The pipeline ruptured in Bellingham, Washington, on June 10, 1999, and remained closed for shipments from BP's Cherry Point refinery and Tosco's Ferndale refinery throughout the remainder of 1999 and all of 2000. Gasoline shipments did not resume until February 3, 2001, and operations on the Olympic system will be limited to 80 percent of capacity until sometime in 2002.[24] Inelastic demand insures that modest supply disruptions have a significant impact on prices.

The pipeline shutdown required the four main Puget Sound refineries to ship gasoline to Oregon via barge, which increased costs by about 2 cents per gallon[25] or more. In addition to refinery production problems, at least one refinery, the ARCO (now BP) refinery at Cherry Point, Washington, was forced to reduce production as a result of logistical constraints that arose out of the Olympic Pipeline break.[26] Oregon is one of only two states (with New Jersey) to ban self-service gasoline sales. Nationally, about 90 percent of all consumers choose self-serve. The Oregon law means that consumers are forced to buy gasoline bundled with some services that are costly to produce. One estimate by an FTC economist implies that the self-serve ban adds about 3.5 cents to average prices in Oregon.[27] This calculation is con-

[19] During the summer months, the Portland area uses an oxygenated, low-Reid Vapor Pressure (RVP) gasoline, which contains some of the same blending components employed in the production of California's CARB gasoline. This low-RVP product is not as expensive as CARB but costs more than conventional gasoline. The Klamath Falls area also requires a low-RVP gasoline in the summer, which would be less expensive than Portland gasoline but more expensive than the conventional gasoline used elsewhere.

[20] See Energy Information Administration, Petroleum Marketing Monthly, Table 31, various issues. The retail price includes full service in Oregon, but in the rest of the country, only about 10 percent of customers opt for full service. In January 2001, the latest month available, the rack price in Oregon was 5.5 cents below the national average. The rack price is a wholesale price at the terminal.

[21] Since 1990 California refining capacity has fallen by about 9 percent while capacity in the rest of the country has risen by about 11 percent. See Petroleum Supply Annual, Table 38.

[22] While antitrust authorities can prevent further consolidation of the West Coast refineries, they are not in a position to encourage or promote new entry of refineries.

[23] The Olympic Pipeline is a 400-mile system running from Ferndale, Washington to Portland, Oregon, that connects the four main Puget Sound refineries.

[24] Overall shipments on the Olympic Pipeline in 1999 were 25 percent below 1998 levels, while overall shipments in 2000 were more than 45 percent below 1998. As for gasoline and jet fuel, 1999 shipments were 27 percent below 1998 levels, while shipments in 2000 were 26 percent below the levels of 1998. Olympic Pipeline Company, FERC Form 6, 1998-2000.

[25] Kim Christensen and James Long, "Lack of competition holds Oregon hostage at the pump," The Oregonian (Aug. 29, 1999), *www.oregonlive.com / news / 99 / 08 / st082901.html* (quoting an employee of a barge company to the effect that shipping by barge should cost around 2 cents per gallon more than shipping via pipeline).

[26] Atlantic Richfield Company S.E.C. report 10k for 1999, pp. 9-10.

[27] Michael G. Vita, "Regulatory Restrictions on Vertical Integration and Control: The Competitive Impact of Gasoline Divorcement Policies," 18:3 J. Regulatory Econ. 217 (2000). In areas that permit self-service stations, sales through full-service pumps represent only about 10 percent of all gasoline sales.

sistent with Oregon's higher than average retailing costs and margins as reported by the Energy Information Administration.[28]

Many of these factors that lead to higher prices reflect the public policy choices of government officials whose concerns are not limited to the price of gasoline, but include clean air, land use, and other factors. It should not be surprising that cleaner-burning, lower pollution gasoline, regulations on refineries, zoning rules limiting entry, and laws designed to protect maritime and gasoline station jobs will lead to higher consumer prices. I have not performed any analysis of the benefits of these governmental policies, nor their overall costs.

CONCLUSION

The main points I would make before this committee are:

- The West Coast gasoline market is integrated: supply and demand events in California, Oregon and Washington affect all three states.
- West Coast gasoline refining is concentrated in the hands of a small number of firms.
- Inelastic demand for gasoline implies that modest supply disruptions have significant impacts on prices.
- The divestitures obtained in the Exxon-Mobil merger insured that competition by refineries and retailers was maintained.
- The merger of BP and ARCO, absent the divestiture, would have reduced competition for bidding, exploration and development of oil resources in Alaska.
- The divestiture of ARCO's Alaskan assets to Phillips preserves competition for oil bidding, exploration and development in Alaska.
- BP exercised monopoly power in the sale of oil to refineries, evidenced by price discrimination, which requires monopoly power.
- BP's attempts to increase West Coast oil prices had a very small impact of West Coast gasoline prices, and manipulation of oil prices does not account for the extent to which West Coast prices are higher than in other parts of the country.
- The divestiture of ARCO's Alaska assets reduces or eliminates BP's potential profits from increasing West Coast oil prices. Thus, it is unlikely that BP-ARCO will attempt to increase West Coast prices by exporting.
- Major factors that have recently increased Oregon prices include:
- Increased world oil prices.
- Growing West Coast demand.
- Reduced West Coast supply due to CARB requirements.
- The absence of new refineries[29]
- The isolation of the West Coast market.

Senator SMITH. Let us go on to the next panel. I will come back to you, professor, for questions.

Professor Shapiro.

STATEMENT OF CARL SHAPIRO, TRANSAMERICA PROFESSOR OF BUSINESS STRATEGY, HAAS SCHOOL OF BUSINESS, UNIVERSITY OF CALIFORNIA AT BERKELEY

Dr. SHAPIRO. Thank you very much, Mr. Chairman. I am Carl Shapiro. I am a Professor at the University of California at Berkeley. I do a lot of work in the antitrust area and I worked with BP and ARCO studying the effects of their transactions for their FTC investigation and the subsequent litigation. I am now appearing on my own behalf, however, and I believe I am probably the person in the room who has most recently suffered the high prices, at least in California, since I filled up my car on the way to the airport yesterday before I came here.

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[28] See for example, the EIA's Petroleum Marketing Monthly for April 2001, Table 31. The difference between the pre-tax prices for "sales to end users" and "sales for resale" are typically several cents per gallon higher in Oregon than they are in the U.S. as a whole.

[29] The proposed ban on MTBE as an oxygenate additive in gasoline will likely exacerbate the already tight supply situation. This ban will effectively reduce the capacity of refineries producing CARB by as much as 11 percent, making it more likely that in the future the marginal source of supply for gasoline in California will be the Gulf Coast, for all or at least most of the year, unless substantial refining capacity is added.

I actually am a big believer in antitrust enforcement and have served previously in the Justice Department as their Chief Economist in the Antitrust Division.

I would like to make two main points and then I will articulate them. First, I believe that the higher West Coast gasoline prices are fundamentally not based on what is going on at the level of crude oil. We are all throughout the country paying basically worldwide crude oil prices. That does not explain the problems with the high prices on gasoline on the West Coast. The same is true; the Alaskan exports when they were taking place were not the cause of the price premium on the West Coast.

The second point is what is the cause and I think there is really a chorus, a consensus on this, and I would particularly agree with Chairman Pitofsky that fundamentally it is a problem of limited refinery capacity on the West Coast which reflects somewhat higher refinery costs that is the root of the problem.

As far as the crude oil, let me talk about crude and then the products. I provided a series of exhibits with my prepared testimony that demonstrate how the Alaskan crude oil prices move very, very closely over time with a number of other crude oil prices throughout the world and the increasing importance of imported crude oil on the West Coast. This is a classic economic situation where the prices for this commodity, crude oil, are governed by worldwide conditions.

In fact, one of the clearest things from the study I did in the merger context between BP and ARCO was that the prices that BP could get for its crude oil were based on competition with imported crude oils.

So yes, I suppose there is collusion going on, but it is OPEC and that is at the crude oil level the fundamental factor. Now, I understand, of course, both of you Senators from Oregon in particular are very concerned about the issues about BP's conduct and pricing in exports. That is very clear to me. I have looked at this very closely. It is my belief that the price that BP received for selling its Alaskan oil on the West Coast was at what can reasonably and I think accurately be called a competitive level, not a monopoly level.

I think there is agreement here among economists that the competitive level is the level that would give the same return on the West Coast versus an export opportunity. On average—not every single transaction, but on average—that is what BP was able to get for its oil on the West Coast. There has certainly been a focus on certain transactions where it was out of balance, as you put it, and I recognize that and the documents indicate that. But on average, the prices were at this competitive level, and I think that is, I think, a key point here.

Also I would say the notion that if there had been, at a time when BP was exporting 50- or 60,000 barrels a day to the Far East, if those barrels had appeared on the West Coast instead, that it would have really made a significant difference for West Coast prices I just do not think is correct. We can go back a few years and the shipments to the West Coast of Alaskan oil were considerably higher—several hundred-thousand barrels a day higher—and the Alaskan prices were no lower. So we do not need to theorize

or speculate about that. The West Coast did absorb considerably higher volumes of Alaskan crude oil in the years past when the production was higher, without any reduction in price. This is again perfectly consistent with the worldwide market in which they are trading.

I also want to say I think there is a considerable degree of agreement, even if you accept some of the short-run trading documents and the calculations you have asked about what is the effect, is it 1 cent a gallon, 3 cents a gallon, this question about pass-through. I have done also a statistical analysis. I know that you questioned the GAO results, but it is a question of pass-through and there is no evidence of any significant pass-through that we can detect of Alaskan prices to West Coast gasoline prices. So GAO has looked at that, just testified about that. I have done the same.

But even if you believe there was some pass-through and recognizing how much of the Alaskan crude oil actually gets purchased at these prices that you are concerned about, my calculations I put in my prepared statement, if you would take that approach you are talking about something like one-tenth-of-a-cent a gallon. Professor McAfee has indicated something less than one-quarter-of-a-cent a gallon.

We can quibble about that, but I think it is sort of ancient history in the sense it does not really matter in today's market and that it is just not going to solve the problem that we have on the West Coast. That really goes, to return to what are the problems, it would be the refinery capacity. I think we have heard pretty clearly, and I have seen statistics to this, that the refineries are running flat out. So they are producing what they can.

It is not a problem of crude oil supplies. We need more gasoline on the West Coast to drive the prices down. We need to think about how long it takes to build a facility, the permitting. The environmental restrictions obviously have to be respected, but is there a way to get more capacity.

The alternative would be to import more gasoline from other parts of the country, which is pretty expensive. So it is a supply problem that needs to be addressed.

[The prepared statement of Professor Shapiro follows:]

PREPARED STATEMENT OF CARL SHAPIRO, TRANSAMERICA PROFESSOR OF BUSINESS STRATEGY, HAAS SCHOOL OF BUSINESS, UNIVERSITY OF CALIFORNIA AT BERKELEY

1. INTRODUCTION AND SUMMARY

I am Carl Shapiro, Transamerica Professor of Business Strategy at the Haas School of Business, and Director of the Institute of Business and Economic Research, both at the University of California at Berkeley. I regularly conduct research and provide economic advice in the area of antitrust economics and business strategy. I served as Deputy Assistant Attorney General for Economics in the Antitrust Division of the Department of Justice from 1995 to 1996, and have recently testified as an expert witness on behalf of the Department of Justice and the Federal Trade Commission in antitrust cases. My curriculum vitae is available on my web site at U.C. Berkeley, *www.haas.berkeley.edu/shapiro*. I thank the Committee for inviting me to offer an economic analysis of West Coast crude oil and gasoline prices here today.

Two years ago, when BP Amoco ("BP") and ARCO announced their plans to merge, I was retained by BP and ARCO to conduct an economic analysis of the antitrust issues associated with their merger. During the subsequent year, I closely studied West Coast crude oil and refined-product markets, focusing on the supply of Alaskan North Slope ("ANS") crude oil and the role of ANS crude oil in West

Coast crude oil and refined-product markets. My analysis included an examination of competition and pricing in these markets, BP's strategy regarding the sale and disposition of its ANS crude oil, and the impact of ANS crude oil supply and exports on West Coast prices. I am now appearing before the Committee on my own behalf as an antitrust economist and California citizen, not on behalf of BP.

I offer the following observations to the Committee:

West Coast Crude Oil Prices

- The price paid by West Coast refineries for crude oil, including Alaskan North Slope crude oil, is governed by conditions in the worldwide crude oil market.
- Over the 1995 to 2000 time period, BP was a major supplier of ANS crude oil to West Coast refineries. During that time, the price BP received for its ANS crude oil was at a competitive level, not a level reflecting monopoly power. BP's exports did not have a material effect on the price of ANS crude oil, much less the price of gasoline.
- BP's historical trading strategies as a net seller of ANS crude oil are no longer relevant in today's markets. Today, BP is a net buyer of ANS crude oil to serve its refineries at Los Angeles and Puget Sound.

West Coast Gasoline Prices

- West Coast gasoline prices move up and down directly with movements in world crude oil prices. But crude oil prices do not explain the higher level of gasoline prices that prevails on the West Coast vs. the rest of the country.
- Reimposing the ban on the export of ANS crude oil is not a solution to the problem of high West Coast gasoline prices. There have been no exports of ANS crude oil to the Far East since May 2000.
- The West Coast gasoline price premium is primarily explained by (a) the higher costs of refining gasoline to meet California's more stringent requirements for reformulated gasoline, (b) the limited amount of refinery capacity on the West Coast, along with (c) the cost of importing gasoline from refineries in other parts of the country.

2. ALASKAN NORTH SLOPE CRUDE OIL PRICES ARE DRIVEN BY WORLD CRUDE OIL PRICES

The West Coast is part of the worldwide crude oil market. Alaskan North Slope crude oil prices closely track the prices of other grades of crude oil. As shown in Exhibit 1, ANS crude oil prices move up and down extremely closely with other prices in the world crude oil market such as the widely traded benchmark crude oils West Texas Intermediate (WTI) and Brent. Exhibit 2 measures the correlation between ANS crude oil prices and the prices of some other benchmark crude oils. The correlations shown in Exhibit 2 are exceptionally high and indicate that ANS crude oil trades in a market with these other crude oils.

For the past 5 years, the West Coast has been a net importer of crude oil. From 1995 to 2000, Alaskan North Slope production declined by 516 thousands of barrels per day ("MBD"), and shipments of ANS crude oil to the West Coast declined by 302 MBD.[1] Since the production of California crude oil has been approximately constant, at roughly 800 to 900 MBD, and since total usage of crude oil on the West Coast also has been approximately constant, at roughly 2500 MBD, the shortfall created by declining ANS production has necessarily been made up by imports. Exhibit 3 shows the increasing volume of imports of crude oil into the West Coast from 1989 through 2000. As shown in Exhibit 4—a pie chart of crude oil sources in 2000—last year imports made up 28 percent of the supply of crude oil on the West Coast.

Under these conditions, the price of crude oil on the West Coast, including ANS crude oil, has been determined by the delivered price of *imported* crude oil to the West Coast. The fact that there has been no increase in the price of ANS relative to the prices of other crude oils, despite a very large decline of 302 MBD in ANS shipments to the West Coast, is powerful evidence that ANS crude oil prices on the West Coast are governed by world crude oil prices, *not* by the volume of ANS shipped to the West Coast. This is a classic economic demonstration that ANS crude oil competes directly with these other crude oils. Technically, the demand for ANS crude oil exhibits a very high price elasticity.[2] These facts are central to any assessment of the impact of ANS exports.

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[1] Shipments of ANS crude oil to the West Coast were 1314 MBD in 1995, 1348 MBD in 1996, 1222 MBD in 1997, 1184 MBD in 1998, 1070 MBD in 1999, and 1012 MBD in 2000. Department of Energy, *Petroleum Supply Monthly*, DOE/EIA 0109, Table 28, various issues.

[2] Along with my colleagues John Hayes and Robert Town, I have performed an econometric analysis to estimate the elasticity of demand for ANS crude oil on the West Coast. This analysis

By looking at specific West Coast refineries, we can see just how competition between ANS crude oil with other grades of crude oil plays out in the marketplace. As ANS supplies and shipments have fallen, refineries have smoothly substituted imports for ANS crude oil. For example, market intelligence indicates that Chevron's Richmond and El Segundo refineries replaced significant volumes of ANS crude oil with imported crude oils during 1995-2000, and that UDS eliminated ANS at its Wilmington refinery in favor of imports. Likewise, Valero announced last November its plans to import crude oil from the Mideast to compete with Alaskan North Slope crude and drive ANS prices lower.[3] I say this substitution has been very "smooth" because there has been no increase in the relative price of ANS crude oil. This tells us that a number of West Coast refineries were able to switch from ANS to imported crude oils at minimal expense. In contrast, when a freeze in Florida reduces the supply of oranges, the price of orange juice rises. In that case, many orange juice drinkers find it "costly" to switch to other drinks, and will keep drinking orange juice even if orange juice prices go up.

3. BP'S HISTORICAL TRADING STRATEGIES FOR ALASKAN NORTH SLOPE CRUDE OIL

I understand that the Committee is interested in BP's historical ANS trading strategies, and specifically in understanding the impact of BP's exports of ANS crude oil on West Coast crude oil and gasoline prices. I now address those issues.

I believe the starting place for this inquiry is to ask whether BP received prices for ANS crude oil from West Coast refineries that exceeded the prices that would prevail in a competitive market. In a perfectly competitive market, a company selling ANS crude oil would ship that oil to the location giving the highest price, net of transportation costs. This net price is known as the "netback," in this case measured from Valdez, Alaska, where the oil exits the Trans-Alaska Pipeline and is put onto tankers. The "competitive price" for ANS crude oil on the West Coast is the price that yields equal netbacks (out of Valdez) to the Far East, which has been the most attractive alternative destination over the past 5 years.

In fact, the netback that BP received from its sales of ANS to the West Coast was no higher than the netback it received from its exports to the Far East.[4] In other words, BP's prices for Alaskan North Slope crude oil were at competitive levels. The prices BP actually received for its ANS crude oil simply do not indicate that BP had monopoly power.

Economists generally regard trading and arbitrage activities as an important part of the operation of competitive markets. When a market participant sells its output in the geographic location yielding the highest price, market efficiency is promoted because products flow to the buyers who value them most highly. This is a general principle in commodity markets, from crude oil to bulk chemicals to agricultural markets. In my opinion, BP's trading activities and exports are best seen in this light, namely as a normal part of the workings of competitive markets. Exports certainly are a normal part of competitive commodity markets. Given that BP had sufficient shipping capacity to send some ANS crude oil to the Far East rather than the West Coast, and given the willingness of some customers in the Far East to pay enough to compensate BP for the extra cost of shipping the oil to the Far East (so that the Far East *netback* was equal to the West Coast netback), we should expect to see exports in a competitive market.

I understand that FTC Chairman Robert Pitofsky has suggested that BP's exports may be indicative of monopoly power, because BP recognized that selling additional ANS crude oil on the West Coast at certain times would tend to lower the West Coast spot price of ANS. Of course, it is common for traders in competitive markets to have small, transitory effects on prices. In financial markets, for example, the price of a stock may fall by 1 percent (e.g., 25 cents for a $25 stock) or more as a result of a single trader unloading his or her position. In BP's case, since BP sold significant volumes of ANS crude oil under long-term contracts with prices *indexed* to the West Coast spot price of ANS, BP naturally accounted for the fact that tempo-

shows an extremely high elasticity of demand for ANS crude oil. See John Hayes, Carl Shapiro, and Robert Town, "The Extent of the Market: Estimating the Effects of the BP/ARCO Merger."

[3] According to a November 9, 2000 press release, "Valero plans to import crude to the US West Coast from the mideast over the next few months to compete with Alaska North Slope crude and drive ANS prices lower, a Valero official told analysts Thursday. The refiner will be bringing in three cargoes of imported crude which will 'put pressure on the ANS price,' improving the economics at the company's Benicia, California refinery."

[4] My calculations show that BP's netback on sales to the West Coast were approximately equal to BP's netback on sales to the Far East over the 1997-1999 time period. These calculations include both spot and term contract sales.

rarily lowering the ANS spot price by, say 0.5 percent (10 cents per barrel on a $20 barrel of oil) would lower BP's revenues under its term contracts.[5]

I believe it is mistaken to characterize this type of short-run impact on spot prices as monopoly power. As I indicated earlier, BP's sales of ANS crude oil to West Coast refineries were at competitive prices, not monopoly prices. Furthermore, we directly observe a reduction in ANS shipments to the West Coast from 1314 MBD in 1995 to 1070 MBD in 1999. Compare this number to the average level of ANS exports by BP during 1998 and 1999 of 60 MBD. We can ask how much lower West Coast ANS prices would have been, had BP exported no ANS crude oil, so that ANS shipments to the West Coast in 1999 would have been 1130 MBD rather than 1070 MBD. Well, we know that ANS prices were *not lower* relative to other crude oil prices even when ANS shipments were as high as 1314 MBD, as they were back in 1995. The inescapable conclusion is that 60 MBD more ANS shipments to the West Coast would not have led to lower ANS prices during the 1998-1999 timeframe. BP's exports of ANS did not have any measurable impact on the West Coast price of ANS, much less the price of gasoline.

In any event, for three powerful reasons, BP's historical trading strategies are not a fruitful place to look to explain why West Coast gasoline prices are higher than gasoline prices elsewhere in the country.

First, while the overall level of worldwide crude oil prices directly affects gasoline prices, no connection has been found between the level of ANS crude oil prices (moving alone) and West Coast gasoline prices. The GAO studied this question and was unable to detect any impact on West Coast gasoline prices even when ANS prices rose by roughly $1 per barrel. According to the GAO, "Despite higher crude oil prices for some refiners, no observed increases occurred in the prices of gasoline, diesel, and jet fuel."[6] I have conducted my own study of the relationship between ANS crude oil prices and West Coast gasoline prices, and I find no statistically significant relationship between ANS prices (moving alone) and West Coast gasoline prices.

Second, even those who suggest that BP's exports of ANS crude oil led to higher prices on the West Coast recognize that any such effects are small as regards ANS crude oil prices, and smaller still when it comes to West Coast gasoline prices. The majority of the Federal Trade Commission indicated at the time of the BP/ARCO merger that ANS exports *at most* raised gasoline prices on the West Coast by one-half cent per gallon. Referring to BP's exports of ANS crude oil, Commissioners Anthony, Swindle, and Leary said: "We have reason to believe that the upward price effects of these sporadic sales amounted to no more than one-half cent per gallon at the pump."[7] They go on to say: "We acknowledge the public concern over the relatively high price of gasoline on the West Coast, but people will be cruelly disappointed if they are led to believe that the export restriction would have a detectable effect on the situation."

In fact, going back to the model from which the FTC majority calculated the half-cent per gallon of gasoline *upper bound* , it is clear that the *actual effect* estimated using this model would be no more than one-tenth of a cent per gallon of gasoline. The underlying model upon which the FTC relied translated 60 MBD of exports to a temporary increase of about one-half cent per gallon in the price of *ANS crude oil* . But higher ANS crude oil prices, moving apart from other crude oil prices, simply do not translate one-for-one into higher gasoline prices. In fact, during 1998 and 1999, only around 25 percent of the crude oil used on the West Coast was sold at prices tied to the ANS spot price. So, even if refiners fully passed on an increase of one-half cent per gallon in the price of ANS crude oil, this would only correspond to an increase in gasoline prices of about one-tenth of a penny per gallon.[8] Further-

[5] Now that ANS term contracts (which Phillips has taken over from BP) are indexed to crude oil prices other than the ANS spot price, with these other crude oils being much more thickly traded, neither BP nor Phillips has the same incentives to refrain from specific ANS spot market trades that have the effect of temporarily lowering the spot price of ANS.

[6] General Accounting Office, "Alaskan North Slope Oil: Limited Effects of Lifting Export Ban on Oil and Shipping Industries and Consumers," GAO/RCED-99-191, July 1999, p.6.

[7] See Statement of Commissioners Anthony, Swindle, and Leary in BP Amoco/ARCO, April 13, 2000, available at *http:2 / / www.ftc.gov / os / 2000 / 04 / bpstateasl.htm.* It is my understanding that the FTC's economic expert in the BP/ARCO case, Professor Preston McAfee, agrees that BP's ANS exports had at most a very small effect on West Coast gasoline prices.

[8] Even this number is too high, for two reasons: (1) There is no allegation that all of BP's exports to the Far East were at netbacks less than BP could have earned selling those cargoes on the West Coast. Even Chairman Pitofsky objects to BP's exports only when the Far East netback is less than the West Coast netback. Therefore, a number smaller than 60 MBD should be used for these calculations. (2) There is no reason to expect 100 percent of any increases in refineries' cost of purchasing ANS crude oil to be passed on to motorists in the form of higher

more, for the reasons I gave above, I believe it is mistaken to rely on a short-run trading model, rather than longer-term data on ANS production and shipments, to estimate the effects of ANS exports on ANS crude oil prices. Looking at longer-term production and shipment data, 60 MBD of exports in 1998 and 1999 had no measurable effect on the price of ANS.

Third, BP's historical trading strategies and exports of ANS are simply not relevant in today's market. BP produces about 280 to 290 MBD of ANS and uses about 350 to 400 MBD of ANS crude oil at its two West Coast refineries at Carson and Cherry Point. So BP is a net *buyer* of ANS crude oil of more than 70 MBD. Phillips, which acquired ARCO Alaska as part of the settlement between BP and the FTC, also inherited term contracts that BP had signed with Equilon, U.S. Oil, and Tosco. None of these term contracts are now indexed to ANS spot prices. As a result, both buyers and sellers in the (very thin) ANS spot market no longer have incentives to influence the ANS spot price as a result of having term contracts tied to that price. Finally, there have been no exports of ANS since May 2000.[9] Phillips appears to lack sufficient shipping capacity to export its ANS to the Far East, even when netbacks to the Far East (calculated based on excess tonnage economics) are higher than netbacks on the West Coast.

4. EXPLAINING THE WEST COAST GASOLINE PRICE PREMIUM

The evidence is compelling that the higher West Coast gasoline prices we are now experiencing, in comparison with the rest of the country, are not the result of higher West Coast prices for crude oil, either for imported crude oil or for Alaskan North Slope crude oil. The West Coast gasoline price premium certainly is not today, and has not been, the result of ANS exports.[10] What *does* explain these prices differences, and what can be done to reduce gasoline prices on the West Coast?

The causes of the West Coast gasoline price premium have been closely studied by many others, including the Energy Information Administration and the California Energy Commission. Happily, there is considerable consensus as to the causes of the West Coast gasoline price premium. I will simply summarize what I consider the consensus findings on this issue, adding in my own observations on possible policy responses.

First, refinery capacity on the West Coast is limited. Building new refineries appears to be nearly impossible, and existing refineries have limited ability to expand their capacity.[11] The result is that the West Coast is perilously close to having insufficient refinery capacity to meet its needs. Since the demand for gasoline is quite inelastic, this creates a situation where disruptions in supply (e.g., from refinery outages) create a genuine scarcity, causing price to rise sharply to clear the market. In other words, at the refinery level, West Coast gasoline markets are habitually tight, leaving no margin for error. Inventories are not sufficient to buffer shocks resulting from supply disruptions. Consumers on the West Coast are thus vulnerable to price spikes as a result of refinery outages or breaks in pipelines. Policies to encourage the addition of refinery capacity on the West Coast would help ease these problems. The Federal Trade Commission should also scrutinize any mergers or joint ventures that would increase the concentration of ownership of West Coast refinery capacity.

Second, refinery costs are higher in California than in the rest of the country, due in part to California's stringent rules for reformulated gasoline (RFG), specifically the California Air Resources Board (CARB) standard for RFG. The CARB standard raises the cost of gasoline refining by about four cents per gallon.[12]

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gasoline prices. Generally, the passthrough rate for higher input costs depends upon how much marginal costs are affected, and the ratio of the elasticities of supply and demand.

[9] See Department of Energy, *Petroleum Supply Monthly*, DOE/EIA-0109, Table 46, various issues.

[10] As noted above, there have been no exports of ANS for nearly a year. Re-imposing the ban on ANS exports would not have any material impact on West Coast crude oil or gasoline prices.

[11] Many West Coast refineries have expanded their capacity over time through debottlenecking and other capital expenditures. However, the ability of these refineries further to expand capacity is limited by a range of permitting requirements and environmental restrictions, as well as various other factors.

[12] Since its introduction in 1996, the wholesale price for CARB has averaged roughly 4 cents per gallon more than conventional gasoline. "Report on Gasoline Pricing in California," Staff Report and Attorney General's Comments and Recommendations, May 2000, p. 5. Before CARB regulations were implemented in 1996, the California Air Resources Board estimated the new formulation would cost between 5 and 15 cents more per gallon than conventional gasoline. Keith Leffler and Barry Pulliam. "Preliminary Report to the Attorney General Regarding California Gasoline Prices," November 22, 1999, n. 11.

Third, it is costly for the West Coast to import gasoline from other parts of the country.[13] On top of these transportation costs is the fact that California standards for RFG are more stringent than Federal standards, so refineries elsewhere in the country cannot simply ship to California the gasoline they normally produce. In fact, there are a limited number of refineries outside California that produce CARB gasoline.[14] Thus, refinery capacity outside PADD V has very limited ability to keep West Coast gasoline prices in line with gasoline prices elsewhere in the country. Policies designed to reduce the cost of transporting gasoline from the Gulf Coast to the West Coast would help integrate gasoline markets on the West Coast with those in the rest of the country.

Unfortunately, there is reason to believe that the West Coast gasoline price premium is likely to grow rather than shrink in the near future. First, as West Coast demand for gasoline slowly grows and refinery capacity does not, the basic problem of supply/demand imbalance on the West Coast will tend to worsen. Second, the price premium for CARB gasoline over conventional gasoline may rise as California refineries are forced to pay royalties to Unocal on Unocal's RFG patents.[15] Third, as MTBE is phased out in California, effective refinery capacity will be further reduced and refinery costs will likely rise.[16] Finally, the West Coast electricity mess may spill over and cause disruptions in the supply of gasoline on the West Coast.[17]

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[13] It costs 8 to 12 cents per gallon to import gasoline from the Houston area. Keith Leffler and Barry Pulliam. "Preliminary Report to the Attorney General Regarding California Gasoline Prices," November 22, 1999, p. 7 (citing *Octane Week*, August 2, 1999).

[14] Refineries outside California that produce CARB include Valero (Gulf Coast), Amerada Hess (Caribbean), and Neste (Europe). "Report on Gasoline Pricing in California," Staff Report and Attorney General's Comments and Recommendations, May 2000, p. 5. These refineries do not produce CARB gasoline on a regular basis.

[15] A jury decision awarding Unocal 5¾ cents per gallon on its 393 patent was affirmed on appeal in March 2000. Unocal claims a total of five RFG patents.

[16] MTBE is prohibited in California gasoline after December 31, 2002. California Air Resources Board Press Release, March 10, 2000 (*http://www.arb.ca.gov/newsrel/ph3cbg.htm*). Removing MTBE from gasoline will cause effective production capacity to decline by from 5 to 11 percent. Gordon Schremp, "Staff Findings: Timetable for Phaseout of MTBE from California's Gasoline Supply," California Energy Commission, presentation dated June 18, 1999, and Keith Leffler and Barry Pulliam. "Preliminary Report to the Attorney General Regarding California Gasoline Prices," November 22, 1999, p. 8. Replacing MTBE with ethanol will initially add 4 to 7 cents per gallon to the price of gasoline; over the long term, removing MTBE is expected to raise gasoline prices by to 2 to 6 cents per gallon. "Supply and Cost of Alternatives to MTBE in Gasoline," California Energy Commission, P300-98-013, February 1999, and California Air Resources Board Press Release, March 10, 2000 (*http://www.arb.ca.gov/newsrel/ph3cbg.htm*).

[17] The *Los Angeles Times* reported that blackouts have already shut down product pipelines, and threatened to shut down refineries in California. Chris Kraul, "Gas Shortage Possible as Crisis Affects Refineries, Pipelines," *LA Times,* January 20, 2001. I understand that BP reduced production at its Cherry Point refinery for a brief period of time because of the high price of electricity.

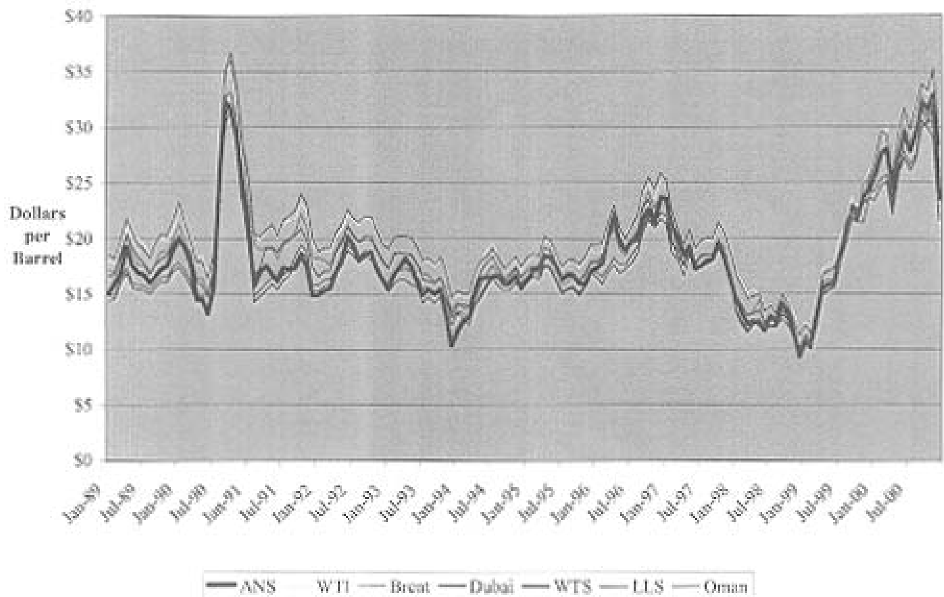


Exhibit 1: Crude Oil Prices
1989-2000
Dollars per Barrel
$40
$35
$30
$25
$20
$15
$10
$5
$0
Jan-89
Jul-89
Jan-90
Jul-90
Jan-91
Jul-91
Jan-92
Jul-92
Jan-93
Jul-93
Jan-94
Jul-94
Jan-95
Jul-95
Jan-96
Jul-96
Jan-97
Jul-97
Jan-98
Jul-98
Jan-99
Jul-99
Jan-00
Jul-00
ANS
WTI
Brent
Dubai
WTS
LLS
Oman
Carl Shapiro Senate Testimony
April 25, 2001

Exhibit 2: Crude Oil Price Correlations 1989-2000

	Alaska North Slope	West Texas Intermediate	Brent	Dubai	West Texas Sour	Louisiana Light Sweet	Oman
Alaska North Slope	1.00	0.98	0.97	0.98	0.98	0.97	0.98
West Texas International		1.00	0.99	0.97	0.99	1.00	0.98
Brent			1.00	0.98	0.99	0.99	0.98
Dubai				1.00	0.98	0.97	1.00
West Texas Sour					1.00	0.99	0.98
Louisiana Light Sweet						1.00	0.98
Oman							1.00

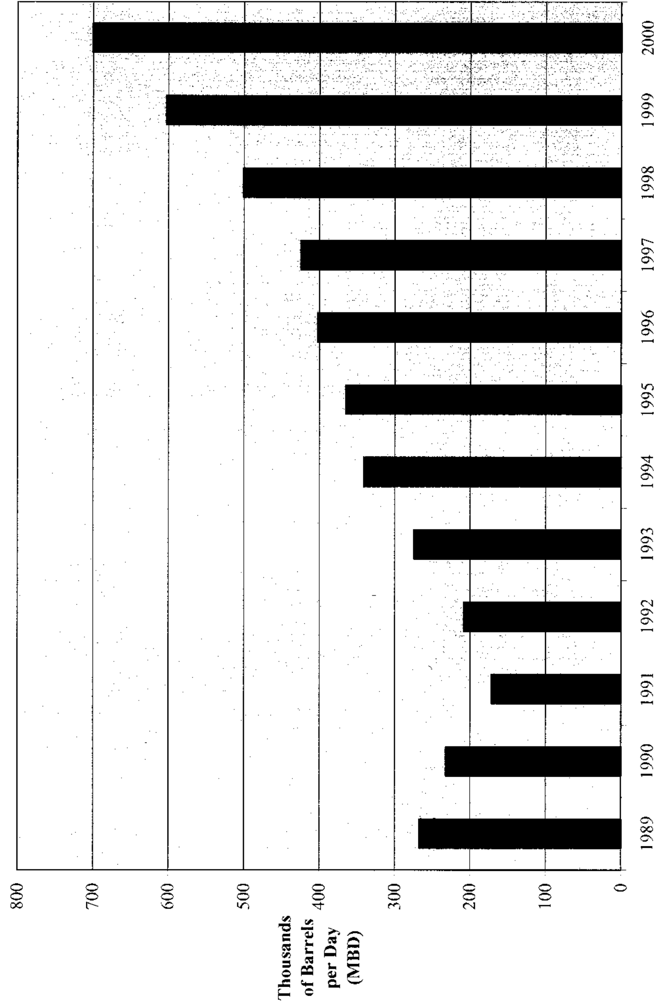
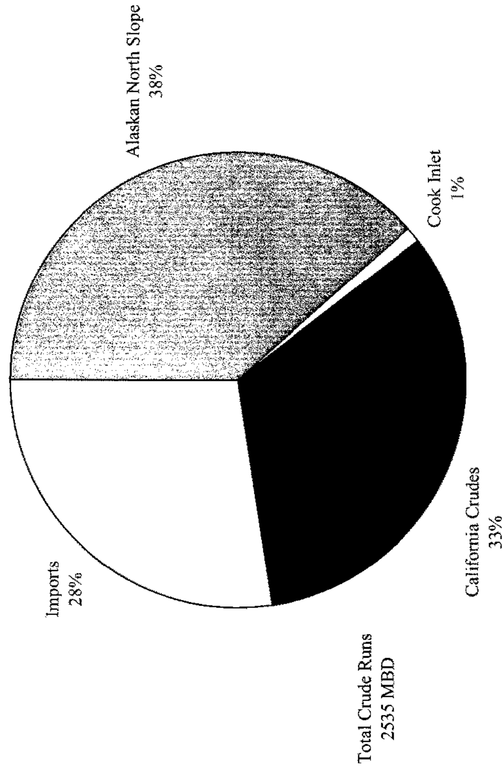


Exhibit 3: Crude Oil Imports to the West Coast
1989-2000
Thousands of Barrels per Day (MBD)
800
700
600
500
400
300
200
100
0
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
Carl Shapiro Senate Testimony
April 25, 2001

Exhibit 4: Usage of Crude Oil on the West Coast 2000



Carl Shapiro Senate Testimony
April 25, 2001

Senator SMITH. I think it is important right now to stop and ask questions of these two professors. This is important for the constituents Senator Wyden and I serve. BP has taken a hammering in our State because of an article in our State-wide newspaper. Are you aware of that?

Dr. SHAPIRO. I certainly am.

Dr. MCAFEE. Yes, sir.

Senator SMITH. In fairness to this company, I want to ask you some questions, not impugning your integrity at all, but I think people need to know the truth. You have no affiliation with BP, do you?

Dr. SHAPIRO. I do not, that is correct.

Senator SMITH. Professor McAfee.

Dr. MCAFEE. I do not and never have.

Senator SMITH. I think it is important that people know.

Professor McAfee, you are aware of this article in *The Oregonian*, is that correct?

Dr. MCAFEE. Is that the one I am quoted in?

Senator SMITH. You are front and center. You are the first witness, and this is "Experts: BP Rigged Prices." Now, you are here today saying you never said they rigged prices?

Dr. MCAFEE. Correct. I said they manipulated prices. I have never used the phrase "rigged" because that means collusion.

Senator SMITH. No collusion. So in your view, your understanding of the law and their business practices, they did not break any law?

Dr. MCAFEE. They did not break any law that I know of.

Senator SMITH. You have also testified that at one time that what they did translated in a cost to Oregonians of 1 to 3 cents a gallon higher. Have you revised your testimony now down to a quarter-of-a-cent?

Dr. MCAFEE. The quarter-of-a-cent referred to gasoline, not oil. The 1 to 3 cents was intended to refer to oil on a per-gallon basis. So translating into barrels would be 40 cents to $1.20 on a barrel. But that was also intended to be an upper bound. That is, the largest extent of manipulation, not the average extent of manipulation, was on that order.

Senator SMITH. So you think it is a fairly de minimis impact, if at all?

Dr. MCAFEE. Absolutely.

Senator SMITH. Notwithstanding that it was de minimis, your testimony is that there was overwhelming evidence that the company manipulated West Coast oil prices?

Dr. MCAFEE. That is correct.

Senator SMITH. But there is no evidence that they broke any law?

Dr. MCAFEE. Not that I know of.

Senator SMITH. Because you have not seen the documents Senator Wyden has referenced?

Dr. MCAFEE. I have not. Am I correct, Senator, that those documents refer to ARCO's behavior and not BP's?

Senator WYDEN. I think both the Chairman and I would be interested in whether you have seen the FTC documents that are under seal in court for purposes of the question he just asked you.

Dr. MCAFEE. I have seen very extensive—there were millions of pages of documents. I have read a very small fraction of those, but I have seen many documents that remain under seal, including the report I wrote. Parts of that were released, but parts—it was a redacted version.

Senator WYDEN. I was not going to ask either of you any questions because I have many for the other two. I think what I feel very strongly about is that it seems that virtually no one here has seen those documents that are under seal, the 1400 boxes, and has seen various and sundry other things. I gather you as part of your assignment—and that is why I happen to think it is critical to get to the bottom of this issue, that there be a process for examining those documents.

Dr. MCAFEE. May I respond to that?

Senator WYDEN. Of course.

Senator SMITH. May I ask to Senator Wyden's comment. Frankly, I believe you two are the experts on this merger, so you surely saw all the documents involved.

Dr. SHAPIRO. I certainly have had access to and seen mountains of documents. I believe the same is true for Professor McAfee. I do not think either of us—I think there is a tremendous amount of consensus between the two experts who have seen these documents and reviewed this case.

Senator WYDEN. But have you, in fact, seen the 1400 boxes that are under seal, and also have had access to the full extent of the information, rather than the redacted version? That is what is under question.

Dr. SHAPIRO. I have had full access to all this information as part of my role as an expert witness in the case. Professor McAfee can speak for himself.

Dr. MCAFEE. I have had full access. I have actually seen all 1400 of the boxes and I have gone through, not 1400, but a large number of them personally.

Senator WYDEN. We are glad to have that resolved.

Senator SMITH. Professor McAfee, on the basis of having seen all of that and read this article in which you are the featured character, is this an unfair characterization of what BP has done?

Dr. MCAFEE. I objected to the headline on that article strenuously because I have seen no evidence of rigging prices. I have seen evidence of manipulating prices. Now, this is not manipulating at the level of 20 cents per gallon. It is much, much smaller than that. But there is evidence of trying to affect the prices.

Senator SMITH. Very good.

Senator Wyden, do you have any further questions?

Senator WYDEN. Not for the two professors. As I indicated, I have questions for Mr. Malone and Mr. Mau.

Senator SMITH. OK.

Mr. Malone, the mike is yours.

STATEMENT OF ROBERT MALONE, REGIONAL PRESIDENT-WESTERN UNITED STATES, BP

Mr. MALONE. Thank you, Mr. Chairman and Members of the Subcommittee. Good afternoon. My name is Bob Malone and I am the Regional President for BP based in Los Angeles. I want to thank you for inviting me to testify.

I am here to talk about gasoline prices on the West Coast today. That is a matter of concern to you because of the impact of gasoline prices on your constituents and to me because your constituents are my customers. I think it is particularly important that the main focus for discussion be firmly grounded in the present context, the West Coast as it is today. A lot has changed during the last several years and BP is a new and a different company. We have combined the best of five great companies: British Petroleum, Amoco, ARCO, Vastar, and Castrol.

Our role on the West Coast has changed, too. Two years ago, BP was an ANS producer and a seller. Today BP is an ANS producer, an ANS buyer, a refiner, and a gasoline marketer.

Other West Coast participants have changed, too. Phillips acquired ARCO's Alaskan operations. Exxon and Mobil merged.

Valero acquired Exxon's Benecia refinery, and relative shares of ANS production were reallocated with the realignment of Prudhoe Bay interests among BP, Exxon, and Phillips.

All of these changes took place under FTC review and with the FTC's close involvement and understanding of the details of these changes. Our perspective and our comments on gasoline prices today take into account all of these changes.

Before focusing on the main topic of West Coast gasoline prices today, I feel I need to address some of the historic topics. That is, BP's historical ANS exports and our trading documents. Let me begin with ANS exports. In spite of some press reports to the contrary, ANS exports do not affect the price of gasoline on the West Coast. In 1999, the GAO found no observed increases occurred in West Coast consumer prices as a result of lifting the export ban. The FTC made a similar observation in their statement on the BP-ARCO merger approval, stating: "We acknowledge the public concern over the relatively high price of gasoline in the West, but people will be cruelly disappointed if they are led to believe that the proposed ANS export restriction would have detectible effect on the situation."

We just heard now from noted economists that there is no significant correlation between ANS exports and gasoline prices on the West Coast. Today BP does not export any ANS crude. We stopped those shipments last June for commercial reasons.

There have been allegations that BP was manipulating retail gasoline prices on the West Coast by shipping ANS crude to Asia. Let me be clear that one company's ANS trades cannot manipulate the global oil market. If you consider this just for a moment, on average we exported at the highest peak about 76,000 barrels a day. These exports equated to 3 percent of West Coast consumption, which is four-tenths of 1 percent of refining consumption and less than one-tenth of 1 percent of world consumption.

I would like to now turn to the confidential documents. We strongly disagree with those who suggest that confidential documents held in agreement with the Federal Trade Commission be released. Confidential documents are standard procedures for all merger applications. This request affects a number of companies other than BP who are not here today. Some of these companies currently have matters that are pending before the Commission.

This matter has been given rigorous Federal court review and a Federal judge, the FTC, the attorneys general of Oregon, California, Washington, and Alaska participated and endorsed the process and its outcome.

My last point is the trader e-mails. I will say this, that our traders were doing what traders do, which is to try to aggressively work to maximize profits. This is the fundamental notion behind a strong U.S. economy. Are some of the trader e-mails poorly worded? Yes? Did they do anything illegal or improper? No. Did they do anything that affected the world price of oil? Absolutely not. Did they do anything that impacted the price of gasoline on the West Coast? Absolutely not.

I would like to turn to today. Today BP produces 290,000 barrels a day on the North Slope of Alaska. All of this production is transported to our refineries in California and Washington State, where

it is refined and sold through our ARCO branded retail stations. We are very proud of our ARCO brand and the long history it has providing consumers with competitively priced gasoline in the western United States.

In general, gasoline prices on the West Coast tend to be higher for three reasons: Logistically, it is difficult for products to reach the West Coast; State taxes on the West Coast are generally higher; and West Coast fuel specifications are among the most stringent in the country. In particular, California Air Resource Board gasoline is unique and more expensive to manufacture.

There are specific actions that we can take that will help alleviate this for our customers and your constituents. A national energy policy should consider the following. The required use of oxygenates in gasoline complicates my industry's ability to move gasoline to areas in short supply. This happens frequently on the West Coast. Simplicity and consistency in fuel specifications are needed.

We need infrastructure to ensure that growing energy demand can be managed. The current pipeline network must be expanded to ensure that natural gas, crude oil, gasoline and other fuels are efficiently delivered to customers. We have to stop polarizing the debate between energy issues and the environment. We must be able to strike a balance so that we can continue to meet our commitment to a clean environment while allowing for the building of additional capacity to manufacture these cleaner fuels.

Again, I want to thank you for the opportunity to work with this Subcommittee and others as we move forward on an energy policy.

[The prepared statement of Mr. Malone follows:]

PREPARED STATEMENT OF ROBERT MALONE, REGIONAL PRESIDENT, BP

My name is Bob Malone and I am Regional President for BP. BP is a global energy company, formed from the recent mergers of five great companies, BP, Amoco, ARCO, Vastar and Burma Castrol. We are proud of our heritage and the conduct of each company that came together to form BP. Today we stand in front of the Committee as a completely new company.

Energy policy has been in the news on a daily basis over the past few months and West Coast energy concerns have been given particular focus. At BP we are committed to working together with this committee and all stakeholders to better understand the forces at work in the energy marketplace. We must also remain vigilant on behalf of our employees, contractors, shareholders and customers to ensure that the record is accurate as to how we operate in the market.

Our intention is to once again provide answers to any remaining questions regarding the past, with an eye to solving the future energy challenges of our customers, your constituents. We are fundamentally committed as a company and members of the community to give our customers choice for heat, light and mobility; these are the products we sell. We believe our record is second to none in the United States with regard to cleaner fuels, climate change initiatives and openness to the community.

I thank the Committee for this opportunity to address the topic of West Coast gasoline prices. Let me turn directly to some of the issues that I was told would be the subject of today's hearing.

WEST COAST GASOLINE PRICES

West Coast gasoline marketing is extremely competitive, yet West Coast gasoline prices are among the highest in the nation. Numerous studies and findings have determined that the situation is caused by a variety of market conditions. Specifically, West Coast gasoline prices are higher because:

1. Logistically, the West Coast is not easily accessible as compared to other regions. The West Coast infrastructure is challenged in that there is limited pipeline

connection to other regions, and the primary mode of product import is by tanker and barge. Additionally, manufacturing is operating at full capacity resulting in significant risk to supply should an unexpected outage occur.

2. State gasoline taxes on the West Coast are among the highest in the nation.

3. West Coast fuel specifications are among the most stringent in the country. In particular, California Air Resources Board (CARB) gasoline is unique and more expensive to manufacture. California gasoline demand cannot easily be satisfied through imports from adjacent regions nor from other refineries within PADD V. Since CARB gasoline is not fungible among other western states, supply volatility is increased.

PRICING PRACTICES

We have fully cooperated with an ongoing FTC investigation of West Coast gasoline prices and expect the results soon. We believe the evidence will show that BP is one of the most competitive marketers in the region and show no findings of wrongdoing, similar to findings from past investigations.

We also understand that the FTC investigation has become primarily focused on the practice of 'redlining.' Our distributor supply contracts do not contain territorial restrictions, sometimes called 'redlining.' On the West Coast, we have very few distributor supply agreements and this practice does not apply to us. Our decision to use direct marketing facilities is based on the efficiencies of the supply chain for effective cost management.

Concerning dealer pricing practices, we use price zones to meet competition and comply with the law. The Robinson-Patman Act prohibits a supplier from discriminating in price among its customers who are in direct competition. We use price zones to ensure that all branded facilities in a price zone receive the same wholesale price. Price zones are defined through analysis of traffic patterns and physical boundaries such as rivers, freeways and industrial parks, etc. There is no station count criterion for establishing a price zone. As a result, while the wholesale price is the same for every site within a price zone, each station operator independently sets its retail or street price.

ANS EXPORTS

A coalition of Alaska and California oil producers, Maritime Labor, shippers and contractors banded together to repeal the ANS export ban in 1995. The idea originated in Vice President Gore's Report, Reinventing Government that was acted upon through a study by then Secretary of Energy Hazel O'Leary. Legislation was introduced in the House of Representatives where it passed by a vote of 361 to 54, and in the Senate where it passed a vote of 69 to 29. President Clinton signed the bill into law on November 28, 1995.

Regarding the suggestion that BP's ANS exports have increased West Coast gasoline prices, several things can and should be said on this topic:

1. BP's ANS exports have not affected West Coast crude oil prices. Crude oil is a global commodity, and ANS is traded in that global market. The trading activity of no single person or company can affect crude oil prices. On the West Coast as elsewhere, exports are balanced by imports, and the global forces of supply and demand establish prices.

2. ANS exports have had no effect on West Coast gasoline prices. According to the General Accounting Office's statistical and economic analyses in this connection, "the prices of gasoline, diesel, and jet fuel on the West Coast did not significantly change as a result of lifting the [ANS] export ban." The same study found that, "West Coast consumers appear to have been unaffected by lifting the [ANS export] ban, because the prices of important petroleum products they use have not increased." General Accounting Office, "Alaskan North Slope Oil: Limited Effects of Lifting Export Ban on Oil and Shipping Industries and Consumers," GAO/RCED-99-191, (July 1999) at 30,31. Economist Carl Shapiro's own study of the relationship between ANS prices (moving alone) and West Coast gasoline prices came to the same conclusion—increases in the price of ANS crude relative to other crude oils does not affect the price of gasoline.

3. ANS exports have no relevance to current discussions of West Coast gasoline prices. Today, BP is a West Coast refiner and currently refines more Alaska North Slope crude oil than it produces. We have not exported ANS crude since June 2000. To our knowledge, no other company has exported Alaska North Slope crude since that time, either. BP has no plans to export ANS crude at this time.

CRUDE TRADING

We also would like to take this opportunity to address the suggestion made in the press recently that documents produced to the FTC in connection with BP's acquisition of ARCO somehow reflect illegal or improper conduct. The suggestion is simply not true. Some of BP's trading documents may have been unfortunately worded, and the press has highlighted that fact, but the documents do not change the global nature of these West Coast crude markets. Considered in the context of these market realities, BP's trading documents reflect nothing more than efforts to engage in normal trading activities, which are not only proper, but, in the larger view, essential to the efficient operation of global markets.

In this connection, the FTC, in approving the BP/ARCO merger, specifically noted that BP's trading activity was legal: "It is important to emphasize that BP's unilateral actions were not illegal under the antitrust laws—and, indeed, the complaint makes no allegations that exports were illegal." Further, as most relevant to the focus of the hearing, BP's ANS exports have not been a factor in West Coast gasoline prices as established by the General Accounting Office and Shapiro analyses referenced earlier.

CONFIDENTIAL DOCUMENTS

We strongly disagree with those who suggest that confidential documents held in agreement with the Federal Trade Commission be released. These documents must remain confidential.

1. Confidential documents are standard procedure for all merger applications.
2. This request affects a number of companies other than BP, who are not here today and some of these companies currently have matters pending before the Commission.
3. This matter has been the subject of a rigorous Federal court review, and a Federal judge, the FTC and the Attorneys General of Oregon, California, Washington and Alaska have participated in and endorsed this process and its outcome.

The essential information concerning BP's pre-merger ANS exports and trading activity is summarized in the public record. The FTC's interpretation of those documents and activities was included in public filings as part of the FTC's BP/ARCO merger lawsuit last year, and many of the documents themselves were made public as the result of proceedings to unseal the record. The only portions of the BP documents that have not been made public have been determined by Federal court proceedings to contain confidential and legitimately protected trade secret information. BP and third parties alike provide large volumes of sensitive documents to the FTC in reliance upon the continued confidentiality of their trade secrets. These expectations of continued confidentiality need to be honored for the proper and efficient conduct of this system of regulatory review. We have confidence that these rigorous Federal proceedings have struck a proper balance concerning what information should be made public, and what information is properly kept confidential.

RECOMMENDATIONS

Returning to the specific issue for this hearing, West Coast gasoline prices are higher than the national average. We have listed some of the reasons for this fact. While some of these factors can be managed through public policy, we need a national energy policy. We recommend the following:

1. Gasoline must be made more fungible to reduce supply volatility and increase flexibility. Oxygenates are not required in gasoline to meet air emission standards. The required use of oxygenates in gasoline complicates the industry's ability to move gasoline to areas in short supply.
2. We need infrastructure to ensure that growing energy demand can be managed. The current pipeline network must be expanded to ensure that natural gas, crude oil, gasoline and other fuels are efficiently delivered to customers.
3. The tradeoff between energy and environmental policy must be managed so that we continue to meet our commitment to a clean environment, while allowing for the building of new units required to manufacture the new cleaner fuels, which BP supports.
4. The Unocal fuels patent unnecessarily complicates the manufacturing process and increases costs. The patent formulation adds little value and should be reviewed by the United States Patent office.

I thank you for the opportunity to testify.

Senator SMITH. Thank you, Mr. Malone. I want to ask you this because I want to give BP a fair shot at making its case to Oregon,

and I think your testimony has done very well. No one here is under oath, so we want people to just tell us the truth. You are not under oath, but I hope you would answer as though you were.

This probably would never have made *The Oregonian* had there not been an e-mail correspondence between BP employees that was somehow obtained by them, where it was discussed that exporting Alaskan North Slope crude to the Far East was a way that the company could short West Coast refiners in order to short the West Coast and leverage up prices. A BP spokesman is quoted in the article as saying that this conduct was well within the bounds of the law.

Does BP deny that it sought to inflate the West Coast price of crude oil by selling its Alaskan North Slope crude to the Far East or does the company just claim that in its opinion its conduct was not illegal? Do you deny it happened or do you deny that it is illegal?

Mr. MALONE. I am that spokesperson with *The Oregonian.* Let me begin there. I will answer your questions absolutely direct, Mr. Chairman.

Mr. Chairman, that particular e-mail I am familiar with, but I have not been able the get the whole document. So let me begin by saying just a couple of things to set the direct response to your question. Number one, again that document was produced when we were an ANS trader. We had excess and we were selling on the market. Today we do not. We consume all of our ANS as a result of the ARCO acquisition. So the conditions that are referenced in that memorandum do not exist today.

Second, crude oil is a world commodity and traders are looking for arbitrage opportunities within a very narrow band on a product that is sold on a global basis. So if the world price of crude oil is $24.25, we are looking at opportunities to maximize our earnings around $24.25, but we are not going to impact a global commodity on a sustained basis.

Third, I just would like to emphasize that we have heard from our experts and we also heard from the GAO about the relationship of exports to the retail market, and that it is inconsequential if even measurable. So much of the implication for your constituents, Senator, was that they were paying for that at the retail price, versus a document that is talking about looking for opportunities to enhance profitability around a band of crude oil trading, not retail market pricing.

Senator SMITH. Mr. Malone, these experts, who are unrelated to your company, have testified, and I assume you would swear to it, that you have seen all of the confidential documents? You have seen everything that there is to see, and there was not illegal practice?

Dr. MCAFEE. That is correct.

Senator SMITH. The same, Dr. Shapiro?

Dr. SHAPIRO. I agree.

Mr. MALONE. Mr. Chairman, to your question, there were times when we were selling ANS and we were selling those on term contracts. We could have multiple term contracts at the same time. Those term contracts were normally based upon a spot price, and there were times that we shipped that last cargo to the Far East

because, not necessarily at a lower price, but maybe at a lower netback, in order that our term contracts already in place, the spot price would be higher than if we brought that last cargo to market.

Mr. Chairman, that is working with the market in order to be able to look for those type of opportunities to maximize our product. We did not have a downstream marketing system at that time, nor a refining system.

Senator SMITH. Very good. One last question that I had. Senator Stevens has indicated his implacable opposition to any export ban of Alaska oil. I wonder how you feel about such legislation should it prohibit export of Alaskan oil. Would BP be opposed to that and, if so, why?

Mr. MALONE. Yes, we would be opposed to putting the ban back in place, although as has been in my statement and others we have not exported ANS since June of last year. The idea that we would try to restrict a product to try to create a false market versus letting it be with the rest of crude oil in the world is to us restrictive. Second, we never know when, either for commercial reasons, but maybe more importantly, the importance of moving crude oil off of the pad to other locations in order to alleviate an oversupply which could shut down North Slope operations. We have seen that happen, sir.

Senator SMITH. You undoubtedly do not have any current plans to export that oil to Asia at this point. You have need for it on the West Coast. But can you—as the leader of BP on the West Coast—do you understand the political dilemma that creates for some of us who have to explain to constituents why it is, when we are already so dependent upon foreign oil, we would be exporting oil that comes off American shores?

I am trying to get you to say: We will not do it any more.

Mr. MALONE. I cannot say that, Chairman. It is very important, I think, that oil be able to move at a fair market value on a world price. Any commodity that is world priced should be able to do that.

Senator SMITH. You understand the political down side of it?

Mr. MALONE. I do. But I also understand the importance of that to my former home State of Alaska and the importance in what we are able to do now as a refiner and marketer on the West Coast.

If I could also just add, we buy ANS on the open market right now. We are buying all the ANS to meet our needs. We are also importing other crudes on occasion to meet the needs of our refining system. I might also mention, we are also buying gasoline on the market today in order to meet the needs of the California market.

Senator SMITH. Thank you.

Senator Wyden.

Senator WYDEN. Mr. Chairman, I have a number of questions for Mr. Malone, but Senator Stevens indicated he was under a tight time schedule.

Senator STEVENS. No longer.

Senator SMITH. He is back from the doctor. He is going to live, too.

Senator STEVENS. I got my ear fixed.

Senator WYDEN. Well then, let me begin by focusing on this 1995 e-mail exchange. My colleague described it, well, we have got this situation where these BP trading managers are I gather sitting around talking about the benefits to the company of shorting the West Coast, in their words, to leverage up prices, and they described this as being a no-brainer.

Mr. Malone, this took place in 1995. You were not in charge of BP's West Coast operations in 1995, were you?

Mr. MALONE. No, I was not.

Senator WYDEN. I understand the individual who held your job for West Coast operations in 1995 is still working for BP and that person, in effect, was the supervisor of these people, but BP chose to send you to the Subcommittee as its witness. Would you just tell us whether that is correct?

Mr. MALONE. There was not a regional president on the West Coast until I arrived.

Senator WYDEN. No, I understand that. But the person that supervised the people wrote this e-mail and is still with the company, is that not correct?

Mr. MALONE. Both are with the company.

Senator WYDEN. Both the people and their supervisor, is that not correct?

Mr. MALONE. Senator Wyden, I am not sure who their supervisor was, so I cannot say whether they are still with the company or not. I assume so.

Senator WYDEN. My understanding is that the person who was in charge of the folks doing the e-mail who we asked for is still there and you have been sent instead.

You indicated to me in a meeting that you have not reviewed the documents under seal in the FTC matter. Have you reviewed them since we spoke?

Mr. MALONE. No, Senator Wyden, I have not.

Senator WYDEN. Mr. Chairman and Chairman Stevens as well, this is to me the key point in terms of where we are. I have met with Mr. Malone on a number of occasions now and he strikes me as a decent person, an easy to talk to, decent person. But it seems to me what your company is essentially asking is that this Subcommittee trust BP on a matter that occurred long before you took over the West Coast operation, involving documents you have never seen.

You just said, in response to questions from my colleague Senator Smith, that you will start selling the oil to Asia any time you feel like it, that you are going to just do it when you think it is in your interest. Given that, and given the fact that you are asking this Subcommittee to trust BP when there is documentary evidence uncovered by *The Oregonian* that you all exported crude oil to Asia to keep West Coast prices high, that your employees were sitting around and talking about the benefits of doing it, I sort of feel like President Reagan. President Reagan said: I want to trust you, but I have got an obligation to verify.

So my question to you at this point is would you be willing—would BP be willing—to make arrangements with this company to provide all of the documents under seal if this Subcommittee assures the security of those documents?

Mr. MALONE. Senator Wyden, as we have talked about before, we would object because the assumption that you have said is that I ask you to trust me and my company. But in my statement, as you heard, the FTC has seen those documents, the Federal court has seen those documents, a special master has seen those documents, and they released, and we did not object, including that memo—we did not object, Senator Wyden, to that being released to *The Oregonian.*

The other documents the special master and the Federal court found to be competitively sensitive material and that it should remain confidential.

Senator WYDEN. I have no quarrel with your asserting that these are proprietary. But when you say you have nothing to hide and yet you go to great lengths to keep them under seal, even saying, as you just have, that you are not willing to work out an arrangement. I sit on the Senate Intelligence Committee, Mr. Malone, and so I work with secret documents quite a bit. What you are saying is in effect that Members of the U.S. Senate, this Subcommittee, cannot be trusted to see these documents, and I think that is a regrettable statement.

If you are going to assert that you have nothing to hide, your company ought to be willing to work out an arrangement with this Subcommittee to let us take a look at them.

Mr. MALONE. Senator Wyden, if you interpreted my remarks to have shown lack of the least bit of respect for the U.S. Congress and the U.S. Senate, then I apologize, because I have the utmost respect for this body. That is why I am here today.

What I said is that the very agencies that are entrusted by us to look through those documents have looked through them on behalf of all of us, as has a Federal court, and that we were guaranteed the protection of those documents by the Federal Trade Commission.

Senator WYDEN. But none of those people gave Senator Smith and I an election certificate. We got an election certificate to represent more than 3 million Oregonians, and those people are asking questions when they read in their morning newspaper about e-mail, e-mail that says that your people sat around and talked about the benefits of sticking it to our constituents. When you tell us you have nothing to hide, and yet go to great lengths to describe all these convoluted processes where you tell Members of the U.S. Senate who sit on the Senate Intelligence Committee that you cannot work out an arrangement to see documents and have them treated confidentiality, I have got to tell you I do not think that is in the public interest.

I know the light is on and I do not want to hold up Senator Stevens. I have other questions in a moment, but I want to yield to the Chairman for his time.

Senator SMITH. Senator Stevens.

Senator STEVENS. Well, Senator, I am prepared to stay here as long as you are, but I take offense at that comment. I presume we are all familiar with the process and the processes of the various courts. As a Senator, we do not have a right to tell the courts to release documents that they received under a seal of confidentiality.

I think this is rather absurd, as a matter of fact.

Mr. Malone, as I understand this e-mail, it pertained to wholesale prices of crude oil, did it not?

Mr. MALONE. Yes, sir, it did, the market price of crude.

Senator STEVENS. The market price of crude, right. It did not concern consumer pricing in Oregon or California, did it?

Mr. MALONE. No, it did not.

Senator STEVENS. I do not understand this failure to really examine the difference between that. These people have told us that, yes, it might have affected the price of crude oil, but it has not affected the consumer prices in these States.

Is there any evidence here that has been brought to your attention that your company tried to manipulate consumer pricing?

Mr. MALONE. No, Senator.

Senator STEVENS. I really would urge my colleagues to consider the difference. We produce crude oil. Unfortunately, we do not have many refineries. We do not have a posted price. I do not even know if these gentlemen understand that, but as a practical matter our oil is priced at the destination. And there is a process—is there not a building up of a market, like a market in Japan, for instance? We never were able to export before under that ban, which I always thought was unconstitutional. Once the ban was lifted, you did have sort of a responsibility to find out if it was possible to build up a market in Japan, is that not correct?

Mr. MALONE. That is correct, Senator.

Senator STEVENS. Now, if you look at—I do not know if I am overstepping my own band of expertise, but I have always thought that there was a crude stream in the world and that really it would be to the great advantage of the world if the oil was delivered to the nearest destination and we did not have oil coming from Saudi Arabia into California and oil going from Alaska to California. I really think we would be better off in the long run, if we did not have all these political problems, having a destination concept, to ship it to the nearest place, so the risk to the oceans would be less.

We have tried to bring up a concept of cutting down the distance that we ship oil. Your shipments to Japan, they were not under any long-term contracts, were they?

Mr. MALONE. No, most were spot shipments.

Senator STEVENS. Spot shipments. Once you had this merger, as I understand Mr. Pitofski and I think your statement, too, you have retail markets, marketing capability now, right?

Mr. MALONE. We take all of our production and run it through our refineries.

Senator STEVENS. So are we not just sort of beating a dead horse of 1995, 1996, 1997, something that cannot happen again, will not happen again? You have got the marketing capability for your crude. You are not going to sell it to Japan when you need it in California, are you?

Mr. MALONE. We have no plans to export because we need it in our refineries.

Senator STEVENS. I would like to some time, Mr. Chairman to get into the reason why Oregonians and Californians pay more for gasoline. I do not think I have the time right now, but clearly, gasoline taxes are higher than anywhere else. You prohibit your people from

having self-service. You limit yourself in terms of refineries. Oregon has been unwilling to even build one single refinery, in a State that has the demand that it has.

The West Coast in general went down from 42 to 23 refineries on the whole West Coast, despite the fact that we were increasing the supply. The refinery capability went down. And everyone says, "Oh my God, what has happened?" Alaska has driven up the price of oil in California and Oregon.

Now, he is "Bob" to me. Bob, you have been around that company long enough to answer me. Have you been involved in any collusive activity to drive up consumer prices?

Mr. MALONE. Absolutely not, Senator.

Senator STEVENS. I know this guy. We have spent Christmas arguing with one another, things like that. He will tell you that, but about other things rather than this.

But this concept that you two are driving home, that somehow or other back in 1995, 1996, 1997 our oil people tried to drive up consumer prices, is wrong. I do not think you have any evidence to justify that statement. You have made it repeatedly, Senator, and I think you are ignoring the fact that the testimony here shows they were talking about crude oil prices and not about consumer prices.

There is no connection in this market, direct connection, between those two. Is that not a fair statement?

Senator WYDEN. Would the Chairman just yield?

Senator STEVENS. Yes, sir.

Senator WYDEN. Because I do not want to encroach on your time. First I would like to note I was the first person so far today to say that Mr. Malone seems like a decent guy.

Senator STEVENS. You said "seems." I will say is.

[Laughter.]

Senator WYDEN. I will be willing in the name of Subcommittee comity to stipulate to the fact that Mr. Malone is a decent guy.

Senator STEVENS. You have a new friend, Bob.

Senator WYDEN. He had before.

I also want to again reiterate that I am not talking about any confidential document getting out to the public. What I have been interested in, which I think my constituents feel strongly about, is setting up a process by which this Subcommittee, while assuring the confidentiality of documents that are considered proprietary, can examine them. That is what is in question.

Senator STEVENS. I think it is still my time, if I may.

Do you have any evidence that there is anything in those boxes that pertains to consumer pricing? The two documents that I have heard pertain to crude oil pricing, and I hope you will understand the difference in this concept of crude oil marketing. Is there anything that has been brought to your attention that affected consumer pricing?

Senator WYDEN. Mr. Chairman, all we have with respect to this issue is we have lost these stations. Bob Pitofsky says that there is evidence of red-lining, evidence of zone pricing. We have got e-mail that talks—these are their quotes—the benefits of shorting the West Coast to leverage up prices, it is a no-brainer.

Senator STEVENS. At that time they were dealing with exporting crude, not consumer pricing.

Senator WYDEN. Mr. Chairman, what I would say, again as a way to resolve this issue, is that we would set up a process to confidentially examine these documents so as to address the question you are talking about.

We have been here for—I do not know, well over 3 hours. I have not used the word "collusion." Not once. I have not used the word "illegal conduct."

Senator STEVENS. I heard it here today, though.

Senator WYDEN. Not by me, because I went in here with a very detailed set of questions and they were designed to elicit what Bob Pitofsky told us, which is in his opinion he has found substantial evidence of market manipulation. That was essentially his words.

Senator STEVENS. He also said it was not illegal.

Senator WYDEN. Correct.

Senator STEVENS. All right. Why do you want the documents?

Senator WYDEN. Because I think we need to find out exactly what was going on when you have got management sitting around talking about the benefit of sticking it to the West Coast.

Senator STEVENS. I do not think you have any evidence that we stuck it to the West Coast. That is the bottom line, and I join my colleague in saying no to opening up documents unless you have some proof that there is evidence in those documents of manipulating consumer pricing. Again, there could be evidence of manipulating, trying to manipulate, the market for crude oil. They needed more markets for crude oil.

Senator WYDEN. I have great respect for the Chairman. I think he knows that we have worked together on a lot of matters. But I do think that when you have people in our State consistently paying gasoline prices over the national average and you have the testimony we even heard from Bob Pitofsky today, it is not too much to ask that we examine these documents, not in public, not on the streetcorner in the *National Enquirer*, but in private, to essentially assess what is going on.

I will tell my colleagues at least today that I feel even stronger about this than I did coming in, because Bob Malone, to his credit, said that he is prepared to resume exporting gas to Asia any time he feels like it.

Senator STEVENS. Gas.

Senator WYDEN. Again, we can have the debate about what is exported. The documents that I have been dealing with, the BP issue involved oil. With respect to ARCO it involved gas. As the Chairman of the Appropriations Committee knows, these lines can blur, which is all the more reason for us to look at these documents confidentially to try to assess what was going on.

Senator STEVENS. Mr. Chairman, I do not want to prolong this, but I hope my friend understands that about one-half of a barrel of crude oil goes into other than gasoline.

Senator WYDEN. Correct.

Senator STEVENS. And when you export crude oil you are dealing with a lot of other prices than gasoline.

Senator WYDEN. That is correct.

Senator STEVENS. That is one of the reasons why I think you cannot draw the direct connection between crude oil pricing and consumer pricing in California. But for the purpose of this go-round, let me tell you. We have fought a lot of battles in our lives and we have probably more oil than anywhere in the country, and one of the things that we do is produce it. We are the only State that ever faced a ban on an export of the product from that State, the only State in the Union that ever had that.

It was unconstitutional to start with, and you are suggesting initiating it once again. I think that is where I draw the line.

Thank you, Mr. Chairman.

Senator SMITH. Thank you, Senator Stevens.

Mr. Malone, here is the article. You have read it. I believe you disagree with it, do you not?

Mr. MALONE. Yes, I do.

Senator SMITH. It says, the headline, “Experts: BP Rigged Prices.” You believe that is wrong?

Mr. MALONE. I believe it is wrong and I went to Oregon and met with *The Oregonian* and told them so.

Senator SMITH. If it read “Experts: BP Rigged Prices, But Acted Legally,” would you agree with that?

Mr. MALONE. I would object to that as well.

Senator SMITH. Senator Wyden, any further questions?

Senator WYDEN. Does Senator Stevens want to go next?

Senator STEVENS. No, no. Go ahead and I will interrupt you.

Senator WYDEN. All right, fair enough.

[Laughter.]

Senator WYDEN. I want to ask a question about the ARCO documents, recognizing again, Mr. Malone, you have not seen this. So I want to talk conceptually about it. You say in your testimony: “Logistically, the West Coast is not easily accessible as compared to other regions. There is limited pipeline connection to other regions.” That is your quote.

Given these logistics, if gasoline supply to the West Coast is reduced because of a refinery fire or other disruption, it would be fair to say that it would be difficult to replace that gas, is that not correct?

Mr. MALONE. Yes, sir.

Senator WYDEN. When the supply is reduced, that typically raises the price, does it not?

Mr. MALONE. It depends on the gasoline market itself at that time. I think the assumption is that if there is a shortage of it what you would buy on the market would probably have a premium on it. So if there is a shortage in the market and you buy it, it is probably more expensive than the average price.

Senator WYDEN. That is what the GAO said as well, that supply disruptions would increase prices. So my question is, if a company could reduce the supply by exporting gas or through other means, I could create a shortage and increase the price. Given the difficulty of bringing in alternate supply that you have testified about, having a business strategy to “export to keep the market tight,” as ARCO did in the mid-1990s, would make pretty good sense for them, would it not?

Mr. MALONE. Senator, I have not seen the memo. I do not know that document. One of the documents, I received a call last night from *The Oregonian* about it. I followed up and found out that that one particular recommendation that was attached to the Aguilar case they did not, ARCO did not act on that. In fact, there have been four judges now that have reviewed that case and found no collusion by ARCO.

Senator WYDEN. Well, no, I recognize that this is a document that, though public, is still being considered in the legal process. What I am concerned about, and I went through it in my opening statement, is that there was by appearances certainly to a significant degree a strategy to keep the market tight and export and inevitably drive up prices on the West Coast.

As you heard me say in my opening statement, I see an awful lot of parallels between ARCO then and the new entity now, which is why I am so troubled.

Senator STEVENS. Would you yield just a moment?

Senator WYDEN. Of course.

Senator STEVENS. Did you know that was jet fuel that you were referring to and not crude oil?

Senator WYDEN. Again, Mr. Chairman, we do have some questions about exactly what the fuel was used for.

Senator STEVENS. No, no. It was jet fuel when it was exported. It had been refined in my State.

Senator WYDEN. You are certain of that?

Senator STEVENS. That is what I am told.

Senator WYDEN. Well, again, my central interest here is not for more legislation. This Subcommittee has jurisdiction to really get to the bottom of this issue, and again, without sounding repetitive, it is late in the day, I think it is important to set up a process to examine these documents, rather than to have Senator Smith and I go back to the people of Oregon and say: Well, Mr. Malone is a good guy, he met with us, so we are going to trust him.

I think it is especially hard to do that given he said: It is our business judgment; we will start exporting tomorrow if we think it is in our interest. We will export to Asia or South America or anywhere else.

I thank you, Mr. Chairman.

Senator SMITH. Thank you, Senator Wyden.

There have been a lot of tough words used in this hearing and they have always been preceded by "alleged." I think that is important, that we bear this in mind. Part of the purpose of this hearing is to bring light to an issue that just has questions to date, but I think there is a lot more light now. We appreciate very much, Mr. Malone, your testimony.

Mr. Mau from Portland, Oregon, you are the cleanup hitter. We look forward to hearing where the gasoline hits the road.

STATEMENT OF CHUCK MAU, OREGON GASOLINE DEALER, PORTLAND, OREGON

Mr. MAU. Thank you, Senators, for the opportunity to come here and testify. My name is Chuck Mau and I have been a gasoline dealer in Oregon for 15 years, the last 12 selling Texaco branded

fuel. My station is located in southwest Portland about one mile off of I–5.

Less than one mile away is another Texaco station that regularly sells gasoline for 5 to 10 cents less than I can afford to sell. At one point, my competitor's cost was 18 cents cheaper than mine, plus the county tax difference of 2 cents, which totaled 20. It translates out I could sell my fuel at cost and go broke and he still makes a living at 20 cents a gallon. What kind of competition is that, is my question.

The reason for these price differences are I have to buy my fuel directly from Texaco. My competitor buys from a jobber, an independent wholesaler. The gasoline I buy and my competitor buys is delivered from the same terminal. Sometimes even the same truck delivers to me and my competitor. The same gasoline, delivered by the same truck, the same driver, but I get charged a higher price than the same station, less than one mile away.

I tried to get wholesalers to sell to me at the price my competitor pays and the answer was no. They said if they did it would jeopardize their relationship with Texaco.

The consumer does not know there is a difference in the price that each station pays. They just think that I am the one that is gouging them because I have to charge a higher price because I am being charged a higher price.

Today in Oregon, a consumer can pay a lower retail price in central Oregon than the wholesale price that I pay in Portland. It costs more to transport gasoline to central Oregon from Portland. It should be cheaper in Portland. The fuel gets trucked from Portland. The consumer is really the loser, paying far more than they should in the Portland metro area.

Several years ago, Texaco began to turn dealer-operated stations into company-operated stations. Now their operations in the Portland metro area are dominated by company-operated units. There are far less of us independents left today.

I watched Texaco push out one dealer by not taking care of his station. They would replace the pipes, repair the furnace when they needed to be. The dealer finally gave up. Texaco took it, turned it into a company store, and made a huge investment, turned it into one of their Price Starmarts, run by the company.

I have also experienced firsthand how Texaco can squeeze dealers by charging high rents for leased stations. My station was an Exxon station. In November 1988, it was sold to Texaco. I had no choice. Texaco more than doubled the rent on my station. I know that Texaco paid the landlord of the property it was on $1500 per month. They in turn charged me $6700 per month.

Texaco also squeezes dealers out by lowering the price at their company-operated stations and controlling the street. During the fall of 1999, Texaco lowered the street price of all company stations in the Portland area 2 cents overnight, with no reduction in the wholesale cost as a factor for the move. All of a sudden, my customers are asking: Why is not your price going down? All the other Texacos have gone down 2 cents. Well, I cannot compete with a company the size of Texaco.

It looks to me like Texaco does not want to have dealers. They squeeze out their dealers to get control of the entire gasoline mar-

ket, from refinery all the way down to retail. It is like we are in a lobster pot and they are slowly turning up the heat. We do not know we are getting cooked because it has been happening little by little.

I worry about what Texaco is going to do next. They could put me in my own zone and charge me 20 cents more a gallon than my competition.

I fear retribution for me testifying here today. The way things are going, we will only have about two brands left in Oregon. We will not have any more dealers, and that is not good for dealers and it is not good for our consumers.

I hope that Congress will look into what is happening to the dealers and how there is less and less competition in the gasoline market.

Thank you.

[The prepared statement of Mr. Mau follows:]

PREPARED STATEMENT OF CHUCK MAU, OREGON GASOLINE DEALER

My name is Chuck Mau. I have been a gasoline dealer in Oregon for 15 years, the last 12 selling Texaco brand.

My station is located in Southwest Portland about one mile from Interstate 5. Less than one mile away is another Texaco station that regularly sells the same gasoline for 5-6 cents less than I can afford to sell. At one point last year, my competitor was 18 cents cheaper plus there's a 2 cent difference in county tax, making the total price difference 20 cents per gallon. With this 20 cent price difference, I could sell my gasoline at cost and still go broke. And my competitor would make 20 cents per gallon.

The reason for these price differences is I have to buy my gasoline from Texaco directly. My competitor buys from a jobber—an independent wholesaler. The gasoline I buy and my competitor buys is delivered from the same terminal. Sometimes even the same truck that delivers to me also delivers to my competitor. The same gasoline delivered by the same truck charges me a higher price than the station less than a mile away. It's the same fuel in the same truck with the same driver.

I have tried to get jobbers to sell to me at the price my competitor is getting. They wouldn't. They said if they did, it would jeopardize their relationship with Texaco.

The consumer doesn't know there's difference in the prices dealers pay. They think I'm the one who's gouging the price. But I have to charge a higher price because Texaco is charging me a higher price than my competitor.

Today in Oregon, a consumer can pay a lower retail price in Bend in Central Oregon than the wholesale price I pay in Portland. It costs more to transport the gasoline to Bend than to Portland. It should be cheaper in Portland than in Bend. There's no way the price in Portland should be as high as it is.

Several years ago, Texaco began to turn dealer operated stations into company operated stations. Now, Texaco's operations in Oregon are dominated by company stations.

I've watched Texaco push out one dealer by not taking care of his station. They wouldn't replace the pipes when they needed to be fixed. When the dealer gave up the station, Texaco turned it into a company store and made the investment to fix it up.

I've also experience firsthand how Texaco can squeeze dealers by charging high rents for leased stations. My station was an Exxon station. Then, in November 1988, my station was sold to Texaco. I had no choice. Texaco more than doubled the rent on the station. I know that Texaco paid the landlord $1500 per month, but they charged me $6700 per month.

Texaco also squeezes dealers out by lowering the price of gasoline at their company operated stations. During the fall of 1999, Texaco lowered the price of all company stations in the Portland area 2 cents at the same time. There was no reduction in the wholesale price Texaco charged to dealers. A dealer can't compete with a company the size of Texaco.

It looks to me like Texaco doesn't want to have dealers. They want to squeeze out dealers to get control of the entire gasoline market—from refinery down to the retail gasoline stations.

It's like we're in a lobster pot and they're slowly turning up the heat. We don't know we're getting cooked because it's happening little by little.

I worry about what Texaco will do next. They could put me into my own zone, charge me 20 cents more a gallon than my competition. I am sure there will be retribution against me for testifying about Texaco's actions.

With the way things are going, we'll have only two brands of gasoline in Oregon. We won't have any more dealers. That's not good for dealers and it's not good for consumers. I hope that Congress will look into what's happening to dealers and how there's less and less competition in gasoline markets.

Senator SMITH. It sounds like you are about cooked already.

Mr. MAU. Yes.

Senator SMITH. Are you familiar with the legislation in the Oregon legislature on open supply?

Mr. MAU. Currently, yes.

Senator SMITH. If that passes, does that help?

Mr. MAU. Yes. It would benefit me greatly.

Senator SMITH. Will it pass?

Mr. MAU. Will it pass? I do not know.

Senator SMITH. If it did pass, what assurance would consumers have that dealers would pass any savings along to their customers?

Mr. MAU. Well, the way the legislation is written, I believe, in a divorcement issue, in an open contract it would divorce the refineries from having more than 25 percent company-owned stations in the marketplace, which in the Portland metro area would gather quite a few more units up for lease by dealers.

Senator SMITH. Is there anything that you think this Congress should do that could be helpful to you?

Mr. MAU. I think looking into that red-lining and the zone pricing is a big issue.

Senator SMITH. You think that one of the reasons 600 stations have disappeared is what you are experiencing?

Mr. MAU. Yes.

Senator SMITH. Senator Wyden.

Senator WYDEN. Thank you, Mr. Chairman.

Chuck, first thanks for coming. I have done a lot of work on consumer rights issues over the years, really going back to my days when I was director of the Grey Panthers. I do not think I have ever seen a small business sector like yours as frightened as the small gas stations are about their relationship with the suppliers. I have been out talking to the small service stations now for over 2 years and the very first thing that they tell me when I talk about taking notes and getting it down is they say: Ron, I am really worried about retaliation.

Are you worried that you are going to face retaliation for coming to the U.S. Senate today?

Mr. MAU. Yes, I am.

Senator WYDEN. What are you worried about?

Mr. MAU. I am worried about my supply. I am worried about how transactions get taken place with electronic funds transfers and applying of credit cards, and also my price. I have watched as zone pricing—Texaco did not used to do that. But a few years ago they started that. It used to be an east and west, and then all of a sudden it got down smaller and smaller, and I see it going smaller and smaller and ending up being station by station. That is the way I see it could go to. It is very close now.

Senator WYDEN. Does that affect your livelihood? When a small station like yours comes to the Congress or the legislature, you are basically taking the livelihood and your well-being in your hands by coming and speaking the truth?

Mr. MAU. Well, I am coming here with several other Texaco dealers knowing that I am here, and trying to speak out for what is going on there in the State of Oregon.

Senator WYDEN. You say in your statement that you are paying more for the gas you buy from Texaco than other dealers are. How did you go about coming to that conclusion?

Mr. MAU. Well, we get e-mails every day or faxes on our prices, what it is going to be for the next day.

Senator WYDEN. You have invoices showing?

Mr. MAU. Yes. I have provided you with the invoices showing one Texaco retailer who is a lessee dealer at one unit and a wholesaler-supplied in another unit, and on the same day in December of last year the price differential was 15.4 cents for the same gasoline.

Senator WYDEN. When you bring this to Texaco's attention, this huge price differential, what do they say?

Mr. MAU. Nothing.

Senator WYDEN. They do not even try to——

Mr. MAU. No. I have talked to my rep about it and there is nothing we can do. At one point, I e-mailed my dissatisfaction with that procedure, price differential—I call it price discrimination—and my Texaco rep showed up the very next day and he was halfway out of his car asking me: Chuck, who did you send that e-mail to?

Senator WYDEN. You are not the only dealer charged these higher prices or with what certainly does it seem to you to be discriminatory prices?

Mr. MAU. No, I am not.

Senator WYDEN. You have got others?

Mr. MAU. Yes. There is a gentleman in Salem—Salem is dominated by a wholesale market and he is a lessee dealer and he has to buy his fuel directly from Texaco. Well, it comes out of Portland. He pays the Portland price. He is surrounded by wholesale-operated stations, wholesale-supplied stations, company-run stations by Chevron, consistently pricing 10 to 15 cents below him. What kind of competition is that?

Senator WYDEN. I think you have summed it up. We have been talking about theories for over 3 hours. Chairman Pitofsky told me he found in his opinion substantial evidence of red-lining. Mr. Malone says he will resume exporting whenever he feels like it. But you are the human face on it.

You are the human face that I have been talking to over the last 2 years. It is why I feel so strongly about this subject.

I just want to wrap this up by expressing my gratitude to Senator Smith for being willing to work with me on this on a bipartisan basis, because I think at the end of the day what we are talking about, I do not think we need to pass new laws. This is not an area where you have got to run around and pass new laws and have new bills. What you have got to do is try to bring some free enterprise and marketplace forces back to this industry in Oregon, so people like you can go do your thing and give good service to

the people of Oregon. That is what I am committed to doing. I am glad you put a human face on this to wrap it up.

I thank you, Mr. Chairman.

Senator SMITH. Thank you, Senator Wyden.

Senator Stevens.

Senator STEVENS. I went to Oregon State before any of you were born. Maybe I am missing the point here, Mr. Mau. Are you telling me these people are charging less money than you are charged for gasoline?

Mr. MAU. Yes.

Senator STEVENS. And the consumers from those stations are paying 12 to 15 cents less a gallon?

Mr. MAU. Sometimes.

Senator STEVENS. I thought this was the Consumer Subcommittee. Is there a complaint that some people in Oregon are getting gasoline cheaper, priced below what you can sell it for? I do not quite get the point, Senator. If you want to talk something about collusion or something, that usually is associated with raising consumer prices. There seems to be objection here that someone can sell gasoline in Portland for less price than Mr. Mau can sell it.

Is that your objection, Mr. Mau?

Mr. MAU. My objection is that there is no way for me to compete and the consumer can drive right by my station and see the red and the black and the white and drive right down the street.

Senator STEVENS. And get gasoline for less money.

Mr. MAU. Yes, and I would like to be able to sell it.

Senator STEVENS. That is free enterprise as far as I am concerned. I thought we were trying to protect the consumer in this Subcommittee.

Senator WYDEN. Would the Chairman just yield briefly?

Senator STEVENS. Sure.

Senator WYDEN. What Mr. Mau is saying is he would like the same deal as that guy down the street, and that when Mr. Mau gets the same deal as the guy down the street, then we can have the kind of competition that Chairman Stevens wants and that I want, too.

Senator STEVENS. Well, I would like to be able to buy gasoline for the price you can buy it in Oregon. We produce the oil, but we pay more for gasoline than you do.

Thank you very much. I am sorry, Mr. Mau. I understand your situation, but I do not think that it is a consumer matter. Consumers ought to be happy to be able to drive by your station and buy it for less money. I will tell you, if I was buying gasoline I would drive right by you, because I buy the lowest priced gasoline. I am sorry to say, I think you are off the mark.

Senator SMITH. I think, Chuck, your point is that you would like to be able to buy it at a price that is competitive as well.

Mr. MAU. I would like to be able to buy it at the lowest price, so that I can offer it, because the way I view competition is that in the gasoline market, when you price gasoline you decide, I am going to sell it cheaper than that guy down the street, because you would like to sell it, so you do it, because I want to sell the gallons.

Obviously, the oil companies, as well as me, like to move the gallons.

Senator SMITH. But you feel trapped, obviously?

Mr. MAU. Obviously.

Senator SMITH. You must have felt pretty desperate to come to this Subcommittee knowing that retribution could be taken against you.

Mr. MAU. The other issue that I think is involved here is, in the Portland metro area all the people that live there are consistently paying 15 cents a gallon more than in the central part of the State. 80 percent of the population of Oregon lives in that 5-county area and we have the highest prices in the State there. It has to be trucked everywhere else.

The consumer in the Portland metro area is the loser, not me.

Senator SMITH. A reasonable question. Mr. Mau, thank you. I think Senator Wyden and I would be very interested to know if you suffer any retribution for appearing before a Subcommittee of the U.S. Senate. We would hate to see that and would not be amused by it at all. So we hope you will stay in touch.

Mr. MAU. Thank you.

Senator SMITH. Ladies and gentlemen, we are appreciative of your attendance, your participation, your testimony. We hope there is more light now, less heat, but hopefully, prices we can all afford this summer.

We are adjourned.

[Whereupon, at 6:07 p.m., the hearing was adjourned.]

A P P E N D I X

Prepared Statement of Hon. Jean Carnahan, U.S. Senator from Missouri

Thank you, Mr. Chairman, I welcome this opportunity to be with you, our fellow Committee members and distinguished guests to participate in this important hearing.

Although our focus here today is on the price of gas on the West Coast, this is an issue that affects all of us nationwide, no matter where we reside.

As you know, I have been in office only a few short months. However, I have received hundreds of phone calls and letters from angry and distraught constituents in Missouri who, like your constituents in Oregon, California or most anywhere on the West Coast, are faced with the somewhat painful reality of today's national energy market.

Many consumers have experienced sharp increases in the prices of gasoline, natural gas, home heating oil and electricity. Many in Missouri who use natural gas are paying double and triple what they paid last year to heat their homes and businesses. The cost of a gallon of unleaded, self-serve regular gasoline in the St. Louis area has shot up from $1.31 to $1.69. That's 38 cents in less than 4 weeks.

And with the high-demand summer season less than 5 weeks away, we are hearing that we should brace ourselves for more price spikes in the near future.

These price spikes, combined with the crisis in California and the current debate about a national energy policy, have left many consumers surprised and angry about energy costs and anxious about the immediate future.

Further complicating this issue and contributing to consumer unease are reports in the media about the possibility of companies intentionally manipulating the oil and gas markets to strategically benefit from certain market conditions.

These types of allegations are of great concern to all of us nationwide. We would like to believe that, in the complicated world of energy transactions, we have a structure in place that would look out for the general public and would protect the interests of working families, our elderly on fixed incomes, and others who often struggle to make ends meet.

As many of you may know, Senator Lieberman and I, on behalf of a number of our colleagues on the Governmental Affairs Committee, recently wrote to the General Accounting Office to express our concern about recent reports that market power has been abused in the transmission of natural gas in California. It is alleged that this, in turn, has contributed to the spiraling cost of electricity generation in the state.

We have asked Mr. Wells and his colleagues at the GAO to use their oversight authority to review whether the Federal Energy Regulatory Commission, or FERC, is up to the task of protecting consumers and safeguarding the public interest as it works to promote competitive energy markets.

Although this review will take some time, I hope that anything we learn from the GAO review will help us position ourselves to better handle changes not only in the natural gas market, but in all of our energy markets.

In that light, I hope our review today of West Coast gas prices will help us as well. I look forward to hearing from each of you.

Mr. Chairman and Senator Wyden, I thank both of you for calling for this hearing today and look forward to working with the Subcommittee on an ongoing basis to review this issue that affects us all.

Prepared Statement of The Seafarers International Union of North America, AFL-CIO

Mr. Chairman and Members of the Committee: The Seafarers International Union of North America, AFL-CIO, shares the concerns of the members of this panel regarding the rising cost of fuel on the West Coast of the United States and appre-

ciates the opportunity to share our thoughts on this most pressing issue. The SIU represents the unlicensed crew on U.S.-flag vessels engaged in all aspects of the Nation's waterborne commerce. A number of our members are employed by U.S.-flag vessel operators engaged in the U.S. West Coast shipping trades and live with their families in port communities in California, Oregon, Washington and Alaska. Like other Americans, our members have been faced with high home-heating costs and high prices at the gasoline pumps and personally feel their wallets and checkbooks pinched each time they fill up their cars or pay their monthly energy bills.

The energy difficulties we face today are not new. Over the last 30 years, Americans have witnessed firsthand fluctuating energy prices, long gas lines at the pumps, OPEC production cutbacks, and even the engagement of our troops in a war in the Persian Gulf in an effort to protect vital energy interests. Time and again, we have heard the Congress and the Administration speak of the need for a revitalized national energy policy. As we begin the 21st Century, the SIU joins concerned Members of Congress and the Administration in calling for a re-examination of our long-term energy goals. It is time that the Nation formulates a program that will ensure energy independence to future generations.

The SIU's expertise is in the maritime industry and therefore we do not suggest that we are experts in energy policy. However, at home we are consumers of the product and at work we are often engaged in its transport. As such, we take a great interest in national policy as it impacts our daily lives. In our view, a number of factors have coalesced to result in the escalating fuel prices the Nation is presently encountering. In recent testimony before the Senate Energy and Natural Resources Committee, the National Association of State Energy Officials pointed out that the Nation's energy infrastructure (e.g., production capacity, refinery utilization, pipeline capacity and terminal storage) is stretched to its limits. Historically low energy product inventories have been coupled with tremendous price volatility over the last 2 years. While benefiting from downward price swings as low as $11 per barrel of oil in 1998, consumers were faced with historically high heating fuel and gasoline prices a year later. Adding to the high costs of energy products in the United States are actions recently taken by the OPEC nations. In March, OPEC members agreed to reduce production quotas an additional one million barrels per day effective April 1st. This follows an earlier production quota cut of 1.5 million barrels per day announced at the beginning of this year. Unfortunately, these actions will not result in price reductions for the average American, but most likely will result in higher prices to drive our cars and cool our homes during the upcoming hot summer months.

Recently, some Members of Congress have suggested that the House of Representatives and the Senate adopt legislation prohibiting the export of Alaska North Slope oil as one way to address the Nation's high energy costs. The SIU does not agree with that position. Since the ban on exports was lifted in 1995, only about 5 percent (60,000 barrels per day) of all Alaska North Slope oil has been exported. In fact, since June 2000 exports of Alaska crude oil have stopped and are not expected to resume in the near future. A 1999 Government Accounting Office (GAO) report found that "lifting the export ban generally had limited effects on refiners, consumers, and the shipping industry on the West Coast." While finding that lifting the export ban raised the relative price of Alaska North Slope oil for refiners, higher market prices have given oil producers more incentive to develop new oil fields. In addition, despite higher crude oil prices for some refiners, the GAO report found that "no observed increases occurred in the prices of three important petroleum products used by consumers on the West Coast—gasoline, diesel, and jet fuel." The GAO also concluded in its 1999 report that "future production should increase because the ban was lifted." It is understandable that concerned Members of Congress are looking at the ability to export Alaska oil as a. threat to their constituents' energy well being. When the Congress began contemplating legislation in the mid-1990s, the SIU was apprehensive at first, as there was minimal communication between the seafaring unions and its contracted-tanker companies and the oil companies. However, we became convinced after discussions with BP that a change in policy would reverse the decline in oil production and would be in the national good and to the benefit of our membership. Through the requirement that exported oil must be transported on U.S.-flag tankers, we were able to retain and improve the jobs of U.S. seafarers. Working closely with BP over the last several years, the SIU has the highest respect for the BP management team as they are of high integrity and committed to their word.

The 107th Congress and the Bush Administration face rather difficult energy policy challenges. The SIU is pleased that members from both sides of the aisle have focused on this complex issue and have introduced comprehensive legislation for discussion and debate. We are gratified that the Bush Administration has created a

cabinet-level task force and look forward to their recommendations in the very near future. The SIU pledges to work with the Congress to develop a balanced energy policy—a policy that addresses supply side needs by promoting responsible oil and gas development and incentives for the development of renewable energy sources with a policy that addresses demand side issues concerning energy efficiency and conservation. With all parties working together, a reasonable and realistic national energy policy can be a gift we present to the next generation.