FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

THE CHAIRMAN

May 13, 2009

The Honorable Brian Higgins
United States House of Representatives
Washington, D.C. 20515

Dear Representative Higgins:

You and Senator Charles E. Schumer have requested a public report on the Federal Trade Commission's investigation into unusually high gasoline prices in Western New York during the fall of 2008. Thank you for bringing this important issue to our attention. We share your concern about the impact of high gasoline prices on the day-to-day life of consumers and understand the frustration and hardship that are created when those prices rise significantly above those in surrounding areas without any obvious market explanation, as occurred in this instance. Such situations receive our closest attention.

However, after careful and extensive investigation, FTC staff did not find any evidence of illegal activity in gasoline markets in any of the affected cities. To the contrary, staff found evidence suggesting that it is unlikely that illegal conduct caused these price levels, although staff was unable to identify precise reasons why retail gasoline prices in some cities in Western New York and Vermont did not fall as quickly as prices in other Northeast cities. Although we are unable to establish any direct relationship, we do note that prices began to fall soon after you raised public concerns about the elevated prices and both you and Senator Schumer asked us to conduct an investigation. This letter describes the scope of the investigation and summarizes the findings of Commission staff, subject to the Commission's obligations not to disclose confidential information.[1]

I. Investigation of Unusual Pricing Activity in Western New York

The Commission's ongoing Gasoline and Diesel Price Monitoring Project[2] identified retail gasoline prices significantly above predicted values in Western New York cities, and in Burlington, Vermont, during the fall and early winter of 2008. In response to these observations

[1] *See, e.g.*, 15 U.S.C. §§ 46(f), 57b-2; 16 C.F.R. § 4.11.

[2] The Gasoline and Diesel Price Monitoring Project is described at http://www.ftc.gov/ftc/oilgas/gas_price.htm.

and to requests from you and Senator Schumer,[3] Commission staff conducted an analysis of retail gasoline prices in Western New York and Burlington, Vermont, to confirm that prices in those markets were unusually high.

Staff first analyzed whether average retail price levels in the Buffalo, Rochester, and Jamestown, New York, and Burlington, Vermont, metropolitan areas were higher than would be expected, using their normal relationship with Albany gas prices as a baseline.[4] Staff analyzed price data for a ten-year period to establish historical differences between average retail price levels in these cities and Albany. This analysis confirmed that average retail gasoline prices in these cities were significantly higher than expected relative to Albany.

Staff then examined whether supply disruptions or other readily identifiable market conditions could explain the unusually high prices observed in the affected cities. For example, refinery disruptions, pipeline interruptions, terminal outages, or transitions to new fuel specifications are common reasons why we might see supply problems and thus higher prices. Staff could identify no such market conditions that fully explained the unusual price levels in Western New York and Vermont last fall.

Consequently, staff opened a law enforcement investigation and coordinated with the Attorneys General of New York and Vermont. This investigation sought to determine whether these high prices resulted from illegal behavior by participants in Western New York and Vermont gasoline markets.[5]

When conducting law enforcement investigations of this kind, staff seeks to gain a full picture of the competitive situation, including the identity of firms responsible for setting prices in relevant markets and their market shares, and any evidence of an agreement among market

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[3] Your requests for an investigation were received by letter to then-Chairman Kovacic dated October 22, 2008; by letter to then-Chairman Kovacic dated December 4, 2008; and during telephone conversations with Commission staff.

[4] Staff used Albany price levels as the baseline because that allowed us to directly address the concerns you posed regarding the discrepancies between prices in different cities in New York and nearby areas. Our analysis showed that, with one exception, wholesale price levels in the affected cities and nearby areas maintained their normal relationships with each other and with Albany. The one exception was in Warren, Pennsylvania, where the wholesale price of "unbranded" (non-brand-name) gasoline rose relative to Albany during the fall of 2008. The staff investigation concluded that this increase was not the result of anticompetitive activity.

[5] The Commission enforces the Federal Trade Commission Act, 15 U.S.C. §§ 41-58 (whose proscription of unfair methods of competition reaches, among other conduct, violations of the Sherman Act's prohibitions of monopolization, attempts and conspiracy to monopolize, and conspiracies in restraint of trade), and the Clayton Act, 15 U.S.C. §§ 12-27 (which prohibits a number of types of anticompetitive conduct, including mergers and acquisitions likely to substantially lessen competition).

participants to raise price or restrict output. Relevant information may also include evidence that price levels during the time period under investigation followed a pattern that was inconsistent with patterns in other time periods.

Commission staff and attorneys from the offices of the New York and Vermont Attorneys General interviewed more than 20 companies involved in these markets, including refiners, refined products pipeline operators, terminal operators, marketers, distributors, and retail station owners. Staff also obtained documents and data from several participants, including station-specific pricing surveys, competitor lists, station location lists, supply contracts, and bulk supply volume data.

Staff also purchased retail and wholesale price data from the Oil Price Information Service and obtained other relevant data from public sources. Staff used these data to analyze wholesale and retail price differentials between Western New York and Vermont communities in different time periods, examining the range of prices at different retail stations in the affected areas last fall relative to other periods, and measuring how quickly prices stabilize, relative to each other.

Through its investigation, staff discovered that no company possessed a monopoly share of any retail gasoline market in Western New York or Vermont, nor was any company large enough to effectively attempt to create a monopoly through illegal means. Further, staff identified no unfair method of competition that could explain how a company or group of companies could have illegally caused the observed price levels last fall. Accordingly, staff's investigation focused on the only remaining plausible theory of illegal behavior that could explain the unusually high prices last fall – that companies in Western New York and Vermont might have engaged in collusion.

Collusion in each of the affected cities would have been very difficult because numerous companies set prices at retail gas stations in each city and no single station owner or group of owners controls a large share of the volumes sold in any city.[6] For example, staff discovered that at least 35 (but likely substantially more) different companies set retail prices at stations in Buffalo. Staff also found that no single company sets prices at more than 11.5% of pumps in Erie County, and the top four companies in the county combined set prices at fewer than one-

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[6] It becomes increasingly difficult to achieve and maintain successful collusion as the number of parties within a collusive group grows. By way of illustration, the Federal Trade Commission and U.S. Department of Justice Horizontal Merger Guidelines state:

> If collective action is necessary for the exercise of market power, as the number of firms necessary to control a given percentage of total supply *decreases*, the difficulties and costs of reaching and enforcing an understanding with respect to the control of that supply might be *reduced*.

§ 2.0 (emphasis added). As the number of firms increases, the difficulties of reaching an agreement increase. Consistent with this principle, the Merger Guidelines presume that ten firms of equal size would be unlikely to collude successfully, although there are exceptions.

third of the pumps.[7] As a result, it would have been very difficult to establish and maintain an effective collusive agreement to raise retail prices in Buffalo throughout the fall of last year.

Collusion across all of the affected cities would have been even more difficult because numerous companies other than those that operate in Buffalo set retail gasoline prices in Rochester and Jamestown. For example, several different brand-name companies, discount club station owners, supermarket chains, and small independent station owners set retail prices in each of these other affected cities. The need to include these additional market players in any collusive scheme to raise retail prices simultaneously in all of the affected cities last fall would have created substantially greater difficulties in reaching and maintaining an effective agreement.

Other market factors also would have made collusion very difficult. For example, as crude oil prices plummeted during the fall, product costs for gasoline retailers throughout the nation fell with unprecedented speed and magnitude.[8] As wholesale gasoline prices fell substantially on a daily basis, the numerous retail price setters in each affected city would have had to reach agreement on cartel prices on a frequent basis – probably each day if not more frequently. Having to reach agreement so frequently would have made it very difficult to effectively maintain a collusive scheme throughout the fall of last year.

Nor did market data support the notion that a conspiracy existed to raise prices last fall. For example, staff found no evidence that station owners in the affected cities charged prices closer to those of their competitors last fall than they did in previous time periods. Staff also found no evidence that retailers pegged their price levels relative to one another; rather, retailers' prices generally jumped above or fell below those of their competitors last fall, just as they tended to do in other periods.

In sum, staff's investigation yielded no evidence that illegal anticompetitive conduct caused the price levels experienced in Western New York or Vermont last fall.

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[7] The fact that a station sells gasoline under a brand name does not mean that the owner of that brand controls the station's prices. Staff discovered that numerous firms in the affected cities contract with brand-name companies to sell branded gasoline while independently setting their own retail prices.

[8] Between July 2008 and the end of December 2008, the price of crude oil dropped more than $115 per barrel, from just over $145 per barrel in the summer to around $30 per barrel during the week of Christmas. Energy Information Administration, "Cushing OK WTI Spot Price FOB," *available at* http://tonto.eia.doe.gov/dnav/pet/hist/rwtcd.html. The drastic drop in crude oil prices over this time period resulted in large daily decreases in wholesale gasoline prices throughout the country.

II. Potential Policy Proposals Regarding the Petroleum Market

Petroleum markets do not always function smoothly, and policy-makers and consumers often express frustration at retail prices that may not move as expected. Many proposals have been put forth to try to address these concerns, and we note some of them here, although this discussion should not be viewed as a representation of a Commission position on any of the various proposals described below.

Some have suggested that enhancement of consumer knowledge can more effectively prevent the uncertainty and confusion stemming from volatile gasoline prices, and suggest efforts to increase the transparency of petroleum costs and prices. For example, one might take steps to provide consumers additional information about wholesale cost conditions through real-time publication of city-area average retail prices, average wholesale prices, and city-area average margins. Further, consumers might benefit from increased public awareness of the value of price shopping, in falling as well as rising markets, and government could engage in consumer outreach regarding free, online sources of price information, such as GasBuddy.com.

Some have suggested that one way to address high gasoline and diesel prices is through some form of federal price gouging legislation, such as H.R. 2129, which you co-sponsored in the 111th Congress. Many states, including New York, have already made price gouging illegal under state law.[9] Other legislative approaches target potential fraud in the market, such as the wholesale petroleum market manipulation rule currently being considered by the FTC.

Of course, the greatest cause of volatility in the retail price of gasoline is volatility in the price of crude oil, and both a reduction in the demand for crude oil and the development of additional crude oil supplies could damp crude oil price volatility. Some commonly discussed means of doing so include expanding the supply of oil; expanding investment in other sources of energy, such as wind, solar, biomass, nuclear, and geothermal; decreasing the cost and difficulty of refining oil by easing the requirements on refinery construction, expansion, and operations; imposing greater energy efficiency requirements on automobiles and other users of petroleum products; providing incentives to manufacturers to enhance energy efficiency; encouraging or mandating greater investment in infrastructure to minimize unplanned failures that often result in energy shortages and short-term price spikes; and prohibiting OPEC from collusively setting oil prices,[10] an activity clearly contrary to U.S. price-fixing laws.

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[9] On the desirability of such legislation, *compare* FEDERAL TRADE COMMISSION, INVESTIGATION OF GASOLINE PRICE MANIPULATION AND POST-KATRINA GASOLINE PRICE INCREASES 196 (2006) ("[T]he Commission cannot say that federal price gouging legislation would produce a net benefit for consumers."), *available at* http://www.ftc.gov/reports/060518PublicGasolinePricesInvestigationReportFinal.pdf, *with* Concurring Statement of Commissioner Jon Leibowitz at 2 ("These statutes, which almost invariably require a declared state of emergency or other triggering event, may serve a salutary purpose: discouraging outliers from profiteering in the aftermath of a disaster.").

[10] *See, e.g.*, S. 204, co-sponsored by Senator Schumer in the 111th Congress.

Many of these ideas go beyond the specific situation encountered by consumers in Western New York, but most experts believe that no single approach will be sufficient to address the concerns of many people regarding gasoline prices and the petroleum markets more generally.

III. Conclusion

In the meantime, of course, we are always interested in considering any potential evidence of illicit activity in the marketplace, and the Commission will continue its efforts to identify, prevent, and prosecute any unlawful anticompetitive practices in petroleum and other markets.

Again, thank you for bringing this critical matter to our attention. Although the investigation did not uncover any illegal activity, the Commission will remain focused on potentially anticompetitive behavior in order to protect consumers, and your ongoing vigilance is greatly appreciated.

By direction of the Commission, Commissioner Kovacic concurring.[11]

Jon Leibowitz
Chairman

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[11] Commissioner Kovacic concurs, noting: "I would have preferred that the presentation of policy alternatives in this letter include an assessment of their merits. The discussion of policy options also would have benefitted from a fuller treatment of possible supply responses and broader consideration of demand-related measures that focus attention on the real costs, in terms of national security and environmental policy, of consuming petroleum products and electricity."