I. Introduction

The Federal Trade Commission is investigating the causes of the sharp rises in gasoline prices in certain Midwest markets in the spring and early summer of this year. A principal purpose of the investigation is to determine whether those price rises were caused in whole or in part by antitrust violations. This interim report to Congress sets forth the reasons the Commission launched this investigation and provides a status report on the ongoing investigation, including progress to date and a description of the work remaining. In testimony before the House Committees on the Judiciary, Commerce, and Government Reform on June 28, 2000, and the Senate Committee on Energy and Natural Resources on July 13, 2000, Chairman Robert Pitofsky and Bureau of Competition Director Richard G. Parker confirmed the promise made to several members to deliver an interim report to Congress before the end of July.

In the spring and early summer of 2000, gasoline prices increased in markets all over the country. Gasoline prices have long been seasonally cyclical, rising in late spring and early summer as consumer demand increases with the onset of the summer driving season. However, the increases this year in some local markets, particularly in the Midwest, eclipsed those experienced in past years, and were much greater than those experienced in other U.S. markets. Consumers in markets such as Chicago and Milwaukee saw significant price spikes at the retail level, both for the Phase II reformulated gasoline ("RFG"), required under the Clean Air Act for those markets, and for conventional gasoline, which is used in other local markets in the Midwest.

The national average retail price of RFG increased from $1.29 to $1.67 per gallon from November 1999 to June 12, 2000, before declining to $1.61 on July 17, 2000. In Chicago, however, the average RFG price rose from $1.85 per gallon on May 30 to $2.13 on June 20, before falling to $1.57 on July 24, 2000. From May 30 to June 20 in Milwaukee the average RFG price increased from $1.74 to $2.02, but by July 24 had fallen to $1.48.

Conventional gasoline prices in the Midwest also have risen substantially from late 1999 levels, although they also have receded significantly since the highs in mid-June. National average retail prices increased from $1.25 to $1.61 per gallon for conventional gasoline between November 1999 and June 12, 2000, and then eased to $1.51 on July 17, 2000. Average conventional gasoline retail prices in the Midwest rose from $1.55 to $1.85 per gallon from May 29 to June 19, 2000, but had decreased to $1.48 by July 17, 2000. The price runup was intense, but brief, with prices peaking during the week of June 18-24.

The sheer magnitude of the price increases, their particular intensity in one section of the country, and their occurrence in conventional gasoline as well as in RFG, prompted the Commission’s Bureau of Competition to consider the reasons for the price increases and, specifically, whether price fixing or other illegal activity might have occurred. A bipartisan group of Senators and Representatives strongly urged the Commission to investigate these matters.

In early June 2000, Commission staff began a preliminary investigation, relying initially on publicly available data and consumer complaints. Staff interviewed persons knowledgeable about factors that may have contributed to these price spikes, industry structure, and the regulatory environment. Staff also met with representatives of the Environmental Protection Agency and the Department of Energy. A principal focus of that preliminary investigation, and of the ensuing formal investigation, has been to determine whether there is sufficient evidence to conclude that the antitrust laws have been violated and that such violations caused all or part of the price spikes in the Midwest. Commission staff also have sought information on other potential causes of the price spikes.

The staff’s initial inquiry suggested several factors as potential contributors to Midwest gasoline price spikes. The first is the reduced global supply of crude oil. In the second half of 1999, OPEC countries, joined by several non-OPEC oil exporting countries, curtailed the global supply of crude oil. During the same period, worldwide demand for petroleum products increased significantly, as economies in Asia and Europe recovered and economic growth in the United States continued. As a result, worldwide consumption of crude oil has exceeded production, and world and U.S. inventories have been drawn down. Refiners responded to the price increases caused by the crude shortage in the same way they had responded to past supply reductions -- by cutting gasoline production and using inventories of gasoline to meet demand, in the expectation that inventories could be replenished when crude oil prices drop as some OPEC members exceed their quotas. This series of events contributed to exceptionally tight supply situations in many countries, particularly in the United States.

In the last two months, the OPEC countries, and Saudi Arabia individually, agreed to increase production in an effort to moderate the price of crude petroleum. It remains to be seen whether, when, and to what extent OPEC’s and Saudi Arabia’s announcements of crude supply increases will reduce prices in the medium to long run. In the short run, crude oil prices have moderated slightly, from $33.55 per barrel on June 23 to $31.31 on July 14. OPEC actions likely cannot fully explain the exceptional price spikes that occurred in the Midwest, because such actions would be expected to affect prices in all sections of the United States in a broadly similar way.

A factor specific to the Midwest markets that may have contributed to the price increases was the introduction of EPA Phase II regulations for summer-blend reformulated gasoline in high ozone urban areas. These regulations went into effect on May 1, 2000 at the wholesale level in both Chicago and Milwaukee. The new, more-stringent regulations may have contributed to abnormally low inventories for several reasons. They required that winter-blend gas be drained from storage tanks before the summer-blend supply could be added, which led to lower inventories than usual. According to some reports, summer-blend Phase II RFG is proving more difficult to refine than anticipated, causing refinery yields to be less than expected. The ethanol-based RFG used in Chicago and Milwaukee is reportedly even more difficult to produce. Further, St. Louis entered the RFG program for the first time this year, adding additional demand to an already tight Midwest RFG supply situation. Moreover, the recent federal court of appeals decision upholding Unocal’s patent for some formulations of RFG may have caused some refineries to change RFG blends to avoid infringement or high royalty payments, leading to production delays and decreased refinery throughput. RFG-related issues seem


Obtained and made public by the Natural Resources Defense Council, May 2002
unlikely, however, to provide a complete explanation for recent Midwestern gas price increases, because in the Midwest as a whole, conventional gasoline prices rose more dramatically than RFG prices from May to the end of June.\(^\text{14}\)

Another possible contributor to the Midwest price increases was the break in the Explorer pipeline in March. Explorer moves refined petroleum products from the Gulf of Mexico through St. Louis to Chicago and other parts of the Midwest.\(^\text{15}\) The pipeline break caused a disruption in the supply of gasoline to the already tight Midwest markets. That could have contributed to tight supply and rising prices throughout the region.

Although it is likely that each of these supply factors contributed to the dramatic recent price spikes in the Midwest, no single factor appears from staff’s preliminary investigation to be likely to provide a full explanation, and staff does not yet have sufficient information to assess the impact of these factors in combination. Accordingly, it is prudent to investigate the possibility of collusion or tacit coordination, conduct that could be illegal under section 5 of the Federal Trade Commission Act. In order to investigate this and other possible causes of the price spikes in the Midwest, on June 21, 2000, the Commission initiated a formal investigation.\(^\text{16}\) Because of the multiplicity of potential interrelated causes, this investigation is likely to consume, at a minimum, another three or four months.

II. The Commission’s Investigation

This investigation is being conducted pursuant to the Commission’s authority under the Federal Trade Commission Act.\(^\text{17}\) The Bureau of Competition is treating it as a top priority matter and has assigned experienced attorneys, economists, investigators and paralegals to the investigation. The Commission chose its Midwest Regional Office, located in Chicago, to spearhead the investigation because they are well-situated to work with local refiners and witnesses and with other law enforcement agencies in the region. Attorneys and economists from the West Coast Regional Office in San Francisco and our headquarters in Washington, D.C. with particular expertise in the oil industry are assisting the Midwest Office. In all, 12 to 14 Commission attorneys, economists, and paralegals are working on the investigation. We are also coordinating our efforts with the Attorneys General of Wisconsin, Illinois, Michigan, Ohio, Indiana, Missouri, Iowa, Minnesota, Kentucky, South Dakota and West Virginia. The Commission has approved the use of compulsory process in this investigation, permitting the issuance of both subpoenas and Civil Investigative Demands, and the taking of depositions under oath.

The objective of the investigation is to consider the causes of the price increases, and determine whether there was any illegal contact, communication, signaling, or understandings among competitors. With regard to proving illegal conduct, the Commission must show more than parallel behavior among market participants. Standing alone, proof that all companies raise prices at the same time is not sufficient evidence of collusion. The courts have held that some “plus factor” must be present to demonstrate that an agreement was reached. Behavior that would be unprofitable “but for” collusion may be evidence that such an agreement exists.

Consistent with the necessity of protecting the confidentiality of information from participants in the investigation, as well as protecting the legal staff’s work product, we can report the following information about the investigation to date.\(^\text{18}\)


Obtained and made public by the Natural Resources Defense Council, May 2002
Staff is using process to take testimony and gather evidence from the various entities that refine, transport and distribute gasoline in the Midwest, as well as suppliers and customers and other knowledgeable or affected persons. The Commission issued a first round of subpoenas to nine refiners that supply Midwest markets on June 29. A substantial number of documents have already been produced. In less than a month, staff has received approximately 200 boxes of documents. The bulk of the documents from the first round of subpoenas should be in our hands by the middle of August. Staff is carefully reviewing these documents. The Commission issued a second round of subpoenas to other refiners last week. We have also recently issued CIDs to the refiners, requesting compilations of data and answers to written questions.

We issued another set of subpoenas, this time to the entities that own or control the pipelines serving the Midwest markets, on July 25. We expect responsive documents to begin arriving shortly. Staff also has conducted approximately 15 interviews with market participants, consumers, corporate users of gasoline, and others with knowledge of relevant facts, and is in the process of obtaining industry-wide data from the Oil Price Information Service (OPIS). Staff also conducted a site visit at a refinery on July 20. Once the documentary material has been analyzed, staff will take depositions under oath of key decision-making personnel throughout the gasoline distribution chain in the Midwest. The Commission has retained, and is working with, an outside economic consultant with expertise in this industry.

Our investigation is comprehensive. Prices spiked in the Midwest for one or more reasons. Staff is attempting to identify those reasons. Staff is investigating any and all aspects of the distribution chain in which firms could have colluded to increase prices directly or colluded to reduce capacity or supply, or otherwise to take advantage of a tight supply situation and rising prices. For example, staff is examining supply and inventory evidence from integrated oil companies and independent refiners serving the Midwest to determine if supply was manipulated by agreement or understanding such that insufficient product was available to meet increased summer demand in the Midwest and prices spiked as a result. Staff is also considering whether pipeline capacity constraints and allocation decisions were the result of accidental and market-driven factors or, in whole or in part, the product of a collusive agreement designed to restrict supply in local markets. These are but examples of the kinds of inquiries staff is pursuing. At this point, no conclusions, however tentative, have been reached.

III. Conclusion

Much work remains to be done in order to complete this investigation. The scope of the investigation, the volume of the information that has been or will be produced, and the complexity of the issues under investigation suggest that the investigation likely will consume at least three or four more months. The Commission is treating this investigation as a matter of top priority, but answers in antitrust investigations do not typically come quickly or easily. If staff uncover reason to believe that an antitrust violation has occurred, however, the Commission will act promptly.

1. Energy Information Administration, Office of Oil and Gas Daily Price Report (June 12, 2000; July 3, 2000; July 24, 2000). In comparing average RFG prices at different times and different places, it should be noted that RFG requirements may differ between summer and winter and also among localities.
do so with this report.


Obtained and made public by the Natural Resources Defense Council, May 2002
Midwest states probing high gasoline prices

The Clinton administration said Wednesday it has not ruled out possible collusion among oil companies as the reason behind a steep rise in retail gasoline prices in the Midwest.

A rapid run-up in overall U.S. gasoline and crude oil prices has also caught the attention of the Federal Reserve, which is also closely watching for any impact on inflation or economic growth.

Federal officials are investigating whether soaring prices in Chicago, Milwaukee and other Midwest locations are due to free market forces, strict new requirements for cleaner-burning gasoline, or unfair action by U.S. oil refiners, according to Energy Secretary Bill Richardson.

"They're much too high. They're unacceptably high," Richardson said, referring to gasoline prices in the Midwest which have topped $2 a gallon in Chicago and Milwaukee.

"We're trying to determine whether it's market forces or collusion or some glitches with the Environmental Protection Agency's RFG gasoline," Richardson told reporters following a speech at the National Press Club.

The Environmental Protection Agency and the Energy Department met with the region's oil refiners earlier this week to find out why gasoline prices — especially for the new cleaner-burning reformulated gasoline (RFG) — have soared when supplies seem adequate.

Midwest drivers are now paying about 20 cents a gallon more than the U.S. nationwide average price for conventional gasoline, according to the Energy Department.

Illinois Gov. George Ryan, a Republican, asked the state attorney general Wednesday to launch an investigation into gasoline price fraud.

Ryan also said governors in Indiana, Nebraska and Kansas backed his plan to have the federal government temporarily suspend new anti-smog regulations, which have contributed to tight supplies of cleaner-burning gasoline.

Oil companies claim that the new reformulated gasoline, which the EPA requires be sold in polluted areas beginning this month, is too expensive and difficult to produce. They say that this has resulted in supply problems and higher prices.

The government is not buying those arguments, pointing out that RFG in cities outside the Midwest is not as expensive.

"The refiners can't explain and others can't explain why gasoline prices are so high in the Midwest and in other parts of the country they're lower," Richardson said.

Richardson obtained and made public by the Natural Resources Defense Council, May 2002
Attached are Commerce's draft recommendations for your review

(See attached file: DRAFT Commerce Recs.doc)
Margot -

One more from FE (sorry).

---Original Message---
From: Anderson, Margot
Sent: Wednesday, February 21, 2001 7:35 PM
To: Cook, Trevor; Scalings, Paula; PETTIS, LARRY; KENDELL, JAMES; Zimmerman, MaryBeth; Sullivan, John; 'jksler@bpa.gov'; Kripowicz, Robert; Haspel, Ade; Magwood, William; 'jkster@bpa.gov'; Whatley, Michael; Braitsch, Jay; Conti, John; Carter, Douglas; KYDES, ANDY; Pumphrey, David; Hart, James
Cc: Keliher, Joseph
Subject: NEP news

All,

Joe has now received hard copies of chapters 4, 5, and 10 for our review (the ones we didn't do). Sorry but I only had e-copies of 10, rest are hard, so you have to stop by to collect. I'll out them on the PO 7C-034 open area credenza for pick up. Need your comments by Thursday COB - please e-mail me a comments page. I'll compile for Joe. Joe delivered our DOE-led chapters 1, 2, 3, 6, 7, 8 and we will await comments. I'm working on collecting figures and charts. By my calculations, we are still missing chapter 9 (DOT).

The revised outline:
Carter, Douglas

From: Braitsch, Jay
Sent: Thursday, February 22, 2001 4:26 PM
To: Anderson, Margot
Cc: Carter, Douglas
Subject: RE: NEP news

Margot -- More FE Comments

b(5)
Yes, got Doug’s stuff. Sorry for not checking. I think you are right.

I think Doug Carter sent you something, and I will be sending some more comments shortly.

Can I get a sense of who is going to provide comments by the end of the day on these three chapters? I have NE’s (thanks, Trevor) and know EE will comment. Anyone else?

All,

Joe has now received hard copies of chapters 4, 5, and 10 for our review (the ones we didn’t do). Sorry but I only had e-copies of 10, rest are hard, so you have to stop by to collect. I’ll cut them on the PO 7C-034 open area credenza for pick up. Need your comments by Thursday COB - please e-mail me a comments page. I’ll compile for Joe. Joe delivered our DOE-led chapters 1, 2, 3, 6, 7, 8 and we will await comments. I’m working on collecting figures and charts. By my calculations, we are still missing chapter 9 (DOT).

The revised outline:

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Obtained and made public by the Natural Resources Defense Council, May 2002
From: Braitsch, Jay
Sent: Friday, May 25, 2001 9:55 AM
To: Rudins, George; Carter, Douglas; McKee, Barbara; DeHoratiis, Guido; Johnson, Nancy; Juckett, Donald; Pyrdol, John; Freitas, Christopher; Porter, Robert
Cc: Kripowicz, Robert
Subject: National Energy Policy (NEP) Recommended Actions

Recommendations - Summary wit...
Doug,

Thanks for the comments. I have attached that version, which has already gone to Larry Pettis for transmittal to Margot Anderson.

If there are any further opportunities for revisions, I will certainly consider what you sent me.

Scott

-----Original Message-----
From: Douglas Carter_at_HQ-EXCH at X400PO
Sent: Friday, February 16, 2001 1:17 PM
To: Sitzer, Scott
Cc: Robert Kripowicz_at_HQ-EXCH at X400PO; George Rudins_at_HQ-EXCH at X400PO; Robert Porter_at_HQ-EXCH at X400PO
Subject: FW: NEP Coal

Scott -

I wanted to offer you something more concrete than our earlier discussion.
I have marked-up the coal language you drafted for Section 1, and the markup is attached. Please consider this in your future drafts.

Doug Carter, FE-26, x69684

-----Original Message-----
From: SITZER, SCOTT
Sent: Friday, February 16, 2001 1:34 PM
To: Carter, Douglas
Subject: NEP Coal

Doug,

Attached is a slightly "polished" version of what I sent you yesterday, plus

the associated graphs.

I am supposed to turn this in at noon today, so I would appreciate any

30015

Obtained and made public by the Natural Resources Defense Council, May 2002
Margot,

--- Original Message ---
From: Anderson, Margot
Sent: Friday, March 23, 2001 12:46 PM
To: 'Ball, Crystal A - KN-DC'; Carrier, Paul
Cc: 'Stier, Jeffrey K - KN-DC'; Seifert, Roger
Subject: RE: BPA DSI information

Crystal,

--- Original Message ---
From: Ball, Crystal A - KN-DC
Sent: Friday, March 23, 2001 12:35 PM
To: Anderson, Margot; Carrier, Paul
Cc: 'Stier, Jeffrey K - KN-DC'; Seifert, Roger - KN-DC
Subject: RE: BPA DSI information

Margot
Subject: RE: BPA DSI information
Importance: High

5/13/02

 Obtained and made public by the Natural Resources Defense Council, May 2002