



Interim Report on Gasoline Pricing:

A Report to Congress

Federal Trade Commission

March 2006

I. INTRODUCTION

In two separate enactments, Congress directed the Federal Trade Commission to conduct an investigation to examine gasoline pricing. Section 1809 of the Energy Policy Act of 2005¹ (the “Energy Policy Act”) directs the Commission to investigate whether the price of gasoline is being artificially manipulated through refinery capacity reductions, price gouging, or “any other form of market manipulation.” Section 632 of the Science, State, Justice, Commerce, and Related Agencies Appropriations Act, 2006² (“Section 632”) directs the Commission to investigate gasoline prices in the wake of Hurricane Katrina, and specifically requires the Commission to (1) look for evidence of gasoline price gouging by any wholesaler of gasoline or distillates with over \$500 million in 2004 sales, or by any retailer of gasoline and distillates against which multiple complaints of price gouging (with identifying information) were filed in August or September 2005; (2) compare such companies’ profits during the month following Katrina – a period that also included Hurricane Rita – with their profits during the 12-month period ending on August 31, 2005; (3) provide a summary of the “tax expenditures” to which the oil companies are entitled;³ (4) assess the impact of increased gasoline prices or price gouging on economic activity in the United States; and (5) gauge the overall cost of increased gasoline prices and price gouging on the economy, including the impact on consumers’ purchasing power.

Section 632 directs the Commission to spend no less than \$1 million in this investigation, and also requires the Commission to provide a series of updates to Congressional staff on the progress of the investigation. It also requires the Commission to submit an interim written report within 90 days of the date the bill became law, and a final report on this investigation within 180 days of enactment. This interim report will describe issues central to the Commission’s investigation, the investigative process to date, and challenges that the Commission faces in providing Congress the information it has requested.⁴

II. FOCUS OF THE INVESTIGATION

A. The Energy Policy Act

The examination mandated by the Energy Policy Act requires a thorough analysis of the petroleum industry supply infrastructure from the refinery to the street level. Through the use of

¹ Energy Policy Act of 2005, Pub. L. No. 109-058 § 1809, 119 Stat. 594 (2005). The Energy Policy Act became law on August 8, 2005.

² Science, State, Justice, Commerce, and Related Agencies Appropriations Act, 2006, Pub. L. No. 109-108 § 632, 119 Stat. 2290 (2005). The President signed this bill into law on November 22, 2005.

³ For details concerning these tax expenditures, *see infra* pp. 5 *et seq.*

⁴ The Commission has authorized the staff to submit this interim staff report on the status of the investigation.

compulsory process and other tools, the Commission is examining refining, product transportation by pipeline and marine vessel, terminaling, marketing, and retail – to determine whether any firm or firms may have manipulated gasoline prices artificially.

At the refining level, the investigation is focusing on issues relating to refinery capacity in the United States. The Commission is examining factors that influence decisions whether to invest in new refinery construction, as well as the expansion of existing refineries. In addition, the Commission is exploring planned and unplanned refinery shutdowns to determine whether refiners use them to create artificial product shortages for the purpose of manipulating gasoline prices, as well as whether refiners withhold supply or move supply between markets – domestic and foreign – to manipulate prices.

At the product transportation level, the investigation is exploring similar pipeline capacity issues – specifically, the factors affecting decisions to build new pipeline capacity or to expand or extend existing pipelines. In addition, the Commission is examining issues pertaining to marine transportation of refined products, including factors affecting the ability of refiners and other bulk suppliers to compensate for planned or unplanned disruptions to the pipeline flow of products to various markets. The Commission is also inquiring into any instances in which refiners or marketers diverted refined product bound for the United States from foreign markets to any market outside the United States.

At the terminal level, the Commission is examining possible capacity constraints, as well as patterns and practices in the maintenance of petroleum product inventories and the impact of varying inventory levels on price levels and price volatility. In addition, the Commission is trying to determine whether control over key distribution or storage assets may be used strategically to manipulate the prices of futures contracts.

B. Section 632

Section 632 requires the Commission “to conduct an immediate investigation into nationwide gasoline prices in the aftermath of Hurricane Katrina: Provided, That the investigation shall include: (1) any evidence of price gouging by companies with total United States wholesale sales of gasoline and petroleum distillates for calendar 2004 in excess of \$500,000,000 and by any retail distributor of gasoline and petroleum distillates against which multiple formal complaints . . . of price-gouging were filed in August or September, 2005, with a Federal or State consumer protection agency; (2) a comparison of, and an explanation for changes in, profit levels of such companies during the 12-month period ending on August 31, 2005, and their profit levels for the month of September, 2005 . . . ; [and] (3) a summary of tax expenditures (as defined in section 3(3) of the Congressional Budget and Impoundment Control Act of 1974 (2 U.S.C. 622(3)) for such companies. . . .” Section 632 overlaps significantly with the Energy Policy Act in that both require the Commission to look for any evidence of price gouging by significant wholesalers and retailers. Section 632, however, includes significant additional components, requiring the Commission to report on the pricing practices and

profitability of companies that otherwise may not have been the focus of the Energy Policy Act investigation – including retailers subject to complaints of “price gouging” – and on the tax expenditures. Section 632 also requires the Commission to examine additional conceptual issues relating to price gouging, including the effects on the national economy. Section 632 provides a definition of “price gouging” for purposes of the investigation.

The Commission is using compulsory process and other tools to conduct this investigation. In addition, as part of the effort to identify price gouging, the Commission is reviewing retail price data in selected cities in the wake of Katrina to identify areas where prices rose more than would be expected in light of the severe supply disruptions that occurred. The Commission has also solicited the assistance of the various state attorneys general to identify specific areas that displayed suspicious pricing activity, as well as specific retailers or marketers that should be targets of this investigation.

Because the investigations mandated by Section 632 and the Energy Policy Act are substantially interrelated, the agency is pursuing them together.

III. THE INVESTIGATIVE PROCESS

In August and September, Commission staff started the process of planning and organizing the investigation mandated by the Energy Policy Act and the anticipated legislation that became Section 632. Staff began identifying the issues the statutes required the agency to analyze, the information necessary to analyze those issues, and various strategies to obtain that information efficiently. Staff also worked to identify the targets of the investigation, including identifying all gasoline and petroleum distillate wholesalers that had \$500 million in sales, and retail companies. Staff also consulted with various Federal agencies, including the Department of Energy and the Commodity Futures Trading Commission.

Starting early last September, the Commission staff conducted multiple voluntary interviews with industry participants, a process that continues. The staff has interviewed marketers, jobbers, terminal companies, pipeline owners and operators, traders, and price reporting services.

The Commission authorized the use of compulsory process on September 30, 2005. On November 8, 2005, the agency issued Civil Investigative Demands (“CIDs,” similar to subpoenas) to 33 companies seeking information relevant to the investigation. The return date for these CIDs was December 1, 2005. The recipients of this first group of CIDs included integrated and unintegrated refiners, pipeline owners and operators, terminal owners and petroleum marketers.⁵ On November 26, 2005, the agency issued another round of 84 CIDs

⁵ Commission staff based its request for profitability data on a form used by the Energy Information Administration (“EIA”) of the U.S. Department of Energy. The EIA uses this form to collect profitability information from major energy-producing firms operating in the

seeking information required by Section 632, as well requiring import, export and tax information from some of the recipients of the first CIDs. These CIDs bore a return date of January 4, 2006. On January 12, 2006, the agency issued a third set of CIDs to individual terminal owners to obtain targeted information relevant to futures contracts. On February 3, the Commission issued Section 6(b) Orders to 99 retailers targeted by various state attorneys general for price gouging after Katrina, seeking profitability and tax expenditure information required by Section 632. The staff also began conducting investigational hearings (which are similar to depositions) in February to examine industry officials under oath regarding various issues in the investigation. These hearings should conclude in early March.

The Commission has faced relatively little resistance from industry members during this investigation. Most companies appear to have responded in good faith to comply with the CIDs on the very aggressive schedule mandated by Section 632, including those retailers who responded to the Section 6(b) Orders at the end of February. A few companies delayed in providing the required material but are now complying. Responses to all outstanding compulsory process requests are now virtually complete, and we are evaluating the Section 6(b) Order responses that were due at the end of February.

Several companies expressed concern over the confidentiality of tax information that the Commission might include in its final report to Congress, and on December 19, 2005, ExxonMobil filed a petition to quash the CID specification that called for tax expenditure information. ExxonMobil sought to persuade the Commission to seek this information directly from the Internal Revenue Service on the belief this would result in greater protection for the confidentiality of the information. No other company filed a petition to quash, although several withheld their tax information pending resolution of ExxonMobil's petition to quash and the Commission staff's efforts to ascertain whether the tax expenditure information was available from the IRS.

The staff spoke with various IRS officials in December, and again in January after ExxonMobil filed its petition, in an effort to learn what information the IRS could provide. The staff's efforts to obtain the needed tax information from the IRS proved unsuccessful, and all of the companies (except ExxonMobil) that had withheld tax information quickly provided us with the required information. Acting pursuant to delegation by the Commission, Commissioner Harbour denied ExxonMobil's petition on January 10, 2006.⁶ ExxonMobil appealed the denial

United States. Each company submitted its response to the FTC's data request. The companies also granted waivers that allowed the EIA to provide company-specific data (including, where relevant, reported figures for profitability, production, capacity, and inventory). In addition, to aid its analysis of the issues in this investigation, the Commission purchased a significant quantity of price data at the wholesale and retail levels from the Oil Price Information Service.

⁶ Petitions to quash initially are referred to one Commissioner for decision. If that Commissioner denies the petition to quash, the petitioner may appeal to the entire Commission.

to the full Commission, but shortly after lodging that appeal, it withdrew the appeal and provided the tax information.

Before ExxonMobil withdrew its appeal regarding the CID – *i.e.*, when it appeared that the FTC might have to go to Federal court to enforce the CID – the agency took one additional step to expedite the process of obtaining tax expenditure data. On January 10, 2006, the FTC issued to ExxonMobil a Section 6(b) Order Requiring Filing of Special Report⁷ seeking only the tax expenditure information.

IV. SPECIFIC ISSUES

As FTC staff has explained during its monthly oral briefings for Congressional staff, the investigation is progressing according to schedule, but issues have arisen that complicate the Commission’s ability to provide Congress with some of the tax expenditure and profitability information as mandated. One complication arises from the obligation imposed by Section 632 to provide for the survey group a summary of “tax expenditures” as defined by the Congressional Budget Act. The agency should, nevertheless, be able to provide some substantially relevant information. Another issue arises from our efforts to obtain tax expenditure and profitability information from certain retailers as set forth in Section 632, but the Commission expects to provide significant comparable information.

A. Tax Expenditures

To satisfy the requirements of Section 632, we are attempting to compile information relevant to tax expenditures. Section 632 requires the report to include a summary of “tax expenditures” as defined in Section 3(3) of the Congressional Budget and Impoundment Control Act.⁸ The Budget Act defines “tax expenditures” as “revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of liability.” The term “tax expenditure” thus is not simply the sum of reported tax benefits; the appropriate Treasury office estimates figures utilizing its special expertise and historical factors that the Federal Trade

⁷ Section 6(b) of the FTC Act empowers the Commission to require the filing of annual or special reports or answers in writing to specific questions (called “Section 6(b) Orders”). The agency may issue Section 6(b) Orders to obtain information from recipients about “the organization, business, conduct, practices, management, and relation to other corporations, partnerships, and individuals.” As with subpoenas and CIDs, the recipient of a Section 6(b) Order may file a petition to quash, and the Commission may seek a court order requiring compliance. The Commission’s Section 6(b) authority enables it to conduct wide-ranging economic studies that do not have a specific law enforcement purpose. Information obtained through Section 6(b) Orders, however, may be used for law enforcement purposes.

⁸ Congressional Budget and Impoundment Control Act of 1974, 2 U.S.C. § 622(3).

Commission cannot replicate. The FTC requested information and data from each company concerning the 11 tax expenditure categories identified in the FY 2006 Budget that relate to energy.⁹ For those companies that take credits or deductions related to the 11 categories, all but one company responded with its interpretation of tax line items for credits and deductions. Consequently, the Commission likely will report the total tax credit and deduction values in the 11 energy-related categories.¹⁰ The Commission's final report will include a full description of each category, as well as a summary of tax expenditure items as presented in budget documents. Given the complexities of relevant calculations, the limitations of the information to which the Commission has access, and the specialized expertise necessary, the agency will not be able to provide actual "tax expenditure" numbers as defined in the Budget Act; rather, the Commission's final report will summarize tax credit and deduction data as fully and accurately as possible, and explain any distinctions between these data and the Budget Act's definition of "tax expenditures."

B. Retailer Profitability and Tax Expenditures

Section 632 requires the Commission to look for evidence of price gouging by, and to obtain profitability and tax information from, any retailer of gasoline and distillates against which multiple complaints of price gouging (with identifying information) were filed with a Federal or state consumer protection agency in August or September 2005. Although staff had anticipated that this requirement would present a large number of retailers for investigation, neither a review of complaints filed with federal agencies nor a canvass of the state attorneys general's offices yielded complaints that met this standard.¹¹ Retail stations belonging to integrated refiners and wholesalers that meet the statutory threshold of \$500 million in sales are already included within this investigation, and we are examining tax expenditure and profitability data for those

⁹ Analytical Perspectives, Budget of the United States Government, Fiscal Year 2006, at 315 (2005).

¹⁰ Many of the categories will have no response because those items reflect tax expenditure categories not available to the Commission's survey group. In addition, some categories may have been eliminated. In particular, the Alternative Fuel Production Credit appears to have expired in 2002, but companies still reported these credits for the years covered in this investigation. The Clean Fuel Vehicles and Property deduction and credit is phasing out this year, and will be unavailable in 2007. Analytical Perspectives, *supra* note 9, at 336.

¹¹ For example, while almost 20,000 complaints were logged by the Department of Energy's gasoline price hotline during the week immediately following Katrina, many of the complaints failed to identify the gas station or retailer sufficiently to allow the Commission to contact the target of the complaint for additional information, none of the complaints contained information that would allow the Commission to contact the complainant for information identifying the retailers complained about, and none of the stations that were identifiable were the subject of more than a single complaint.

companies. However, to provide as complete a response as possible, the agency has sought information from retailers that various states have charged with price gouging in the wake of Hurricanes Katrina and Rita. As noted, the agency issued Section 6(b) Orders to 99 retailers, many of which had settled state charges without a trial and paid a fine. Although several of these retailers are significant companies with multiple retail stations that should have little difficulty providing the requested information, we are encountering a significant number of small, single-station owners with relatively little sophistication or computer expertise (many of whom speak English only as a second language).

Many of the single-station owners do not keep the kind of data required by Section 632 because it is not required for their reporting purposes. Those that are not computer literate may need to generate those data manually from invoices kept in basements or attics. Moreover, language and cultural barriers are making it difficult for several persons to understand fully the data the agency has requested and how to submit it. All of these individuals seem to be trying hard to comply with the Commission's investigation, but some may not be able to provide the requested information.

For two reasons, the staff has not to date requested that the Commission enforce compliance in Federal court. First, because all retailers seem to be acting in good faith, there is likely little to gain from pursuing enforcement actions against firms actively trying to comply. Second, the agency is likely to obtain enough information from the larger retailers to provide Congress with comprehensive and meaningful information for the retailer segment. Staff will continue to work with all parties to obtain the required information.

V. CONCLUSION

The Commission has made considerable progress in identifying and gathering the information necessary to address the inquiries posed by Congress. The Commission has cast a broad net, using compulsory process to demand information from almost 200 companies across the United States. Moreover, the Commission has interviewed other companies to obtain necessary information and is conducting 15 investigational hearings. The agency is continuing to gather and assimilate information, and it would therefore be premature to draw conclusions at this time.