COMMENTS OF THE ABA SECTION OF ANTITRUST LAW REGARDING THE OIL AND GAS INDUSTRY ANTITRUST ACT OF 2006

The Section of Antitrust Law (the "Section") of the American Bar Association ("ABA") appreciates the opportunity to present its views concerning the "Oil and Gas Industry Antitrust Act of 2006", S. 2557, 109th Cong. (2006). The views expressed in these comments are those of the Section and have been approved by the Section's Council. They have not been approved by the House of Delegates or the Board of Governors of the ABA and should not be construed as representing the policy of the ABA.

Executive Summary

The Section recognizes that there has been a significant increase in consumer complaints over the rising cost of gasoline in recent years. Moreover, in the months after Hurricanes Katrina and Rita allegations of gasoline "price gouging" were at all-time highs, leading state enforcement, officials to open investigations and even seek charges against alleged violators. Currently approximately 25 states have statutes that prohibit "price gouging" during declared states of emergency and there is separate proposed federal legislation in this area.

However, the proposed "Oil and Gas Industry Antitrust Act of 2006" is not federal price-gouging legislation. Instead, this bill is a new proposed amendment to the federal antitrust laws aimed specifically at certain conduct of the oil and gas industry in the United States. Such an amendment is not necessary and may actually negatively impact consumer markets.

The bill is unnecessary because the current federal antitrust laws already bar illegal collusive, monopolistic, and anticompetitive conduct by individuals and business entities, including those in the oil and gas industry. In fact, the history of the antitrust laws are replete with cases involving the oil industry many of which have spurred the development of key antitrust law principles.[1] The bill, by creating industry-specific legislation, does not add significant protection for consumers that does not already exist in the antitrust laws. For over a hundred years, the Sherman Act has barred collusion by competitors and anticompetitive conduct by monopolists.

Moreover, this bill may harm the very consumers that it is intended to protect. As discussed below, ambiguities in the text and questions about oversight may cause industry participants to avoid productive and legitimate conduct, thereby reducing output in the market.

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[1] *See e.g.,* United States v. Standard Oil Co. of New Jersey*,* 221 U.S. 1 (1911) (establishing the "rule of reason" analysis); United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940) (establishing "per se" rule against price fixing).

Comments

I. Introduction and Summary of the Bill

The bill entitled "Oil and Gas Industry Antitrust Act of 2006", S. 2557, 109th Cong. (2006) (the "Bill"), now pending in the United States Senate, would change the antitrust laws as applicable to the oil and gas industry in the United States. Specifically, the Bill would (1) amend the Clayton Act to define a new industry-specific offense for certain unilateral supply decisions, and (2) amend the Sherman Act to eliminate the application of sovereign immunity and the act of state defense to collective actions by foreign states (such as OPEC). In addition, the Bill would require several studies and reviews to be undertaken of the effectiveness of the current antitrust regime in regulating mergers and acquisitions and information exchanges in the industry.

More specifically, S. 2557 contains the following operative provisions:

- Section 2, *Prohibition of Unilateral Withholding,* would amend the Clayton Act to make it illegal to refuse to sell or to export or divert petroleum product supplies with the intention of increasing prices or creating a shortage in a geographic market. The Bill provides that in evaluating whether a defendant has illegal intent a court must consider whether 1) the cost of the petroleum products has increased and 2) the defendant has obtained a higher price in the market to which the product has been exported or diverted.
- Section 3, *Review of Clayton Act,* would require the Department of Justice ("DOJ") and the Federal Trade Commission ("FTC") to conduct a study to determine whether Section 7 of the Clayton Act[2] should be modified with respect to the oil and gas industry.
- Section 4, *Study by Government Accountability Office,* would require that the General Accountability Office ("GAO") report on the effectiveness of any divestitures required by DOJ consent decrees in the industry in the last ten years.[3] Section 4 also would require the DOJ and FTC to respond to the GAO report by considering whether additional action should be taken with respect to any of the divestitures studied.
- Section 5, *Joint Federal and State Task Force,* would require the formation of a joint Federal-State task force to investigate "information sharing (including through the use of exchange agreements and commercial information services)" in the oil and gas industry.

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[2] 15 U.S.C. § 18.

[3] Section 4 of the Bill defines a covered consent decree to mean any consent decree "(1) to which either the Federal Trade Commission or the Department of Justice is a party; (2) that was entered by the district court." Because FTC consent orders are not entered by the district court, Section 4, as drafted, excludes any FTC consent orders from the scope of the study. Presumably this omission was unintentional and will be rectified in any subsequent versions of the Bill.

- Section 6, *No Oil Producing and Exporting Cartels,* would limit the application of sovereign immunity and Act of State Doctrine defenses, while amending the Sherman Act to make it illegal for any foreign state or its instrumentality to limit production or set prices for petroleum.

The Bill would apply to firms at all stages of the oil and gas industry, including any person "in the business of exploring for, producing, refining, or otherwise processing, storing, marketing, selling, or otherwise making available petroleum, gasoline, or other fuel derived from petroleum or natural gas."

II. Antitrust Section Position

The Section believes that industry-specific antitrust laws are not generally beneficial to consumers or the free enterprise system, and the empirical evidence now available does not justify special treatment for the oil and gas industry. Indeed, for the reasons described below, the changes contemplated by the Bill – including statutory changes potentially enacted as a result of the studies mandated in the Bill – could have adverse and unintended consequences for consumers and would likely create inconsistencies in the interpretation of the U.S. antitrust laws across industries.

A. Proposed Amendment to the Clayton Act to Include a Unilateral Withholding Provision

The proposal in the Bill to amend the Clayton Act to make it illegal to refuse to sell or to export or divert petroleum product supplies with the intention of increasing prices or creating a shortage in a geographic market would create a prohibition applicable in the sale of petroleum products different from the standards applicable to such unilateral decisions in other industries, and inconsistent with the economic premises courts have applied to judging the lawfulness of such conduct. Further, the Bill as now drafted contains ambiguous language that may create uncertainty as to the lawfulness of conduct the Bill does not intend to prohibit. For both of these reasons, the Antitrust Section does not believe this provision of the Bill will achieve the ends its proponents envision.

1. An Intent-Based Standard is Inconsistent With Antitrust Law's Focus on Competitive Effects

The Bill proposes an intent-based standard of antitrust liability for unilateral supply decisions. Such a standard would be different from and inconsistent with antitrust law's focus on economic effects in evaluating whether certain conduct is anticompetitive and harms consumer welfare. In interpreting the Sherman Act, the Supreme Court has recognized that proof of anticompetitive intent alone is insufficient to establish that a firm's unilateral conduct is illegal under the antitrust laws. There must also be some showing of an actual or likely anticompetitive effect.[4] However, the Bill seeks to base liability for certain supply decisions on a firm's subjective motivations, which can result in the prohibition or chilling of procompetitive conduct.

The fact that the Bill equates "intent" with more objective factors such as product costs and prices does not eliminate the risk that such a law will prohibit legitimate conduct, and actually makes it more likely that the law will be applied to prohibit (and inhibit) business decisions that benefit consumers. For example, if the Bill is enacted and another hurricane causes similar supply shortages in the Gulf Coast region, a company could be liable under this provision if it chose to divert supplies from areas unaffected by the storm to the Gulf Coast, where petroleum products prices might be higher due to supply shortages and disruptions. This obviously undesirable result arises because the Bill could be read to allow a court to conclude that a defendant has the requisite illegal intent if the price a defendant obtains from diverting product is greater than the price obtained where the existing supplies are located without distinguishing the variety of circumstances that might create such a price difference. Such a standard thus presents a serious risk of chilling legitimate conduct that promotes consumer welfare.

2. The Focus on Single-Firm Conduct Divorced from Market Power Concerns is Inconsistent with Determining Anticompetitive Effects.

The antitrust laws also have long recognized that absent a showing that the unilateral withholding of a good from sale has the potential to create a monopoly, manufacturers and producers are free to decide where and when they will sell: "In the absence of any purpose to create or maintain a monopoly, the [Sherman] act does not restrict the long recognized right of a trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal."[5] Moreover, courts have consistently rejected antitrust claims based on a unilateral refusal to deal that does not involve a competitive relationship between an alleged monopolist and the subject of the refusal to deal: "It requires a long stretch to call an individual refusal to deal 'monopolizing' when it does nothing to increase the refuser's monopoly power and nothing to increase his position in any market."[6] The premise of the antitrust

[4] *See, e.g.,* Spectrum Sports, Inc. v. McQuillan, 506 U.S. 477, 457 (1993) ("it is generally required that, to demonstrate attempted monopolization, a plaintiff must prove (1) that the defendant has engaged in predatory or anticompetitive conduct with (2) a specific intent to monopolize and (3) a dangerous probability of achieving monopoly power").

[5] United States v. Colgate & Co., 250 U.S. 300, 307 (1919). The Section notes that the existing antitrust laws already contain well-established prohibitions on collusion between competitors that leads to a withholding of products from consumers.

[6] Mr. Furniture Warehouse, Inc. v. Barclays American/Commercial Inc., 919 F.2d 1517, 1523 (11th Cir. 1990) (citing P. Areeda, Antitrust Law ¶ 736, at 274 (1978)).

laws is that the free market is better equipped to address such conduct than regulation that may impair procompetitive decisions.[7]

A free market system is premised on the assumption that a manufacturer or producer will normally sell to the person and in the location where it will get the best price. Even if a firm is a monopolist, the courts have found that sound antitrust policy does not permit interference with free market decisions such as pricing. Indeed, the Supreme Court has recently reaffirmed that the ability to charge monopoly prices (which economically is similar to a refusal to deal with a non-competitor) is lawful. Such an ability is an important, positive element of the free-market system because it motivates businesses to develop product or service offerings that are attractive to consumers, while allowing the efficient functioning of the economic laws of supply and demand rather than substituting price regulation for competition.[8] The Bill's inconsistency with these principles risks prohibiting conduct that is typical in a free enterprise system.

3. The Proposed New Standard Is Likely to Result in Inconsistent Enforcement, Which is Not in The Consumer's Interest

The Section is also concerned that ambiguities in the text of the proposal may have consequences inconsistent with the intent of the Bill. For example, the use of terms such as "refusal to sell," "divert," "creating a shortage in a geographic market," and "cost of acquiring," are not clearly defined and could lead to enforcement problems. Where ambiguities exist, market participants may be wary to act at all, facing uncertainties about the legality of the specific types of conduct prohibited. Hesitancy to act because of ambiguous statutory language can lead to reduced output, which adversely affects both supply and prices in the market. Indeed, the ability to act swiftly ensures that markets will respond efficiently in times of shortages or surpluses.

The ambiguity of such terms in the Bill creates the potential for confusion and the risk of litigation challenging appropriate market conduct. For example, a federal district court recently upheld a criminal indictment against an energy company under the Commodity Futures Trading Act to the extent that it was premised on allegations of certain conduct to manipulate the market, but the court specifically recognized that the mere unilateral conduct of withholding supply "if he believes that in the future the commodity will

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[7] Kenneth L. Glazer and Abbott B. Lipsky, Jr. "Unilateral Refusals to Deal under Section 2 of the Sherman Act," 63 Antitrust L.J. 749, n. 142 (Spring 1995) ("Indeed, a monopolist invites erosion of its market position by discriminating among its customers or by exploiting them. Although neither monopoly exploitation nor unjustified discrimination is desirable, at least their tendency to encourage competitive erosion of the monopolist's position is consistent with antitrust objectives.")

[8] *See, e.g.*, Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 407 (2004) ("the mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free market system").

command a higher price" could not, by itself, support the indictment.[9] However, the current Bill, as drafted, appears to give rise to the possibility that parties could bring actions for unilateral refusals to sell based simply on the expectation of increased selling prices in the future.[10]

The use of the term "diverting," in particular, is ambiguous in the context of the oil and gas industry. Because producers build inventories for many reasons in competitive markets, prices may fluctuate during certain periods of necessary and common inventory building. This Bill opens the possibility that an action might be brought against a producer who followed necessary and common practices in the industry with respect to inventories. Again, this could possibly lead to producer hesitation to act that in turn could lead to greater problems involving available supplies for consumers.

Uncertainties about enforcement of the Bill could also inhibit other procompetitive conduct in the oil industry. In setting limits on the enforcement of its unilateral withholding provisions, the Bill sets forth only two considerations that a court could take into account in evaluating an allegation under this section:

1) whether supply-side costs have increased; and
2) whether a seller obtains a higher price by exporting or diverting the commodity.

This leaves other major considerations completely uncovered:

First, prices can increase because of changes in demand-side factors. Price is determined by both supply and demand. In these circumstances, resulting price increases are not inconsistent with a competitive market.

Second, on the supply-side, there are many factors that could cause price increases, including the shut down of major refineries such as those that occurred as a result of Hurricanes Katrina and Rita. In those cases, increased prices are consistent with a competitive market. Arguably, a seller who raises price does not appear to have any safe harbor under the first consideration, where emergencies and increased acquisition costs are at issue, and instead the mere charging of substantially higher prices may be considered a refusal to sell.

The application of such a broadly worded statute is even more problematic given that there is no primary government agency focused on analyzing single-firm conduct in the petroleum markets. Although the Commodity Futures Trading Commission ("CFTC") and the Federal Energy Regulatory Commission ("FERC") have reviewed single-firm conduct, their jurisdiction in the energy area has been primarily limited to natural gas and electric power. Nor do the statutes under which the CFTC and FERC operate create a private right of action. The Bill would, in essence, open all single-firm conduct in the petroleum industry for scrutiny under an ambiguous statute through a private right of action, including class actions. Such enforcement would only increase the possibility of

[9] United States of America v. Reliant Energy Svcs, Inc., No. 04-0125, 2006 U.S. Dist. LEXIS 14037, at *46 (N.D. Cal. Feb. 28, 2006).
[10] It should also not be overlooked that the Bill does not specifically identify who has standing to bring actions for alleged violations.

varying standards of conduct in different jurisdictions, creating greater uncertainty for business decisions that may impact supply; and ultimately harming consumer interests.

B. Studies and Investigations

The Antitrust Section fully endorses timely and probing studies of the effectiveness of the antitrust laws and related agency enforcement activity. The Section cautions, however, against mandating studies or investigations directed at adopting industry-specific antitrust rules for an individual market sector such as the oil and gas industry.[11] Due to the significant costs and uncertainty that any additional industry-specific antitrust system would create, universal and uniformly applied rules of market conduct should be applied to all firms in the United States, regardless of the particular industry in which they operate. Accordingly, before any proposals are made for industry-specific antitrust rules for the oil and gas industry, the Section believes a high burden must be met to demonstrate that (1) under the status quo, the risk of anticompetitive harm is so great that additional antitrust rules are needed; and (2) the costs of industry-specific rules would be less than the harms from allowing general antitrust rules alone to continue to regulate competitive conduct in the industry.[12]

[11] The Section notes that the FTC has previously conducted several retrospective analyses of its merger enforcement actions and remedies. These studies have been self-critical and rigorous in their methodology, and have resulted in changes to investigative and remedial standards. None has indicated a need for, or potential benefit from, industry-specific standards. One of the most comprehensive of these studies was the FTC Bureau of Economics Staff Study, *The Petroleum Industry: Mergers, Structural Change, and Antitrust Enforcement (August 2004)* (the "FTC Petroleum Merger Report"), the third FTC study of the petroleum industry since 1982. Among other things, the FTC Petroleum Merger Report provided a detailed analysis of the FTC's merger enforcement actions regarding all levels of the petroleum industry during the past 20 years. The Section notes that this analysis provides no empirical or other support for unique merger standards but instead appears to demonstrate that (1) the FTC has actively pursued antitrust actions against oil and gas mergers, including challenging several mergers that resulted in market concentration levels much lower than mergers challenged in other industries, and (2) as a result, mergers have not substantially increased concentration or resulted in price increases. *See also* FTC, *Gasoline Price Changes: The Dynamic of Supply, Demand and Competition (July 2005)* (reporting on various causes of price volatility); and FTC, *Conference on Estimating the Price Effects of Mergers and Concentration in the Petroleum Industry* (January 2005) (analyzing, inter alia, the complexity of interpreting market data and attributing price effects to mergers). The Canadian Bureau of Competition has also performed a comprehensive study of petroleum industry mergers, with similar results. *See* Canadian Bureau of Competition, *Gasoline Empirical Analysis* (March 2005) (available at http://www.competitionbureau.gc.ca/ internet/index. cfm?itemid=223).

[12] The Section also notes that the Antitrust Modernization Commission ("AMC") is currently conducting a detailed study of Section 7 of the Clayton Act as part of its

1. Industry-Specific Antitrust Rules Are Undesirable

Consistent with its previous comments on proposed industry-specific antitrust legislation, the Section believes that additional industry-specific antitrust rules are undesirable and would be counterproductive.[13]

The current antitrust laws apply to virtually all industries with the objective of protecting U.S. consumers. Under Section 7 of the Clayton Act, there is a well-developed body of law and practice under which the agencies and the courts determine whether a transaction threatens to harm consumers by substantially lessening competition in any line of commerce anywhere in the country. Under existing law, the DOJ and FTC conduct detailed, fact-specific investigations in which they balance several competing factors to determine whether any transaction threatens consumer harm. These general laws applicable to mergers and acquisitions have been successfully applied across many different industries, including industries that are of fundamental importance to the national economy. Similarly, there is well-established precedent at the agencies establishing the appropriate scope of any consent decree restructuring designed to remedy competitive problems presented by particular transactions. Finally, Section 1 of the Sherman Act has been used effectively to regulate anticompetitive information exchanges that threaten to harm consumers almost since its inception: there is a well-developed approach for distinguishing between information exchanges that are procompetitive or competitively neutral, and those that substantially lessen competition and are therefore unlawful.

The current laws applicable to mergers and acquisitions and information exchanges between competitors have proven flexible enough to deal with the many different competition issues that arise in an almost infinite variety of industries and circumstances. Their potential application is well understood and they have stood the test of time. Any effort to move away from these well-established standards through the development of special rules for the oil and gas industry would risk harming, rather then benefiting, U.S.

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hearings to determine whether the current antitrust laws should be modified. At the conclusion of its comprehensive study into the current antitrust laws, the AMC is required to submit a report to Congress and to the President with detailed findings and “a recommendation for legislative or administrative action the Commission considers to be appropriate.” Antitrust Modernization Commission Act of 2002, Pub. L. No. 107-273, §11058. Given that an independent Commission set up by Congress is currently conducting a comprehensive study of the antitrust laws, the Section believes it would be prudent for Congress to await the findings and recommendations of the existing study, rather than mandating further studies by the antitrust agencies and the GAO.

[13] This position is consistent with the policy of the ABA. In 1992, the ABA adopted a formal Policy (Report 103B) on then-pending legislation regarding gasoline pricing which states: “[T]he American Bar Association opposes enactment of legislation regulating gasoline pricing and modifying the antitrust laws by creating industry-specific laws applicable to the sale of gasoline.” While the current Bill differs substantively from the legislation pending in 1992, the concern with industry specific legislation has the same foundation.

consumers. The development of new rules would impose substantial additional administrative costs and result in significant uncertainty as to how the new rules might be interpreted by the agencies and the courts. This uncertainty could inhibit firms in the oil and gas industries from taking procompetitive actions with significant consumer benefits that would be valid under the antitrust laws applicable to all other industries, for fear that such actions might run afoul of special antitrust standards in the oil and gas sector.

2. Scope of Proposed Study of Existing Antitrust Laws Applicable to Oil and Gas Industry

Given the significant risks and costs arising from industry-specific antitrust rules, the Section believes that no study would be sufficient to justify such rules for the oil and gas industry unless it clearly demonstrated that (1) the oil and gas industry has unique attributes that render general antitrust laws insufficient to prevent anticompetitive harm and (2) the various costs imposed by additional rules would not outweigh the alleged benefits of industry-specific rules. The Section believes that the studies and reports proposed by Section 4 and 5 of the Bill will be of little value in making such a determination, if, as currently designed, they focus solely on a small sample of recent cases specific to the oil and gas industry. Only a comprehensive cross-industry study could produce any meaningful benchmark with which to evaluate the effectiveness of the current antitrust rules applicable to mergers and information-sharing between competitors.

C. "NOPEC" Provisions

The Section does not take a position on the Bill's proposed "NOPEC" revisions to the sovereign immunity and Act of State Doctrine defenses, both of which raise important issues of foreign policy and national interest that lie outside the scope of the antitrust laws. The Section is concerned, however, that although the "NOPEC" provisions are expressly directed at cartels, which have a well understood antitrust meaning and are routinely condemned as *per se* illegal under the Sherman Act, the breadth of the language in the proposed new Sherman Act Section 8 conceivably captures legitimate horizontal activity, such as joint ventures, where parties pool resources and share risk of loss or gain in what may be a procompetitive arrangement or at least one not subject to *per se* condemnation.[14] The Section, therefore, suggests that if Congress decides to enact this Section, the following proviso be inserted at the end of proposed new Section 8(a) to make clear that Congress does not intend to change the substantive antitrust law applied to coordinated activity among competitors:

> Provided, however, nothing in this Act shall be deemed to alter the analysis of the reasonableness of contracts, combinations, conspiracies or restrains under Section 1 of the Sherman Act, whether between or among foreign states or any other person.

[14] *See, e.g.,* Texaco Inc. v. Dagher, 126 S.Ct. 1276 (2006).

The Section also suggests that the legislative history make clear that Congress seeks only to reach cartels and conduct generally accepted as subject to *per se* condemnation and explain the well-accepted understanding under federal antitrust law that a variety of coordinated activities among competitors may have procompetitive effects and are subject to rule of reason analysis by appropriate case citations.

In the event that Congress revises the Sherman Act as proposed in Section 6 of the Bill, the Section further suggests that the language of the Bill (or, at a minimum the legislative history) clarify that no private right of action is being created under this new Section 8, and that the sole right of action against foreign sovereigns is vested in the executive branch.

Respectfully submitted,

SECTION OF ANTITRUST LAW
AMERICAN BAR ASSOCIATION