STATE OF ALASKA

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

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December 29, 2004

Ms. Rynnieva Moss
Office of Representative John Coghill
State Capitol, Room 204
Juneau, Alaska 99801-1182

Re: Studies regarding gasoline prices in Alaska by AG's office

Dear Ms. Moss:

You have requested that the Department of Law provide you with copies of any reports done regarding investigation of gasoline pricing in Alaska. I have located two such reports which are enclosed, one prepared by the Alaska Department of Law dated December 21, 2001 and entitled, "Alaska Petroleum Products Pricing Investigation: Update and Status," and the other also prepared by the Alaska Department of Law, dated November 21, 2002 entitled, "Alaska Petroleum Products Pricing Investigation: Closing Report." Please let me know if you have any further questions.

Sincerely,

GREGG D. RENKES
ATTORNEY GENERAL

By:

David W. Márquez
Chief Assistant Attorney General
Legislation and Regulations Section
Legislative Liaison

DWM:cb
cc: Gregg D. Renkes, Attorney General
Scott Nordstrand, Deputy Attorney General
Kevin Jardell, Director, Governor's Legislative Office

ALASKA PETROLEUM PRODUCTS PRICING INVESTIGATION:
UPDATE AND STATUS
Prepared by the Alaska Department of Law
December 21, 2001

Introduction

The Office of the Attorney General for the State of Alaska began an investigation of Alaska petroleum prices in 1999 by issuing Civil Investigative Demands to petroleum refiners and product distributors. The investigation was begun because of public complaints and inquiries to the Attorney General about the high price of gasoline in Alaska in comparison to other states. The purpose of the investigation is to determine whether Alaska petroleum product pricing is the product of illegal price fixing or other anticompetitive behavior in violation of state or federal statutes.

The Attorney General's investigation is ongoing. The Department of Law is reviewing the documents and data provided by the state's gasoline marketers. The Department of Law has not made a determination regarding whether there is sufficient evidence to warrant bringing an antitrust or other enforcement action.

Background

To bring an action under Section One of the Sherman Act (the federal antitrust law) or under AS 45.50 (Alaska's antitrust law), there must be evidence of an illegal agreement. This could be an actual written agreement, testimony, or other evidence of an agreement to fix prices, divide the market, or otherwise restrain competition.

Under existing law, the State of Alaska does not attempt to regulate wholesale or retail gasoline prices. A business is free to set its own price, but it is illegal for a business to collude with competitors to set prices.

The state has reviewed thousands of pages of documents, conducted interviews, and reviewed market data to determine whether there is direct evidence of an illegal agreement.

All material and data provided to the state in response to the civil investigative demands of the Attorney General are confidential by statute. AS 45.50.592(e). The following is a summary of the non-confidential portions of the analysis prepared by the department to date.

Price Differences Between Alaska and the Lower 48

Retail prices of gasoline in Alaska have more closely followed prices in other West Coast states than prices in the rest of the U.S. Given Alaska's relative proximity to the West Coast, this probably is to be expected. Though Alaska's refineries supply much of the petroleum products required in the state, jet fuel, diesel, and gasoline have regularly been shipped from West Coast refineries to Alaska during the past decade. (Alaska's sources of supply for petroleum products are discussed in greater detail below.) In addition, gasoline and other products have been exported from Alaska to the West Coast. Because West Coast refineries are the closest alternative source of refined petroleum products outside Alaska, and because refined products move from Alaska to the West Coast, Alaska prices are influenced by West Coast prices.

Unfortunately, gasoline prices on the U.S. West Coast have, historically, been higher than prices in the rest of the U.S. Over the past seven years, the average retail price for gasoline, excluding taxes[1], on the West Coast has been 11 cents per gallon ("cpg") higher than the average retail price throughout the 50 states.

Concerns expressed by consumers and others about West Coast gasoline prices prompted the Federal Trade Commission ("FTC") to initiate an investigation. The FTC studied West Coast gasoline pricing practices for almost three years, but ultimately concluded that there was nothing unlawful about the manner in which West Coast wholesalers priced gasoline.

The FTC closed its West Coast investigation in May 2001. In doing so, it concluded that the West Coast has several important characteristics that set it apart from much of the rest of the U.S. gasoline market. One of the most important characteristics is the West Coast's relative distance from the Gulf Coast. The Gulf Coast is the largest refining center in the U.S. and an important source of supply of gasoline and other refined products. Refined products move to much of the U.S. from Gulf Coast refineries through a network of pipelines. There are no pipeline connections, however, between the Gulf Coast's refineries and the West Coast. This means that products like gasoline moving from the Gulf Coast's refineries to the West Coast must be shipped through the Panama Canal on marine tankers. This may explain in part why gasoline and other products refined on the West Coast command higher prices.

Unique product requirements, such as those imposed by the California Air Resources Board ("CARB"), also tend to raise the price of gasoline. In addition, there are a limited number of gasoline refiners and wholesalers on the West Coast, and all refiners and wholesalers do not compete in all metropolitan areas.

[1] Retail gasoline prices at the pump include federal, state, and local taxes. Since Alaska has one of the lowest gasoline taxes in the nation, retail price comparisons understate the differences between prices in Alaska and elsewhere unless taxes are deducted.

Apart from the CARB standards, the West Coast market characteristics identified above are also present in Alaska. Compared to the West Coast, however, Alaska is even more distant from Gulf Coast product markets, has fewer refiners, and has even greater wholesale market concentration. This may explain in part why Alaska prices tend, on average, to be higher than those in other western states.

Yet these market characteristics, by themselves, do not explain why the price difference between Alaska and the West Coast grew sharply between 1995 and 1998. During this period, Anchorage-area prices were on average 17 cpg above retail prices in the Seattle area, a level nearly double the 9 cpg difference seen in the prior four years. This is curious given that Alaska refiners produced more gasoline during this period than was consumed here, and exported the surplus to the West Coast and Far East at prices lower than those offered in Alaska. Beginning in 1999, however—after the Attorney General initiated this investigation—the spread narrowed dramatically. Between January 1999 and December 2000, Anchorage-area retail prices averaged just 3 cpg above Seattle-area retail prices.

Supply and Demand of Petroleum Products

In addition to gasoline, the other major petroleum products sold in Alaska are jet fuel and diesel (No. 2 heating oil and No. 2 diesel fuel). These products and gasoline constitute more than 95% of the total volume of petroleum products sold in the state.

The Tesoro and Williams refineries produce gasoline, jet fuel, and diesel. The PetroStar refinery produces jet fuel and diesel, but no gasoline.

The Williams refinery, near Fairbanks, and the PetroStar refineries, near Fairbanks and in Valdez, all take Alaska North Slope crude ("ANS") directly from the TAPS line. Both companies reinject the unrefined portion of ANS back into the TAPS line.

Alaska's current demand for refined petroleum products is approximately 100 thousand barrels per day (MBD), or 1.5 billion gallons per year. Jet fuel consumption is just over 60 MBD, accounting for a little more than 60% of total demand for refined product in the state. Consumption of diesel and gasoline in Alaska runs approximately 16 MBD, or 245 million gallons per year, for each product.

More gasoline is produced in Alaska than is consumed. The excess is exported to the West Coast and foreign destinations. Nevertheless, gasoline, diesel, and jet fuel are barged into southeastern Alaska from Seattle-area refineries.

Historically, Alaska's refineries have not produced enough jet and diesel fuel to supply the state. These products are imported from the Far East or the West Coast.

Tesoro's refinery supplies the majority of gasoline consumed in Alaska, but Williams supplies most of the gasoline sold in Fairbanks and interior Alaska. Williams also ships gasoline and jet fuel by rail to Anchorage.

The Anchorage metropolitan area accounts for about 60% of the state's retail gasoline sales while Fairbanks, Juneau, the Kenai Peninsula, and Western Alaska account for roughly 10% of retail sales each. There are approximately 300 service stations in Alaska. About one-third of Alaska's 300 retail gasoline stations are located in the Anchorage area. The average retail station in Anchorage is larger and sells much higher volumes than stations in the rest of the state.

Alaska's Gasoline Industry Is Highly Concentrated

Williams, Tesoro, Chevron, and Texaco[2] account for the vast majority of gasoline marketed in Alaska. The state's two gasoline refiners, Williams and Tesoro, were also its largest gasoline marketers, accounting for nearly 65% of Anchorage-area sales between them in 1999. Chevron and Texaco accounted for approximately 32% of Anchorage volumes. These same four marketers have accounted for nearly all of Alaska's gasoline sales over the past decade.

For purposes of analyzing competition within a market, the U.S. Justice Department and the Federal Trade Commission categorize markets into the following three groups: Unconcentrated, Moderately Concentrated, Highly Concentrated. Alaska's gasoline industry is Highly Concentrated at both the refining and wholesale distribution levels. Wholesale gasoline markets in Alaska are more concentrated than in most other wholesale gasoline markets in the U.S. and on the West Coast. Analysis of the available market share data shows that with the exception of the southeast part of the state, concentration levels are much higher in regions outside of Anchorage.

Competition, Oligopoly, and Illegal Behavior

Unconcentrated markets are characterized by a large number of sellers offering the same or similar products to consumers who can shop for the best value. Unconcentrated markets are generally assumed to be competitive. The more sellers, the more likely competition will thrive. In a competitive situation, no single seller has market power; the

2 Since the late 1990's, in the West and Midwest, Texaco brand gasoline has been marketed by Equilon, a joint venture between Texaco and Shell. As a condition to approving the recent merger of Chevron and Texaco, Alaska, other states, and the Federal Trade Commission required Texaco to divest its interest in Equilon to Shell or another buyer. Therefore, the Chevron-Texaco merger should not reduce competition in the Alaska gasoline market.

power to influence prices in the market on its own. Also where there are many sellers, it is difficult for sellers to coordinate their behavior or agree to volume or price restrictions without being detected.

In a competitive market, sellers are motivated to lower their prices in order to increase their sales, while buyers are motivated to seek out the best deal. Prices will tend to drop over time until they are close to sellers' costs. If prices begin to rise above costs, sellers will try to take advantage of the opportunity to increase profits by making more of the product available in the market. This increase in supply will in turn drive prices down to the point where they again are close to the sellers' costs. If prices fall to a level that does not cover sellers' costs, some sellers will go out of business. Those that are left will offer less of the product until prices start to increase again.

On the other end of the spectrum are highly concentrated markets, where there are relatively few sellers of a particular product. Economists call such a market an "oligopoly." Oligopolies do not always lead to higher prices, however. Prices in an oligopoly can be competitive even when there are very few sellers if, for example, potential new sellers are ready, willing, and able to enter the market in the event of even a small increase in price. In this situation, the threat of additional competition may tend to keep prices low. However, if there are relatively high costs associated with entering a market (entry barriers), existing sellers may be able to increase prices without much concern about attracting new competition.

When there are few sellers in a market, it is, presumably, easier for each to observe how its competitors react to decisions regarding output and prices, and each may take into account the potential impact of its own actions on market prices and the potential responses from other sellers. This type of competitive behavior, which is dependent in part on the expected actions or reactions of other sellers, is often referred to as "oligopolistic pricing" or "oligopolistic interdependence." In this environment, it is easy for sellers to develop a "live and let live" attitude toward their rivals that would not be possible to maintain in a competitive market. As a result, oligopolistic behavior can result in prices that are above competitive levels over extended periods of time.[3]

This type of interdependent behavior on the part of sellers is not generally regarded as a violation of antitrust laws so long as each business develops and implements its pricing and output decisions independently. That is, in determining what volumes to produce or what prices to offer, businesses can incorporate their expectations about a rival's likely reactions as long as those expectations are developed independently and without the aid of other sellers. If the sellers communicate about price setting or enter into

[3] Not all economists agree with this theory, and some would require empirical evidence supporting the theory before considering it valid for a particular market. In any event, whether higher-than-competitive prices in a market can be explained by oligopolistic interdependence is highly dependent on the facts.

an agreement that affects prices, it is considered collusion and a violation of the antitrust laws.

Economists believe collusion is more likely when certain conditions are present in a market, especially in markets for a relatively homogenous product like gasoline. These conditions include (1) the presence of only a few sellers (oligopoly), (2) inelastic demand, (3) relatively static or declining demand over time, (4) easy detection of sales by competitors, (5) price visibility, (6) difficulty of entry by potential new competitors, (7) frequent contact between sellers, and (8) few "fringe" or smaller sellers. All of these conditions are present in Alaska. But their presence, together with gas prices higher than one would expect in a competitive market, do not in themselves constitute a legal basis for an antitrust enforcement action. There must also be evidence of an illegal agreement or evidence that would allow the inference of such an agreement.

Additional Information on the Investigation

The companies have recently finished producing documents to the state. The state is in the process of reviewing and analyzing those documents to determine whether any laws or regulations have been violated.

Under Alaska's antitrust law, many aspects of this case are to be kept confidential. In particular, documents and their contents provided to the state in response to the Civil Investigative Demands (CIDs) issued by the Office of the Attorney General are to be kept confidential in the absence of a court order authorizing their disclosure to the public. AS 45.50.592(e). Such an order might be requested by the state if the investigation leads to an enforcement action. If the state finds no evidence of a violation of the antitrust laws, CID information may not be disclosed to the public in the absence of express authorization by the firm that provided the documents. AS 45.50.592(e). Because of the lawsuits filed against the state by some of the companies being investigated, court pleadings have been filed in the public record that contain some information about the investigation that would normally not be available to the public.

The state's initial CIDs were served upon several dealers of wholesale petroleum products in June, July, and August of 1999. Shortly thereafter, Tesoro, Chevron, and Texaco filed suit in Alaska Superior Court in Anchorage protesting the scope of the CID questions and the state's intended use of the produced documents. Those cases were consolidated under case number 3AN-99-8544CI. In an order issued October 7, 1999, the Superior Court upheld the propriety of the CIDs, with minor modification to a small number of questions, and the right of the state to share the documents with contract counsel without permission of the producing companies.

On October 13, 1999, Tesoro filed an appeal of the Superior Court's decision in the Alaska Supreme Court (Case No. S9379). Tesoro appealed both the scope of the CIDs and the state's right to share documents with contract counsel. The Alaska Supreme Court heard oral argument on November 15, 2000, but has yet to issue a decision.

The initial petition filed by Tesoro in the Superior Court explains Tesoro's contentions with respect to the scope of the CID. The CID, attached to the petition as an exhibit, lists the issues being examined by the Department of Law. Likewise, the state's opposition to Tesoro's petition outlines the issues that are the focus of the CID. The state's brief in the Alaska Supreme Court analyzes the issues being pursued and gives a brief history of the case proceedings. These documents are available at the state court clerk's office in Anchorage.

Other Resources

Interested persons may obtain gasoline pricing information from a number of sources on the Internet. The Energy Information Agency of the Federal Department of Energy tracks petroleum-related information nationwide. It compiles retail and wholesale gasoline pricing data and maintains reference documents about petroleum economics and various aspects of the energy markets:
http://www.eia.doe.gov

There is information on average wholesale prices at:
http://www.eia.doe.gov/pub/oil_gas/petroleum/data_publications/petroleum_marketing_monthly/current/pdf/pmmtab35.pdf

The following article discusses the reasons that West Coast prices tend to be higher than those in the rest of the country:
http://www.eia.doe.gov/pub/oil_gas/petroleum/presentations/2001/senate_testimony/[illegible].htm

The following article explains the many factors influencing the costs of refining:
http://www.eia.doe.gov/emeu/finance/usi&to/downstream/index.html

In August 2001, the Federal Trade Commission conducted a hearing regarding factors influencing the price of refined petroleum products. Testimony and information regarding that hearing can be found at:
http://www.ftc.gov/bc/gasconf/

The American Automobile Association publishes daily average gasoline prices at:
http://www.fuelgaugereport.com

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ALASKA PETROLEUM PRODUCTS PRICING INVESTIGATION:

CLOSING REPORT

Prepared by the Alaska Department of Law

November 21, 2002

Introduction

At my direction, the Alaska Department of Law conducted an extensive three-year investigation into the pricing of petroleum products in Alaska. The investigation was initiated in 1999 in response to public complaints about the high price of gasoline in Alaska in comparison to other states. I am closing the investigation because there is insufficient evidence indicating a violation of the antitrust laws.

Conditions Prompting the Investigation

Historically, the price of gasoline on the West Coast of the United States averaged 11 cents per gallon (cpg) higher than the average retail price throughout the 50 states, excluding taxes,[1] and the price of gasoline in Alaska has tended to be higher than the price of gasoline on the West Coast by about 9 cpg. Between 1995 and 1998, however, gasoline prices in Alaska were as much as 17 cpg higher than West Coast prices. This was the impetus for the investigation. Immediately after I initiated the investigation, beginning in 1999, the spread between prices in Alaska and the West Coast narrowed dramatically, more closely tracking the historical spread between Alaska and the other states.

Legal Standards

In order to establish a violation of Alaska's antitrust statute, AS 45.50.562 and AS 45.50.564 (or the comparable federal law), there must be evidence that two or more companies entered into an express or "tacit" agreement to fix petroleum prices. A showing that companies charged prices in excess of the competitive level, or raised and lowered prices in a parallel fashion, is not enough to establish the existence of a tacit agreement. Instead, evidence of uniform pricing must be accompanied by additional evidence demonstrating that two or more parties had a "meeting of the minds" to engage in cooperative pricing behavior, such as: (1) actions contrary to an entity's independent economic interests; (2) departure from normal business practices; (3) motive to conspire; (4) opportunity to conspire; (5) high level of inter-company communications; and (6) past antitrust violations involving collective action.[2]

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[1] Retail gasoline prices at the pump include federal, state, and local taxes. Since Alaska has one of the lowest gasoline taxes in the nation, retail price comparisons understate the differences between prices in Alaska and elsewhere unless taxes are deducted.

[2] *See, In re Baby Food Litigation*, 166 F.2d 112, 122 (3d Cir. 1999) (proof of plus factors is a "prerequisite to finding that parallel action amounts to a conspiracy").

The Investigation

The investigation began in the summer of 1999 when my staff issued Civil Investigative Demands (CIDs) to refiners and distributors of petroleum products in the state. Hundreds of boxes of documents were produced in response to the demands. The investigation involved the review of thousands of pages of internal company documents, detailed analysis of pricing data, interviews of witnesses and potential witnesses, and formal depositions of several current and former oil company employees and executives.

Findings

My staff provided a summary of the investigation in a report entitled "Alaska Petroleum Price Fixing Investigation: Update and Status," December 21, 2001, http://www.law.state.ak.us/civil/oil-gas-mining/AKPPPI-1a_final.pdf. That report describes the economic conditions and market forces present in Alaska that affect the pricing of petroleum products. All of the information and data provided to me in response to the CIDs is, by statute, confidential. AS 45.50.592(e).

The investigation found that Alaska's gasoline industry is highly concentrated, in that four marketers accounted for the vast majority of gasoline sales during the relevant time period. When there are few sellers in a market, like Alaska, it is easier for them to observe how competitors react to decisions regarding output and prices, and each may take into account the potential impact of its own actions on market prices and the potential responses from other sellers. This type of interdependent behavior on the part of sellers often leads to parallel pricing, but that is not, in the absence of an express or implied agreement to set prices, a violation of the antitrust laws so long as each business develops and implements its pricing and output decisions independently. The investigation has not produced evidence of an express or implied agreement to set prices or to otherwise violate antitrust laws.

For the reasons set forth above, I am closing this investigation without further action. However, I expect the Department of Law to continue to monitor gasoline prices in Alaska.