

EMERGENCY PRICE CONTROLS (GOUGING)

ISSUE BACKGROUND

Few things agitate consumers more than rising gas prices. As crude oil prices hit unprecedented levels which reached \$147 a barrel in 2008, consumers and politicians point the finger at oil companies and how they are “gouging” the public. While there is no evidence to support these claims, a lack of understanding as to how gasoline prices are set leaves marketers and retailers to bear the brunt of consumers’ frustration.

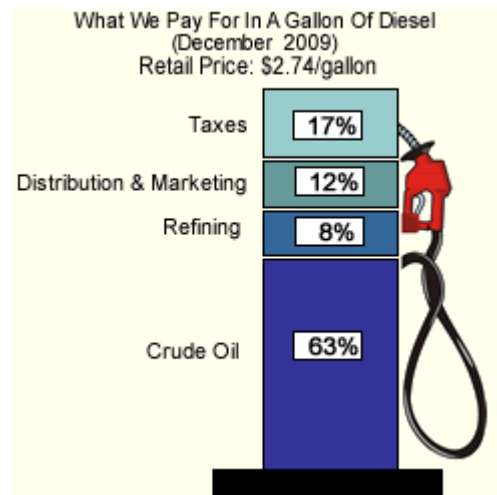
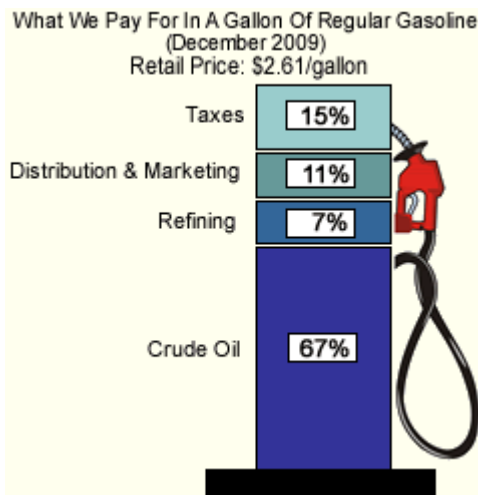
HOW GASOLINE IS PRICED

The U.S. motor fuels production and distribution system is extremely complex and few people outside of the petroleum industry truly understand how the retail price of gasoline is determined.

- 1) **Crude Oil:** The price of crude oil is the biggest contributor to the price of gasoline accounting for 76 percent of the price per gallon consumers paid during July 2008. Worldwide industrial growth and geo-political as well as U.S. failure to develop crude oil reserves in the Gulf of Mexico, the Outer-Continental Shelf (OCS) and the Arctic National Wildlife Reserve (ANWR) push prices up.
- 2) **Refining Capacity:** A new U.S. oil refinery has not been built in over 30 years and dozens have been shuttered. Cumbersome environmental regulations and permitting processes make refiner plans to expand production capacity more difficult than they should be.
- 3) **Futures Market Speculation:** Futures markets have become the dominant wholesale pricing mechanism for daily gasoline, diesel and heating oil prices. With the massive inflow of capital and non-commercial speculators such as hedge funds, pension and endowment funds into commodity markets, prices on energy contracts become increasingly volatile and excessively high without the supply and demand fundamentals to justify the run-up from about \$50-\$60 dollars per barrel in early 2007 to almost \$150 in July 2008.

The influx of non-commercial investment has created artificial demand for energy commodities which has destroyed the price discovery mechanism that commodity markets provide to physical hedgers such as petroleum marketers, airlines and farmers. Furthermore, loopholes in law allow non-commercial investors to avoid position limits which leads to excessive speculation and higher energy prices. PMAA supports an open and transparent energy futures market with aggregate position limits on non-commercial traders.

- 4) **Boutique/Renewable Fuels Mandates:** Some states and localities have imposed specific recipes for gasoline and diesel supplies sold within their jurisdiction. These boutique fuels requirements create supply shortages, and in most circumstances, supply shortages foster higher prices.
- 5) **Credit Card Fees:** In 2008, gasoline retailers paid \$8 billion to banks and credit card companies in fees. Card companies collect an outrageous percent of the total per gallon price in interchange fees. Until interchange fee reform is addressed, retailers will continue to pay excessively high and unfair interchange fees, which were the second largest expense item in 2009 for motor fuels retailers.



Source: Energy Information Administration, Washington, DC

RETAIL PROFITS

Major integrated oil companies have removed themselves from the retail gasoline business. Of the 160,000 U.S. retail gasoline locations, 97 percent are owned by independent businessmen and women. While those small businesses may sell a particular brand of gasoline, they do not share in any of the profits (or losses) generated by refiners. Gasoline retailers do not benefit from high crude oil or gasoline prices. Because they operate in such a competitive environment, the higher prices climb, the further margins are squeezed.

LACK OF EVIDENCE

In the wake of Hurricanes Katrina and Rita, our nation's infrastructure was severely damaged. We saw widespread product shortages and gas prices began to skyrocket. If there was ever an opportunity for retailers to price gouge, this would have been it. Instead, the overwhelming majority of retailers behaved as responsible corporate and community citizens and set their prices according to prevailing market conditions.

According to the Federal Trade Commission (FTC) in its Spring 2006 report, *Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases*, 99 retailers were sent investigative orders for violating the FTC's definition of price gouging. Of those who had not already settled state charges, only 24 individual retailers were further investigated by the FTC. Of those 24, only six were found to have had "price increases that could not be substantially attributed to increased costs or national market trends." In any industry with 160,000 retail locations, there will inevitably be some bad actors. PMAA will certainly not make excuses for those who charge excessively high gasoline prices. However, a 99.9 percent compliance rate for the industry as a whole shows that state laws are working and that further federal legislation is not needed.

EFFECTS OF PRICE CONTROL LEGISLATION ON CONSUMERS

Gasoline price control legislation will not just affect small businesses. The FTC report, *Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases*, includes general findings on the impacts that price gouging legislation may have on consumers. The FTC recognizes that when faced with an emergency or a similar time of rapidly rising gas prices, suppliers may be reluctant to send product to an affected area for fear of running afoul of price gouging laws. The result will be product shortages in affected areas creating further price discrepancies and building higher hurdles for consumers and emergency responders who desperately need fuel. Instead of being protected from unconscionable pricing, consumers would pay dearly at a time when their needs are the greatest.

"THE ASK"

PMAA urges Members of Congress to appeal to reason rather than emotion when considering legislation to solve the "problem" of price gouging by mandating outrageous fines should a refiner, marketer or retailer charge an "unconscionable" price for their product.

PMAA STAFF CONTACT: Sherri Cabrera, scabrera@pmaa.org; Rob Underwood, runderwood@pmaa.org